STRATEGY

SEEDS OF CHANGE

How the Canadian Wheat Board de-risked its DB plan in a challenging and unique transaction

By Yaldaz Sadakova / Photography by Ian McCausland

It was, literally, a big deal when the Canadian Wheat Board (CWB) off-loaded the risk of its underfunded DB pension plan to Sun Life Financial with a $150-million group annuity purchase. Steering this complex deal seemed impossible at times—no Canadian pension plan had bought an inflation-adjusted group annuity before. But the Winnipeg-based grain marketer plowed on, confident that this was the best way to clean up its balance sheet *and* keep its pension promise to plan members.

"It was a very overwhelming project that we undertook," says Brita Chell, the CWB's chief financial officer. "It is incredibly detailed work that you have to go through."

The CWB's recent history is one reason why it undertook this overwhelming project. Between 1935 and 2012, farmers in the Prairies couldn't sell their grains directly to buyers—they had to sell them to the board, which then sold them on the farmers' behalf. But in August 2012, a federal bill ended the CWB's monopoly as a grain marketer. The CWB must shut down in its current form as a federal agency and privatize by July 2017. Meanwhile, farmers in Western Canada can now bypass the board when they sell their grains, forcing the agency to compete with other grain companies for their crops. Due to these developments, the organization has shrunk in the past two years to 100 employees, down from 400. "With the volume of staff that's been reduced, it just didn't make sense to continue the plan, as the new employee base was disproportionate to the old employee base," Chell adds.

Another reason for de-risking was the underfunded status of the board's inflation-adjusted pension plan. As with most DB plans today, the sustainability of the CWB's plan was threatened by rising longevity and investment risks. "We were incurring significant solvency deficiencies—we had to get this liability and risk off our balance sheet," Chell says. (As of July 2012, the agency's plan was underfunded on a solvency basis by approximately 15%.)

However, the the wheat and barley marketer was concerned about the pension commitments it had made to its plan members. So, Chell explains, the best option was to wind down the DB plan and transfer the associated responsibility to an insurance company.

Getting Buy-in

The CWB's de-risking strategy was to buy an annuity from Sun Life Financial—essentially, "a group annuity contract that the pension plan holds as an asset," Chell explains. That group contract—known as an annuity buy-in—covers both active members and retirees, and the pension fund, not the insurer, pays the retirees. It's a different strategy from an annuity buyout, in which every member has an individual annuity arrangement with the insurer.

"We were looking to wind up the plan,

and in the case of individual annuity contracts, you can't purchase those unless your termination report is approved by the Office of the Superintendent of Financial Institutions [OSFI]," Chell says. But the CWB won't stick to the current de-risking arrangement over the long term. "We view this annuity buy-in as an interim step," she notes. Once OSFI approves the termination report—which could happen by the end of this year or in 2014—the annuity buy-in will be converted to an annuity buyout.

Plan sponsors that go the buy-in route don't have to switch to an annuity buyout, as CWB intends to do, explains Brent Simmons, senior managing director of DB solutions with Sun Life Financial. But if they want to completely transfer the administration of their pension plan to the insurer, they do have that option. "With 60 days' notice, the employer can flip a switch and convert the annuity buy-in to an annuity buyout," he adds.

The Devil in the Details

Executing such a large annuity purchase did have its challenges. For example, one remarkable feature of the CWB's annuity is that it is adjusted for inflation. "It is the largest single-day purchase of an inflation-linked annuity. That's a big deal," says Scott Sweatman, a partner at Dentons Canada LLP, who advised the board during the transaction.

Adjusting an annuity to inflation is tricky, since it's difficult to predict price changes 30 or 40 years down the road. "The biggest challenge with an indexed annuity is that we're making a promise that increases with inflation every year, so we need to back it up with assets that increase with inflation every year," Simmons explains.

For her part, co-ordinating this complex, unique deal has taught Chell some valuable de-risking lessons. The first step, she says, is to thoroughly understand the pension plan.

"Really understand your plan benefits as plan specifics that can impact and potentially increase costs," says Chell. "Understand the characteristics of your liabilities in relation to your assets; understand how they move together." It's also critical to ensure that the plan data you use is as accurate as possible, she adds. Chell also advises pension plan sponsors that are looking to de-risk through an annuity to get as many quotes as possible and to research the insurers providing the quotes.

What's Old is New Again

Following this landmark deal, Canada's demand for annuities will likely grow, according to industry stakeholders. "With the whole focus around trying to contain the risk and off-load the risk, I could see this becoming a very good solution for plan sponsors and plan members as well," Chell says.

Sweatman agrees, explaining that the de-risking doesn't have to be complete: employers can off-load some of their liabilities or, if they have an inflation-adjusted plan, some of their indexed exposure. Since 2009, about 15 annuity buy-in deals have occurred in Canada, involving several of the country's insurers, while the U.S. has seen just one buy-in deal, Simmons adds.

What's interesting is that the use of annuities as a de-risking tool has actually been around for decades. "The concept is not new—it's just repackaging an old idea," Sweatman explains. The practice became less popular over time, as pension plan sponsors progressively looked to equities in order to increase returns. However, lately—especially since the 2008 financial crisis, which brought the volatility of equity markets to the forefront—pension funds are eyeing annuities once again, Sweatman adds.

North America's annuity renaissance began in the U.S. in the summer of 2012, when General Motors Co. shifted its pension risk to Prudential Financial of America in an effort to reduce pension obligations by $26 billion. Then, in October 2012, Verizon Communications transferred a quarter of its pension obligations—$7.5 billion—to Prudential as well. "That piqued interest in Canada," Sweatman notes.

Meanwhile, in Manitoba, the CWB looks back on its de-risking initiative as a win-win. "We've secured the benefits for plan members while reducing our risk," says Chell.

Yaldaz Sadakova is associate editor of *Benefits Canada*. yaldaz.sadakova@rci.rogers.com

Q&A

BRITA CHELL EXPLAINS HOW THE CANADIAN WHEAT BOARD POSITIONED ITS DE-RISKING STRATEGY TO STAKEHOLDERS

How hard was it to make the case for change to senior decision-makers?

Pension is a complex topic, and not one that senior decision-makers are familiar with. [But] they knew very well we had incurred a number of solvency deficiencies, which they asked management to research. So with this request—plus the change in the CWB's mandate—it wasn't too difficult to persuade them that we had to wind down the plan and transfer the risks associated with it to an insurance company.

How did you communicate the change to plan members?

We used a letter in the mail—we sent two letters over the year. It might seem a bit old-fashioned, [but] our members are diverse in terms of age. Also, when you have subject matter that is so complex, and it all pertains to a very important decision, it helps to have the information in your hand so you can refer to it as many times as you need to.

Did plan members voice any concerns?

Benefit security and maintaining the full benefit promise, including the indexing portion, was key for plan members. In fact, the most common question asked by plan members was, 'Is this annuity indexed?' Knowing plan members' concerns or 'trigger points' was an important factor in our decision. We delivered on the indexing and all elements of the plan benefits; plus, we de-risked the plan to a highly rated insurance company that has a very strong reputation in Canada. Therefore, making the case for de-risking to plan members was easier. [And] members had an appreciation that, going forward, [the board] could not bear the risk of the pension plan.