Enhancing retirement income options for Canadians

Supporting Canadians as they age

CLHIA ACCAP

November 2019

About the CLHIA

The CLHIA is a voluntary association whose member companies account for 99% of Canada's life and health insurance business. The industry provides a wide range of financial security products such as life insurance, annuities - including RRSPs, RRIFs and pensions - and supplementary health insurance to almost 29 million Canadians. It also holds more than $850 billion of assets in Canada and employs over 156,000 Canadians.

For more information:
Sarah Hobbs
Director, Policy
(416) 359-2012 / shobbs@clhia.ca

clhia clhia_accap www.clhia.ca

Toronto

79 Wellington St. West, Suite 2300
P.O. Box 99, TD South Tower
Toronto, Ontario M5K 1G8
416-777-2221

Ottawa

World Exchange Plaza
100 Queen Street, Suite 750
Ottawa, Ontario K1P 1J9
613-230-0031

Montréal

1001 de Maisonneuve Blvd. W., Suite 630
Montreal, Quebec H3A 3C8
514-845-9004

Contents

Executive Summary

It is becoming less common for Canadians to retire with secure, adequate income for life. While existing public plans provide a limited degree of financial certainty, the continuing shift away from Defined Benefit (DB) pensions places a growing onus on individuals to ensure they have sustainable income in retirement. Currently, there are limited products and solutions available in the market to provide stable, long-term, retirement income. As such, new measures that support retiring Canadians' attaining dependable income security are required.

In response to this reality, the federal government introduced changes in federal budget 2019 to permit the use of Advanced Life Deferred Annuities (ALDAs) and Variable Payment Life Annuities (VPLAs) in certain retirement plans. These initiatives are an important first step, but without further reforms these options are likely to fall short of expectations. The CLHIA recommends enabling:

More flexible types of annuities for registered pensions, Registered Retirement Savings Plans (RRSPs), Registered Retirement Income Funds (RRIFs) and Tax Free Savings Accounts (TFSAs), including that:

1. **The federal government should allow Canadians to waive liquidity requirements of their TFSAs to use these accounts to provide sustainable, secure, retirement incomes without tax penalties;**

2. **The federal government should expand on the proposed tax legislative changes so that free-standing VPLAs are permitted to pool participants from all registered plans used to save for retirement; and**

3. **Provincial governments should introduce corresponding legislative changes as soon as possible.**

Introduction

Canada's retirement savings system generally works well, ranking with the top ten national retirement income systems globally, according to the Melbourne Mercer Global Pension Index.[1] The success of the Canadian system is based on several factors including: the federal and provincial governments' commitment to providing a baseline retirement income for all citizens; occupational pensions and other workplace retirement plans; a number of products that support individual savings; and a world-class insurance and financial services industry whose reputation for prudence, stability, and innovation is recognized internationally. However, the Melbourne Mercer report notes that there are areas for improvement in order for our retirement income system to be considered a first class and robust retirement income system, especially given our aging population.

In recent years, improvements to Canada's retirement income system have focused on improving retirement outcomes for all Canadians, such as through enhancements to the Canada and Quebec Pension Plans (C/QPP) and enhancing flexibility and cost-effective plan availability for Canadians who don't have access to workplace retirement savings plans (e.g. creation of Pooled Retirement Pension Plans (PRPPs)).

1 Melbourne Mercer Global Pension Index. 2018.

However, limited products and solutions exist in the market to support Canadians' need to ensure they have secure, adequate income for life. From 2011 to 2016, Canada registered the largest increase in the proportion of seniors since Confederation. This is the result of the first baby boomers (born between 1946 and 1964) reaching the age of 65, which resulted in a 20 per cent increase in the number of people aged 65 and older in Canada. By comparison, Canada's overall population only grew by five per cent over the same period.[2] Further, the life expectancy of 65-year-old Canadians has risen by almost two years over the past decade.[3] This added fact means that it is more challenging for Canadians to reasonably anticipate the length of their retirement and calculate what their likely financial needs will be. This highlights the growing number of Canadians who will struggle with how best to ensure they do not outlive their savings.

The inability to anticipate the length of retirement and associated financial needs pushes many to be overly cautious in their spending habits out of fear that they will outlive their savings or require expensive late-life care. Studies have consistently shown that retirees hold on to their financial assets as long as possible to mitigate these risks or create an estate, often impairing their comfort in later life.[4]

The Canadian market has been slow to develop a robust suite of decumulation products to help Canadians manage this risk. Existing tax and pension laws constrain financial institutions' ability to offer innovative private sector solutions to help Canadians protect themselves against outliving their savings.

The ongoing shift from DB plans means that, increasingly, Canadians must rely on Defined Contribution (DC) pension plans, PRPPs, RRSPs, RRIFs and TFSAs (collectively known as "money purchase plans") that do not guarantee stable lifetime incomes. This decline has been most pronounced in the private sector, where DB coverage shrunk from 67 per cent in 2006 to 41 per cent in 2016.[5]

Money purchase plans typically provide members with a lump sum amount at retirement, with no sustainable, professionally managed decumulation mechanism. The responsibility for managing retirement income is placed on the individual versus the individual's employer and plan administrator as is the case with DB plans.

Currently, Canadians can purchase a narrow range of products that help them meet their retirement income goals in later years, such as annuity products. Annuities are purchased for a lump-sum of money and provide guaranteed income payments over a period of time. For instance, life annuities provide guaranteed income payments for as long as you live. Despite the fact that an annuity's fully guaranteed lifetime income can provide a solid foundation for an individual's retirement plans, the current historically low interest rate environment coupled with legislative restrictions have hampered Canadians' access to and use of annuities. As a result, we do not currently see a large demand for annuities in Canada.

---

2 Statistics Canada. *Age and sex, and type of dwelling data: Key results from the 2016 Census.* May 2017.

3 Statistics Canada. Table 13-10-0403-01 Life expectancy, at birth and at age 65, by sex, five-year average, Canada and Inuit regions.

4 C.D. Howe. *Deferring Receipt of Public Benefits: A Tool for Flexibility*. June 2018. p. 3.

5 Office of the Superintendent of Financial Institutions. *Registered Pension Plans (RPPs) and Other Types of Savings Plans – Coverage in Canada* (2016).

To start to address this, the federal government introduced changes in Budget 2019 to permit the use of Advanced Life Deferred Annuities (ALDAs) for money purchase plans. However, the Budget proposal put some limits on this and excluded the use of TFSAs. Budget 2019 also introduced Variable Payment Life Annuities (VPLAs), but restricted their use to certain, limited, pension plan designs. The CLHIA believes that these initiatives are a good first step, but without further reforms, these amendments are likely to fall short of expectations.

Summary of Existing Federal Budget Measures to Support Retirement Income Longevity

ALDAs

Current tax rules require an annuity purchased with registered funds to commence by the end of the year in which the purchaser (i.e., the "annuitant") attains 72 years of age. The new budget proposal would permit Canadians to use part of their retirement savings (up to 25 per cent or an inflation-adjusted dollar limit) from a money purchase plan to purchase annuities that provide guaranteed income for life, commencing at ages up to 85. This will enable Canadians to have greater certainty in their income later in life.

VPLAs

Current tax rules do not permit PRPPs or defined contribution RPPs to provide in-plan annuities to members. Instead, tax rules require that benefits from these types of plans be provided to a member by means of transfer to a RRIF or an annuity provided by a life insurance company.

Proposed tax measures would permit PRPPs and defined contribution RPPs to provide variable payment life annuities to members directly from the plan. This new flexibility will allow a plan administrator to pay an estimated lifetime income to participants who have elected the VPLA option, and would periodically adjust benefit payments paid from the pool of participants' assets to reflect the evolving investment yields of the pool and the mortality experience of the pool's participants. This shifts the risk of managing assets to provide a sustainable retirement income from each individual to the pool, which can be expected to reduce volatility and improve broad outcomes.

Description of Weaknesses in Existing Federal Budget Measures

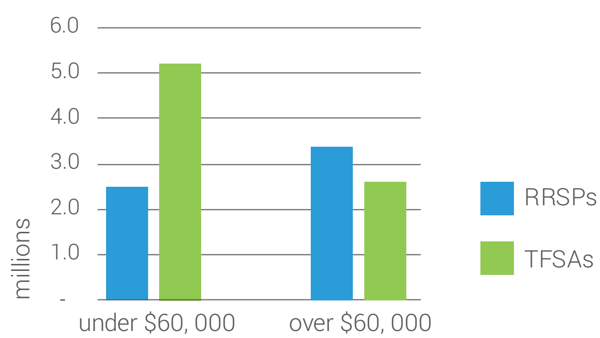
The new measures in Budget 2019 will go some way towards providing Canadians who are close to retirement, or are already retired, with the flexibility to draw down income in the short-term while also providing income security for life. It will also go some way to preserving exposure to capital markets while including greater long-term income certainty than RRIFs provide. However, more is needed.

Further Consideration to Allow TFSAs to Hold ALDAs

We are supportive of the government's proposal to introduce ALDAs. However, currently legislation would prevent ALDAs to be held within TFSAs. We believe this will unduly constrain Canadians' access to decumulation options.

The federal government introduced TFSAs in 2009 as a means for individuals to set aside money, tax-free, throughout their lifetime. Originally, TFSAs were designed to encourage savings at any time, for any purpose, and not specifically to support retirement savings. However, over time, data has shown that TFSAs have led to better savings habits among those who hold an account. For instance, in 2016, Canadians contributed $54.8 billion into their TFSAs, bringing total investment in these accounts to over $230 billion.[6] In addition, data has shown that lower income Canadians invest more in TFSAs than in RRSPs.[7]

RRSP & TFSA contributors by income range



Source: OSFI

Currently, legislated liquidity requirements allow flexible RRIF-like drawdowns from TFSAs but prevent TFSAs from holding, or being structured as, life annuities that provide guaranteed lifetime income.

Limitations of VPLAs

With respect to the VPLA proposals, we are concerned that they underestimate the importance of scale for private industry to be able to offer these solutions to Canadians. For example, if the VPLA option is contained within a DC pension plan, the CLHIA estimates that at least 100 participating lives would be necessary for the VPLA to be economically viable and provide reasonably stable incomes to those participants.[8] Since obtaining that scale is unlikely to occur in the first year, we assume that this scale could be obtained over a four-year period, with 25 retirees electing the VPLA option each year.

Based on current annuitization rates, the industry believes that approximately five per cent of retirees each year might be expected to elect the VPLA option. To obtain the required scale, this suggests that a plan must have over 500 retirees each year. Assuming a 40 year working period based on the current trend toward longer careers in the private sector, the CLHIA estimates that only plans with more than 20,000 active members would typically be able to support an “in plan” VPLA option.

A CLHIA survey of federal and provincial pension regulators indicates that there are fewer than ten DC pension plans with more than 20,000 active participants in existence. The eligible population is therefore estimated to be under 300,000 individuals.

Consequently, the CLHIA believes that these measures, as proposed, effectively prevent six million Canadians, who save through RRSPs and smaller DC plans, from accessing VPLAs.[9]

6 Canada Revenue Agency. Tax-Free Savings Account, 2011 Statistics and 2018 Statistics.

7 Office of the Superintendent of Financial Institutions. Registered Pension Plans (RPPs) and Other Types of Savings Plans – Coverage in Canada (2016).

8 Even at this level, annual volatility in income payments could be significant. One estimate of such volatility suggests potential income fluctuations of approximately twelve per cent, suggesting a significantly larger pool of participants would be required in order to provide reasonably consistent income levels from year to year.

9 Statistics Canada, Selected characteristics of tax files with Registered Retirement Savings Plan (RRSP) contributions, Total RRSP contributors.

Further, uptake on PRPPs has been well below expectations. As of 2018, only five PRPPs exist, with a total membership of only 111 individuals and assets totaling just over $150,000.[10] Comparatively, participation in the Voluntary Retirement Savings Plan (VRSP, the PRPP equivalent in Quebec) has been slightly more successful,[11] largely due to the fact that it is mandatory for employers in Quebec to offer a VRSP to their employees if they do not have another workplace pension plan in place. Regardless, no PRPP or VRSP has the necessary scale or asset value to offer a meaningful VPLA option and it is unlikely that limiting access of VPLAs to individuals saving within DC pension plans or PRPPs is likely to kick-start PRPP enrolments.

Recommendations

The CLHIA believes that these measures should be expanded in order to provide the broadest possible access for Canadians. Further consideration should be given to amending tax rules to allow TFSAs to hold life annuities.

As TFSA balances grow, they become an increasingly useful source of retirement income. Canadians should be permitted to elect to use their TFSAs to supplement retirement income savings via life annuities in the same tax-effective manner as for individuals who simply draw-down TFSA balances as a source of retirement funding

We therefore recommend that the federal government allow Canadians to waive TFSA liquidity requirements so that Canadians can use these accounts to provide retirement incomes without tax penalties.

With respect to the proposed introduction of VPLAs, the CLHIA is concerned that only a limited number of Canadians would be able to benefit from this new proposal. As outlined above, we believe that this solution would only be commercially viable for plans exceeding 20,000 active members.
We therefore recommend that the federal government expand on the proposed measure so that free-standing VPLAs are permitted to pool participants from all registered plans used to save for retirement.

Finally, in order for these budget measures to be fully implemented, changes to federal and provincial pension law will be required to complement the proposed changes to federal tax law. The federal government released draft legislation in July 2019 in order to implement appropriate tax amendments. However, corresponding legislative changes to federal and provincial pension legislation will need to be introduced and implemented before the proposals come into effect fully.

As seen with PRPPs, despite federal legislation being in effect, provincial governments have been slow to make respective legislative changes. In order to make these options available to Canadians as soon as possible, **we recommended that following the October 2019 election, the new federal government move ahead with draft tax legislation within the first year of its mandate, initiate simultaneous changes to the Pension Benefits Standards Act and Pooled Registered Pension Plans Act, and encourage provinces to make corresponding legislative changes as quickly as possible.**

10 Office of the Superintendent of Financial Institutions Canada. Annual Report 2017-18, p. 20.

11 In 2018, there were 10 providers of VRSPs serving 11,882 employers with 90,820 participating employees and total assets of $119.2 million.

Conclusion

Canada's retirement savings system performs well, but it also limits the products and solutions that the market could provide to support secure retirement income as Canadian age. This paper identified a number of policy changes which could increase long-term security in retirement income for Canadians.

The life and health insurance industry plays a key role in helping Canadians prepare for retirement not only through workplace plans, but also through the advice and lifetime income solutions delivered by thousands of financial advisors who serve Canadians every day in communities from coast to coast to coast.

The industry is available to work with governments to support the recommendations put forward in this paper in order to improve the retirement system for more Canadians.