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CAPSA issues guidance on using annuity quotes for solvency or hypothetical windup liabilities

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Generally, when a pension plan goes through a solvency or hypothetical windup valuation, the actuaries will value some of the expected liabilities as commuted lump-sum payments and some as annuity payments.

When valuing the annuity portion, plan actuaries often use a proxy method based on guidance from the Canadian Institute of Actuaries. Instead of this option, however, plans will sometimes use an annuity quote provided by a life insurance company.

While standards have allowed actuaries to do this for a long time, the Canadian Association of Pension Supervisory Authorities has issued guidance for those plans that decide to use an annuity quote from a life insurance company.

In the guidance, the CAPSA specifically highlighted it expects actuaries to consider the quote irrespective of whether the premium amount in the quote is lower or higher than the solvency or hypothetical windup liabilities using the CIA guidance. It also noted the approach to calculate the liabilities should be applied consistently.

In addition, the CAPSA said the date of quotation should coincide with the valuation date, but it will also be considered valid if it's within six months of the date. The guidance included further details about how this should be adjusted if the quote isn't on the valuation date. As well, if that's the case, it may not be applicable if there have been significant changes, noted the CAPSA

While Jason Vary, president of Actuarial Solutions Inc., says very few plans use annuity quotes for funding purposes, he notes a plan will sometimes use a quote it didn't transact on. "I think sometimes actuaries may be using it because maybe they got a quote from an insurance company because they were thinking about doing a buy-in or buyout anyways, and they said, 'Hey, we have this quote here and we happen to be doing a funding valuation at more or less the same time. Why not?'"

In some cases, actuaries will ask insurers for a quote as a favour, while being upfront there's no intention to transact on it, he says. For example, a plan with very complicated indexing can be hard to price using the CIA's annuity proxy. So in this situation, Vary says he'll ask an insurance company to price it and provide an annuity quote.

Neil Duffy, vice-president of group retirement solutions pricing and pension risk transfer at Canada Life, says he generally doesn't receive requests from plan sponsors just looking for the quote for the sole purpose of funding valuation. "We actually see the quotes that come in are generally thinking about purchasing an annuity for purposes of a windup or it could be de-risking. But we actually don't see a lot of experience where it's clear that they were only asking for a quote for purposes of getting a better valuation for their plan."

That being said, he notes insurers have specific views about a plan's mortality that will translate to variations in pricing not currently captured by the CIA guidance. "A better and more accurate way of determining the liability would be to actually get an insurer quote."

Gavin Benjamin, senior director of retirement at Willis Towers Watson, says it isn'tvery common to use annuity quotes from insurers for solvency and hypothetical windup situations, but it's an additional piece of information that can be used to set the assumptions for these valuations.

The CIA guidance is based on a typical pension plan, he says, whereas if a plan goes to purchase annuities the insurers will look at the characteristics of the population, like expectations around mortality experience and then the insurers will adjust their pricing. "From my perspective, one of the things which is important is actuaries will still need to exercise judgment if a quote is, or quotes are, received from insurance companies for this purpose."

Annuity pricing can vary based on a number of factors, including the insurance company's assets and the yields of those investments, competition in the group annuity market at the time and whether the insurer knows the quote is illustrative and there's no intent to transact, says Benjamin.

The CAPSA guidance also included a list of information the insurance company must provide and information to be included in the actuarial report.

Overall, Vary says actuaries have been allowed to use bonafide annuity quotes for some time and what's outlined in the CAPSA guidance is reasonable. "[They] more or less are things that we would have been doing already. So none of this really offends me. It's all quite reasonable."

There isn't anything in the section for what an insurance quote needs to include that it wouldn't already be providing, notes Duffy. "I actually think it was relatively clear. It does help the pension actuaries use the quotes they may be receiving already."