OSFI temporarily freezes portability transfers, annuity purchases due to coronavirus

Yaelle Gang, the Canadian Investment Review | April 1, 2020

The Office of the Superintendent of Financial Institutions is introducing some measures to help federally regulated defined benefit pension plans get through the difficult times caused by the coronavirus.

Particularly, the regulator is temporarily freezing portability transfers and annuity purchases. In both cases, plan sponsors can write to the OSFI to for consent to a transfer or an annuity purchase based on individual circumstances. The regulator will be reviewing the temporary measure in the coming months.

Portability transfer freeze

When a plan member either leaves a plan or the plan terminates, they can choose to transfer the commuted value of their accrued pension benefit to a locked-in fund or another pension plan if that plan is willing to accept it. This is known as a portability transfer.

However, the security of benefits for remaining members could be affected by the payment of full commuted values when the funded position of a plan has deteriorated significantly due to the current market volatility, says Gavin Benjamin, senior director of retirement at Willis Tower Watson.

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Further, plans with a significant number of terminations could see a large number of commuted-value lump sums transferred out, he adds. “And if you combine that sort of scenario with a scenario where the funded position of the plan is poor, or has deteriorated significantly, and the employer who might be in jeopardy given the current economic circumstances, the intent presumably would be to avoid a scenario where you’re jeopardizing the security of the benefits of remaining plan members by paying out full commuted values in this type of environment.”

Indeed, many pension plans have taken a hit, so the OSFI’s measures will come as a relief to plan sponsors. For one, selling assets to pay members portability transfers in a depressed market can be problematic, says Jason Vary, president of Actuarial Solutions Inc. “You want to buy low and sell high. That’s the biggest thing, just keeping money in the plans.”

Most plan sponsors would probably have enough liquidity in their assets to be able to pay out lump sums without a significant burden, he adds, noting it will depend on the employer. “If an employer goes through a large downsizing now because of what’s going on in the economy and has to lay off or terminate lots and lots of workers, then the probability of a run on the bank as far as the pension plan is concerned is huge now. Those plan sponsors probably don’t want to necessarily pay out a whole bunch of lump sums all at once. They may not be able to have enough liquidity to deal with that.”

The practical side of the freeze

When a plan member leaves a plan, federal pension legislation requires plan administrators to provide them with a termination statement with transfer options within 30 days of the end of their membership. The plan member then has 60 days to select whether they want a portability transfer or whether they want their accrued benefits to remain in the plan.

While OSFI’s announcement means changes for terminating members, plan sponsors should still provide option forms, it said in a statement to *Benefits Canada*.

Read: What do OSFI’s new rules for assessing pensions mean for plan sponsors?

“Under the portability freeze, the member’s entitlement to a pension benefit calculated as of their termination date is unaffected. However, the transfer options are temporarily on hold. The member can select a commuted-value option, but the administrator cannot make the transfer at this time without the prior consent of the superintendent.”

Once the freeze is lifted, a member will be able to transfer their entitlement out of the pension plan and interest would be added to the delayed payout, added the OSFI, noting the commuted value would be calculated on the members’ termination date.

The downside for plan members

The freeze could potentially be detrimental to former plan members. In one potential scenario, they may only receive their commuted value after equity markets rebound, missing the chance to reinvest and capture those gains, notes Benjamin. “Or the interest rate environment might have changed a lot since they terminated membership. And there might be an inconsistency between the interest rate environment that’s prevailing at the time that they actually can invest their lump sum versus the interest rate environment that was used to calculate their commuted value.”

Further, some plan members may choose to end the relationship with their employer and just take their money and run, but that won’t be an option for a period of time, says Vary.

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Benjamin says it will be interesting to see under which circumstances the OSFI allows plans to continue paying commuted values upon request. He notes these transfers shouldn’t be problematic if the funded position of a plan remains strong and the employer is still financially sound. “It would be ideal in that kind of scenario that the superintendent continues to permit the paying of commuted values.”

Putting annuity buyouts on ice

In addition to the OSFI’s freeze on portability transfers, it also announced a freeze on annuity purchases.

Presumably, the move stems from a similar concern about paying out a significant amount of cash from a pension plan in circumstances when the funded position has deteriorated significantly, says Benjamin.

“The other thing that does come to mind — because annuity purchases can sometimes involve large premiums — if [they cover] a significant number of retirees, for example, in this type of environment, some of the pension plan assets might not be very liquid and so there maybe is a concern about having to sell an asset that is not illiquid; therefore, sell it at a lower price in order to pay the annuity purchase premium."

Brent Simmons, senior managing director and head of DB solutions at Sun Life, notes that while buyouts are falling under the OSFI's freeze, annuity buy-ins are still permitted. "It's only if a company wanted to do an annuity buyout that they would have to ask for permission from OSFI, and we're hopeful that OSFI would have some reasonable criteria to be able to grant such an exemption fairly quickly."

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While a buy-in annuity is treated like a pension plan investment, a buyout is treated like the settlement of a plan.

"The interesting thing with buy-ins is that they can be converted to buyouts down the road and the pricing is virtually the same," says Simmons. "If a pension plan did want to do a buyout, my first piece of investment advice would be talk to OSFI and understand how easy or difficult it would be to get an exemption to be able to do a buyout. If it turns out to be easy to get the exemption, then great, charge ahead with the buyout. If it's obvious that it's going to become harder to get that exemption to do a buyout, do a buy-in. The pricing will be the same and you don't need the exemption — and down the road you can easily convert that buy-in to a buyout."

In addition to the freeze on portability transfers and annuity purchases, the OSFI also announced it will be extending deadlines on certain actions and annual filings.