Report in Brief

Affordable Lifetime Pension Income for a Better Tomorrow

How we can address the $1.5 trillion decumulation disconnect in the Canadian retirement income system with Dynamic Pension Pools

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Over the last several decades, there has been a global decline in traditional workplace defined benefit (DB) pension plans that provide lifetime pension income for workers after retirement. In Canada, workplace DB pension incomes are now out of reach for nine out of 10 private sector employees.

In response, Canadians have been encouraged to save more, particularly in registered retirement savings plans (RRSPs) and defined contribution (DC) pension plans. And this push has been met with some success, as these individual retirement savings accounts now hold more than $1.5 trillion nationwide. However, what is sorely lacking is support in delivering what Canadians need most in retirement: reliable lifetime income to help replace their employment wages.

As Canadians contemplate how to turn their savings into income, they are trapped between two extreme and inadequate decumulation options: buy a life annuity from an insurance company or move their accumulated savings into a personal retirement income fund (i.e., Registered Retirement Income Fund (RRIF), Life Income Fund (LIF) and Locked-in Retirement Income Fund (LRIF)), where they must individually manage the fund's investment and drawdown. Life annuities have traditionally been very unpopular and remain so today. Nearly all Canadians rely on the second option instead, attempting to finance their income needs throughout retirement without running out of money.

Considering that retirement is expected to last several decades—with unpredictable financial markets and changing personal circumstances—turning accumulated lifetime savings into lifetime income is more than just a challenge. It's a tremendously difficult task that threatens the financial and emotional security of a growing portion of the Canadian population.

Ageing Canadians who are concerned about having sufficient income in later life may decide to follow the mandated minimum RRIF withdrawal schedule and withdraw the lowest possible amount from their RRIFs. Yet even when taking the minimum required amount, RRIF withdrawals are designed to lead to precipitously declining payouts after age 95. There is a one-in-five probability that a 65-year-old Canadian will live beyond that age, so running out of money is a realistic risk that burdens Canadians throughout their retirement. With that in mind, it's not surprising that running out of savings is a significant fear among older adults (Angus Reid Institute, 2015).

The lack of an acceptable, readily available option to convert retirement savings into affordable monthly lifetime income is creating a dangerous disconnect in the Canadian retirement income system, and there is widespread concern that this will lead to increasing financial insecurity for a large portion of the elderly population.

Motivated by this concern, in 2018, a large and varied coalition of pension experts, organizations and industry stakeholders came together to ask the federal government to change tax and pension legislation to allow a third decumulation option: one that enables Canadians to combine their registered savings at retirement and generate pension income less expensively, through **Dynamic Pension (DP) pools**.

Note: The coalition's letter in 2018 referred to this decumulation option as a Variable Payment Life Annuity (VPLA). For compelling reasons explained later in this paper, we propose and encourage the use of "Dynamic Pension" instead ("rente dynamique" en français).

Understanding DP Pools and How They Work

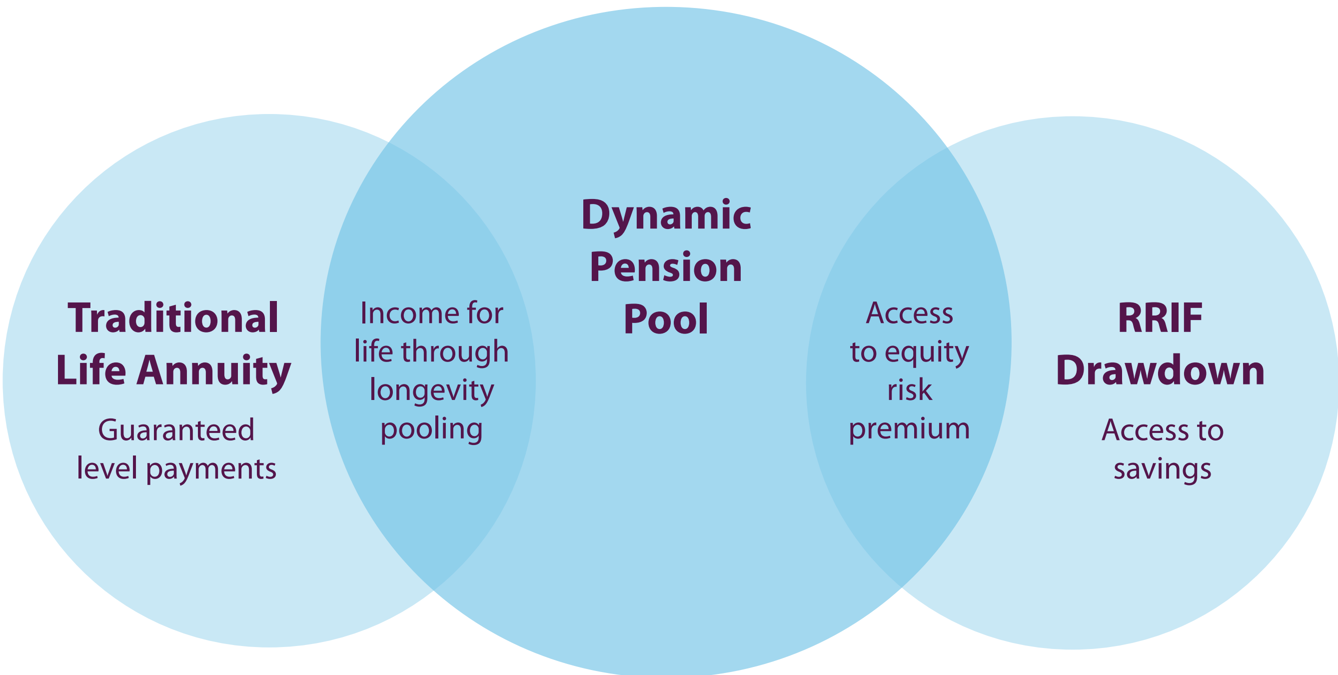
A DP pool is an efficient financial decumulation vehicle with a simple but profound goal: **to help people optimize their expected lifetime retirement income while ensuring they never run out of money**.

DP pools operate on a risk-sharing principle. While protecting a single individual from outliving their savings is often prohibitively expensive, the same protection becomes affordable when spread across a large group.

In a DP pool, any funds left over when a member dies remain in the pool, so those who die earlier than average subsidize those who die later. This gives retirees the freedom of not holding on to savings to cover the possibility of living beyond their life expectancy, providing a substantial boost to their lifetime retirement payments.

In a traditional annuity, longevity pooling is bundled with prohibitively expensive investment guarantees; a DP pool offers the former without the latter. This innovative design allows members to take advantage of longevity pooling while also harnessing the equity risk premium—that is, the additional returns expected to be earned in exchange for taking on investment risk.

From the member's perspective, registered savings are voluntarily directed to a DP pool, which provides a lifetime pension income that is adjusted each year in response to actual investment returns and the pool's mortality experience. Because they are "dynamic", pension payments may fluctuate from one year to the next—much like systematic RRIF withdrawals will fluctuate according to the financial performance of the underlying assets. However, unlike self-managed RRIF savings, DP pools address the risk of running out of money in old age.



DP pools give Canadians the opportunity to benefit from a robust governance structure and professional investment management. As part of a large group, DP pool members may also benefit from economies of scale, such as reduced fees for asset management and administration (compared with what is available in the retail market), stronger asset purchasing power and better capacity to diversify investments across asset classes and over time.

From the provider's perspective, DP pools do not impose DB liabilities, nor do they require risk capital, reserves or deficiency contributions. In other words, there is no direct financial risk for providers in offering them.

While many retirees appreciate the potential benefits of longevity pooling, some may have concerns over the potential loss of value in case of an early death. To address this, income from a DP pool can be structured to include a death benefit, such as a money-back option: if a member passes away before receiving payments equal to the value of their original purchase price, then the difference is payable to their beneficiaries or estate. This feature can help retirees overcome the psychological hurdle of entering a longevity pooling arrangement.

Social and Fiscal Impact of DP Pools

DP pools can help improve social welfare. By providing an inexpensive longevity pooling solution, they can reduce income insecurity and psychological stress, increasing retirees' confidence to spend and enjoy their hard-earned income. DP pools can also help mitigate potential exposure to predatory elder abuse by automating and rationing structured monthly pension payments from otherwise accessible (and potentially large) saving accounts.

DP pools may have an impact on tax revenues. In the short term, transfers to DP pools from registered retirement savings vehicles are expected to accelerate both income and consumer tax revenue. Over the longer term, these fiscal gains will be offset to some extent by the loss of tax revenue on registered balances remaining at death that would have otherwise formed a taxable distribution to heirs.

In addition, DP pools should also help support the financial sustainability of federal and provincial senior social support programs. For example, higher taxable income among the elderly would reduce eligibility for income-tested federal and provincial senior social transfers, such as the Old Age Security (OAS) and the Guaranteed Income Supplement (GIS). These programs were already the largest federal budget spend items prior to the pandemic, and their cost will be under increasing pressure due to Canada's changing demographics and proportionally shrinking base of working taxpayers.

Building an Efficient Decumulation Solution for *All* Canadians

In response to the coalition's 2018 request, the federal government recently enacted important amendments to the Income Tax Regulations that allow sponsors of registered DC plans and Pooled Registered Pension Plan (PRPP) providers to set up DP pools and make them available to members within those plans.

This is a step in the right direction. However, DC plan assets are just the tip of the decumulation iceberg, representing just 10% of the $1.5 trillion of registered individual savings nationwide, and covering less than 7% of working Canadians. Those who expect PRPPs to fill the gap may well be disappointed. There are serious obstacles to access in the current PRPP marketplace and, given the lukewarm enthusiasm exhibited by PRPP licensees to grow this segment, these obstacles are unlikely to disappear without further regulatory intervention. The result is that, in the absence of changes to the regulatory framework, dynamic pensions will likely be out of reach for the vast majority of Canadians.

To effectively address the decumulation disconnect, affordable lifetime pension income needs to be broadly available to *all* retiring Canadians, from a variety of providers. This report outlines the key features of a universally accessible regulatory framework that can bridge the decumulation gap by promoting successful implementation of DP pools across the entire Canadian retirement income system.

To ensure DP pools reach their maximum potential in the Canadian retirement income system, the regulatory framework needs to support the following six objectives:

1 Uniform treatment of registered savings

DP pools should be able to accept assets from any registered retirement savings vehicle (i.e., registered pension plans (RPPs), deferred profit sharing plans (DPSPs), RRSPs, RRIFs and their locked-in variants).

2 Universal member eligibility

Affordable lifetime pension income must be accessible to all retiring Canadians, regardless of their employment histories.

3 Effective protection from longevity risk

The DP pool must be large enough to provide meaningful longevity risk pooling.

4 Robust governance

DP pool providers must have a fiduciary duty to the members, and the pool must operate transparently with appropriate controls and oversight.

5 A diverse ecosystem of providers that are willing and able to bring DP pools to scale quickly

The product must be attractive to, and feasible for, a variety of providers to achieve appropriate scale. The framework should support a range of providers, including not-for-profit entities, to foster competition.

6 Clear, simple and harmonized regulations

Legislation must be clear and unambiguous: the rules must be explicit to facilitate providers' understanding and ease implementation.

With input from a panel of pension thought leaders across Canada, this report provides guidance on how to remove unnecessary obstacles and clear the path for DP pools. It describes four possible vehicles for implementation: **the two options included in the current regime (registered DC pension plans and PRPPs), an emerging solution through securities and a new purpose-built container (a standalone DP pool to be created under pension legislation).**

Following is an evaluation of each option based on the objectives outlined above, with critical areas for additional legislative support identified.

	DP pools within DC plans	DP pools within PRPPs	DP pools via securities	Standalone DP pools
1 Uniform treatment of registered savings	satisfied	satisfied	satisfied	satisfied
2 Universal member eligiblity	needs adjustment	needs adjustment	satisfied	satisfied
3 Effective protection from longevity risk	needs adjustment	satisfied	needs adjustment	satisfied
4 Robust governance	satisfied	needs adjustment	needs adjustment	satisfied
5 Providers are willing and able to bring DP pools to scale	unlikely to be achieved	needs adjustment	satisfied	satisfied
6 Clear, simple, harmonized regulations	unlikely to be achieved	needs adjustment	needs adjustment	satisfied

satisfied needs adjustment unlikely to be achieved

No matter which implementation vehicle(s) the regulatory framework supports, legislative action is needed to allow DP pools to reach their full potential.

A Call to Action

In the face of an ageing population, turning a blind eye to the decumulation disconnect and failing to act is dangerous to the financial well-being and peace of mind of Canadian seniors and their families, as well as to the financial viability of Canada's social systems.

The heartbreaking tragedies of the COVID-19 pandemic in Canadian nursing homes have not only illuminated the systemic deficiencies of Canada's long-term care services, but they have also given Canadians a glimpse into a future where the public system can't afford to support the needs of a growing elderly population. This is yet another wake-up call that thoughtful public policy reforms must be put in place now to allow our ageing population to become more financially self-reliant by improving the effectiveness of the private resources they will need to fall back on. The urgency is underlined by Canada's demographic shift, which already has seniors outnumbering children for the first time in history.

Now is the time to implement transformative policy reform and create a future where our elderly population can properly benefit from the retirement savings they have so painstakingly accumulated.

The global consensus, built on academic studies and practical examples, is that DP pools are an effective, inclusive and sustainable solution to the decumulation challenge. With the legislative changes identified in this report, all Canadians could gain access to DP pools—the missing link in our retirement income system today.

For more information about DP pools, their transformative potential for Canadians and the public policy steps needed to make them accessible, available and successful, read the full report at nia-ryerson.ca/reports#dynamicpensions

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The National Institute on Ageing is a Ryerson University think tank focused on the realities of Canada's ageing population. Follow us on Twitter @RyersonNIA and support our call for a National Seniors Strategy @NSS_Now.

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