Intelligence MEMOS

From: Don Ezra

To: The Hon. Bill Morneau, Minister of Finance

Date: March 21, 2019

Re: Some welcome steps towards longevity insurance

Thank you. It's not perfect, but it's a start in a good direction.

Your proposed rules that would permit longevity insurance, known technically as "advanced life deferred annuities" were a welcome piece of this week's budget. These annuities are a form of insurance under which individuals pay a (small) single premium to an insurance company, and if they survive past a certain age (no later than age 85, in the budget) they will receive regular (annuity) payments until they pass away.

I advocated for just that my recent C.D. Howe Institute's publication. The biggest fear of retirees, consistently identified in surveys around the world, is outliving their assets. With the purchase of longevity insurance, that fear vanishes. Making it permissible is definitely a step in the right direction. Hence my thanks. Incidentally, with your background in pensions and employee benefits, you are well qualified to understand how such an exotic form of insurance can improve the lives of many retirees.

The budget's supporting documents contain other good features:

- inflation protection on the deferred annuity payments may be negotiated in advance;
- the annuity may be continued to a surviving partner who outlives the purchaser, possibly at a reduced amount to the survivor, since typically one person does not need as much as two;
- the potential for a final death benefit if the sum of the payments received by the end of the insurance amount to less than the purchase price.

All good, but the proposed rules also leave room for improvement.

Requiring age 85 as the latest possible age for the payments to start is actually quite early. True, it follows similar US legislation. But for a 65-year-old Canadian male, the chance of surviving past 85 is pretty close to 50/50 – half our 65-year-olds will survive past age 85. Eighty five feels more like a gamble than insurance. Permitting, let us say, age 90 to be the starting point is more like insurance, which would protect against true unlikely outcomes – and would cost much less.

Longevity insurance would now be permissible in "qualifying" plans, essentially tax-deferred arrangements. But it makes just as much sense to permit it as a normal tax-prepaid contract. This would require further changes in tax legislation, making longevity insurance annuity payments taxable only when paid out. Today, amazingly, purchasers of deferred annuities are liable to tax on interest even in the deferment period when no income is actually received, and even if they never survive to the deferred age.

Also, the amount permissible as a single premium is limited to a very low threshold. The budget proposes a ceiling not only of 25 percent of the amount in a qualifying plan, but an absolute dollar ceiling of $150,000 from all of someone's qualifying plans. Admittedly this is similar to the US "qualified longevity annuity contract" limit, currently $130,000. But there is no valid policy reason for an absolute dollar limit on top of an existing 25-percent limit.

Simply to offer this new contract will be a challenge to Canadian insurance companies and will require a willingness to make it work. Financial professionals too will have to educate their clients, regardless of how they are compensated for it.

I do not have US statistics as to the usage of longevity insurance since it was first made available in 2014. I'm guessing the uptake was small. But it should not matter. Life insurance sold slowly when it first became available. It takes time to get used to a new financial product. Centuries later, life insurance is an essential planning tool. It will be the same with longevity insurance. And ours will be a better society when it is available.

Don Ezra is a former vice-president of the Canadian Institute of Actuaries.