THE CANADIAN BAR ASSOCIATION
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Via email: rpd/dre@cra-arc.gc.ca

Jeffrey Boxer
Manager, RPP Policy and Technical Services
Registered Plans Directorate
Canada Revenue Agency
Ottawa ON K1A 0L5

Dear Mr. Boxer:

Re: Registered Pension Plan Annuity Contracts under section 147.4 of the *Income Tax Act*

The Canadian Bar Association Pensions and Benefits Law Section (CBA Section) is pleased to comment on the Canada Revenue Agency (CRA) *Draft Newsletter* (Newsletter) *respecting Registered Pension Plan Annuity Contracts under section 147.4 of the Income Tax Act* (ITA).

The CBA is a national association of 36,000 members, including lawyers, notaries, academics and law students across Canada, with a mandate to seek improvements in the law and the administration of justice. The CBA Section contributes to national policy, reviews developing pensions and benefits legislation and promotes harmonization. The CBA Section comprises lawyers from across Canada who practice in pensions and benefits law, including as counsel to benefit administrators, employers, unions, employees and employee groups, trust and insurance companies, pension and benefits consultants, investment managers and advisors.

Introduction

The Newsletter offers guidance on the purchase of annuity contracts under section 147.4 of the ITA. As this interpretation of section 147.4 will impact many stakeholders, including registered pension plan administrators, plan members, consultants and licensed annuities providers, the CRA has invited feedback to ensure that it adequately addresses issues related to acquiring outside annuities to satisfy a member's rights to benefits under a registered pension plan.

The CBA Section appreciates guidance on interpreting section 147.4 of the ITA and offers suggestions for improvement. In this letter, we have generally relied on the same headings as those used in the Newsletter to organize our comments.

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Preliminary Remarks

The purchase of an annuity by a plan administrator concerning some or all of the liabilities of a pension plan, and/or pursuant to portability provisions of a pension plan on termination of employment by plan members, is heavily regulated under the minimum pension standards legislation of each jurisdiction. Annuity purchases arise in several situations:

1. "Bulk" annuity purchases are increasingly common as a means of "de-risking" a pension plan so they can and do arise while the plan is ongoing. In these situations, the plan sponsor or administrator seeks to underwrite part of the plan's liabilities, sometimes for a single tranche of plan members (for example, retired members). The terms of the plan dictate the terms of the annuity purchased.

2. Annuity purchases are required when a pension plan is wound up or terminated as part of the distribution of the assets of the pension fund. Sometimes these purchases are made in the context of an underfunded pension plan being wound up under a formal insolvency procedure. In that case the terms of the annuity may reflect compromises reached as part of the plan of arrangement or other resolution of the insolvent employer's estate.

   Either way, there are pension standards provisions that govern the terms of the purchase aimed at ensuring that plan members' vested rights are protected in the transition of their entitlements out of the pension fund.

3. Pension plans (and pension standards legislation) permit and govern the transfer out of a pension plan, on an individual basis, the commuted value of the member's entitlement when the member terminates plan membership. The commuted value entitlement is often transferred to an insurer for the purchase of an annuity, the value of which must equate to the commuted value transferred from the pension plan.

Given the complex layers of legislation already governing annuity purchases, including whether the terms of the annuity may vary from the benefit entitlement in the pension plan, the CBA Section suggests that the Newsletter include an introductory passage clearly stating that it does not address any of the regulatory or compliance issues that arise under provincial pension standards legislation, nor replace the terms of the pension plan under which the annuity is purchased. This would clarify that the sole focus of the Newsletter, especially concerning the meaning of "not materially different", is to provide guidance for federal ITA purposes and that compliance with the Newsletter is not necessarily compliance with provincial or federal pension standards legislation.

Similarly, it would be helpful for that introductory passage to state that the Newsletter addresses group annuities purchased using plan assets (such as buy-out or wind-up annuities), as well as individual annuities purchased with a plan member's commuted value on termination of plan membership.

Materially different

The Newsletter explains that annuity purchases "must not allow for a reconfiguration of the amount or form of benefits that are provided under the particular RPP".

The CBA Section suggests offering a non-exhaustive list of examples of "reconfiguration of benefits" that would render an annuity purchase "materially different". For example, it would be helpful for the Newsletter to confirm whether the amount of the annuity must match the monthly pension amount payable under the registered pension plan on the commencement date selected for the annuity. (See the related discussion below under the heading "*Individual annuity purchases using commuted values"*.)

Cost of living adjustments

We appreciate that the Newsletter gives greater certainty about the fixed rate adjustments that CRA will accept as equivalent to cost-of-living adjustments based on the Consumer Price Index (CPI). As lawyers, we do not have the expertise to suggest additional fixed-rate adjustments that may also be equivalent to CPI, but we support CRA's flexibility in agreeing to review additional methods of calculating equivalent fixed rate adjustments on a case by case basis.

Individual annuity purchases using commuted values

The Newsletter indicates that where the commuted value transferred from the pension plan is insufficient to purchase an annuity providing the same benefits as under the pension plan, it will be acceptable to reduce the lifetime retirement benefits or ancillary benefits "but without further reconfiguring the benefits that would have been provided from the RPP". The meaning of "reconfiguring the benefits" is unclear. For example, would the lifetime retirement benefit and an ancillary benefit have to be reduced proportionately? Or, could the lifetime retirement benefit be reduced while keeping the ancillary benefits the same, or an ancillary benefit be reduced while keeping the lifetime retirement benefit the same?

In our view, the plan member should have the flexibility to determine which benefits from the pension plan are preserved or reduced under the annuity to account for the limited commuted value available, so long as the annuity does not offer a greater lifetime retirement benefit than would have been available to the member under the pension plan, nor an ancillary benefit greater than that provided to the member under the pension plan. The following example clarifies our concerns about the interpretation of "reconfiguring the benefits".

Assume a member has accrued an immediate unreduced pension and ancillary benefits as specified below. The normal form under the RPP for a member with a spouse is a joint and 60% survivor pension, and a 10 year guarantee for a member without a spouse or where the spouse provides a waiver. In this example, the member has a spouse and the commuted value of the member's benefits is $300,000. The member's benefits payable from the pension plan would be:

- Immediate lifetime retirement benefit - $25,000 per annum
- Bridge benefit - $5,000 per annum
- Survivor pension to spouse - 60% of $25,000

The insurer quotes a premium of $333,333 to provide the same benefits as the pension plan. The commuted value available to the member is 10% less than the premium quoted, so the member considers several options costing $300,000.

a) Option 1: all benefits reduced by 10%
    - Immediate lifetime retirement benefit - $22,500 per annum
    - Immediate bridge benefit - $4,500 per annum
    - Survivor pension to spouse - 60% of $22,500

b) Option 2: lifetime retirement benefit preserved but no bridge benefit
    - Immediate lifetime retirement benefit - $25,000 per annum
    - Immediate bridge benefit - $0 per annum
    - Survivor pension to spouse - 60% of $25,000

c) Option 3: lifetime retirement benefit and survivor benefit reduced, bridge preserved
   - Immediate lifetime retirement benefit - $22,000 per annum
   - Immediate bridge benefit - $5,000 per annum
   - Survivor pension to spouse - 50% of $22,000

d) Option 4: lifetime retirement benefit and bridge preserved but starting 16 months later
   - Deferred lifetime retirement benefit - $25,000 per annum
   - Deferred bridge benefit - $5,000 per annum
   - Survivor pension to spouse - 60% of $25,000

All of these options should be acceptable, since none offers a greater lifetime pension or a higher amount for the bridge benefit than under the pension plan. Comparing the annuity to the pension plan should reflect the nature of the member's entitlement under the pension plan in the particular circumstances; so if the member's spouse waived entitlement to a 60% survivor pension, then the member could substitute a 10- year guarantee, which would also be acceptable.

In contrast, we expect that the fifth option below would be unacceptable because of the increased lifetime retirement benefit.

e) Option 5: lifetime retirement benefit increased, bridge and survivor benefit decreased
   - Immediate lifetime retirement benefit - $26,200 per annum
   - Immediate bridge benefit - $0 per annum
   - Survivor pension to spouse - 50% of $26,2000

Individual annuity purchases using plan assets

When setting out the general description of tax consequences of an individual annuity purchase that qualifies under section 147.4(1) of the ITA, it would be helpful to confirm that section 8517 transfer limits do not apply to an annuity purchase.

In the final sentence of the individual annuity purchase section, the Newsletter explains that the portion of commuted value of a pension beyond the annuity premium must be paid in cash, included in income for tax purposes and not transferred directly to another registered vehicle. For clarity, it should also indicate that a pension plan could allow for a direct payment to an RRSP as a contribution for a member with sufficient RRSP contribution room.

Do these rules apply to money purchase plans?

The Newsletter correctly notes that section 147.4 of the ITA applies to annuity contracts that replace benefits under both defined benefit and money purchase registered pension plans.

However, we recommend that the Newsletter expressly recognize that, for purposes of confirming compliance with the "not materially different" requirement in section 147.4(1)(b) of the ITA (as discussed above), most money purchase plans will not provide any specific amount or form of lifetime pension benefit. Rather, money purchase plan texts (which do not include variable benefit provisions) normally say that, upon retirement or termination of employment, members are to elect a portability option, including the option of purchasing an annuity from an insurance company, with the entirety of their account balance under the plan. Expressly recognizing this reality in the Newsletter would prevent confusion by money purchase plan administrators in confirming compliance with section 147.4(1) when purchasing annuities from the plan.

Inspections and requirement to provide documents or information

The Newsletter does not offer guidance about the condition in section 147.4(1)(c) regarding further premiums paid after the contract is acquired.

For group annuity policies purchased pursuant to an administrator's decision to "de-risk" or as a result of a pension plan wind-up, the industry practice is to allow for premium adjustments for a limited period to reflect data corrections and membership changes that occur between the date of the annuity purchase and the date when the insurer assumes the obligation to make pension payments. Premium adjustments may result in refunds to the pension fund or an increase to the original premium, and are typically completed within a six month premium adjustment period. These adjustments are intended to ensure that the annuities accurately reflect members' pension entitlements under the terms of the registered pension plan and ensure that the premium accurately reflects the risk transfer.

The Newsletter should confirm that this standard practice is not considered to be a further premium that would cause the purchase to lose the protection of section 147.4(1). Alternatively, we welcome legislative change to reflect industry practices consistent with the tax policy of permitting annuity purchases.

The CBA Section appreciates the opportunity to provide input on the Newsletter. We trust that our comments are helpful and would be pleased to offer further clarification.

Yours truly,

(original letter signed by Nadia Sayed for Sonia Mak)

Sonia Mak
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