October 10, 2019

Tax Policy Branch
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario
K1A 0G5

Via email: fin.legislation-taxation-legislation-taxation.fin@canada.ca

Re: Our Comments on the Draft Income Tax Legislative Proposals regarding Advanced Life Deferred Annuities (ALDAs) and Variable Payment Life Annuities (VPLAs)

To Whom It May Concern:

ACPM (The Association of Canadian Pension Management) is the leading advocate for plan sponsors and administrators in the pursuit of a balanced, effective and sustainable retirement income system in Canada. We represent plan sponsors, administrators, trustees and service providers and our membership represents over 400 companies and retirement income plans that cover millions of plan members.

We welcome the opportunity to comment on the draft *Income Tax Act* legislation for the new ALDA and VPLA retirement income vehicles announced in the 2019 budget. We acknowledge the enormous efforts of the CLHIA and others in the coalition who proposed the concept of the ALDA and VPLA to the Finance Minister, and also appreciate CLHIA's continued efforts through its own submission on the proposed tax legislation. Following are our comments on each of the draft legislation on each of these two new vehicles.

Technical Comments on ALDAs

Providers of ALDAs

The draft legislation suggests that only a licensed annuity provider may issue an ALDA. We note that there are a number of large DC pension plans that have been very successful in providing lifetime income solutions payable directly by the DC Plan through either provincial legislation or the *Income Tax Act* grandfathering legislation. We think it is reasonable to allow such large DC Plans to be able to issue ALDAs provided they adhere to the restrictions imposed for such DC Plans.

For example, it is understood that the block of annuities and ALDAs payable through a DCPP are self-funding, *i.e.,* no other source of funding is allowed into the DCPP in the event that the assets backing the annuities or ALDAs prove insufficient over time. Participants who elect a DCPP paid annuity or ALDA are provided with information so that it is understood that there is no guarantor of the annuity or ALDA and reductions in the monthly income may be necessary if investment or mortality experience is particularly unfavourable. Further it is clear to the sponsors and administrators of these DC Plans, that only participants in these DC Plans would have access to the annuity or ALDA option through the DC Plan.

Reversal of Excess Transfers to ALDAs

We believe that the requirement to receive either a taxable cash payout or transfer to the <u>source</u> plan on account of excess transfers to ALDAs is too restrictive. In many cases, it would be expected that the source plan will cease to exist since that is in fact the likely strategy for which ALDAs were designed, to provide late life retirement income after a time period when the retiree would have spent all or almost all his/her other registered retirement income assets. Accordingly, excess amounts should be permitted to be transferred to any RRIF, and where a member does not possess a RRIF, any required legislative changes should be made that would allow an individual (over 71) to open a new RRIF vehicle and allow the transfer of the excess amounts from the ALDA to the newly opened RRIF vehicle. We would anticipate that ALDA providers could bundle their products with a side RRIF account ready to receive cash payments if and when an excess transfer requiring a refund occurs.

Technical Comments on VPLAs

Requirement to adjust amounts annually

The draft legislation suggests that the amount payable to each member or beneficiary must be adjusted at least annually if the VPLA fund rate of return or the rate of mortality of members and beneficiaries differ <u>materially</u> from the actuarial assumptions used to determine the VPLA benefits. We note that there already exists a number of (grandfathered) DCPPs who have been offering a lifetime income to retirees very successfully using different approaches. We highlight three illustrations of existing arrangements which could potentially be covered by VPLA legislation.

	Low-Risk with Infrequent Adjustments	Low to Medium Risk with Frequent Adjustments	Moderate Risk with Annual Adjustments
Goal of the Strategy	Provide lifetime income with very low probability of reductions, and infrequent increases.	Provide lifetime income with moderately low probability of reductions, but target increases on average equal to inflation (from experience gains).	Provide lifetime income with annual adjustments in line with actual aggregate experience in investment and mortality experience.
Discount Rate Approach	Based on annuity market rates.	Based on annuity market rates.	Based on long-term return assumptions of the fund.
Investment Approach	Very low risk. Invest primarily in liability matching assets.	Invest in mix of bonds, equities and alternatives with a low to moderate risk budget (return volatility around 8% per annum).	Invest in mix of bonds, equities and alternatives with a moderate risk budget (return volatility around 10% per annum).
Adjustment Approach	Margins are included in the pricing of the annuities so that there is a low probability of requiring a reduction. If the level of surplus exceeds a significant level, then the fund can grant modest pension increases. (But not a priority of the strategy.)	Margins and a provision for adverse deviation are included in a formal written funding policy which is made available to participants before electing the pension option. If funded status in aggregate exceeds the prescribed PfAD, the Trustees can award pension increases. The PfAD is usually sufficient to avoid reductions except the worst economic scenarios. Over the past 30 years, well over 50% of cases, upward adjustments have been made.	The actuary assesses actual investment and mortality experience each year and determines the adjustments that would need to be made to return the fund towards a fully funded (but not overly funded) state.

We would encourage Finance Canada to recognize the success of these and other similar situations and potentially encourage others to follow their example through the VPLA legislation. In particular, the legislation should allow each DCPP or PRPP offering a VPLA to develop its own funding and investment policies and communications to retirees about the objectives of the VPLA and the likely frequency of upward and downward adjustments to lifetime incomes. A DCPP or PRPP that wishes to adopt a target PfAD for example, shouldn't be required to make annual adjustments to lifetime income amounts when the funded ratio sits between 100% and 100%+PfAD. Perhaps that can be clarified in the meaning of <u>materially</u> different experiences. We also wonder if clarifications are needed in respect to ITR 8506(1)(e.2)(iv)(B) to make it clear that mortality experience can be computed in the aggregate (rather than treating each single age-cohort as its own VPLA fund).

VPLA Wind-Up

Despite the best intentions of a DCPP or PRPP to offer a viable VPLA, situations may arise where the number of retirees in a VPLA dwindles below what would be economically necessary to maintain that option. Such a situation could arise without a parallel wind-up of the DCPP or PRPP under which the VPLA is offered.

In such circumstances, it should be possible for the administrator to declare a partial wind-up of the VPLA component of the Plan. We recommend that the legislation clarify that settlements of a VPLA arrangement may include either another VPLA enabled PRPP, a life annuity contract, or a direct transfer to a RRIF. (With respect to the RRIF settlement option, since the original transfer into the VPLA would have been from a money purchase arrangement, there should be no restrictions on the amount of direct transfers permissible to a RRIF).

PRPP as Conduit for Individuals without Access to VPLA enabled DCPP

As has been noted in a number of discussions with ACPM and others in the coalition letter sent last year requesting VPLA and ALDA legislation, we believe it is important, for the viability of the VPLA vehicle, that it be accessible to all Canadian retirees with registered savings regardless of whether they are fortunate enough to work for an employer who sponsors a VPLA-enabled DCPP or offers a VPLA-enabled PRPP to its employees.

We would encourage the government to clarify, where necessary in legislation, that an individual can join a PRPP (even at the point of retirement income commencement) regardless of whether they are or have worked for an employer who provided access to the chosen PRPP.

We believe that such clarifications could provide incentive for new PRPPs to be created and marketed specifically for access to a VPLA (and to a lesser extent the variable benefit income) option.

PRPP as an Eligible Purchaser of Liabilities from a Terminating Pension Plan of Distressed Employer

One of the potential challenges to VPLAs starting up, is the time and expense involved in attracting enough retirees to make the product viable. One approach that may accelerate the creation of viable VPLAs is to allow PRPPs to bid on the settlement of underfunded terminating pension plans from distressed employers. We could envisage situations where retirees (and non-retired former plan members) may be faced with the choice of either a reduced commuted value (with a large taxable component, under the current ITR 8517 limits) or an annuity purchase for some percentage of the original promised pensions. As an alternative, retirees and former plan members may value a third alternative such as a VPLA, using one of the three models illustrated earlier. By selecting a VPLA with moderate investment risk, a retiree could potentially over time recover some or all of the initial pension reduction caused by the termination of an underfunded plan with a distressed employer.

Accordingly, tax legislation could be clarified so that it was clear that a direct transfer from a DB Plan to a VPLA under a PRPP would be an acceptable settlement (without application of ITR 8517).

Importance of Broad Access to VPLA

In order for VPLAs to have a meaningful impact for Canadian retirees, the VPLA solution needs to be viable and broadly available. Under the current tax regulation proposals, this means DCPP or PRPP as the only vehicles eligible to offer them. In the context of broad access, this effectively means only PRPPs as few Canadians will have the opportunity to work for an employer who sponsors a DCPP with a VPLA option. Our comments above address some issues around PRPP access and highlight some potential opportunities for a PRPP to kick-start a viable VPLA solution (with some minor tax code changes).

That being said, we suspect that PRPP legislation will require some adjustments to allow viable VPLA-enabled PRPPs to be created. For example, it may be necessary to allow providers to create a separate decumulation-only PRPP that is used to provide VPLAs as a decumulation option for capital accumulation plans such as group RRSPs, DPSPs and DCPPs. We can see the potential appeal of using the PRPP construct as a way to provide regulatory oversight of the VPLA on various aspects such as:

- ensuring adequate disclosures are provided to consumers selecting this non-commutable income option;
- mortality risk adjustments factors applied to retirees selected the VPLA are done in a fair and equitable manner for both the purchaser and the other retirees in the pool;
- valuations are conducted in accordance with actuarial standards and remitted to the oversight body;
- benefit adjustment and funding policies are developed, maintained, administered, and communicated to the retirees; and
- appropriate annual reporting disclosures are provided to retirees.

We think it is possible to do this with the PRPP legislation but it is also possible other oversight mechanisms could accomplish the same goals, such as an insurance role. If it is determined that PRPP legislation, even adjusted as necessary, will not solve the viability issue, Finance Canada may need to consider exploring other avenues to ensure broad access to the VPLA solution.

We appreciate the opportunity to provide our thoughts and comments on the proposed tax legislation for ALDAs and VPLAs. We believe these new vehicles, if structured appropriately and made broadly available, could be very useful to Canadian retirees in managing their needs for a lifetime retirement income.

Sincerely,

Ric Marrero
Chief Executive Officer
ACPM

Todd Saulnier
Chair, National Policy Committee
ACPM