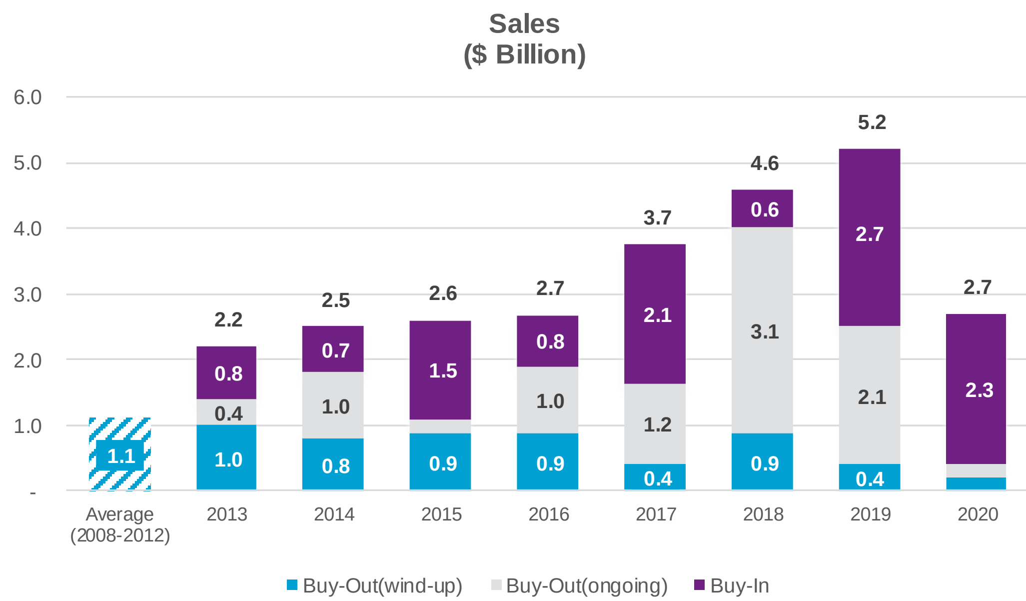
Group Annuity Market Pulse

Third Quarter 2020

Canada

Willis Towers Watson Annuity Purchase Index [1,2]



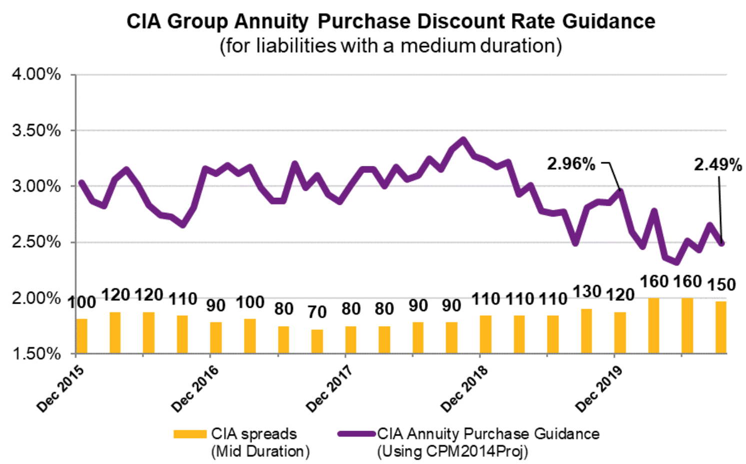
Key Observations:

- Estimated sales of $2.2 billion of group annuities were placed during the third quarter of 2020, driven by large transactions coming to market.
- Total year-to-date sales reached $2.7 billion, in line with the total volume at the same date last year ($2.6 billion).
- Although many transactions are expected during the fourth quarter of 2020, an 8th consecutive record-breaking year is unlikely.

CIA Annuity Purchase Guidance [3]

The Canadian Institute of Actuaries ("CIA") annuity purchase discount rate guidance ("CIA guidance") supports actuaries in selecting actuarial valuation assumptions, without having to request annuity quotes from insurers, by providing market pricing for blocks of business of three different durations at a given date.

The most recently published CIA guidance indicates annuity pricing at unadjusted long Government of Canada (GoC) marketable bond yields (CANSIM V39062) plus a spread of **150 bps** (using the CPM2014Proj mortality table) for non-indexed pensions with a medium duration, resulting in a discount rate of **2.49% as at September 30, 2020** (down from 2.96% as at December 31, 2019).



The **47 bps decrease** in the CIA guidance since the beginning of the year can be attributable to the decrease in GoC bond yields (77 bps) partially offset by the 30 bps increase in the CIA guidance spread for non-indexed pensions with a medium duration.

Notes:

1. 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.
2. 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.
3. Details regarding the most recent CIA guidance can be found at www.cia-ica.ca/publications/guidance.

Impact of COVID-19 on the Group Annuity Market in 2020

The COVID-19 pandemic was detrimental to many parts of the economy, but as it is the case with any crisis, it provided opportunities. Willis Towers Watson helped many plan sponsors transact over an aggregate of $2B of pension liabilities during 2020. Our overall assessment is that, all else being equal, sponsors who purchased annuities this year by sourcing the premium from bonds saved tens of millions of dollars compared to the pre-COVID-19 environment. The table below summarizes the impacts of COVID-19 on various factors affecting annuity pricing in 2020.

Plan sponsors who purchased annuities in 2020 saved tens of millions of dollars!

Factor	Impact on Annuity Pricing
Mortality view of insurers	• No impact – *see below.*
Level of interest rates	• Neutral to negative impact – *see below*
Increase in credit spreads	• Positive impact – *refer to our* ***Second Quarter Group Annuity Market Pulse.***
Supply and demand	• Positive impact – *see below.*

Mortality view of insurers - Despite over 1,000,000 deaths caused by COVID-19 worldwide including 10,000 in Canada, most insurers and reinsurers share the view that it is too early to draw conclusions and adjust their mortality assumptions.

A recent study conducted by Willis Towers Watson in the UK draws similar conclusions on the impact on pension plans. While the impact of the pandemic has been devastating, the direct mortality impact on pension plans is likely to be small. In fact, sponsors will likely not see their pension plan liabilities decrease by more than 0.1% resulting from the mortality experience in 2020.

At this point, it remains unlikely that the pandemic will reduce insurers' projected life expectancy improvements any time soon, which otherwise would result in a reduction in their annuity pricing. Any new trend will take time to establish, and history tells us that insurers are cautious about incorporating trends that reduce life expectancy in their group annuity pricing. Consequently, contrary to what one might think, the increase in the number of deaths caused by COVID-19 did not result in better annuity pricing in 2020.

Level of interest rates - The lower the interest rates, the higher the price of annuities since insurance companies price the annuities similar to fixed income assets. However, the impact of lower interest rates on plan sponsors looking to purchase annuities depends on the assets being used to pay for the annuity premium.

If one sells bonds to purchase annuities, the increase in annuity premium caused by the decrease in the level of interest rates is mostly neutralized due to the increase in the value of the underlying bond portfolio. One can use the analogy of a homeowner shopping for a new house in a booming market – you may need to pay more to buy a new house, but you can also sell your house for a much higher amount.

On the other hand, plan sponsors who have not undergone a de-risking exercise within their asset portfolio may have seen their solvency position deteriorate during 2020 due to the drop in interest rates. Furthermore, they may perceive annuities as being expensive if part of the annuity premium is to be sourced from equities.

Supply and demand - The decrease in demand due to the disruption from the pandemic during the first half of the year caused an increase in competitiveness among insurers in the third quarter thereby producing favourable pricing for plan sponsors coming to market.

Want more information?

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