February 23, 2012

**PRIVILEGED & CONFIDENTIAL**

**Judicial Compensation and Benefits Commission**
99 Metcalfe Street, Suite 812
Ottawa, Ontario
K1A 1E3

Attn: Mrs. Suzanne Labbé, Executive Director

Dear Members of the Commission:

Re: **Earnings Equivalent to the Judicial Annuity**

As requested, we have estimated, for lawyers in private practice, the portion of their earnings that would be needed each year to accumulate, in RRSPs and in after-tax savings, the funds necessary to generate retirement income comparable to the employer paid portion of the judicial annuity. A similar analysis was made in 2000 for the Drouin Commission.

The value of the judicial annuity as determined in our February 14, 2012 letter represents the discounted value of expected future pension benefit payments using a discount rate deemed appropriate for compensation benchmarking purposes. Income tax rates are not factored into these calculations.

On the other hand, for purposes of the current determination of the earnings equivalent, we take a prospective approach assuming a long term rate of return on investments and taking into account the applicable income tax rates and RRSP contribution limits. The result of this exercise provides a measure of the fiscal advantages derived from the judicial annuity.

The following table shows the estimated gross earnings that a lawyer in private practice currently age 50 must allocate every year so that, once the maximum contributions are made to his or her RRSP and income taxes are paid on the balance of such earnings, the lawyer can accumulate in a TFSA and other savings arrangements, the funds necessary to generate retirement income comparable to the employer paid portion of the judicial annuity.

| | Required Gross Earnings as a Percentage of the Judicial Salary | Required Gross Earnings in Current Dollar Terms |
|---|---|---|
| 2012 Study | 61% to 71 % | $ 170,000 to $ 200,000 |
| 2000 Study | 55% to 70% | $ 95,000 to $ 120,000 |

The percentages in the above table would remain constant at 71% of salary assuming retirement at the age of 65 or at 61% of salary assuming retirement at the age of 70. However, the applicable percentages would vary significantly according to the current age of a lawyer. For instance, the results for a lawyer currently age 52 which is the average age at which judges were appointed between January 1, 1997 and March 31, 2011 compared to the results for a lawyer currently age 50 are compared in the following table.

| Current Age of Lawyer In Private Practice | Required Gross Earnings as a Percentage of the Judicial Salary | Required Gross Earnings in Current Dollar Terms |
|---|---|---|
| 50 | 61% to 71 % | $ 170,000 to $ 200,000 |
| 52 | 70% to 78% | $ 195 000 to $ 220,000 |

The actuarial assumptions used for this analysis are described in Appendix A. The relevant provisions of the judicial annuity are described in Appendix B.

Of course, even if comparable in value, the lawyer's retirement income would be exposed to the usual risks associated with defined contribution arrangements including investment and longevity risks. In contrast, the judicial annuity is fully guaranteed by the Government of Canada and, accordingly, does not expose the judges to any of the investment and longevity risks inherent to private retirement savings plans. For example, the following table shows how the required gross earnings change, if a lawyer currently age 52 anticipates a long term annual rate of return on investments of 5.50% or 6.00% instead of 5.75% per annum.

| Assumed Long Term Annual Rate of Return on Investments | Required Gross Earnings as a Percentage of the Judicial Salary | Required Gross Earnings in Current Dollar Terms |
|---|---|---|
| 5.50% | 72% to 81% | $ 200,000 to $225,000 |
| 5.75% | 70% to 78% | $ 195 000 to $ 220,000 |
| 6.00% | 69% to 75% | $ 190,000 to $ 210,000 |

Finally, please note that the estimated gross earnings as calculated above would be lower in provinces with lower income tax rates and higher in provinces with higher tax rates. Further, the results could change over time if income tax rates or RRSP and TFSA contribution limits were to change.

The undersigned remains available to answer any questions that you may have on this analysis.

Respectfully submitted,

André Sauvé, F.S.A., F.C.I.A.

# *Appendix A – Actuarial Assumptions*

### Economic Assumptions

For purposes of this analysis, we took a prospective approach using a long term annual rate of return on investments. To that end, we assumed that lawyers in private practice would adopt reasonably aggressive investment policies with 50% to 60% exposure to equities. The following table compares the economic assumptions used for the current analysis to those used in 2000 for the similar analysis prepared for the Drouin Commission.

| | Inflation | Salary Increases & Increases in RRSP Contribution Limits | Long Term Annual Rate of Return on Investments | Long Term Annual Real Rate of Return on Investments |
|---|---|---|---|---|
| 2012 | 2.0% | 3.0% | 5.75% | 3.75% |
| 2000 | 3.0% | 4.0% | 7.50% | 4.50% |

The assumptions for the current analysis correspond to the assumptions adopted by Mr. Haripaul Pannu in his December 13, 2011 report. However, this should not be interpreted as being the only acceptable assumptions for purposes of determining the compensation value of the judicial annuity as explained in our February 14, 2012 letter.

We also took into account the estimated income tax rates as well as the RRSP and TFSA contribution limits. The current TFSA contribution limit of $5,000 per year was assumed to remain constant over time.

### Income Tax Rates

The combined federal and provincial marginal tax rate in Canada varies by province from 39% in Alberta to 50% in Nova Scotia. For purposes of this analysis, we have assumed a marginal tax rate of 46%. Also, we have assumed that the average tax rate applicable to the judicial annuity and to retirement income from individual RRSPs will be equal to 40%. For purposes of the analysis conducted in 2000, the marginal and average tax rates were assumed to be equal to 50%.

For purposes of estimating the marginal tax rate applicable to investment income on taxable investments, we have assumed that after-tax savings would be invested with the following asset mix.

| | Asset Mix | Expected Long Term Annual Rate of Return on Investments | Expected Long Term Annual Real Rate of Return on Investments |
|---|---|---|---|
| Canadian Equities | 30% | 6.75% | 4.75% |
| Foreign Equities | 25% | 6.75% | 4.75% |
| Fixed Income | 45% | 4.50% | 2.50% |
| | 100% | 5.75% | 3.75% |

On the basis of the above asset mix and assuming average annual dividend yields of 2% on Canadian and foreign equities, we have assumed, for income tax purposes, that investment income would be made up of 35% interest, 20% dividends (equally divided between Canadian and foreign dividends) and 45% capital gains, resulting in an estimated marginal tax rate applicable to investment income of 34%.

**Demographic Assumptions**

The present analysis was made for lawyers in private practice currently age 50 assuming retirement between the ages of 65 and 70. The same assumptions were used in the analysis prepared in 2000 for the Drouin Commission. Additional scenarios were made for lawyers currently age 52, also assuming retirement between the ages of 65 and 70.

For the sake of simplicity, we have assumed no mortality or termination before retirement and no disability retirement.

| | | |
|---|---|---|
| Mortality | : | Before retirement : No mortality<br>After retirement : UP-94 mortality table with projection to 2020 on a unisex basis (2/3 males, 1/3 females) |
| Terminations before retirement | : | None |
| Disability retirements | : | None |
| Proportion of lawyers with spouses at retirement | : | 90 % |
| Age difference between spouses | : | Spouses are assumed to be of the same age. |

The mortality assumption was updated for the purposes of the current analysis and a unisex approach was used. In 2000, the 1983 Group Annuity mortality table was used with adjustments of 90% and 80% applied to the male and female rates.

## *Appendix B – Judicial Annuity*

The relevant provisions of the Pension Plan for the Federally Appointed Judges are as follows.

| | |
|---|---|
| Normal Retirement Age | Age 75 or the age at which the sum of the age and service equals 80 with a minimum of 15 years of service. |
| Normal Retirement Pension | Two-thirds of the judge's annual salary at the time of retirement. If a judge has less than 10 years of service, the pension is reduced on a pro-rata basis. |
| Early Retirement | Age 55 and 10 years of service. |
| Early retirement Pension | The normal retirement pension reduced by the ratio of the judge's number of years of service in the judiciary to the number of years he would have completed at his normal retirement age. In addition, the pension is reduced by 5% for each year that the early retirement date precedes the age of 60. |
| Normal form of pension | For judges with an eligible spouse : Joint life and 50% survivor pension<br>For judges with no eligible spouse: A return of contributions with interest in excess of the benefits paid. |
| Cost of Living Increases | 100% of the increases in the Consumer Price Index. |
| Termination prior to retirement | A return of contributions with interest. |
| Disability retirement | Immediate unreduced pension. |
| Death before retirement | A lump sum of one-sixth of the judge's salary, plus<br>• For judges with an eligible spouse : a survivor pension of one-third of salary;<br>• For judges with no eligible spouse: a return of contributions with interest.<br>• A pension for eligible surviving children of 20% of the survivor pension for up to four children. |
| Judges' contributions | 7% of salary reducing to 1% after normal retirement age. |