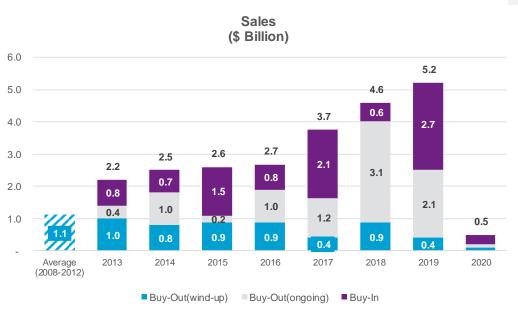
Group Annuity Market Pulse

Second Quarter 2020

Canada

Willis Towers Watson Annuity Purchase Index



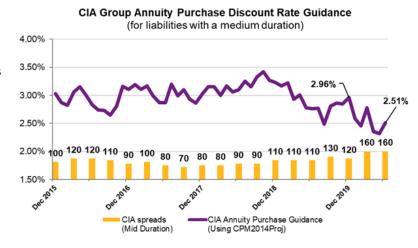
Key Observations:

- Sales of \$0.4 billion of group annuities were placed during the second quarter of 2020, bringing the 2020 market volume to \$0.5 billion, compared to the prior year volume of \$1.5 billion after two quarters.
- We expect that the volume of sales will increase significantly in the second half of the year, driven by some large transactions coming to market.
- Despite a slow start, it will be interesting to see whether we will witness an 8th consecutive recordbreaking year (unlikely, but still possible).

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 (GoC) marketable bond yields over 10 years (CANSIM V39062) of **160 bps** (using the CPM2014Proj mortality table) for nonindexed pensions with a medium duration, resulting in a discount rate of **2.51% as at June 30, 2020** (down from 2.96% as at December 31, 2019).



The **45** bps decrease in the CIA annuity purchase discount rate since the beginning of the year is attributable to the decrease in GoC bond yields (85 bps) partially offset by the **increase of 40 bps in the CIA guidance** spread for non-indexed pensions with a 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/quidance.

2020... A Roller Coaster Year for Credit Spreads

Awareness of credit spreads is very important for pension plan sponsors, especially this year. For instance, at the end of the first quarter, it was common for sponsors to see an improvement in their plans' accounting funded status while observing a deterioration in the solvency funded status. Such counterintuitive divergence was explained by an increase in credit spreads through the end of the first quarter while GoC interest rates decreased significantly.

Credit spreads and insurers' ability to acquire illiquid assets at high spreads also have a significant effect on group annuity pricing. The widely accepted measure for estimating the cost of Canadian group annuities is based on the CIA guidance, which adds a fixed spread to an index of unadjusted GoC marketable bond yields over 10 years. This spread is typically updated on a quarterly basis and is heavily influenced by the movement in credit spreads for public and private fixed income assets available to insurers. A volatile environment, as we have experienced in 2020, makes it challenging to accurately estimate the cost of annuities for plan sponsors looking to transact simply by referring to the most recent CIA guidance.

The Willis Towers Watson Annuity Tracker was created to specifically address this issue as described in the box to the right. For example, the WTW Annuity Tracker indicates that at the end of July, actual annuity pricing that appeared expensive relative to the CIA guidance may still in reality have been competitive.

Willis Towers Watson Annuity Tracker

WTW Annuity Tracker assists sponsors in tracking the cost of annuities (shown as the yield in the chart below) and assessing the true competitiveness of quotes received from insurers by reflecting a marked-to-market evolution of credit spreads.

In addition, the WTW Annuity Tracker can be calibrated to reflect the underlying expected mortality experience of specific cohorts based on socio-economic factors obtained from an analysis of the members' data and postal codes using the WTW Postal Code Mortality Tool. When combined, the tools provide an even better estimate of what should be considered a competitive quote from insurance companies.



2020 Market Observations

Market volatility continues – After a steep decline during the first quarter of 2020, solvency funded positions slowly recovered as all major global equity markets partially or fully rebounded. Credit spreads also contributed to the market volatility after reaching a multi-year high in March. This was showcased by the increase in the spread published in the CIA guidance of 160 bps at the end of the first two quarters of 2020 – an all-time high! Since March, credit spreads for investment grade bonds dropped by up to 100 bps through the end of July, but the spread published in the CIA guidance remained at 160 bps at the end of June, highlighting the competitiveness of the group annuity pricing in the market during the second quarter of 2020.

So far, a buyer's market – Plan sponsors who were able to come to the group annuity market during the second quarter benefited from very favourable pricing due to the increase in insurers' appetite and competitiveness driven by the low volume of transactions during the first half of the year. To the extent that sales continue to lag 2019 volumes, we expect this appetite and competitiveness to continue during the second half of 2020.

Outlook for the second half of the year – We expect a volume of at least \$3 billion to \$4 billion in the coming months driven by some large transactions coming to market.



Want more information?

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