Intelligence MEMOS

*Federal budgets are an annual rite of spring in Ottawa, as is the deluge of advice to the Department of Finance. But budget-making is a yearlong process, and the work is now in progress. Accordingly, the C.D. Howe Institute is presenting a series of Intelligence Memos in the next few weeks, outlining recommendations that we hope will help inform the policy decisions that are being made now.*

From: Alexandre Laurin

To: The Honourable Bill Morneau, Minister of Finance

Date: November 29, 2018

Re: **RETIREMENT POLICY PLANNING FOR BUDGET 2019**

Governments can improve Canadians' retirement security in many ways. The CPP expansion recently adopted by the federal and provincial governments is meant to improve the retirement security of younger Canadians, although future benefits and contributions are contingent on investment performance. But there is more to be done to give Canadians more flexibility in how they accumulate retirement assets, facilitate the efficient decumulation of retirement funds in retirement, and ensure employees gain access to sustainable pension plan designs from their employers.

Many Canadians approaching retirement have accumulated capital in RRSPs and defined- contribution (DC) pension plans to fund their retirement. With a large swath of babyboomers retiring or set to retire, governments must shift their policy attention to reducing the risk that many Canadians might outlive their savings.

Retirees invested in RRIFs still face a material risk of outliving their tax-deferred savings due to the mandatory minimum withdrawal schedule, despite the 2015 budget improvements. Further liberalization of the tax rules to allow for more regular adjustments to minimum withdrawals to keep them aligned with returns and longevity, or eliminating minimum withdrawals entirely, would be worthwhile initiatives toward ensuring retirees enjoy lifelong security. As well, the provision of longevity insurance is an essential component for making this happen. Tax rules need to be reformed to enable much needed innovative products in this field. As well, governments could go beyond that and institute their own public longevity insurance scheme for retirees.

Interest in target-benefit pension plans (TBPs) has increased with the recognition that sharing risks related to retirement income between employers and employees fosters more durable pension plans than requiring either side to bear disproportionate burdens in plans whose benefit commitments depend, at least to some degree, on their funded status. The government should move forward with Bill C-27, in addition to updating federal tax rules to accommodate single-employer TBPs now allowed in many jurisdictions – whether new or conversions from existing defined-benefit (DB) and DC plans.

Moving to capital accumulation, life expectancy in Canada has been rising more than two years per decade since the 1960s, but current age limits related to retirement do not reflect this. Canadians (and their employers) now must stop contributing to tax-deferred retirement saving plans at age 71, which is also the age at which contributors must start drawing down their wealth. Increasing the age at which contributions to tax-deferred retirement saving schemes must end to 72 initially, and then at regular future intervals following advances in life expectancy, may encourage older Canadians to stay in the workforce longer.

Canadian income-tax rules limit the amounts of retirement wealth Canadians can accumulate on a tax-preferred basis. Because people are living longer and, even more important, yields on investments suitable for retirement saving are now very low, the cost of obtaining a given level of retirement income has risen. The current rules for calculating equivalency between DB and DC pension plans or limits for RRSPs are badly out of date, putting people with DC plans and/or RRSPs at a major disadvantage relative to those in DB plans. Accordingly, the assumptions underlying the equivalency factor (Factor of Nine) should be updated to reflect current economic and demographic realities: the tax-deferred savings limit for capital accumulation plans would increase as a result from its current 18-percent-of-income level to 30 percent. Alternatively, annual savings limits could be replaced by a larger lifetime accumulation limit. Since tax owing on higher contributions is deferred to be paid when invested funds and income are withdrawn, the tax deferral is effectively a current asset to governments – making the fiscal cost of this measure negligible on a present value basis.

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