



INVESTMENT INDUSTRY ASSOCIATION OF CANADA  
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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Dear Mr. Keenan and Ms. MacLean:

**Re: IIAC Comments on Income Tax Act Changes to Accommodate PRPPs**

Further to our recent discussions, we would like to provide the Investment Industry Association of Canada's (IIAC's) recommendations with respect to the "Income Tax Legislative Proposals in Respect of Pooled Registered Pension Plans and Explanatory Notes" (the Tax Proposals) released for comment on December 14, 2011. IIAC supports improving the effectiveness of private-sector savings vehicles to meet retirement goals and build a pool of investible capital by addressing identified gaps and obstacles in ways that complement, rather than supplant, existing retirement instruments.

The government's stated goal for Pooled Registered Pension Plans (PRPPs) is to provide a low-cost savings option "for those without access to a workplace pension plan". We believe that it is not consistent with this goal for PRPPs to accelerate the decline in defined benefit (DB) and defined contribution (DC) plans through incenting transfers to PRPPs. Nor do we believe, in the interests of maintaining the competition necessary to keep costs low, that it will be beneficial to reduce, effectively, the number of entities that are able to offer PRPPs by limiting the ability of administrators to charge reasonable, all-inclusive fees for a vehicle that includes advice.

**Our recommendations are aimed at making it easier for small and medium-sized businesses to offer employees, and the self-employed to access, a retirement savings option, while preserving current arrangements that have proven to be important parts of Canada's retirement savings framework. Canada's framework is well-diversified and therefore highly respected<sup>i</sup>, and any reduction in its diversification could reduce its strength. To this end, we recommend, for greater neutrality, that:**

- **the Tax Proposals (and/or *PRPP Act* or regulations) exclude transfers to locked-in PRPPs from unlocked-in retirement sources**
- **the payroll-related tax benefits of PRPPs be made available to group Registered Retirement Savings Plans (RRSPs).**

Mr. Sean Keenan/Ms. Alexandra MacLean  
Re: Income Tax Act Changes re PRPPs  
February 16, 2012

As well, we suggest that the federal government consider additional changes beyond the creation of PRPPs to increase the amount of Canadians' retirement savings.

## **Background**

We have looked at the proposed introduction of PRPPs in the context of the overall retirement savings landscape. In addition to the \$153 billion in publicly mandated employer- and employee-paid CPP holdings, there are \$1.7 trillion in workplace retirement savings. This is comprised of \$1.1 trillion in workplace pension plans (\$1 trillion in DB and \$65 billion in DC plans); a further \$40 billion in workplace group RRSPs; and some portion of the \$630 billion in RRSPs that is employer-paid. Also, the government, when initiating tax-free savings accounts (TFSA) that now total some \$15 billion in value, estimated that half would be used by seniors and some TFSA contributions may also be employer-paid.

These forms of retirement savings, taken with the pay-as-you-go Old Age Security (OAS) and Guaranteed Income Supplement (GIS) and Allowance, show the diversification of retirement-income sources available to Canadians. It is our understanding that the Tax Proposals have been drafted to provide maximum flexibility, allowing PRPPs to be workable with provincial retirement savings enhancement goals. However, there is a risk of unintended consequences resulting from the deliberately very broad wording of the Tax Proposals and *PRPP Act* (collectively, the Enabling Legislation).

## **Concerns**

- 1. Large shifts in savings patterns and assets:** PRPPs have been targeted at Canadians without workplace pensions; however there is nothing to guarantee that there will not be extensive shifts between existing retirement savings vehicles and PRPPs. An interesting parallel is income trusts: these vehicles were not, at inception, expected to be used in sectors beyond petroleum and real estate, however, large mainstream corporations began announcing their intentions to use the structure. While no large company has yet announced, to our knowledge, its intention to replace its existing DB or DC plan with a PRPP going forward, PRPPs' lower costs and lower employer liability may be two factors difficult for companies to ignore in our current financially challenging and litigious environment. Similarly, while no smaller companies offering Group RRSPs have yet announced that they will change directions, it will be hard for smaller companies to ignore an immediate savings of 4.95% in Canada Pension Plan (CPP) payments and 2.56% in Employment Insurance (EI) premiums on contributions to a PRPP versus Group RRSP on salaries up to a certain threshold (as well as greater certainty for the employer regarding no employer liability). A large shift in assets from a retirement framework component with advice on not just which investment to choose, but also other essential aspects of financial literacy (such as tax planning, estate management, educating teens, assistance with financing elder care, etc.) to an unadvised channel will likely have a negative impact on investor outcomes, and possible on the finances of related family members. *Our concern is the long-term results from a potentially significant shift between retirement savings types, especially in the absence of financial advice.*
- 2. No or "one-size-fits-all" advice:** Lower costs for PRPPs are expected to be achieved through economies of scale achieved through the pooling of funds, filtered into fewer choices, with no

Mr. Sean Keenan/Ms. Alexandra MacLean  
Re: Income Tax Act Changes re PRPPs  
February 16, 2012

personalized advice other than through the choice architecture of the limited fund types. Allowing advice to be purchased but only if separately disclosed appears to be a reasonable alternative given that Ipsos has shown that advised households save more, use tax-advantaged opportunities better, and invest in securities with a greater opportunity for future investment growth than non-advised peers in each income range and age group<sup>ii</sup>. This results in higher levels of net worth and better overall savings outcomes than non-advised households. However, some may be deterred from paying separately for advice. Indeed, a majority of Canadian mutual fund holders say they prefer embedded advice assuming that both approaches cost the investor the same amount<sup>iii</sup>. ***Our concern is that the lack of personal advice and reduced access to advisors – an important avenue to financial literacy in areas beyond stock-picking – may outweigh the benefits of PRPPs’ lower fees.***

3. **Locking-in or locked out:** The enabling legislative proposals appear to make transfers between PRPPs and RRSPs possible without restriction on either the transfer of RRSPs (unlocked) in to PRPPs (locked-in) or on transfers from PRPPs to locked-in retirement instruments. Additionally, repayments of home-buyer and lifelong learning plan withdrawals and transfers on death can see a further transfer in RRSP moneys into PRPPs. Furthermore, the requirement that over-contributions to PRPPs first be addressed by withdrawals from RRSPs seems to add to the perception that the federal government favours PRPPs over other RRSPs. We have heard that one policy justification for PRPPs is that RRSPs are not locked in like pension plans are and so they may be used for any purpose, such as vacations. In fact, we believe there are a number of factors, set out in **Attachment 1**, suggesting that this concern ignores certain facts and is overstated, incorrect or able to be addressed. ***Our concern is that a shift for Canadians from an open to a locked-in option can have an extremely negative effect on Canadians’ ability to buy a home, start a business, finance education, or cope with unexpected emergencies.***
4. **Equal opportunity/level playing field:** Current measures penalize the many Canadians who contribute to retirement savings in Group RRSPs – and the employers offering these retirement plans – by subjecting contributions to payroll taxes solely, we understand, because a minority cash in their savings for other purposes. Due to the advent of TFSAs, the minority who withdraw from RRSPs, for reasons that may be considered inappropriate from a public policy perspective, will likely decline, as should the related public policy concern leading to differential payroll tax treatment of contributions to pension plans and group RRSPs, or employer contributions (e.g., bonuses) to personal RRSPs. ***Our concern is the impact of unequal payroll tax treatment on retirement savings alternatives will lead to a decline in group RRSPs that results in less competition and less choice.***

### **Recommended Income Tax Act (ITA) and/or PRPP Act Amendments**

1. **We strongly recommend that the Tax Proposals (and/or PRPP Act or regulations) exclude transfers to locked-in PRPPs from unlocked-in sources.** This is to avoid potentially significant switches between pension and non-pension retirement savings options – effectively from advised to non-advised options – and to allow consideration of the related impacts by governments and Canadians. As an example of possible effects, OMERS has recently introduced additional voluntary contributions (AVCs) attracting the transfer into OMERS of some or all of plan member RRSPs to be managed by OMERS. In the first six months of this

Mr. Sean Keenan/Ms. Alexandra MacLean  
Re: Income Tax Act Changes re PRPPs  
February 16, 2012

option's availability, it attracted \$90 million – 8% of 2010 employee contributions. While there is a tool alerting those transferring in funds that they will be limited to withdrawals of \$500 a year, it is too early to tell what impact this will have on members and on RRSPs more broadly.

**2. We strongly recommend that the benefits of PRPPs be made available to Group RRSPs and specifically that the ITA be amended to eliminate application of CPP and EI deductions from both employer and employee contributions to employer Group RRSPs as well as to employer contributions to personal RRSPs, as is the case for such contributions to DB and DC plans, and now PRPPs. This would:**

- Reduce costs for businesses and, in particular, for small businesses, as they constitute the majority of Group RRSP users, leaving these businesses with more money for growth, for jobs and/or income on which taxes would be paid. Ideally, this tax reduction would be self-financing to the extent that the CPP and EI not collected would be replaced by income tax revenue and a reduced call for government-funded assistance at retirement;
- Treat Group RRSP holders equally, from a payroll tax deduction perspective, to DC and PRPP plan holders (although federal tax rules are said to prevent workers in DC, PRPP, Group RRSP and RRSP plans from saving as much as career members of DB plans can on equivalent career incomes<sup>iv</sup>); and
- Enable an advice-inclusive alternative to PRPPs, providing a balanced choice of retirement options.

To the extent withdrawal of funds from Group RRSPs is the cause for government concern about insufficient amounts at retirement, the federal government can increase the amount of RRSP savings available to some Canadians when they retire by:

- Eliminating RRSP and registered retirement income fund (RRIF) income from the Guaranteed Income Supplement clawback, as is the case with TFSAs, to preserve more revenue for low-income Canadians
- Allowing the self-employed, whose incomes may vary widely from year to year, to base RRSP contributions on average income with a carry-forward or back into years of leaner earnings
- Permitting Canadians, at least those whose employment is terminated by their employer, to accumulate RRSP room based on an average of preceding working years' contributions and/or to recontribute to RRSPs any amounts that have been withdrawn from RRSPs and taxed (so that a loss of contribution room does not compound the loss of the potential growth in the investment during the period an amount has been withdrawn)
- Permitting those who leave work for an approved purpose (e.g., maternity or paternity leave, caregiving, or education), to accumulate RRSP room based on an average of preceding working years' contributions.

Mr. Sean Keenan/Ms. Alexandra MacLean  
Re: Income Tax Act Changes re PRPPs  
February 16, 2012

While our membership is unlikely to be able to administer or distribute PRPPs due to their low-cost requirement – which may be impossible to meet given the expense of investment dealer and advisor regulatory obligations (know-your-client (KYC), suitability, conflict of interest, reporting, and others) – other recommendations we will be making with respect to the *PRPP Act* include:

- making changes to enable investment dealers to act as administrator and to allow an embedded advice PRPP option;
- ensuring that any mandating of companies to provide or contribute to PRPPs could be met equally by employers offering Group RRSPs or directing contributions to RRSPs; and
- ensuring that efforts to simplify pension plan administration for PRPPs and provincial equivalents flow to Group RRSP offerors, ideally, by assigning this to a joint industry/Canadian Association of Pension Supervisory Authorities working group.

We would be pleased to provide further information on our recommendations. We are hoping to meet with your pension colleagues in the near future to discuss these and others matters that cross pension and tax policy. Please do not hesitate to contact Andrea Taylor ([ataylor@iiac.ca](mailto:ataylor@iiac.ca); (416) 687-5476) or me ([bamsden@iiac.ca](mailto:bamsden@iiac.ca), (416) 687-5488) for any information you may need in the meantime.

Yours sincerely,



Cc: Ms. Leah Anderson ([Leah.Anderson@fin.gc.ca](mailto:Leah.Anderson@fin.gc.ca))  
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Mr. Sean Keenan/Ms. Alexandra MacLean  
Re: Income Tax Act Changes re PRPPs  
February 16, 2012

## Attachment 1

### Group RRSPs Generally Meet Pension Policy Objectives

1. To the extent that the unlocked nature of RRSPs is the policy justification for differential CPP and EI treatment of contributions, we believe it is important to recognize that the government introduced changes in 2008 to allow Canadians easier access to their locked-in retirement accounts (LIRAs), which hold money transferred in from DB and DC plans. This suggests that there are acceptable policy reasons for such withdrawals, whether from pensions or RRSPs. Similarly, some provinces allow unlocking of locked-in pension plans, for example, in the following cases:
  - Small balances in the account, under a specified threshold amount
  - Becoming non-resident of Canada
  - Shortened life expectancy
  - Financial hardship
  - Spousal or child maintenance enforcement orders.
2. A Bank of Montreal Financial Group survey<sup>v</sup>, conducted by Leger Marketing, identified similar reasons for why Canadians were withdrawing money early from their RRSPs with all but 6% being reasons that we believe would be considered “acceptable” from a public policy and/or financial literacy perspective:
  - Emergencies, such as the loss of a job (36%)
  - Paying off everyday debt, such as credit card balances (26%)
  - A house purchase or home renovation (25%)
  - Education – either their own or their child's (10%)
  - Vacation/leisure (6%).
3. A less recent analysis (2005), albeit the most recent Statistics Canada study<sup>vi</sup> we were able to identify, noted that:
  - The percentage of Canadian tax filers taking money out of their RRSP in 2001, at 6.7%, was almost double the 3.8% withdrawn in 1993. Even 6.7% is relatively low and was arguably the result of a global recession in 2001, coming after 10 years of growth – the longest expansion on record in the United States – compounded by the 9/11 aftermath.
  - The same study noted that “While the number of people withdrawing increased [in 2001], the median withdrawal amount fell significantly – over 46%. The median withdrawal in 2001 was \$1,600. In comparison, the median contribution increased 11% to \$2,600.”
  - In addition to people withdrawing due to unexpected expenses, some may have viewed their RRSP as a means of savings. With the advent of TFSAs three years ago, and assuming they are used appropriately, it is highly likely that short-term savings needs and emergency cash objectives will be achieved through TFSAs.
  - The 2005 Statistics Canada study also found that amounts withdrawn also are recontributed, albeit not in all cases or as quickly as would be desirable.

Mr. Sean Keenan/Ms. Alexandra MacLean  
Re: Income Tax Act Changes re PRPPs  
February 16, 2012

4. It is not clear whether payments as part of the Home Buyers' Plan (HBP) or Lifelong Learning Plan (LLP) are included in RRSP withdrawals in either the Statistics Canada or BMO Financial Group survey. As well, the HBP is limited in application to \$25,000 for first-time homebuyers, thus even were numbers for HBPs and LLPs excluded from these analyses, RRSPs might still be "acceptable" sources of funds for homes in higher-cost-housing cities or where an individual is not a first-time home buyer. And while there continues to be considerable debate in the media and among experts about the benefits of paying down debt versus RRSP benefits, to the extent that money from an RRSP is used for a downpayment on a house or to pay down a mortgage, this is a switch in, rather than a withdrawal from, retirement assets. Similarly, a maximum contribution of \$20,000 to LLPs is not enough for some levels of education that also arguably are an investment that will result in a higher salary and better retirement outcome.

Mr. Sean Keenan/Ms. Alexandra MacLean  
Re: Income Tax Act Changes re PRPPs  
February 16, 2012

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- <sup>i</sup> “Retirement-income provision in Canada is well diversified: between public and private provision and pay-as-you-go and pre-funding as financing mechanisms. Diversification offers security against the range of many different risks and uncertainties affecting pension systems and individuals' retirement incomes.”, Edward Whitehouse, “Canada's retirement-income provision: An international perspective”, 2009, commissioned by the federal Research Working Group on Retirement Income Adequacy.
- <sup>ii</sup> “The Value of Advice” (featuring results from Ipsos Reid’s 2009 Canadian Financial Monitor), IFIC, July 2010.
- <sup>iii</sup> “Canadian investors’ perceptions of mutual funds and the mutual fund industry”, Pollara, 2011.
- <sup>iv</sup> “Legal for Life: Why Canadians Need a Lifetime Retirement Saving Limit,” by James Pierlot with Faisal Siddiqi, October 27, 2011, C.D. Howe Institute.
- <sup>v</sup> “BMO Study: Troubling Trend Sees Canadians Dipping into Their RRSPs Prior to Retirement”, February 26, 2011.
- <sup>vi</sup> “Using RRSPs before retirement”, Philip Giles and Karen Maser, December 2004 (<http://www.statcan.gc.ca/pub/75-001-x/11204/7745-eng.htm>).