Guideline

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Introduction

Life insurance companies have issued participating and adjustable policies for many years. Management of these policies is subject to discretion by the company with respect to the management of the business, the level of policy dividends for participating policies and post-issue changes for adjustable policies. As a result, participating policies have historically been subject to a number of provisions in the *Insurance Companies Act* (ICA)The participating and adjustable policies requirements referred to in the ICA apply to Canadian incorporated life insurance companies, including any foreign branch operations outside of Canada. The participating and adjustable policies requirements of the ICA do not apply to a foreign subsidiary of a Canadian insurance company or to the Canadian branch business of a foreign insurance company. . In 2005, the ICA was amended to incorporate additional requirements for the management of participating policies and new requirements were added for adjustable policies. In 2010, the

new *Policyholders Disclosure Regulations* (Regulations), which support the ICA on the subject of participating and adjustable policies, were enacted.

This guideline outlines OSFI's expectations regarding the implementation of the requirements found in the ICA and the Regulations. In 2023, the guideline was updated to provide:

- additional clarification of OSFI's expectations, to aid companies in their interpretation of the ICA and the Regulations, and to facilitate greater consistency of practices by companies in satisfying the requirements of the ICA and the Regulations; and
- additional guidance on the disclosure requirements of the Regulations, to promote greater transparency and consistency of policyholder disclosures.

Please refer to OSFI's *Corporate Governance Guideline* for OSFI's expectations of company Boards of Directors in regards to operational, business, risk and crisis management policies.

1. Requirements of the ICA for participating insurance policies and adjustable policies

A participating insurance policy is defined by the ICA (Section 2(1)) as "a policy issued by a company that entitles its holder to participate in the profits of the company." The ICA requires companies to maintain participating accounts if they have participating policies in-force. Participating policies participate in the profits of such participating accounts.

Generally, participating policies are distinguished from other policies by the existence of policy dividends "Dividends", "policy dividends" and "participating policy dividends" are used interchangeably throughout this guideline. . These dividends are the normal mechanism used for the sharing of profits with policyholders. However, there are cases where policy dividends are zero, fixed or minimal. In cases where the policyholder contract states that the policy is participating, such policies are subject to all of the participating requirements of the ICA, the Regulations and OSFI guidelines.

The following summarizes the sections of the ICA that specifically deal with participating policies:

- Subsection 2(1) defines “participating policy”
- Section 165 specifies the duties of directors, including the establishment of a policy for determining dividends and a policy for the management of the participating accounts
- Section 165 specifies several reports and opinions required from the Appointed Actuary
- Section 165 specifies notification requirements to the Superintendent and disclosure requirements to shareholders and policyholders
- Section 456 requires companies to maintain separate participating accounts
- Sections 457, 458, 459 and 460 deal with allocations of investment income and expense to the participating accounts, and their continuing fairness
- Sections 461 and 462 deal with payments or transfers from participating accounts to shareholder accounts; and
- Section 464 specifies requirements concerning the declaration of participating policy dividends.

Adjustable policies are referenced in Section 2(1) of the ICA, which points to the Regulations for a detailed definition. This definition is discussed in more detail in Section 4 below.

The following summarizes the sections of the ICA that specifically refer to adjustable policies:

- Subsection 2(1) defines “adjustable policy” by reference to the Regulations
- Section 165 requires the Board to establish criteria for changes to adjustable products; and
- Section 464.1 specifies reporting requirements (by the Appointed Actuary to the Board and to policyholders) concerning adjustable policies.

2. Operation of participating accounts

Sections 456 through 462 of the ICA deal with certain requirements regarding the operation of participating accounts. This part of the guideline outlines OSFI’s expectations with respect to these requirements.

Section 456 of the ICA requires companies to maintain accounts in respect of participating policies separate from those maintained in respect of other policies. The Superintendent has the authority to determine the form and manner to be used to maintain these participating accounts. Depending on a company's history and past operations, there may be several separate participating accounts maintained under section 456 of the ICA. Unless specifically excluded, the expectations set out in this guideline apply to all separate participating accounts established by a company pursuant to section 456 of the ICA.

The term "closed block" used in this guideline refers exclusively to closed participating blocks resulting from demutualization.

OSFI is committed to having companies enhance the level of disclosure to participating policyholders in order to facilitate informed decision-making and policyholder expectations. In this regard, OSFI expects companies to develop and publish meaningful descriptions of the investment income and expense allocation methodologies required pursuant to sections 457 and 458 of the ICA.

Section 459 of the ICA requires that the Board of Directors (the Board) of a company file a copy, with the Superintendent, of a resolution approving the method of allocation of investment income and expenses to a participating account within thirty days after making the resolution.

Given the importance of fairness to participating policyholders, the ICA requires that the allocation methodologies must:

- in the written opinion of the Appointed Actuary of the company, be fair and equitable to the participating policyholders; and
- be approved by resolution of the Board, after considering the written opinion of the Appointed Actuary of the company.

Even where a company has met the above two requirements, the Superintendent may disallow an allocation method if it is deemed not to be fair and equitable to the participating policyholders. See Section 3 of this guideline for a discussion of the general principles for deciding on fairness and Policyholder Reasonable Expectations (PRE).

Section 461 of the ICA addresses payments to shareholder accounts from participating accounts. Each financial year companies are permitted to transfer an amount from each participating account. These amounts are based on a calculation using the following information and factors specified in Section 461:

- A transferable percentage (varying from 2.5% to 10%) is calculated based on the size of the sum of all the participating accounts, including any closed blocks resulting from demutualization;
- A portion of the profits of each non-closed block participating account is determined for that financial year by the Board as the portion to be distributed to the shareholders and policyholders;
- The transferable percentage from above is applied to this portion of the profits of each non-closed block participating account;
- The amount resulting from applying this transferable percentage is the maximum that may be transferred from each non-closed block participating account to the shareholders account. This calculation of the maximum transferable amount is to be performed separately for each of the non-closed block participating accounts;
- Although the calculation of the transferable percentage is expected to include closed blocks resulting from demutualization, these closed blocks operate under rules set out at the time of demutualization which do not allow payments to shareholders under section 461 of the ICA to be made from these blocks; and
- This calculation is done for each financial year and does not permit any retroactive transfer. If, for example, the maximum permissible amount in a prior year was not transferred in that year, it should not be added to the current year's transfer amount.

3. Requirements and opinions of the Appointed Actuary

The ICA requires several opinions by the Appointed Actuary with respect to the operation of the participating accounts. Section 165 of the ICA requires the following with respect to reports from the Appointed Actuary concerning participating accounts:

- The Appointed Actuary shall report to the Board in writing on the fairness to participating policyholders at the time of the establishment or the amending of policies for determining dividends of participating accounts.

The Appointed Actuary shall report at least once during each financial year on its continuing fairness.

- The Appointed Actuary shall report to the Board in writing on the fairness to participating policyholders of policies on the management of each of the participating accounts, and shall report at least once during each financial year on its continuing fairness.
- The Board shall consider these reports before establishing or amending a policy for determining dividends or managing participating accounts.
- These reports by the Appointed Actuary are to be in accordance with generally accepted actuarial practice, with such changes as may be determined by the Superintendent and any additional directions that may be made by the Superintendent.

Sections 457 and 458 each require a written opinion by the Appointed Actuary that the methods of allocation of investment income and expense to the participating accounts are fair and equitable to the participating policyholders. Section 460 requires an annual opinion by the Appointed Actuary to the Board on their continuing fairness.

Section 464 requires the Appointed Actuary to report in writing to the Board on the fairness to participating policyholders of a proposed dividend and whether it is in accordance with the policy. The Board shall consider the Appointed Actuary's report before declaring the dividend. OSFI expects the Appointed Actuary to send a copy of all such reports to the Superintendent within thirty days after such reports are presented to the Board.

However, the ICA and the Regulations do not explicitly specify how fairness is to be determined. The following are general principles for deciding on fairness for policy dividends:

- Dividend classes, or cohorts, should be set at issue;
- Policyholders with similar characteristics and classified in the same dividend class or cohort, at issue and projected, should be treated consistently;
- There should be no post-issue changes in policy classifications to a dividend class or cohort, except as justified or required as a result of external circumstances, beyond the control of the company, arising post-issue;

- There should be no material, planned, or systemic cross-subsidization, such as dividends or contributory amounts (e.g. contribution to surplus), of one cohort by another;
- The method for determining dividends should be objective, unbiased, impartial, and conform to rules established at issue;
- All experience factors and other contributory factors (e.g. contribution to surplus) to dividend determination should be taken into consideration when deciding on fairness of policy dividends. Dividend experience factors should be consistent with the associated underlying experience of each participating account and applied consistently to maintain fairness to participating policyholders. Post-issue changes to dividend experience factors (if any) should be justified and not be disadvantageous to participating policyholders;
- Contributory amounts, including the contribution to surplus (if applicable) should be similarly defined for all policies within each dividend class or cohort to promote fairness to participating policyholders.
- Dividend policy should be applied consistently and equitably over time and as respects different cohorts of policyholders;
- Materiality in dividend determination should be judged from the point of view of the participating policyholder, even if it only applies to a relatively small block of policies. Materiality should not be judged from the point of view of a total participating account or the company. However, ensuring strict fairness to small cohorts should not result in unreasonable implementation expenses;
- The actual dividends paid should be kept up to date, reflecting underlying experience of participating accounts, and other contributory factors, so as to maintain equity between different cohorts of policyholders; and
- Smoothing of dividends should be allowed, and may even be desirable, but should not result in cross-subsidization of one cohort by another. Smoothing should only be used to avoid undue yearly fluctuations in the dividend scale and the method used should be reasonably justifiable and documented. An internal guideline on smoothing should be established in advance as part of the dividend and/or management policies required by the Regulations.

In addition to the above general principles on fairness, OSFI expects that the company will consider PRE. PRE are the reasonable expectations by policyholders of the company's exercise of discretion in matters concerning their

policies. PRE arises from the company's communications in marketing materials, from information provided at the point of sale (such as policy dividend and investment performance illustrations), from its past and continuing administration practices and from general standards of market conduct. Past practice includes the non-exercise of discretion by the company.

The ICA also requires several opinions from the Appointed Actuary with respect to adjustable products. Section 165 requires the following with respect to adjustable products:

- The Appointed Actuary shall report to the Board in writing on the fairness to adjustable policyholders of the criteria to be established or amended for changes made by the company in respect of its adjustable policies to the premium or charge for insurance, amount of insurance or surrender value.
- The Appointed Actuary shall report to the Board at least once during each financial year on their continuing fairness.

Section 464.1 requires the Appointed Actuary to report in writing to the Board on whether the changes that the company made to its adjustable products are in accordance with the criteria established and are fair to the policyholders. OSFI expects the Appointed Actuary to send a copy of all such reports to the Superintendent within thirty days after such reports are presented to the Board.

The following are general principles for deciding on fairness for changes made to adjustable policies:

- Policy classifications, or cohorts, should be established at issue;
- Policyholders with similar characteristics, at issue and projected, should be treated consistently;
- There should be no post-issue changes in policy classification, except as justified or required as a result of external circumstances, beyond the control of the company, arising post-issue;
- The changes to adjustable policies should be based on associated underlying experience and projected future expectations;
- The changes to adjustable policies should be consistent with the policy contracts and PRE;
- There should be no material, planned or systemic cross-subsidization of one cohort by another;
- Except as explicitly provided for in the adjustable policy contract or in documented sales disclosure material, future adjustments should not permit recovery of past insured losses;

- If the company decides to not make unfavourable adjustments to some policy cohorts, even though actual underlying experience would permit such changes, this should not be considered to be unfair to policyholders; and
- If the company decides to not make favourable adjustments to some policy cohorts, even though actual underlying experience would permit such changes, this would normally be considered to be unfair to policyholders. However, ensuring strict fairness to cohorts should be determined in accordance with policies established by management (e.g. materiality of a favourable adjustment) and should not result in unreasonable implementation expenses.

4. Policyholder Disclosure Regulations Requirements

The ICA provides for regulations to be made with respect to the content of company policies regarding the management of each of the participating accounts and the criteria for changes to adjustable policies.

In this regard, the *Policyholders Disclosure Regulations* came into force on June 1, 2011. The Regulations have the following sections:

- Part 1, Subsection 2: Describes the requirements for the content of the policy for determining the dividends to be paid to the participating policyholders;
- Part 1, Subsection 3: Describes the requirements for the content of the policy respecting the management of the participating accounts;
- Part 1, Subsection 4: Describes the information a company must publish in the annual financial statements with respect to the policies for determining participating policy dividends and managing the participating accounts; and
- Part 2: Describes requirements for adjustable policy disclosures.

The disclosures made pursuant to the Regulations are expected to have the following characteristics for participating accounts and adjustable products:

- The description should be understandable by a person with a rudimentary understanding of life insurance concepts and vocabulary. Expert technical knowledge should not be required to understand the descriptions .

Technical terminologies used should be clearly defined and explained;

- The goal should be clear and straightforward communication that is informative and transparent and leads to an understanding of the company's participating accounts and adjustable policies;
- The disclosure should provide the context within which the information should be considered;
- The disclosure should avoid being overly generic or "boilerplate";
- Disclosure should not include immaterial information or material that does not promote understanding by the reader. Materiality for policyholder disclosures should be judged based on the policyholders' perspectives, and consider Policyholder Reasonable Expectations. However, if in doubt about whether to include or exclude certain disclosures, the company should err on the side of inclusion; and
- The disclosure should recognize the balance between presenting information clearly and understandably while not over-simplifying important complex information or sacrificing appropriate levels of complexity or distinctions.
- The description of items in public disclosures should be consistent. As an example, if contributions to participating account surplus are disclosed through both the policy for determining dividends and the policy with respect to management of the participating accounts, the descriptions in both policies should be consistent.
- The disclosure should be up to date such that policyholders are able to relate the information to current actions by the company, including actions on policy dividends.

The Regulations require that the company's policies dealing with dividends and bonuses to be paid to the participating policyholders and the management of the participating accounts be disclosed and available to shareholders and policyholders. In this regard, OSFI expects companies that have participating policies in force to provide the information necessary for the policyholder to have an understanding of the operations of participating accounts. Such appropriate disclosure should contribute to enabling policyholders to form reasonable expectations with respect to dividends, and to obtain reasonable knowledge of the nature of participation, the operation of participating accounts and the methods used in deciding on the distribution of participating account surplus to policyholders.

The following include OSFI's comments for select subsections of the Regulations dealing with participating accounts. OSFI expects that companies read these comments in conjunction with the disclosure requirements of the Regulations, when developing their participating policyholder disclosures.

Subsections of regulations - 2(a) (i) and (ii)

A statement indicating:

i. that the dividends or bonuses are declared at the discretion of the board of directors of the company, and
ii. that the company's policy respecting participating policy dividends and bonuses may be amended from time to time at the discretion of the board of directors of the company.

Comment

The statement of the company's policy should begin with a clear description of the principles used to determine the company's policy respecting participating policy dividends.

The company should explain its policy concerning the determination of distributable surplus which is to be paid as participating policy dividends.

If a permanent contribution to participating account surplus is expected under the policy, this methodology should be explained and the rationale for this approach should be provided. Guidance should be given with respect to the effect on the participating accounts. If other methods are used to manage participating account surplus, they should be explained and the rationale should be provided.

The policyholder's participation in the experience of the company (which is common policy contract language) should be explained such that policyholders understand that they are participating in the results of the participating account to which the particular policy belongs. It should be clear how that participation is achieved, e.g., through policy dividends, bonuses, etc.

The statement should be clear that since actual levels of experience cannot be known in advance, dividends cannot be guaranteed. It is also important for the statement to note that experience can deteriorate over time and that, as a result, dividends may be reduced.

The company should explicitly state whether or not it pays terminal dividends, as well as under what circumstances terminal dividends will be paid. If the company pays terminal dividends, it should describe 1) the discretionary aspects when deciding on the level of the terminal dividends, and 2) any difference between terminal dividends and normal periodic policy dividends.

Subsection of regulations - 2(b)

The frequency with which experience and dividend and bonus scales are examined and, if necessary, adjusted, and the principal factors that, in the opinion of the board of directors of the company, would be expected to affect the amount of the dividends and bonuses declared under section 464 of the Act.

Comment

The frequency with which experience and dividend scales are examined and adjusted should be disclosed. If this differs among major segments of the participating business, this difference should be explained.

The company should disclose whether or not smoothing is used for dividend determination. When smoothing is used, the disclosure on smoothing is expected to include:

- the objective of smoothing
- the factors considered when deciding on smoothing
- any differences in smoothing by sub-account or by dividend class; and
- whether or not the company has established an internal guideline to govern the practices of dividend smoothing.

Subsection of regulations - 2(c)

The principal factors that might cause the board of directors of the company to review its policy respecting participating policy dividends and bonuses.

Comment

The Board's dividend policy is required to include the principal factors that might cause it to review its dividend policy. These factors are meant to refer to higher level deliberations than the factors used in the setting of dividends.

Subsection of regulations - 2(d)

a description of the basis upon which dividends and bonuses are allocated among different classes of participating policies.

Comment

The description should include a statement that the dividend recommendations the Appointed Actuary made and/or opined on were prepared in compliance with any relevant standards of practice of the Canadian Institute of Actuaries. If the actual distribution of policy dividends differs materially from the dividend recommendations the Appointed Actuary made and/or opined on, this should be disclosed and explained.

Subsection of regulations - 2(e)

A description of the principal sources of income considered for the purpose of declaring dividends and bonuses and, in the case of a mutual company, if income other than income derived from the participating business of the company is not considered, the use to which that other income is put.

Comment

The company should clearly describe the principal sources of income considered for the purpose of declaring dividends. The description is expected to include:

- all factors that enter into the determination of policy dividends
- any constraints on experience sharing along with the supporting rationale; and
- whether or not the investment returns from the participating account surplus are included in the determination of dividends.

It is important to indicate that policy dividends are generated by the differences between actual levels of experience for certain factors (e.g. mortality, expenses, investment income, etc.) and assumed levels of experience for these factors.

The company should clearly disclose whether the experience factors to determine policy dividends can be changed post-issue and the underlying principles that would drive any changes. Any post-issue changes should be in accordance with the contractual terms of the policy contracts and any representations made to policyholders.

In the case of a company that distributes profits from sources other than participating business to participating policyholders, the company's policy and practice should be described.

Subsection of regulations - 2(f)

A description of how specific policyholder behaviour is reflected in the dividend or bonus scale.

Comment

The company should clearly describe whether or not specific policyholder behaviour (e.g. policy loans taken at guaranteed rates, bonus payable if policy not lapsed for a certain number of years, etc.) is reflected in policy dividends. If specific policyholder behaviour is reflected in policy dividends, the company should describe how this behaviour impacts policy dividends.

Subsection of regulations - 3(a)

A description of the participating account and its associated policies.

Comment

If a company has established one or more participating accountsA participating account may arise for a number of reasons, including:</p><ul class="indent-xlarge">
required by a demutualization (e.g. closed fund, open fund)
required as part of an agreement to take over/acquire/merge a block of business from another company
used in its accounting to internally track experience for use in determining dividends. , this should be described in plain language.

For each participating account, the methods used for the measurement of experience of these participating accounts should each be described.

It should be clear which participating accounts, if any, are closed to new business. The company should disclose whether there are cohorts or dividend classes in a specific participating account that are closed to new business. The company should also disclose the implications of being in a cohort or dividend class that is closed to new business.

Subsection of regulations - 3(b)

A description of the investment policy for the participating account.

Comment

The description of the investment policy for the participating account is expected to include:

- the asset segment(s) supporting participating policies
- the quality of assets supporting the participating accounts, including different classes of assets, credit quality and liquidity quality
- the investment strategy, policies, and procedures to be followed in respect of assets supporting the participating accounts and the factors that drive the company's investment strategy
- any material changes from the previous year to the investment policy. Such changes should be disclosed and explained
- any external constraints on the company's investment policy (e.g., regulatory constraints); and
- the company's approach to the use of derivatives to support the participating accounts. If derivatives are not used, the company should explicitly state so.

Subsection of regulations - 3(c)

A description of the method, under section 457 of the Act, for allocating investment income to the participating account.

Comment

The description of the method for allocating investment income both between shareholders and participating policyholders and between participating accounts. is expected to include:

- whether or not there is any commingling of assets between different participating accounts (e.g. the commingling of assets between open participating accounts and closed participating accounts)
- the company's degree of reliance on income generated by assets that support both the participating and non-participating accounts; and
- whether or not the investment income allocation methodology can be changed, and the circumstances that would drive any changes.

Subsection of regulations - 3(d)

A description of the method, under section 458 of the Act, for allocating expenses, including taxes, to the participating account.

Comment

The description of the method of expense allocation, including taxes, to participating accounts should explain how expenses arise and are charged to participating accounts and should include an explanation of how the level of expenses is affected by the nature of the business and of the assets supporting the participating account. The description is expected to include:

- the expenses, including taxes, that are currently allocated to participating accounts
- the criteria that the company uses to apportion expenses, including taxes, between participating accounts and shareholder accounts, and between participating accounts; and
- example(s) of the circumstances under which the company would charge expenses to the participating account at an amount other than allocated cost along with the supporting rationale.

Subsection of regulations - 3(e)

A description of the company's approach in respect of managing and using the surplus, if any, in the participating account.

Comment

The description of the company's approach in respect of managing and using the surplus in the participating account is expected to include:

- objectives of maintaining surplus within participating accounts, including its use for acquisition of future business
- the sources of surplus (e.g. seed capital and contribution to surplus)
- criteria used to determine the use of surplus to top up dividends to existing policyholders; and
- any limits/constraints to the level of surplus.

Subsection of regulations - 3(f)

The principal factors that might cause the board of directors of the company to change the policy.

Comment

OSFI has no additional comments on this subsection of the Regulations.

Subsection of regulations - 3(g)

If the company does not accept new business in the participating account, information on how the company would manage and dispose of the surplus, if any, in the participating account.

Comment

With respect to any closed blocks resulting from demutualization, and participating accounts not accepting new business, describe policies and practices of the company to manage the participating accounts' surplus and to avoid a tontine effect.

In the case of closed accounts resulting from demutualization, such practices were required to be implemented upon demutualization and the description should make reference to the company's obligation in this regard.

Subsection of regulations - 3(h)

In the case of a converted company under section 237 of the Act, the measures taken by the company to ensure fairness to participating policyholders whose policies form part of a closed block.

Comment

OSFI has no additional comments on this subsection of the Regulations.

Subsection of regulations - 3(i)

The percentage that the amount that the company intends to transfer to shareholders or a shareholder account of the company out of the company's participating accounts in a financial year in accordance with section 461 of the Act represents of the total amount that the company intends to transfer to shareholders or a shareholder account of the company and participating policyholders from those participating accounts in that year in accordance with that section.

Comment

This subsection requires the participating account management policy to specify the percentage of the total distributable amountPer section 461 of the ICA, this refers to the portion of the profits of the participating account that is determined by the directors as the portion to be distributed for that financial year to the shareholders and participating policyholders. that the company intends to transfer to shareholders from the participating accounts in a financial year in accordance with section 461. Subsection 4(g) of the Regulations requires this to be disclosed.

If this amount is less than the maximum allowable percentage that the company may transfer to shareholders, this is expected to be disclosed.

The policy is expected to indicate if the company intends to transfer the full permitted percentage of distributable participating profits to shareholders. If the company has a practice of limiting the amount of this transfer, this

should be disclosed.

Subsection of regulations - 4(a)

A summary of all the information required under sections 2 and 3.

Comment

This subsection states that the company must provide a summary of the information required for the dividend policy (subsection 2) and the participating account management policy (subsection 3). In deciding on the appropriate level of summarization, the characteristics of disclosure stated earlier in this guideline are expected to be followed. Such disclosure is for the benefit of the policyholders and should be supportive to this expectation.

The company can satisfy the requirement to provide a summary by providing the policies themselves, provided they meet the characteristics of disclosure stated earlier.

Subsections of regulations - 4(b)-(d)

2. A statement of changes for each participating account for the two financial years immediately preceding the annual meeting, showing such information and particulars as in the opinion of the directors of the company are necessary to present fairly, in accordance with the accounting principles referred to in subsection 331(4) of the Act, the financial position of the account as at the end of each financial year to which the statement relates and the results of the operations and changes in the financial position of the account for each financial year.

3. The surplus in each participating account of the company for the two financial years immediately preceding the annual meeting.

4. In the case of a converted company under section 237 of the Act, the amount by which the value of the assets in a closed block exceeds the amount of the policy liabilities in that closed block.

Comment

This section of the Regulations and Section 331(1)(e) of the ICA require each company to include in its annual financial statement a statement of changes for the financial year in each participating account. This is expected to be a statement of the change in surplus in each participating account. This disclosure is intended to inform policyholders of the status of the account(s) containing their policies.

It is OSFI's view that disclosure of just the total annual change in surplus provides insufficient information to policyholders to form their expectations. This is due to a number of factors:

- There may be several participating accounts that contain blocks of business with significantly different surplus amounts relative to liabilities, different experience and different dividend scales.
- Closed participating accounts resulting from demutualization do not contain surplus. Any amounts accumulating from operations are held in a dividend stabilization reserve (DSR) (individual companies may use different terms) that is technically considered to be part of the actuarial liabilities of the account. As such, it is generally not visible to policyholders.
- It is difficult to understand the status of a participating account simply by measuring the annual change in a single quantity.

Consequently, OSFI expects that disclosure will include the following items for participating accounts other than closed participating accounts resulting from demutualization:

- Opening surplus;
- Currency adjustment;
- Net earnings before the payment of policy dividends;
- Policy dividends distributed during the year;
- Amounts transferred to shareholders under s. 461 of the ICA;
- Other transfers under s. 462;
- Closing surplus; and
- Total assets.

For closed participating accounts resulting from demutualization, the corresponding items are:

('Excess' is defined as the amount by which the value of the assets in a closed block exceeds the amount of the policy liabilities in that closed block.)

- Opening Excess;
- Currency adjustment;
- Net earnings before the payment of policy dividends;
- Policy dividends distributed during the year;
- Closing Excess; and
- Total assets.

To facilitate transparency, consistency and comparability in the disclosure to policyholders, the following information should be included in the annual financial statement.

- The approximate percentage of the policy dividends that is based on investment experience, and the approximate percentage that is derived from other factors (e.g. mortality, expense, etc.)
- The current year, and the historical 5-, 10-, and 20-year average annual dividend scale interest rate, participating account investment rate of return, participating surplus investment rate of return, as per the following table. Investment rate of return should be expressed as a market yield without smoothing and net of investment expenses. Historical average annual rates prior to 2023 should be reported on a best effort basis.

Sample table for annual financial statement

	Current year	Historical average annual rate		
		5	10	20
Dividend scale interest rate				
Participating account investment rate of return				
Participating surplus investment rate of return				

- Whether or not the investment returns from the participating account surplus are included in the determination of dividends.
- The current year target asset mix vs. the actual asset mix

Subsections of regulations - 4(e) – (h)

5. The amounts from each participating account that are invested in segregated funds of the company or its subsidiaries, and the performance of those funds for the two financial years immediately preceding the annual meeting, if applicable.
6. The actual amounts that have been transferred to shareholders or a shareholder account of the company out of the company's participating accounts in accordance with section 461 of the Act in the two financial years immediately preceding the annual meeting.
7. The percentage that the amounts referred to in paragraph (f) represent of the total amount paid to shareholders or a shareholder account of the company and participating policyholders from the company's participating accounts in accordance with section 461 of the Act, which, in the case of a converted company under section 237 of the Act, shall be calculated without taking into account any amounts paid out of a closed block, in the corresponding financial year.
8. A statement that the company's policies referred to in sections 2 and 3 are available on request to a shareholder or participating policyholder and, on payment of a reasonable fee, to any other person.

Comment

OSFI has no additional comments on these subsections of the Regulations.

Subsection of regulations - 4(i)

Information on the manner in which the company's policies referred to in sections 2 and 3 may be obtained from the company.

Comment

OSFI expects that the company makes the summary of the information required for the dividend policy (subsection 2) and the participating account management policy (subsection 3), or the policies, available on its publicly accessible websites, with appropriate notification to policyholders as to the availability of this information.

With respect to adjustable policies, Part 2 of the Regulations defines them as "an individual life insurance policy, other than a participating policy, that is issued by a life company and for which the company may at its sole discretion directly or indirectly change the premium or charge for insurance, the amount of insurance or the policy's surrender value, but does not include:

1. A policy where the premium or charge for insurance, amounts of insurance and surrender values are stated in the policy or a schedule to the policy or can be determined under the terms of the policy or schedule to the policy;
2. A group insurance policy including a creditor's group insurance policy;
3. An annuity contract, including a deferred annuity or a savings, investment or capital accumulation plan under which the life company has undertaken to provide an annuity; or
4. A reinsurance policy."

The specific reference to "life insurance policies" results in the adjustable policy disclosure requirements in the Regulation not being applicable to accident and sickness policies. Accident and sickness policies include, but are not limited to, critical illness, long-term care and individual disability income policies.

The definition of adjustable policies in the Regulations states that policies are not classified as adjustable if changes "…can be determined under the terms of the policy or schedule to the policy." For this exclusion to apply, this determination should be possible to be made by the policyholder using the provisions in the policy contract. The following are examples of where such exclusions would apply, even if an actual schedule is not included in the policy contract but a methodology is specified:

- A universal life contract that credits interest based on a specified external public measure/index or other measures described in the terms of the policy contract (e.g., daily interest);

- Market value adjustments that vary over time based on specified market interest rates;
- Policy loans.

Policies that allow changes to the premium or charge for insurance, the amount of insurance or the policy's surrender value based on company decisions not linked to market rates, indices or other measures determinable by policyholders should be classified as adjustable policies.

The Regulations use the term "directly or indirectly" in reference to changes in premiums, charges for insurance, amount of insurance or surrender values. This term is interpreted to cover, in the broadest sense, any possible changes, including but not limited to, revised product designs, administration charges, etc. which affect the premium or charge for insurance, the amount of insurance or the policy's surrender value.

The Regulations require disclosure to the policyholder when a change has been made in an adjustable policy. This is different than for participating policies in that it is only required after a change, if any, is made. The characteristics of the disclosure after a change are expected to be the same as shown at the start of this section of the guideline.

5. Closed blocks resulting from demutualization

This section deals with the operation of closed blocks of participating policies resulting from the demutualization of Canadian mutual life insurance companies. It replaces the 1999 OSFI document *Participating Account Restructuring in Canadian Company Demutualizations*, which was used previously as a model for the structuring of participating and shareholder accounts during a demutualization.

OSFI considers that the requirements of this section apply to these closed blocks, whether they are still in the parent Canadian company, including its foreign branches, or whether they were subsequently transferred to its subsidiaries. Ancillary accounts which are not policyholder funds, are excluded from the requirements of this guideline.

Establishment of initial closed participating blocks

The Operating Rules established at the time of a demutualization specify the restructuring of participating accounts commencing with demutualization and the rules to be followed in the operations of such participating accounts in

future years.

If any requirement in this guideline is in conflict with a provision in the Operating Rules of a closed participating account established prior to the effective date of the *Policyholders Disclosure Regulations*, the Operating Rules will prevail and the provision will be deemed to be in compliance with this guideline.

The structure and rules can vary somewhat by company, but the following are required features of the past demutualizations and are expected to be followed in the case of any future demutualizations:

- All participating policies in force at the date of demutualization are to be placed into a distinct sub-account of the participating account, to be referred to as the closed block;
- If a company has parent company operations in more than one country, a separate closed block is to be set up in each country with participating policies in force at the date of demutualization;
- The liabilities of the policies in the closed block at the time of demutualization are based on best estimate assumptions of future experience;
- The best estimate of liabilities should include future policy dividends based on Policyholder Reasonable Expectations;
- Assets are assigned to the closed block at the time of demutualization such that the value of the assets and the best estimate of their future earnings will be sufficient to satisfy the best estimate liabilities;
- Subsequent changes in experience in the closed block, positive or negative, should be reflected in changes in policy dividends;
- Amounts consistent with requirements in the Operating Rules, that are the responsibility of shareholders, are to be held in a separate ancillary sub-account of the participating account. As these amounts are released in future, the resulting profits will accrue to the shareholders and not to the closed block policyholders;
- Small sub-segments of policies, such as riders or policies with no or fixed dividends, may be included in the ancillary accounts;
- New participating policies issued subsequent to demutualization should be in an open participating account; and

- Commingling of assets backing the closed blocks and the open participating blocks is allowed for practical reasons, if separate asset blocks for open participating accounts are not warranted.

The detailed Operating Rules can vary slightly for each demutualization, as long as the above structure is followed. Examples of such variances in treatment include, but are not limited to:

- Whether rider liabilities are included in the closed block or in the ancillary sub-account;
- Whether expenses are allocated to the closed fund;
- Whether allocated expenses are variable or fixed;
- Whether related liabilities, such as amounts on deposit, are included in the closed block or the ancillary sub-account; and
- Whether assets for the closed block and open participating account are co-mingled.

If a company considers it necessary to change the basis of operation of the closed participating blocks, OSFI expects the proposed change to be made in accordance with the Operating Rules agreed at the time of demutualization. It is expected that a company will notify OSFI of any such planned changes. OSFI's permission is required before such changes are implemented.

Dividend stabilization reserve

Gains and losses from operations will emerge each year in the closed participating blocks. The aggregate of any accumulated gains or losses in a closed block may be referred to as a Dividend Stabilization Reserve (DSR), which is the term used in this guideline, or some similar name as established by each company. OSFI expects that each company will manage its closed blocks so as to avoid the development of material excess,The amount by which the value of the assets backing the policies in a closed block exceeds the amount of the policy liabilities as determined under generally accepted actuarial practice, based on the current approved dividend scale. or deficit, positions with respect to a closed block's assets over policy liabilities. Any such excess or deficits from operations that emerge are to be distributed over time to the policyholders in the block through changes to the dividend scale. For this reason, the DSR is treated as an additional policy liability.

In order to avoid a tontine effect (under which dividends are inappropriately shifted from current policies to a smaller number of policies which remain active in future years), a DSR, positive or negative, should not continue to grow for an extended period. OSFI expects that each company has a policy with respect to the maximum operational size of the DSR for each closed participating account and that at least the amounts in excess of this will be distributed in a timely manner to policyholders through modification of the policy dividend scale.

In order to have assurance that this distribution is being done in a fair and orderly manner, OSFI expects that each company will retain, at least once every five years, an independent actuary to review the progress of the closed block and to offer an opinion as to whether the dividend policy and the actual payment of policy dividends are fair to the closed block participating policyholders, are consistent with their reasonable dividend expectations, and are such that the emergence of a tontine is avoided. The independent actuary should also opine on whether the company's policy with respect to the maximum operational size of the DSR is appropriate and fair to policyholders. This review applies to all the closed blocks set up at the time of demutualization, whether they are still in the parent Canadian company, including its foreign branches, or whether they were subsequently transferred to its subsidiaries. The first such review is required as of the first financial year-end after 2012 January 1. The independent actuary should satisfy the criteria set out in OSFI's guideline E-14 *Role of the Independent Actuary*.

Terminating a closed block

With the passage of time, a closed block will decrease in size. It may reach a size such that a company may no longer consider it to be practical to maintain a closed block separately. In such a case, OSFI expects that the company would apply for permission to either merge the closed block with other blocks of participating business or implement another acceptable method of terminating the closed block. Any such termination methodology is expected to conform to the relevant provisions of the demutualization plan and the closed block Operating Rules. Application should be made using normal OSFI procedures for obtaining approvals of business changes. OSFI may require a report from an independent actuary on the fairness and appropriateness of the termination.

Annual reports to OSFI

OSFI expects the company and its Appointed Actuary to report annually to OSFI, no later than 180 days following the company's financial year-end on all closed participating blocks set up at the time of demutualization, whether they are still in the parent Canadian company, including its foreign branches, or whether they were subsequently transferred to its subsidiaries. In addition, OSFI expects the company and its Appointed Actuary to report annually to OSFI, no later than 180 days following the company's financial year-end on closed participating blocks resulting from demutualization residing in subsidiaries.

The annual Appointed Actuary's report to OSFI on each closed participating block is expected, at a minimum, to contain the following disclosures:

1. A summary of the Operating Rules;
2. A description of the methods used to allocate investment income, expenses and taxes;
3. A comparison of experience rates of interest, mortality, expense, etc. in the past year to current best estimate valuation assumptions and to current dividend assumptions;
4. A financial analysis of the experience in the preceding year;
5. Any material changes in practice with respect to managing risks within the block;
6. The size of the assets and liabilities;
7. The dividend recommendations that the Appointed Actuary made and/or opined on and a discussion of factors that led to any material changes in these recommendations
8. A statement of change during the preceding year in the "Excess" of the closed participating account;
9. The target maximum level of the DSR, both positive and negative, and a comparison to the actual DSR at year end;
10. The amounts released from associated ancillary sub-accounts to the shareholders' account;
11. An analysis of the amounts held in the associated ancillary sub-account; and
12. Five year projections of future gains and losses and DSR accumulations if emerging experience is according to the Appointed Actuary's current best-estimate valuation assumptions.

Professional opinions

The Appointed Actuary's report on the closed participating blocks resulting from demutualization should contain professional opinions in respect of each closed block stating that:

1. the closed block is being maintained in accordance with commitments made at the time of demutualization
2. assets backing liabilities of the closed block are sufficient and the asset mix is appropriate
3. the DSR is being managed such that Policyholder Reasonable Expectations should be met and a tontine will be avoided
4. allocations of investment income, expenses and taxes are fair and consistent with the Operating Rules
5. Policyholder communications whose purpose is to allow a reasonably knowledgeable participating policyholder to understand the operation of each closed participating block, are accurate and complete; and
6. All closed participating blocks are included in the report.