Pension risk transfer.

2024 Q1 review.

May 2024

In this issue: Market activity, latest statistics, mortality improvement scale update and comments on the recent US lawsuits regarding annuity purchases.

TELUS Health

Annuity purchase market outlook.

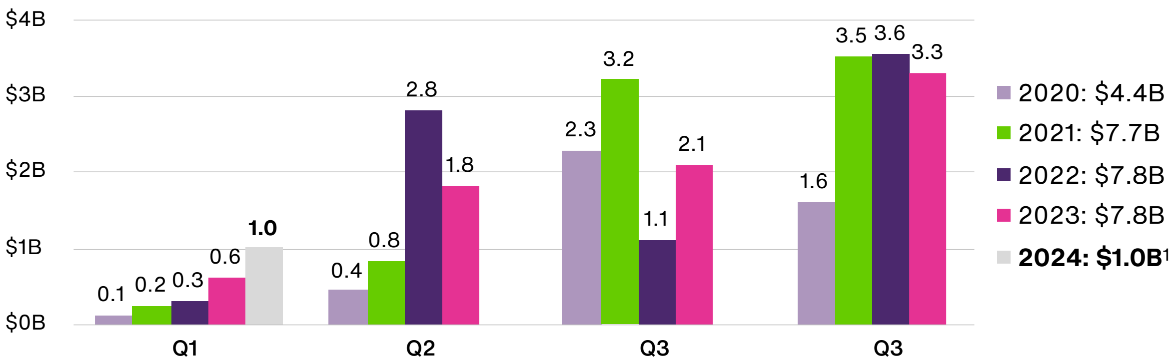
Market Activity

During the first quarter of 2024, the Canadian annuity purchase market witnessed a substantial upswing in activity in contrast to the same period in previous years. Specifically, approximately $1 billion worth of liabilities were successfully transacted during this period, a significant contrast to the average transaction volume from the first quarters of 2020 to 2023, which averaged around $0.3 billion.

While some large transactions initially planned for 2023 were deferred to 2024, the surge in activity in the first quarter of 2024 is mostly due to the higher number of transactions and could be attributed to plan sponsors seizing opportunities to conduct transactions during a traditionally quieter period of the year, avoiding therefore busy periods such as the last quarter. As a result, insurers' pipelines have rapidly filled up, and this trend is expected to continue throughout the year, rather than being concentrated in specific periods as was often the case previously. Additionally, certain insurers might reassess their volume objectives for 2024, considering that their targets could nearly be achieved within the first quarter alone and to better align with levels of market activity.

Considering this development, some insurers could become more selective much earlier in the year. Plan sponsors with a risk transfer objective, short or longer term, should be positioning themselves sooner rather than later by working with their consultant on developing a well-defined strategy. This includes identifying objectives and triggers, shaping the data, and socializing with insurers. By laying the foundation and closely monitoring the market, plan sponsors can position themselves with the agility required to capitalize on favorable market conditions and capture opportunities that could arise.

Transaction volume



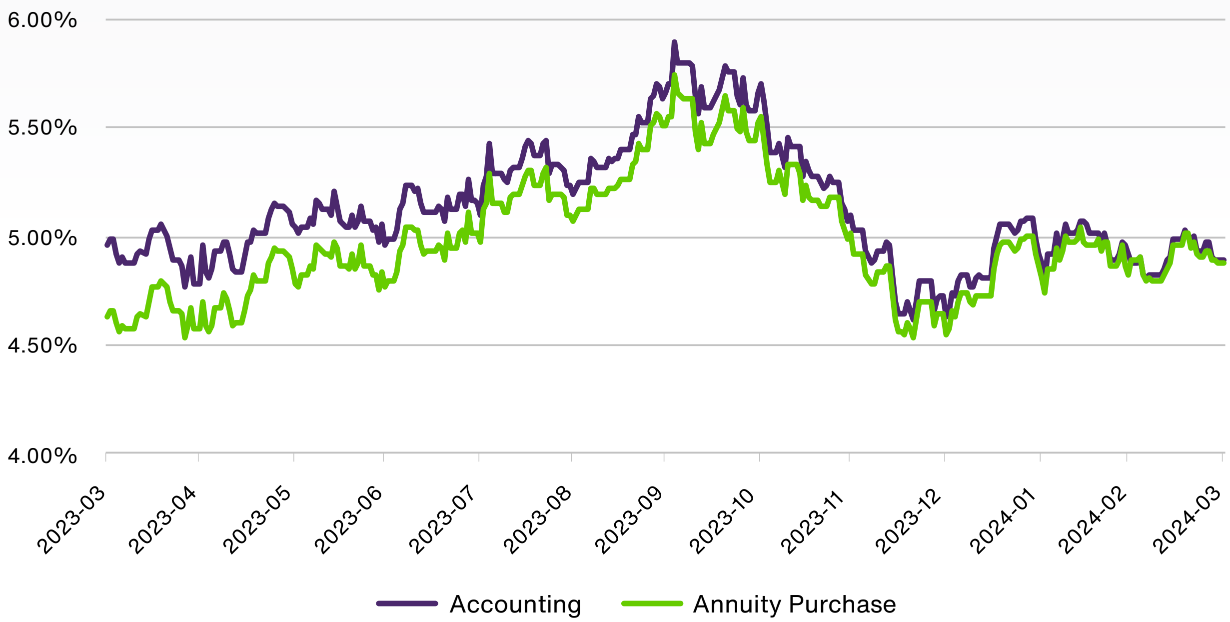
1. Q1 2024 volume of $1.0B is an estimate based on discussions with insurers.

Other remarks

Discount rates

As of March 31st, 2024, the annual accounting discount rate for a typical pension plan was approximately 4.9%[1], while the annual annuity purchase discount rate also stood at around 4.9%[2]. This reflects a slight increase and a smaller difference between the two rates compared to the end of the year. Consequently, buying annuities continues to present an attractive risk transfer opportunity from an accounting perspective.

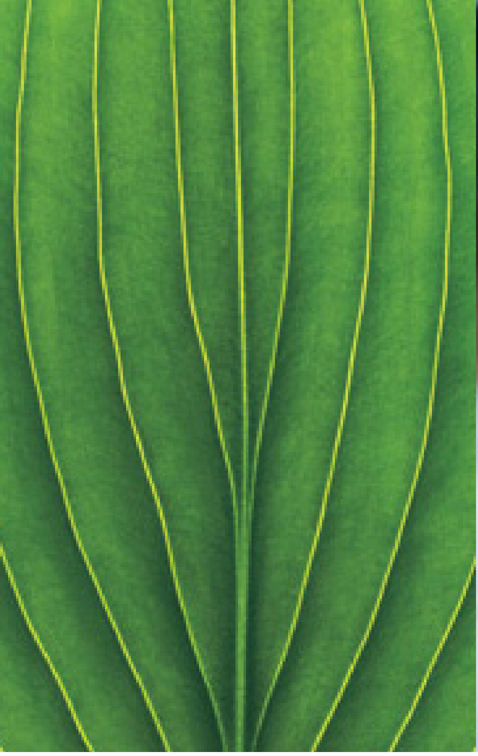
Annualized daily rates for an average duration plan.



1. Accounting discount rate derived from the TELUS Health AA Corporate Bond curve.
2. Annuity purchase rate based on most recently available CIA guidance and market conditions at March 28, 2024 for a medium duration annuity purchase (10 years).

Mortality improvements update.

Pension plans' risk management strategies are influenced by member's longevity, impacting their funded status and contribution requirements. On April 11, 2024, the Canadian Institute of Actuaries published a research paper on Canadian Mortality Improvements. Mortality improvements, which track changes in the likelihood of death over time, play a vital role in estimating the lifespan of pension plan members.




The research paper proposes a new best-estimate mortality improvements assumption that could be adopted by pension plans. This new assumption implies higher life expectancies compared to the current ones commonly used by pension plans, resulting in increased pension plan liabilities.

Moreover, the paper highlights the significant uncertainty surrounding long-term mortality improvement rates. There are a wide range of reasonable alternative assumptions and an even wider range of plausible long-term outcomes for changes in longevity over time.

This update is particularly pertinent for risk transfer activities. It underscores the need to consider the true value of longevity risk when making decisions about pension plan strategy and risk management.

It is also important to proactively update longevity assumptions before implementing risk management strategies. Accurately estimating the group's mortality profile is crucial for insurers when pricing longevity risk transfer.

Further guidance on the practical implementation of the research is anticipated from the Canadian Institute of Actuaries, in particular on whether the new assumptions will be used to calculate Commuted Values. As insurers review this research, our initial conversations suggest they don't foresee immediate impacts on their annuity pricing given that insurers are generally already using more sophisticated and up to date mortality improvement models. However, their stance may evolve as they delve deeper into the research findings.

The TELUS Health team will continue to engage with insurers and reinsurers to evaluate the implications on the pension risk transfer landscape and pinpoint opportunities for plan sponsors seeking risk transfer solutions.

US lawsuits on annuity purchase.

There have been 2024 lawsuits in the US concerning pension buyout transactions, and it is essential to understand the differences of the Canadian pension risk transfer (PRT) landscape when supported by a leading consultant like TELUS Health.

What happened?

In recent months, 3 lawsuits, two of which are class actions, have been commenced in the US against large plan sponsors by retirees or former employees. The cases are similar in that they involve the transfer of defined benefit liabilities to the same insurance company as part of pension risk transfer strategies (i.e., the purchase of group annuity contracts). The allegations, amongst other things, center around breach of fiduciary duty by plan sponsors who transferred plan liabilities to an insurance company that is alleged to be a riskier investment than a traditional pension fund.

While these cases are in the early days of the judicial process, they highlight concerns among retirees and other stakeholders about the security of pension funds, and individual entitlements, in such transactions.

In light of this recent potentially new wave of litigation in the US, one may ask what the implications for the Canadian PRT market are, particularly as many plan sponsors have increased their interest in de-risking activities.

How does this relate to the Canadian PRT market?

Understanding the distinctions between the Canadian and US PRT markets is important:

Legislative and regulatory framework:

- In the US, plan sponsors, in selecting an annuity provider, are subject to fiduciary standards under the Employee Retirement Income Security Act of 1974, more commonly known as ERISA, and a related Department of Labour Interpretive Bulleting 95-1 (IB 95-1) . ERISA requires that a fiduciary obtain the “safest annuity available” and IB 95-1 provides guidance to fiduciaries in discharging the obligations imposed by ERISA.

- While there are requirements in pension legislation in various Canadian jurisdictions in respect of purchasing annuities, they are different from those contained under ERISA and IB 95-1 and do not include the requirement for a fiduciary to obtain the “safest annuity possible”. For example, as of today some jurisdictions in Canada don’t allow annuity purchase transactions with discharge while the plan is ongoing. Others, such as Quebec, allow for it and prescribes specific funding rules and other requirements such as the adoption of an annuity purchasing policy (which must include the process and the criteria for choosing the insurer).
- Canada’s PRT insurers are overseen by the Office of the Superintendent of Financial Institutions (OSFI), which ensures streamlined compliance and uniform standards in terms of financial strength and reliability. However, the life insurance industry in the U.S. is regulated at the state level rather than by a federal body which leads to varying oversight in each jurisdiction.

Market dynamics:

- In 2023, there were 8 active annuity providers in Canada with a transaction volume of $7.8 billion, compared to 21 insurers in the US with a volume of $45 billion.
- New entrants have recently been less frequent in Canada, contributing to stability compared to the US market. Since 2022, there has been 3 new entrants in the U.S. but none in Canada.
- The Canadian market, with fewer annuity providers and lower transaction volumes, offers heightened stability.

Benefit security coverage:

- While the US has nationwide coverage through the PBGC[1] and the loss of this coverage is being cited as one of the detrimental impacts of this transaction, Canada only has one provincial coverage through Ontario’s PBGF[2] for Ontario members.
- In Canada, Assuris provides an additional layer of protection in case of insurer insolvency, whereas each US state regulates its life insurance industry and has its own guaranty associations.

1. Pension Benefit Guarantee Corporation
2. Pension Benefit Guarantee Fund

What to keep in mind?

While we will monitor these cases closely, Canadian pension plan fiduciaries looking to de-risk through the use of annuity contracts are in a substantially different position than US counterparts, especially if they ensure process and practices are in place to comply with relevant legislative requirements as well as conduct comprehensive research and assessment with broader considerations, aside from pricing alone, of market players in order to provide and protect retirement benefits. This is one reason why working with an experienced consultant is essential. Proper risk management can help to mitigate risks associated with pension risk transfer transactions. Regardless of the regulatory environment, thorough due diligence is essential to help ensure the long-term security of retirement benefits and demonstrate a sound approach to a transaction decision.

Reach out to our TELUS Health's consultants to learn more on how we can assist in fulfilling fiduciary duty when selecting an annuity provider, keeping the best interests of plan members in mind.

Let’s create a
healthier future together.

Learn more

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