February 25, 2019

Registered Plans Directorate
Canada Revenue Agency
Ottawa, ON K1A 0L5

Re: Response to the Federal Government's Draft Newsletter: Registered Pension Plan Annuity Contracts

To Whom It May Concern:

ACPM (THE ASSOCIATION OF CANADIAN PENSION MANAGEMENT)

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 more than 3 million plan members.

Initial Comments

ACPM supports the federal government's clarification of Income Tax Act Section 147.4 to determine when an individual is deemed not to have received an amount out of or under the registered pension plan (RPP) as a consequence of acquiring an interest in an annuity contract. In general, we support provisions that provide flexibility for individuals to receive secure retirement income at a reasonable cost. Specifically, we support legislation that removes barriers and reduces the cost for individuals who choose to purchase an annuity.

We have provided comments on relevant sections of the newsletter below.

Materially Different

The wording in the last sentence of this section of the draft newsletter suggests that annuity purchases that include a reconfiguration of the amount or form of benefits would be considered materially different. However, the remainder of the draft newsletter provides several examples of reconfigurations that would not be considered materially different.

Therefore, we suggest removing the last sentence of this section.

Cost of living adjustments

Although the methodology provided seems reasonable for the specific case provided – a fixed-rate adjustment in lieu of full CPI indexation adjustment – the scope is too narrow.

First of all, we would suggest that any result between those two results should also be accepted, rather than simply one or the other.

Additionally, a plan sponsor may wish to purchase an annuity with or without a fixed-rate adjustment that is not intended to replace the plan's full CPI indexation adjustment. For example, a plan sponsor may purchase an annuity with no CPI adjustment or with partial CPI adjustment and continue to provide CPI adjustments (full or partial) to members as paid from the fund. We believe that cases such as this, where the member's total benefit is paid partially from an interest in an annuity contract and partially from the pension fund and the total benefits are not materially different, should be specifically referenced in the newsletter. In these cases, there should not be immediate taxation on acquiring the annuity contract and any payments under the contract should be included in the individual's income in the year received.

Furthermore, we would suggest that some provision be added regarding the determination of acceptable fixed-rate adjustments in lieu of CPI-linked indexation with caps and/or floors. A simple example of this is an RPP which provides indexation of 100% of the change in CPI in excess of 2% (e.g., if inflation is 3%, pensions are increased by 1%; if inflation is 1.5%, pensions are not increased); in this example, there is an adjustment "floor" of 0% and there is no carry-forward into future years of any indexation "lost" to this floor. Taking the current 2% midpoint of the Bank of Canada's inflation-control target range, it might seem that this implies a 0% equivalent fixed-rate adjustment.

However, inflation is expected to fluctuate around its long term expected average and actuaries are required to make adjustments to the implied rates of indexation to reflect the likelihood that a floor or ceiling will affect the amount of indexation provided in a given year (*c.f.* Canadian Institute of Actuaries' latest Educational Note on the Assumptions for Hypothetical Wind-Up and Solvency Valuations.) In our experience, in cases with floors or ceilings that are expected to have a material impact on the actual future rates of indexation, actuaries will often use stochastic modelling to determine a fixed rate of indexation that is equivalent to an RPP's indexation formulas. We believe that the Agency should accept the certification from the actuary that the equivalent fixed rate was determined in accordance with accepted actuarial practice.

Individual annuity purchases using commuted values

We agree that a reduced annuity that does not reconfigure the benefits that would have been provided from the RPP should have the protection afforded under subsection 147.4(1) of the Act. However, we believe that the newsletter should specifically include reference to another option for the situation where the commuted value is not enough to provide an annuity that equals the benefits that would have been provided under the RPP. In this case the member would purchase an annuity that has the same base benefit and form of pension as the RPP (i.e. joint-and-survivor percentage, guarantee period), but indexation that is either a portion of the CPI adjustment that otherwise would have been provided by the RPP or a fixed rate equivalent.

Do these rules apply to money purchase plans?

We do not believe that the wording in this section is sufficiently clear. If a money purchase RPP is silent on annuity purchase provisions, would any annuity satisfy subsection 147.4(1)?

In general, we believe that members of a money purchase RPP should be able to purchase an individual annuity without immediate taxation on the value of the annuity contract.

Buy-in annuities?

We agree that subsection 147.4(1) of the Act has no application with respect to buy-in annuities. However, we would suggest that the definition of buy-in annuities be clarified to reflect that in some cases the insurer pays the buy-in annuities directly to pensioners rather than indirectly to the pension fund; in such cases, the insurer performs administrative duties while the pension plan still remains responsible for providing the benefits.

Thank you for the opportunity to provide our input on this consultation and we are available if you require any further assistance.

Sincerely,

R Marrero

Ric Marrero
Chief Executive Officer
ACPM