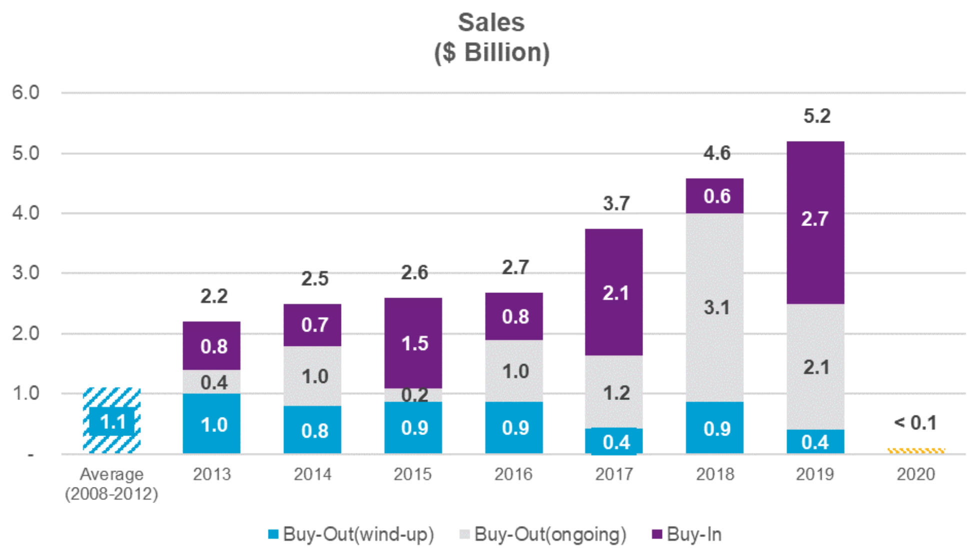
# Group Annuity Market Pulse

## First Quarter 2020

Canada

## Willis Towers Watson Annuity Purchase Index



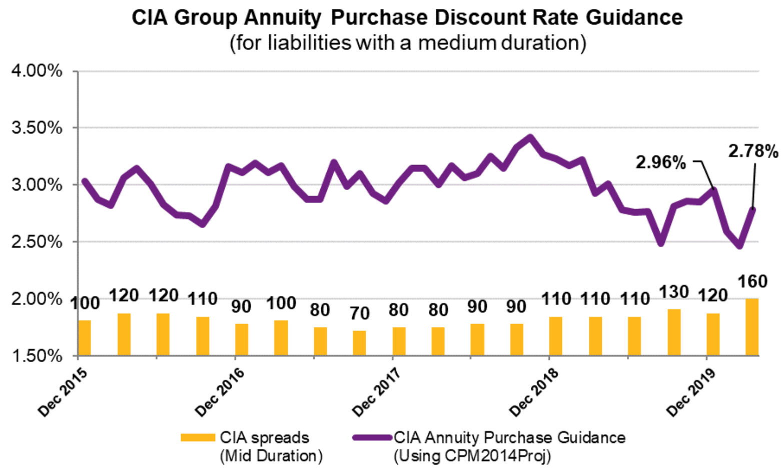

### Key Observations:

- The group annuity market volume for Q1 2020 is estimated at $50M, compared to last year's Q1 2019 of $1B.
- Many transactions that were expected to occur in Q1 were cancelled or postponed due to the COVID-19 crisis and the financial market volatility.
- Although many plan sponsors are still hopeful to purchase annuities later this year, total volume for 2020 may be lower than 2019.

## CIA Annuity Purchase Guidance

The Canadian Institute of Actuaries ("CIA") annuity purchase discount rate guidance is intended to provide actuaries with guidance regarding market pricing for blocks of business of three different durations at a given date. This allows actuaries to select assumptions for actuarial valuation purposes without the need to request annuity quotes from insurers.

The most recently published CIA annuity purchase discount rate guidance provides for a spread above unadjusted Government of Canada marketable bond yields over 10 years (CANSIM V39062) of **160 bps** (using the CPM2014Proj mortality table) for non-indexed pensions with a medium duration, resulting in a discount rate of **2.78% as at March 31, 2020** (down from 2.96% as at December 31, 2019).




The **18 bps decrease** in the CIA annuity purchase discount rate since the beginning of the year is attributable to the decrease in Government of Canada bond yields (58 bps) partially offset by the **increase of 40 bps on the CIA guidance** spread for non-indexed pensions at medium duration.

**Notes:**

- For 2008 to 2012, the breakdown of sales between buy-in and buy-out for terminated plans and buy-out for ongoing plans is not available. Excludes longevity insurance agreements.
- Source of data: LIMRA, BMO Financial Group, Brookfield Annuity, The Canada Life Assurance Company, Co-operators Life Insurance Company, Desjardins Financial Security, Industrial Alliance, RBC Insurance and Sun Life Financial.
- Details regarding the most recent Canadian Institute of Actuaries ("CIA") group annuity purchase discount rate guidance can be found at www.cia-ica.ca/publications/guidance.



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## Impact of Financial Market Volatility

The recent market volatility caused headaches to many plan sponsors as solvency positions deteriorated due to the downturn in equity markets and solvency discount rates. Many pension plans that could afford a buy-out annuity purchase at the beginning of the year can no longer execute a transaction without incurring a significant balance sheet impact or having to make a special cash contribution to fund the solvency deficiency. In some jurisdictions, approval from the regulator for a buy-out transaction is also required.

### Regulatory Considerations due to Market Volatility

**Federal –** Effective March 27, 2020, OSFI announced a full freeze on portability transfers and buy-out annuity purchases relating to a plan's DB provision. The freeze does not affect periodic pension payments to members in-payment, nor a buy-in annuity transaction. Plan administrators may request the Superintendent's consent on a case-by-case basis. This is a temporary measure that OSFI will review in the coming months.

**Other** – Multiple jurisdictions require approval from the regulator to make commuted value transfers or purchase buy-out annuities if the plan's transfer ratio declines by more than 10%.

From an insurer's perspective, volatility in the bond markets also creates challenges to adequately price new group annuity business. In recent cases, we have witnessed insurers refusing to guarantee quotations for more than a few hours, or being forced to add margins to their pricing for potential adverse changes in bond yields during the day. For larger deals, there is also a concern that there would be insufficient time for the selected insurer to enter into a hedged position prior to market close on the transaction day. This risk is also prevalent for plan sponsors as their assets are also subject to volatility risk and there may be challenges to liquidate bonds to pay for the annuity premium. To address these concerns, we recommend transferring assets in-kind, if possible, and to consider a price adjustment mechanism for the portion of the premium paid in cash.

## Is There a Buying Opportunity?

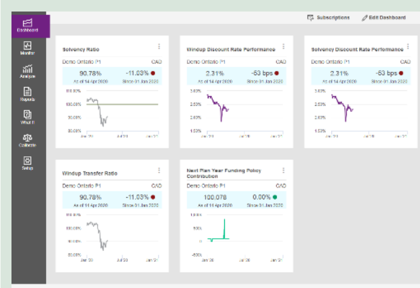
Opportunities can present themselves through adversity:

**Buyer Market** – Prior to the crisis, we had forecasted that 2020 would be another record year driven by high demand from plan sponsors. This has quickly taken a turn as many plan sponsors decided to postpone transactions as pension plans' financial positions deteriorated. However, pension plans that were fully funded and had de-risked prior to the crisis may now benefit from a market that has tipped in favour of buyers, as insurers compete to close the few deals coming to market.

**Improved Pricing** – Through the beginning of Q2,  insurers are benefitting from the increase in credit spreads in fixed income assets sourced to back new annuity business. These spread increases, as evidenced by the CIA guidance spread of 160 bps as at March 31, 2020 which is the highest ever, are resulting in lower annuity prices relative to high quality bonds. Although financial market conditions ares changing daily, the environment at the end of Q1 and beginning of Q2 offers a real window of opportunity for pension plans holding a portfolio of very high-quality bonds willing to substitute a portion of the high-quality bonds for annuities.

### Willis Towers Watson Channel

A holistic monitoring of a plan's key financial metrics is crucial in the current economic environment.  The Channel can help track the funded status of a plan using daily market data with embedded user-friendly features such as setting triggers and push-notifications.



**Tactical Buy-In** – As a reminder, a buy-in annuity is an investment and does not require regulatory approval or a special cash contribution. A buy-in could be used as a short-term tactic to lock-in favourable annuity pricing and be converted to a buy-out once conditions improve.

### Want more information?

This document is not intended to constitute or serve as a substitute for legal, accounting, actuarial or other professional advice. For information on how these issues may affect your organization, please contact your Willis Towers Watson consultant, or:

**Marco Dickner**
**Leader, Retirement Risk Management**
514 982 2097
marco.dickner@willistowerswatson.com

**Jonathan Morin**
**Leader, Group Annuity Purchase Team**
514 982 2029
jonathan.morin@willistowerswatson.com

**Charbel Abi-Assal**
**Group Annuity Purchase Specialist**
514 982 2078
charbel.abi-assal@willistowerswatson.com

**Simon-Alexandre Lachance**
**Group Annuity Purchase Specialist**
514 982 3008
simon-alexandre.lachance@willistowerswatson.com

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