

Variable Life Benefits

**2024
Ontario Consultation
Document**

Ontario Consultation Paper on Variable Life Benefits

Introduction

In 2021, the federal government made amendments to the federal Income Tax Act (ITA) to permit Canadian jurisdictions to regulate a new pension option that can be offered to members called a Variable Life Benefit (VLB). A VLB, often also referred to as a variable payment life annuity, can be paid from pooled registered pension plans, defined contribution pension plans, and those pension plans that provide for additional voluntary contributions (AVCs). Retirees who choose a VLB would receive a lifetime monthly benefit with payments that are adjusted based on the investment performance of the fund and mortality experience of the fund's members.

Currently, members who are retiring from one of the eligible pension plans have the option to:

- 1) Transfer their retirement funds from their pension plan to a locked in account at a financial institution and be responsible for the investment strategy and the amount of withdrawals; or
- 2) Use the proceeds of their pension plan to purchase an annuity from an insurance provider, which provides lifetime income at the current market rate applicable at the time of purchase; or
- 3) Leave their retirement funds in the pension plan if the plan offers this option.

With the introduction of VLBs, eligible pension plans would be permitted to provide their members with the option to purchase a VLB. These members could invest a portion, or the entirety of their DC, PRPP or AVCs in a VLB and in return receive monthly payments from the VLB fund. The plan administrator would be responsible for managing the investments in the VLB fund to provide a lifetime stream of monthly payments to all VLB members. These monthly payments would vary depending on the VLB fund's actual rate of return relative to its expected return, as well as the mortality experience of the members in the VLB fund relative to the assumed life expectancy.

In order to establish VLBs in Ontario, amendments to the *Pension Benefits Act* (PBA) and the *Pooled Registered Pension Plans Act, 2015* (PRPPA) would be required.

As part of developing a future framework for VLBs, the Ministry of Finance will also take into consideration opportunities for harmonization with the approaches in other Canadian pension jurisdictions.

Objective and Scope of This Consultation

Through this consultation paper the Ministry is seeking to gather input and perspectives on a future framework for VLBs that:

1. protects members' interests and supports informed decision-making; and
2. minimizes regulatory burden and supports interprovincial harmonization as appropriate.

How to Participate

In this discussion paper the Ministry has outlined key elements for a future VLB framework along with questions for feedback and input. The Ministry welcomes responses to the questions in this paper and any additional comments or suggestions related to VLBs.

Responses can be provided directly through the links provided on the Ontario Regulatory Registry website, or to pension.feedback@ontario.ca

In addition, Ministry staff are available to meet with interested stakeholders to discuss VLBs and the questions posed below. Meetings can also be arranged by emailing pension.feedback@ontario.ca

The consultation period will end January 10, 2025.

How VLBs Work

Framed by the federal ITA, provincial legislation and regulations would permit members of PRPPs, DC plans and DB plans that offer AVCs to purchase a VLB through a separate fund within the plan. Upon retirement, if a member prefers to receive a VLB annuity from the plan instead of taking a lump sum from the plan, the member could transfer all or part of their pension savings into the VLB fund.

The plan sponsor would be responsible for the plan design elements of the VLB including the investment strategy, administration fees, and compliance with the PBA or PRPPA. The plan sponsor or administrator would be required to register the VLB fund with Ontario's pension regulator. Plan administrators would retain fiduciary responsibility for the VLB which includes the requirement to adjust benefits to reflect investment returns and mortality experience. This latter adjustment captures the difference between the actual and expected number of deaths over a period.

A VLB may offer one or more "hurdle rates", from which the member can choose. The hurdle rate the member chooses is a permanent decision and is used as the benchmark against which the fund's expected rate of return is measured, and against which the member's monthly payment is adjusted. For example, the sponsor of the VLB may offer a hurdle rate of 5%. If the VLB's rate of return is better than 5% then the benefit would

increase and if the rate of return is less than 5% the benefit will be reduced. It is also possible for a VLB to offer two hurdle rates to choose from, such as 4% or 7%. A member who chooses a lower hurdle rate is more likely to have their payments increase over time while choosing a higher hurdle rate is likely to result in declining payments over time.

Under the ITA, once a member purchases a VLB annuity and receives a payment, the member can no longer withdraw the funds transferred to the VLB fund. However, the ITA allows for a VLB fund to be structured to provide for a partial return of capital if the member dies before receiving an amount equal to their initial investment.

Provincial Framework: Consultation Questions

The federal ITA stipulates the minimum requirements for a plan administrator or sponsor to offer a VLB. These requirements include the following:

1. The VLB can only be offered by an eligible plan, and the monthly amounts must be paid from the VLB fund within that plan.
2. The VLB fund can only receive amounts transferred from the member's account. No other member or employer contributions are permitted to be made to the VLB fund.
3. The VLB payments can be increased or decreased due to the difference between the hurdle rate and the fund's rate of return and the difference between the mortality assumptions and the mortality experience of the VLB members.
4. The VLB fund must have 10 members to establish the benefit and maintain a minimum of 10 members to keep it running.

While the Ontario VLB framework must operate within the federal ITA, amendments to the PBA and PRPPA are required to enable VLBs to be offered in Ontario. The Ministry of Finance is interested in better understanding how to create a VLB framework that provides a new retirement option for members of pension plans while also protecting members.

Benefit Determination and Adjustment

The frequency of VLB adjustments is not stipulated by the ITA. Requiring that benefits be adjusted annually better reflects actual investment experience and helps reduce the potential size of the changes to retirees' payments by avoiding a scenario where overpayments are made which then require a larger payment decrease in subsequent years. By contrast, less frequent adjustments provide longer periods of stable benefits,

reduced administrative costs, and an opportunity for the VLB to recover any investment losses. Mortality adjustments may have less impact on the size of changes to the payment amounts and, if so, could be performed less frequently than investment adjustments.

Questions

1. The hurdle rate is used by a VLB provider to determine the size of the monthly payment. It is an important operational element of the benefit. Should there be limits on the level or number of hurdle rates? A hurdle rate other than the expected rate of return can add complexity to a VLB. Should it be required to approximate the expected rate of return of the investments? Why or why not?
2. Would annual investment adjustments and triennial mortality adjustments be appropriate? Why or why not? Should alternative timelines be considered depending on the size of VLB? Should investment experience adjustments require an actuarial report certified by an actuary and filed with the regulator? Is a regulatory filing without an actuary sufficient? Why or why not?
3. Should mortality experience adjustments be set out in an actuarial report certified by an actuary and filed with the regulator? Why or why not? Should the mortality table be prescribed? Why or why not?
4. How much time is required to calculate the annual investment experience adjustment after the fund's year end? What would be a reasonable deadline to require notices of the annual investment experience adjustment be sent to members?
5. What other requirements should be considered with respect to benefit adjustments under the fund?
6. A VLB may be able to offer a partial return of capital on death of the member, if the sum of the member's monthly receipts did not at least equal the capital invested. Should this be permitted or required in a VLB? How can this be provided, and does it raise any concerns?

Family Law

In the event of a marriage breakdown, Ontario's family law rules would apply to VLBs. The PBA requires that a spouse of a member with pension benefits be entitled to a survivor benefit. Accordingly, the surviving spouse of the VLB member would receive a life-time VLB payment not less than 60% of the amount of the last VLB payment the member received, adjusted for investment experience. The VLB fund could choose to offer other options. For example, the VLB fund could allow a spousal waiver by the VLB member's spouse, for an amount less than 60%, or choose to offer options greater than the 60% entitlement which could be priced into the cost of the VLB.

Fee Restrictions and Disclosure requirements

Currently, fees charged for the administration of a pension plan are not regulated and can vary depending on the type of pension plan. In some pension plans, the employer pays the fees and in other plans the employee pays the fees. In the case of a traditional annuity, the amount of the payment is guaranteed and not subject to annual fees. In the situation where retirees manage their own investments, they can move to a new financial institution if they are unhappy with their fee. In the VLB context, fees are particularly important as the purchase is a lifelong commitment and the fees charged could impact the amount of the benefit a member receives. For PRPPs, legislation requires that costs be no more than 1.25% for default investment options and 1.5% for all other investment options.

A critical component of a future VLB framework would be to set standards for plan administrators to ensure informed decision-making by potential members and transparency for all members, including fees.

To support this, the Ministry proposes that disclosure requirements apply before a retired member purchases a VLB, annually after a VLB purchase and, if the pension plan or VLB fund is terminated, upon termination.

i. VLB Option Statement

Upon a plan member's retirement, the administrator would be required to provide the member with a disclosure statement explaining the VLB product. This statement would explain how the VLB works and clearly state that the payments will vary every year. It would state that, once the funds are invested in the VLB, the funds cannot be withdrawn. It would include an estimation of the cost for a given initial monthly payment and include key information such as how fees will be calculated and charged and what the targeted rate of return for the fund is. It would explain how the member's investment is treated on the member's death, as well as spousal benefits. It would also need to explain the permanent nature of the VLB and the possible impact of termination of the plan.

ii. Annual VLB Statement

In addition, the administrator would be required to send an annual statement to each VLB member would inform members of the performance of the fund, what fees were charged and how the member's monthly payment will be adjusted for the following year. The statement would provide details on the investment fund's return and mortality experience and how those impact the amount of the benefit.

iii. VLB Termination Statement

Finally, in the case of a VLB termination, the administrator would be required to send a termination statement to all members explaining the process of plan termination in the event of a wind up, how the VLB fund's assets will be distributed and what restrictions would be placed on the member's assets. The statement could clarify a member's portability options at termination as well as the possible value of those options.

Questions

1. What is the most appropriate way to regulate the fees charged for the investment and administration costs associated with operating a VLB fund to ensure a VLB is operational but also protects members?
2. In considering the three examples of disclosure above, do they capture the relevant information that would be useful to members in understanding the benefits and risks of a VLB? Are there other disclosure or information requirements that would be valuable to members?
3. In considering the three examples above, are there additional events or circumstances that ought to require disclosures to members?
4. Are there any other approaches that the government should consider that would support informed decision-making and transparency in contemplating a VLB framework?

Plan Termination

There may be reasons for a VLB fund to be terminated. For example, it may be the case that the number of members falls below a sustainable amount or the pension plan itself is terminated. On plan termination, DC plans and PRPPs generally provide members and deferred members with portability options such as the option to transfer their pension benefits to a locked-in retirement income vehicle, another pension plan, or to purchase a life annuity. However, in the context of a VLB, purchasing a life annuity with the remaining assets in the VLB fund may provide a much smaller life-time monthly payment while the return of a lump sum would be a fundamental change to what was originally purchased.

In accordance with the PBA, when a plan sponsor decides to wind up their pension plan or Ontario's pension regulator orders the plan to be wound up, the plan administrator must file a wind up report within six months of the wind up date. Once the regulator has approved the wind up report, the plan administrator issues a statement setting out each person's entitlements under the plan after which the plan administrator distributes the benefits. This process would also apply to VLBs in the event of wind up.

Questions

1. What portability options should be considered for VLB retirees and beneficiaries on plan termination?
2. What would be an appropriate approach to the calculation of plan termination commuted values for VLBs?
3. How should the VLB wind up report differ from a plan's wind up report already contemplated by the PBA?

Additional Considerations

As noted at the beginning of this consultation document, the Ministry is seeking to gather input and perspectives on a future framework for VLBs that provides new lifetime option for retirees, where members' interests are protected. As such, are there additional policy and regulatory considerations that the Ministry should take into account for a future VLB framework?

Contact Information

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