Canadian Life & Health Insurance Association
Association canadienne des compagnies d'assurances de personnes

Submission to the Federal Department of Finance on the 2024 Budget Consultation on Qualified Investments

July 15, 2024

Executive Summary

The CLHIA is supportive of modernizing the rules with respect to qualified investments within the various registered plans (i.e., RRSPs, RRIFs, TFSAs, RESPs, RDSPs, FHSAs, and DPSPs), and improving the clarity of the regime. However, rather than narrowing the definition, it should be expanded to allow for increased choice and access to financial products. This will enhance the savings and retirement security of Canadians.

Our comments focus on two of the five themes outlined in the 2024 Budget, namely:

1. **Canadian-based Investments**: Whether and how qualified investment rules could promote an increase in Canadian-based investments, and

2. **Annuities:** Whether annuities that are qualified investments only for RRSPs, RRIFs, and RDSPs should continue to be qualified investments.

CLHIA recommends that:

1) The government use its fiscal policy tools to promote an appealing policy and economic environment for Canadian-based businesses to compete and attract capital to thrive in a competitive global marketplace.
2) The government work with the industry to maintain the existing framework of retirement solutions and broaden others to allow Canadians to obtain more secure lifetime incomes (as they approach or are in retirement). This can be achieved by:

   - Maintaining the current eligibility of immediate and deferred annuities (i.e., payout annuities) as a qualified investment to ensure retirees continue to have desirable options.
   - Allowing Canadians to use payout annuities in their TFSAs to supplement retirement savings.

INTRODUCTION

The Canadian Life and Health Insurance Association ("CLHIA") is pleased to provide comments on the federal government's consultation on qualified investments as announced in the 2024 Federal Budget.

The CLHIA is the national trade association for life and health insurers in Canada. Our members account for 99 per cent 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 over 29 million Canadians.

In 2022, insurers paid out $114 billion in benefits, including nearly $54 billion in retirement benefits, approximately $44 billion in health benefits and $16 billion in life insurance. Insurers hold over $1 trillion in assets in Canada and employ more than 170,000 Canadians. In addition, insurers manage $418 billion of the approximately $3.0 trillion in total pension assets (i.e., private and personal, excluding public pensions).

We look forward to working with the Department of Finance to modernize the qualified investments rules in the Income Tax Act (ITA) to ensure policy objectives with respect to both the accumulation and decumulation phases of the various registered plans under review are being optimized and achieved. Our comments are primarily focused on various types of annuities currently available in the Canadian market, their purpose, and their continued importance in serving the needs of Canadians in retirement. We have attached a chart (in the Appendix) that summarizes the types of annuities and their characteristics to aid in our dialogue.

Our recommendations also consider the growing concern of the risk that Canadians outlive their savings. To mitigate this, we believe more decumulation solutions are needed. Overall, the CLHIA wants to ensure the changes, if any, to the qualified investment rules improve the financial security of Canadians in retirement.

1. Canadian-based Investments

The CLHIA strongly believes that the primary purpose of investing or saving for retirement is to optimize risk-adjusted returns over the long-term horizon of Canadian retirees' needs. Keeping to that primary focus should continue to be the key driving factor for investments.

At the same time, we understand the call to promote the use of Canadian-based investments in retirement portfolios generally, given the growing magnitude of retirement assets in pension plans and in retail registered retirement funds. However, the qualified investment rules may not be the most appropriate avenue available to the government to achieve that policy objective. Instead, the focus should be on creating an attractive policy and economic environment for Canadian-based businesses to compete and attract capital and talent to thrive in a competitive global marketplace. We support the calls for urgent action to address the growing productivity gap between Canada and its main trading partners.

Governments can use their fiscal policy tools to encourage capital flows to innovate and improve productivity and profitability for Canadian businesses. For example, the low tax rates for small business corporations are good policy to encourage new entrants to the market during the initial years. However, having a higher rate for larger companies likely creates incentives for businesses to remain below the small business tax threshold. This is a disincentive for growth and striving to make the businesses more competitive and profitable.

The recent trend of introducing new sector-based taxes creates an unlevel playing field and inhibits fair competition. As noted by Jack Mintz in a *Financial Post* article dated December 23, 2022, “countries that have retreated from tax holidays, business subsidies and targeted tax preferences in favour of corporate tax rate reductions have done better in attracting investment and growing their economies…. A tax-competitive strategy that keeps taxes low lets the market determine winners, not the government.”

Finally, the CLHIA is of the strong view that the Department should refrain from reintroducing foreign content limits, which were in place in the past to force or direct more Canadian-based investments. They did not serve Canadian retirees well and added administrative complexity to providers of these registered products. The better solution is to ensure Canadian business performance compares well and their risk-adjusted returns attract Canadians’ retirement dollars.

2. Annuities as qualified investments

CLHIA recognizes that several decades of incremental policy changes with respect to qualified investment rules for registered plans may have resulted in certain inconsistencies and unnecessary complexity. We support a review to seek alignment in the use and treatment of annuities within registered products where warranted. We understand the Department also welcomes recommendations of where qualified investment annuities could be broadened to serve Canadians’ retirement needs.

Annuities are an insurance contract issued by life insurers with the promise to pay a fixed stream of payments (either immediately or in the future), for life or for a fixed term.

The attached Annuity chart outlines the attributes, along with ITA references related to their eligibility, for various registered plans. For the purposes of this analysis, annuities are divided into two groupings:

a) Payout Annuities (Immediate and Deferred), and
b) Accumulating Annuities (Guaranteed Interest Accounts and Segregated Fund Contracts)

We understand that accumulating annuities that are redeemable or cashable, and readily valued, are outside the scope of the Department’s review at this time. We also understand that the concern with immediate and deferred payout annuities stem from the illiquid nature of these contracts, and difficulty in assigning a fair market value to them.

Payout annuities are illiquid by nature because of the risk of anti-selection. Essentially, a person who expects to live a long and healthy life has an incentive to purchase an annuity and to enjoy payments for many years to come; however, if they find that they are facing a shorter lifespan (for example, due to a diagnosis of a health issue), they would be tempted to cash out their contract early if that option was offered. Since insurance companies base their

rates on actuarial expectations of life expectancy of a large group of individuals (and the ability to invest the annuity premiums over the long term to cover those eventual annuity payments), having to offer an early cash out could result in lower promised payout rates, making annuities riskier to the insurer and less attractive to investors.

It should be noted that while the value of payout annuities may not be readily available and depend on actuarial assumptions (i.e., present value of future payments adjusted for mortality as applicable), they can indeed be valued. However, valuing annuities on an annual basis would be complex, challenging, and impractical. Our remaining comments below, unless otherwise noted, are limited to immediate and deferred payout annuities.

Why Payout Annuities are Critical for Canadians' Retirement planning

From a retirement perspective, payout annuities protect individuals from outliving their savings by providing predictable income over the life of the insured or for the fixed term of the contract. This provides the holders with peace of mind against market volatility, and the confidence that certain living expenses can be covered. From a public policy perspective, higher adoption of these annuities should be encouraged. It would result in a reduction in the possibility or risk that the government may be called upon to provide financial support to a larger segment of retirees in the future to maintain a minimum standard of living.

A recent Ipsos survey revealed that 47% of Canadians lack an adequate source of guaranteed income and 48% are concerned about outliving their hard-earned savings. More and more Canadians who work in the private sector do not have access to any workplace pension or savings plan, let alone are fortunate enough to have a defined benefit plan with a guaranteed lifetime pension.

Other studies in the United States have shown retirees are more likely to spend when there is a steady stream of reliable income instead of dipping into their accumulated savings. [1] As noted in our CLHIA submission to the Department of Finance on Standalone Variable Payment Life Annuities, dated February 23, 2023, individuals saving for retirement seldom know either the amount of retirement income they can draw from those savings or how long those savings need to last. The inability to anticipate their length of retirement and associated financial needs pushes many to be overly cautious in their spending habits out of fear they will outlive their savings. Not only could this impair the comfort of retirees but also minimize their spending contributions back into the economy, thereby reducing economic growth in the country.

The Canada/Quebec Pension Plan and Old Age Security (OAS) are not typically sufficient on their own to provide adequate replacement income for most Canadians in retirement. Those who are self-employed or without an adequate defined benefit pension may very well need a product solution, such as an immediate or deferred annuity, to ensure all or part of their

[1] The Decumulation Paradox – Why are Retirees not Spending More? By Todd Taylor, Nick Halen, and Dylan Huang, Investment & Wealth Institute, 2018

retirement savings (RRSPs and RRIFs) can be converted to a lifetime guaranteed income, to fill this gap.

Annuities can effectively work in the same manner as a Defined Benefit (DB) pension plan, by providing a guaranteed income for life. Using registered funds from RRSPs and RRIFs to acquire an annuity can be part of a retirement solution for Canadians without adequate guaranteed income from other sources.

Protect Choice for Canadians

In our view, Canadians should continue to have a choice regarding the way in which accumulations in RRSPs and RRIFs are used to fund tax-efficient retirement income security. The same flexibility should also continue to apply with respect to RDSPs and DPSPs.

Registered funds amassed for retirement purposes, either in an accumulating annuity with a life insurer or in trusteed accounts at other financial institutions, may be used to acquire a payout annuity with continued tax deferral on the funds used to acquire it. This is usually done during retirement or as Canadians approach retirement. The lack of liquidity (or even a readily available calculable fair market value) of a payout annuity is of little relevance for a retiree trying to secure cashflow for life and should not be the reason for the government to deny their inclusion as a qualified investment.

Further, as the annuity benefit payments start, they are fully taxed, ensuring a flow of tax revenues to governments following years of tax-deferred accumulation. To be clear, when an annuitant of an RRSP reaches the year in which they turn 71, the funds must either be transferred to a RRIF or matured into an annuity. The registration requirements of an RRSP under the *Income Tax Act* require the plan to provide retirement income in the form of a life or term payout annuity. As such, a payout annuity should not be removed as an eligible investment of an RRSP as a matured RRSP is by definition a payout annuity.

The CLHIA regards payout annuities as part of a retirement income solution, along with the draw-down of benefits from RRIFs, ALDAs (advance life deferred annuities), VPLAs (variable payment life annuities) and VLPs (variable life payments). Retirees, on their own or with advice from professionals, can decide the right mix of solutions, based on their resources, needs and expectations. The non-cashable nature of payout annuities should not be a reason for government to deny Canadians the ability to purchase annuities in their RRSPs and RRIFs. Also, eliminating annuities as a qualified investment would be counter-productive from a socio-economic perspective, as noted above.

<u>Allow TFSA assets to be used to purchase Payout Annuities</u>

Balances in TFSAs continue to grow and are being increasingly used as a source of savings to support retirement needs. This is especially true for the low-to-middle income Canadians. However, the liquidity requirement of the TFSA rules prevents holding payout annuities within TFSAs. Canadian retirees or those approaching retirement should be permitted to waive this liquidity requirement and have the flexibility to secure their retirement through a guaranteed lifetime income from their funds in TFSAs, if they feel it is appropriate for them. The CLHIA would be pleased to discuss how payout annuities could be held within a TFSA.

Finally, we note that higher interest rates in recent years have generated renewed interest in payout annuities as new sales have increased in Canada. According to an *Investment Executive* article dated May 8, 2023, new sales for payout annuities increased by 25% in 2022 compared to 2021. People who buy annuities in a higher interest rate environment typically enjoy higher payouts. Annuities also provide protection from market volatility.

CONCLUSION AND RECOMMENDATIONS

We thank the Department of Finance for the opportunity to provide our comments and recommendations with respect to the qualified investment review.

CLHIA recommends that:

1) The government use its fiscal policy tools to promote an appealing policy and economic environment for Canadian-based businesses to compete and thrive in a competitive global marketplace. This is a better way to encourage Canadian-based investments than to re-introduce foreign content limits.

2) The government work with the industry to maintain the existing framework of retirement solutions and broaden others to allow Canadians to obtain more secure lifetime incomes (as they approach or are in retirement). This can be achieved by:

    - Maintaining the current eligibility of immediate and deferred annuities (i.e., payout annuities) as a qualified investment to ensure retirees continue to have desirable options.
    - Allowing Canadians to use payout annuities in their TFSAs to supplement retirement savings.

Annuities and Registered Plans Summary

Type of Annuity:	**Immediate Pay-out Annuities**	**Deferred Pay-out Annuities**	**Guaranteed Interest Accounts (GIAs)** (Deferred Accumulating Annuity)	**Segregated Fund contracts** (Deferred Accumulating Annuity)
Characteristics of annuities generally	• Annuities are generally issued by insurance companies. • Once annuity pay-outs commence, they provide guaranteed income for the period of the annuity. • Under all annuities the holder can designate a beneficiary for settlement at death (if applicable) which avoids cost and delays associated with probate and estate settlement and provides privacy. • Deferred annuities can provide an annuity settlement option at death - i.e. provide beneficiaries with a scheduled payments rather than a lump sum. • Under the Income Tax Act an insurance contract includes an annuity contract			
Description	Annuities that begin periodic payments immediately (or within the period specified) after purchase No additional deposits can be made after purchase	Annuities that are purchased today but the stream of periodic payments is delayed until a future time. No additional deposits can be made after purchase.	Accumulation annuities that work like a GIC but are an insurance contract. (Includes Guaranteed Interest Annuities or Guaranteed Interest Contracts (GICs), daily interest contracts, market linked contracts, etc. – various names of the same annuity product used by the industry).	An insurance contract (typically an annuity contract) whose income and value is determined by reference to a segregated pool of assets held by the insurer. There were life insurance segregated funds that were sold in the past
Options/ Variations	• Pay-outs can be for a fixed term or for life • Pay-outs must be made at least annually (could be monthly, quarterly, etc.) • May guarantee (in case of death) a period of payout (continuing payments or lump sum) • May provide for a lump sum payout at death equal to premiums less payments to date • Payments may be fixed, variable or indexed to a benchmark • May have a commutable/cash value during life • Single or joint life contracts (pay-outs continue until last to die, sometimes with a reduction in payment after first death)	• Generally, has the same characteristics/options as immediate annuities, only difference is deferred start date of pay-outs.	• GIAs have an option to convert to an Immediate or Deferred annuity at a later date. And contracts may become non-cashable when the payment stream begins. • A single payment is made to buy the contract and the annuity ends/pays out in full at a selected interval (e.g., 6 months, 1 year, 5 years, etc.) Can add money to the contract - but additions would each have a separate term • May be cashable during the accumulation period with an interest penalty for early cash-out (similar to bank GICs)	• A deferred annuity - payments will begin at a defined time in the future (e.g., age 71 for RRSP contract) • Money can be invested or withdrawn at any time up to entering the payout phase • May be individual annuity (which must guarantee at least 75% return of premium at death or contract maturity) or a group annuity (no guarantees but would typically be held by an employer or other group plan sponsor on behalf of individual members)
RRSP [146]	• Contract may itself be registered as an RSP [146(1) definition of *retirement savings plan*] • An annuity may commence at maturity of an RRSP. Issuance may be automatic where the original RRSP is a deferred annuity or segregated fund contract. [146(2)(b.4) and 146(1) definition of *retirement savings plan*] • May be purchased with money from an RRSP. [60(l)] • Qualified investment of a Trusteed RSP [146(1) definition of *qualified investment* – paragraph (c) and (c.2)]		• Contract may itself be registered as an RSP [146(1) definition of *retirement savings plan*] • Qualified investment of trusteed RSP [146(1) definition of *qualified investment* – paragraph (c.1)]	
RRIF [146.3]	• Non-commutable contract cannot be registered as a RIF due to liquidity requirement [146.3(2)(e)] • May be purchased with money from an RRIF [60(l)]		• Contract may itself be registered as a RIF [146.3(1) definition of *retirement income fund* and *146.3(2)(e.1)*] • Qualified investment of a trusteed RIF [146.3(1) definition of *qualified investment* – paragraph (b.1)]	

Annuities and Registered Plans Summary				
Type of Annuity:	**Immediate Pay-out Annuities**	**Deferred Pay-out Annuities**	**Guaranteed Interest Accounts (GIAs)** (Deferred Accumulating Annuity)	**Segregated Fund contracts** (Deferred Accumulating Annuity)
	• Qualified investment of a Trusteed RIF [146.3(1) definition of *qualified investment* – paragraph (b.2)]			
TFSA [146.2]	• Contract cannot be registered as a TFSA due to liquidity requirement [146.2(2)(e)] • Contract cannot be a qualifying investment of a trusteed TFSA due to liquidity requirement [207.01(1) definition of “qualified investment” subparagraph (b)(ii)]		• Contract may itself be registered as a TFSA [146.2(1) definition of *qualifying arrangement* subparagraph (b)(ii)] • Contract can be a qualified investment of a trusteed TFSA [207.01(1) definition of “qualified investment” subparagraph (b)(ii)]	
DPSP [147]	• Arrangement cannot be an annuity; must be trusteed • Sec 204 definition of qualified investment para. (h) and Reg 4900(3) - allows a DPSP to purchase an annuity payable to a DPSP beneficiary with payments to begin by the end of the year when the employee attains age 71		• Sec 204 definition of qualified investment para. (h) and Reg 4900(3) - allows a DPSP to purchase an annuity payable to a DPSP beneficiary with payments to begin by the end of the year when the employee attains age 71	
RESP [146.1]	• Contract cannot be an RESP or a qualifying investment of a trusteed RESP due to liquidity requirement [RESP [146.1(1) definition of *qualified investment* – paragraph (c)]		• Contract may itself be registered as an RESP [146.1(1) definition of *education savings plan*] • Contract can be a qualified investment of a Trusteed RESP [146.1(1) definition of *qualified investment* – paragraph (c)] as long as it is cashable	
RDSP [146.4]	• Arrangement cannot be an annuity; must be trusteed • Contract can be a qualified investment of a Trusteed RDSP [146.4(1) definition of *qualified investment* – paragraph (c)]		• Arrangement cannot be an annuity; must be trusteed • Contract can be a qualified investment of a Trusteed RDSP [146.4(1) definition of *qualified investment* – paragraph (c)]	
FHSA [146.6]	• Contract cannot be registered as an FHSA due to liquidity requirement [146.6(2)(e)] • Contract cannot be a qualifying investment of a trusteed FHSA due to liquidity requirement [207.01(1) definition of “qualified investment” subparagraph (b)(ii)]		• Contract may itself be registered as a FHSA [146.6(1) definition of *qualifying arrangement subparagraph (b)(ii)*] • Contract can be a qualified investment of a trusteed FHSA [207.01(1) definition of “qualified investment” subparagraph (b)(ii)]	
Comments	• Given that TFSAs are used by Canadians as a retirement savings vehicle, it would make sense to permit payout annuities to be registered as TFSAs • In very specific circumstances, a life insurance policy may be purchased and not treated as a non-qualifying investment of the DPSP (198(6)-(8)) - very limited application			