



Category: Investments

Subject: Draft – Buy-in Annuity Products

No: 2012-001

The Office of the Superintendent of Financial Institutions (OSFI) has been asked to provide comments on the acceptability of a potential investment option for pension plans - a group annuity policy referred to as a buy-in annuity. The buy-in annuity policy presented to OSFI would cover pensions in pay only.

OSFI has concluded that, provided this investment would be permissible under the plan terms, we would have no objections in principle to a federally regulated pension plan investing in a buy-in annuity issued by a life insurance company for pensions in pay. This policy advisory is intended to inform plan administrators of OSFI's expectations in areas relevant to such a buy-in annuity investment for the plan.

Background

The buy-in annuity policy presented to OSFI would be similar to a traditional annuity; however, instead of issuing individual certificates to the covered retirees and paying pensions to them individually, the policy would pay the aggregate pension amount to the pension fund. The responsibility for administering the benefits to the retirees would remain with the plan administrator.

The aim of the investment is to limit potential losses related to the retiree liabilities of the plan covered by the policy. The buy-in annuity would provide a hedge against investment, longevity and inflation risk for the liabilities covered by the policy.

Investment Considerations

The purchase of the buy-in annuity would be considered an investment of the pension plan and therefore the administrator would have to satisfy itself that the investment with that insurance company was in accordance with the prudent portfolio rule under subsection 8(4.1) of the *Pension Benefits Standards Act, 1985 (PBSA)* and in accordance with *Schedule III of the Pension Benefits Standards Regulations, 1985 (Regulations)*. As is the case with all plan investments, the plan administrator would be responsible for continuing to monitor this investment.



As the pension plan would remain ultimately responsible for paying all benefits, regardless of what happened to the insurance company, the administrator's obligation to pay these benefits would not be affected by the transaction. As further described below, the value of the investment would be expected to equal the liabilities it covers and would be included as part of the assets and liabilities of the plan

An investment in a buy-in annuity would not generally impair the solvency of the pension fund and would not be considered an immediate or deferred life annuity under section 26.1 of the *PBSA*. Therefore the purchase of a buy-in annuity would not require the consent of the Superintendent and would not be subject to section 9 of the June 2011 *Directives of the Superintendent (Directives)*.

If, however, the buy-in annuity policy is converted to a traditional annuity while the plan is ongoing, section 26.1 of the *PBSA* would apply and the conversion would have to meet the requirements of section 9 of the *Directives*.

Value Attributed to the Investment

It is expected that the asset value of the buy-in annuity policy would be equal to the liabilities covered by the policy under both a going concern and solvency valuation. This would effectively result in the asset value of the buy-in annuity policy being different under the going concern and solvency valuations. As the buy-in annuity does not provide benefits directly to retirees, the value of both the assets and liabilities would be included in the calculation of the solvency ratio as defined in section 2 of the Regulations.

In the event of plan termination, the administrator must file a termination report with the Superintendent. Assets of the plan cannot be applied towards the provision of any benefits until the termination report is approved by the Superintendent. Upon the Superintendent's approval of the termination report, the buy-in annuity policy would convert to a traditional annuity policy, and the insurance company would issue individual certificates to the retirees covered by the policy and begin paying their pensions directly.

In the event that benefits payable to the retirees covered by the policy are subject to a reduction in accordance with a termination report submitted for approval by the Superintendent, the buy-in annuities would convert to traditional annuities paying the reduced amount. The insurer would determine the cash value of the difference between what would be payable under the buy-in annuity and the reduced annuity payments to individually covered retirees. This cash value would be paid into the plan and available to all plan beneficiary benefits.

The policy must address how this cash value would be calculated. For valuation purposes, in order for OSFI to agree that the value of the buy-in annuity policy is equal to the liabilities the policy covers, the plan should not be exposed to a potential additional loss at the time of termination. The buy-in annuity must provide a total value (to the covered retirees and the plan) reasonably equal to the liability that would exist at the time

of termination for the individually covered retiree liabilities. A suitable basis for calculating this cash value would be the basis used to determine the actual solvency (wind-up) ratio of the plan at the date of plan wind-up¹ i.e. the CIA recommendation for the valuation of liabilities to be settled by the purchase of annuities. Any other proposed basis must meet the condition set out in this paragraph and should be discussed with OSFI.

Asset Smoothing

If the going concern valuation uses an asset smoothing method, we believe that the value of the buy-in annuity should be excluded from the asset smoothing calculation.

¹ Wind-up means the distribution of the assets of a pension plan that has been terminated (s. 2 – *PBSA*)