



Pension Investment
Association of Canada

Association canadienne des
gestionnaires de caisses de retraite

January 16, 2017

The Honourable Bill Morneau
Minister of Finance
Department of Finance
90 Elgin Street
Ottawa, Ontario
K1A 0G5
Via email: Bill.Morneau@parl.gc.ca

Dear Minister,

Re: Defined Contribution Plan Decumulation Issues

The purpose of this letter is to highlight an issue of great concern to members of the Pension Investment Association of Canada (“PIAC”) regarding defined contribution (DC) pension plans and the failure of our pension system to provide tax effective decumulation options to the growing number of members of those plans who are approaching retirement.

PIAC has been the national voice for Canadian private and public pension funds since 1977 in matters related to pension investment and governance. Senior investment professionals employed by PIAC’s member funds are responsible for the oversight and management of over \$1.5 trillion in assets on behalf of millions of Canadians. PIAC’s mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries. PIAC’s positions on public policy reflect the fiduciary framework in which member funds operate and its commitment to work in the best interests of plan members.

The Problem

While there is significant consideration in the design of DC plans regarding accumulation of retirement assets, there is very little recognition in the pension system of the risk facing the growing number of Canadians relying heavily on DC plans as they approach and move into retirement. They face both investment and longevity risks that are not easily managed by average citizens who are not actuaries or investment experts. There is a very real risk that many of these Canadians may outlive their retirement assets.

The regulatory regime for the Canadian Capital Accumulation Plans (CAPs) has evolved over time, but remains reflective of the view that CAPs are supplementary to defined benefit (DB) plans (occupational DB plans and CPP). A number of structural changes in the economy challenge that view. The rise of hi-tech professions, increase in labour mobility, industrial outsourcing and decline of corporate DB plans all point to a future where a great proportion of Canadians will have to rely on a combination of CPP and their CAPs, with no occupational DB benefits. Yet CAPs face a number of regulatory barriers preventing them from being able to stand on their own, as a core of retirement savings for Canadians who don't have occupational DB plans.

Views of the OECD

The growing importance of DC pension arrangements has led the OECD to incorporate these arrangements into the new Core Principles of Private Pension Regulation. The OECD Roadmap for the Good Design of DC Pension Plans has been endorsed and approved by pension regulators from OECD countries. Of the Roadmap's 10 recommendations, four are directly related to the payout (decumulation) issues:

- Ensure the design of DC pension plans is internally coherent between the accumulation and pay-out phases and with the overall pension system.
- For the pay-out phase, encourage annuitisation as a protection against longevity risk.
- Promote the supply of annuities and cost-efficient competition in the annuity market.
- Develop appropriate information and risk-hedging instruments to facilitate dealing with longevity risk.

Potential Solutions

The most significant problem of the CAPs, which can be traced to outdated regulation, is the lack of cost-effective lifetime income solutions. PIAC hereby proposes two changes that will enable such lifetime income options for CAP members.

1. **Establish a new type of qualifying annuity for CAPs, where the amount of payment may be adjusted for changes in expected longevity of the pool of annuitants.** Under ITA 146(3)(b), the only qualifying annuities with unequal payments are inflation-adjusted annuities (up to the CPI rate) and escalated/indexed annuities (up to 4% a year). Variable benefits paid from member accounts are all subject to RRIF minimum withdrawal factors. Consequently, variable benefits are not guaranteed to provide lifetime income, as the member may outlive the savings regardless of the level set of minimum withdrawals.

These new longevity-adjusted annuities will allow for shifting of the longevity risk from the annuity provider to the pool of annuitants, which should improve annuity pricing and make such annuities more attractive to CAP members. These annuities would also be more suitable for sponsored retirement arrangements, such as group RRIFs, either as a standalone individual option, or as a part of dollar-cost averaging solution.

2. Permit a late life deferred annuity as a qualifying investment within the CAPs, up to some limit. At this time, annuities can only be deferred to age 71, which is also the maximum age for starting to draw retirement income in any form. Canadians now live longer than at the time when the 71 years limit was established by about 10 years and average life expectancy continues to rise. The value of an annuity is the greatest to individuals who exceed the average life expectancy (86-88 years). In the US, such late-life annuities have been permitted for 401(k) plans since 2015, up to a limit of 20% of the retirement assets at time of purchase.

Such a late-life annuity will be a cost-effective retirement planning instrument. When bought at the time of retirement (65-67 years), it would cost a fraction of the price required by the annuity provider at the age of 85 – i.e. when an annuity is actually needed to be in place. Such annuities can also be an effective component of target-date funds, or any other group investment solution. We believe a limit along the lines of that established in the U.S. is reasonable.

The main objective of these proposals is to enable additional options for retiring CAP members. As larger cohorts of Canadians will be retiring in the near future, making such lifetime income options available and cost-efficient would not only improve the retirement outcomes and lower the lifetime investment risk, but also reduce the risk of some CAP members outliving their savings and falling onto the safety net provided the OAS/GIS.

Provincial Regulatory Issues

There may be some need for jurisdictional pension regulation to be reviewed in light of the introduction of such tax changes.

Clarity from provincial regulators on offering the proposed solutions within the DC plans during accumulation phase will come after enabling Income Tax Act changes, and may take the form of exemptions provided to target benefit plans.

We look forward to your response and would be pleased to meet with the Department of Finance to discuss our comments further.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Kevin Fahey". The signature is fluid and cursive, with a large, stylized "F" at the end.

Kevin Fahey
Chair

cc. Association of Canadian Pension Management (ACPM)