Canadian Life
and Health Insurance
Association Inc.

Association canadienne
des compagnies d'assurances
de personnes inc.

Submission

2015 Federal Budget

to the

**House of Commons
Standing Committee on Finance**

by the

**Canadian Life and Health
Insurance Association Inc.**

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EXECUTIVE SUMMARY

The Canadian Life and Health Insurance Association (the "CLHIA") commends the Government for being on target to achieve its goal of a balanced budget for the current fiscal year. In addition, we support the Government's key themes for the upcoming 2015 budget, especially ***supporting and helping vulnerable Canadian families, ensuring prosperous and secure communities through support for modern infrastructure*** and ***improving Canada's taxation and regulatory regimes***.

The Canadian life and health insurance industry plays a key role in Canada's economy. It protects over 75% of Canadians through a wide variety of life and health insurance and annuity products. The industry paid over $75 billion in benefits in 2013 or almost $1.5 billion a week, with over 90% paid to living policyholders. Over 150,000 Canadians earn some or all of their income directly from the industry (as employees or independent agents). The industry is a major investor in Canada with more than $645 billion in assets, over 90% of which comprise long-term investments, an important source of long-term capital for the federal and provincial governments and businesses. Canada's life insurers also have a longstanding history and track record of being internationally competitive, with almost $56 billion, or 40% of their worldwide premiums, coming from outside Canada.

In this submission, we recommend the following four initiatives that align with the Government's key themes for the 2015 budget***:***

- ***Supporting families and helping vulnerable Canadians by focusing on health, education and training by:***
    1. ***Incenting and encouraging Canadians to take responsibility for their long-term care needs***

- ***Ensuring prosperous and secure communities, including through support for infrastructure, through:***
    2. ***Increased use of public-private partnerships***
    3. ***Setting a benchmark volume for ultra-long bonds***

- ***Improving Canada's taxation and regulatory regimes by:***
    4. ***Reducing or eliminating capital tax on financial institutions***

These four recommendations will aid the industry in continuing to provide a wide range of risk management options to Canadian consumers at competitive prices.

Supporting families and helping vulnerable Canadians

1. Encouraging Canadians to take responsibility for their long-term care needs

The demand for long-term care in Canada will grow dramatically as the baby boomers age. Government programs aimed at assisting Canadians with long-term care expenses are not adequate to cover the full costs of providing long-term care to Canadians. The CLHIA conservatively estimates that Canadian baby boomers have an unfunded long-term care liability of almost $600 billion. ***The longer all Canadians and governments wait to take action, the more difficult it will be to close this gap.***

Unfortunately, many Canadians continue to hold the mistaken belief that all of their long-term care expenses will be covered by governments and those individuals are financially unprepared for these potential costs. Three quarters of Canadians (74 per cent) admit they have no financial plan to pay for long-term care if they need it and two-thirds of them believe government will cover half or more of the cost of their long-term care needs.

At the end of 2013, only 350,000 Canadians were covered under long-term care insurance plans, with most of them covered through group arrangements. It is important that the 2015 budget take steps to:

(a) inform Canadians about their personal/family responsibility for their long-term care needs and

(b) financially incent them to take prompt action to prepare for those potential costs.

Pooling of risks through long-term care insurance is an effective way to protect against the potentially debilitating costs of long-term care, shifting the risk away from governments and families. In order to incent and provide financial assistance to Canadians to prepare financially for their potential long-term care expenses, ***the CLHIA recommends that the Government introduce a non-refundable 15% tax credit on policy premiums paid for qualified long-term care insurance.*** Such a tax credit would also act as an important and powerful signal from government about the need for Canadians to take financial responsibility for their potential long-term care expenses**.**

This recommendation aligns with the Government's various initiatives to encourage Canadians to be financially responsible. ***Such targeted and specific support for long-term care will encourage Canadians to provide for their long-term care needs and will help maximize personal responsibility for long-term care needs by those who can afford to do so***.

Ensuring prosperous and secure communities through support for infrastructure

2. Increased use of public-private partnerships

The CLHIA acknowledges and congratulates the Government's efforts to provide long-term support for public infrastructure, including the measures in the 2014 Economic Action Plan to allocate further funds in support of essential investments.

Public-private partnerships (P3s) are an attractive funding mechanism for long-term infrastructure projects such as hospitals, airports, roads, bridges, water supply and waste water treatment. The life insurance industry is ideally positioned to not only invest in such long-term projects to match or hedge their long-term liabilities but also bring their expertise in terms of governance and execution to deliver projects on time and within budget.

Given the bulk of Canada's $400 billion infrastructure deficit is at the smaller municipal government level, a more nuanced approach is needed to address this specific segment of the country's infrastructure deficit. The 2014 Economic Action Plan acknowledges the challenges that exist with smaller, inexperienced jurisdictions in bringing projects to market. Active collaboration between all levels of government and the private sector to develop a comprehensive long-term plan to fund and facilitate identified needs at the local level will help speed projects to market and reduce the infrastructure deficit.

The Government can do more to encourage P3 investments in Canada - particularly for smaller infrastructure projects***. In particular, we recommend that the Government lower the Building Canada Fund P3 screening threshold to $20 million. We also recommend that the Government instruct PPP Canada to take a leadership role in developing, in close collaboration with key stakeholders, including provincial governments, life and health insurers and other institutional private investors, standardized P3 documentation for P3 projects under $50 million.***

A targeted action plan will help reduce the infrastructure deficit at the municipal level and contribute to more prosperous and secure communities across Canada.

3. Setting a benchmark volume for ultra-long bonds

The CLHIA commends the Government on its recent successful issuances of 50 Year Government of Canada bonds, totaling $2.5 billion in 2014.

The historically low long-term interest rates in Canada present a unique opportunity for governments to secure long-term funding for their planned long-term infrastructure expenditures. Issuing longer-term debt also has important intergenerational benefits as future roll-overs of shorter-term debt are avoided and the risk to the active working population of unexpectedly higher short-term funding rates is reduced. While not common practice currently, some degree of matching of the term of government assets and liabilities would represent a best practice.

As issuers of long-term products, the life insurance industry has a strong appetite to invest in ultra-long bonds to provide long-term protection products, such as life annuities and long-term care insurance, to Canadians at reasonable costs. In addition, increased long-term investment opportunities would allow insurance companies and pension funds to match more closely their long-term liabilities with high quality assets, contributing to more security and savings for Canadians.

Accordingly, we recommend that the Government make a sustained commitment to issue more 50-year bonds and to increase the supply of these bonds to a benchmark level over the next five years. We believe achieving a benchmark level over this period is important to meet market demand and to develop a robust secondary trading market in these bonds in Canada.

Improving Canada's taxation and regulatory regimes

4. Reduce or eliminate capital tax on financial institutions

Canada is the only major country in the world which levies a capital tax on financial institutions (FIs). This tax, introduced in 1990 at the rate of 1.25%, essentially taxes the regulatory capital associated with the Canadian operations of FIs, such as banks and life companies. While this capital tax is only payable to the extent it exceeds regular corporate income tax, the perverse nature of this tax is such that the level or amount of capital tax (which is not dependent on profitability) has often exceeded the corporate income tax (which is based on profitability) for a number of life insurers over the years.

Canadian and foreign governments, independently and collectively (through the G20), continue to review, increase and strengthen regulatory capital requirements for FIs to protect customers and prevent the need for taxpayer bail-outs. While income taxes move in tandem with economic cycles, capital tax can be static or even countercyclical since it increases as regulatory capital is raised to better withstand losses and other adverse shocks.

Although the capital tax is creditable against corporate income taxes, lower profitability and higher capital levels have resulted in excess capital taxes being carried forward as deferred tax assets (DTAs) on the balance sheet of life insurers, in expectation of future recovery when income taxes exceed capital taxes. However, the plans by regulators to strengthen capital by disallowing DTAs in determining available capital will further exacerbate the perverse nature of capital taxes. In addition to being the only major country in the world to impose capital tax on FIs, Canada is also viewed as having higher capital requirements compared to its trading partners, both before, during and after the financial crisis. This further challenges the competitiveness of Canadian life insurers on multiple fronts, both domestically and abroad.

If elimination of this capital tax is not possible in the short term, ***the CLHIA recommends that the capital tax rate be reduced immediately from 1.25% to .67%. This reduction would be consistent with the Government's reductions in the corporate income tax rate, from 28% to 15% over the last decade.*** This reduction would ensure the rate of capital tax is better aligned with the average rate of return on capital for the life insurance industry, thus ensuring life insurers have a reasonable chance of recovery of capital tax against corporate income tax. **As the only nation in the G20 with a capital tax on FIs, it is inconsistent and counterproductive for Canada to continue imposing a tax that penalizes financial institutions for strengthening their capital.**

The recommendation will only have a modest reduction of around $70 - $80 million in cash taxes annually for the Government, however, it will enable insurers to attract capital to grow their businesses and invest in Canada's economy. ***Elimination of the capital tax on FIs would not only contribute to the strength of the industry, but also bring Canada in line with other jurisdictions and our major trading partners. Such a clear action by the Government would send an unequivocal message that capital accumulation by FIs is encouraged and supported.***