Pension risk transfer.

2023 year-end review.

March 2024

In this issue: Economic and market outlook, latest statistics, optimizing execution, de-risking alternatives, and more.

TELUS Health

Annuity purchase market outlook.

Economic recap

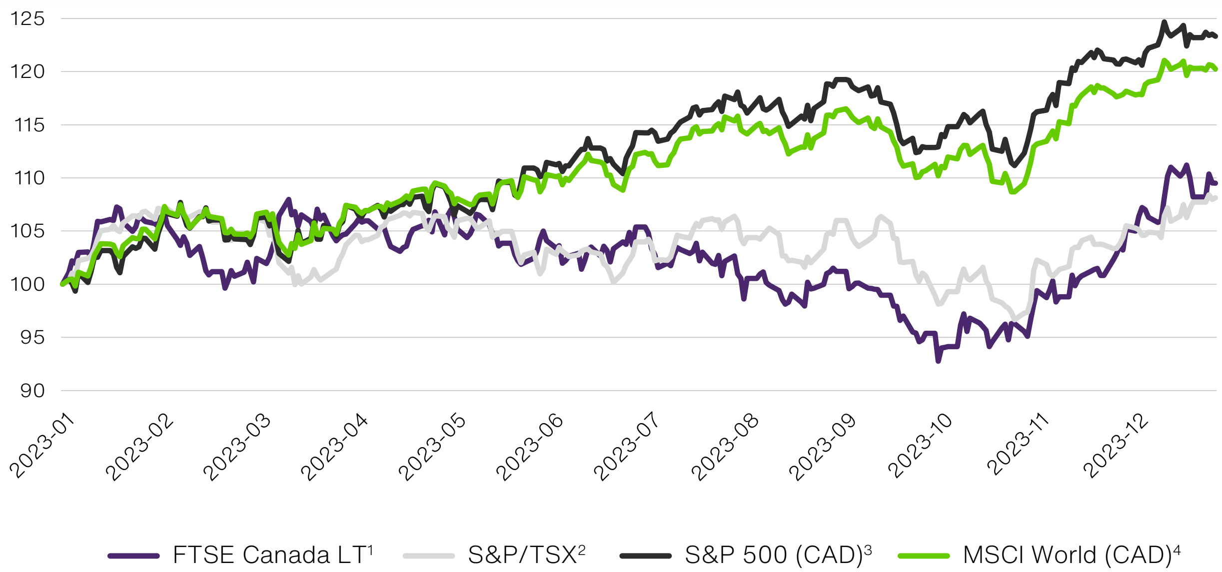
The year 2023 was marked by a combination of turmoil and excitement in the financial landscape. Notably, long-term yields remained relatively high through most of the year, following rate increases implemented by central banks in 2022 and the first half of 2023. Additionally, the stock market experienced a significant rally in 2023, erasing the losses incurred in the previous year. This favorable market environment presented a unique opportunity for pension plans in an advantageous financial position. They witnessed a substantial surge in asset returns and a simultaneous decline in liabilities, creating an ideal scenario for de-risking. Consequently, the demand for annuity purchases by sponsors soared, as plan sponsors sought to capitalize on the favorable conditions and strategically manage their risk exposure.

On the flip side, long-term bond yields experienced a decline of approximately 1% from October to December. Concurrently, credit spreads also decreased notably during this period. These developments consequently influenced annuity purchase. Moreover, this sudden shift poses a potential risk to funded positions in the future.

The highly volatile swings in economic conditions, as shown in the graph below, underscore the high unpredictability of the future, which in turn can present opportunities for pension plan sponsors that are ready and prepared to take action, but also pose many risks. In this environment, de-risking through annuity purchases when the opportunity arises becomes even more appealing. While alternative solutions like Liability-Driven Investment (LDI) strategies effectively hedge most of a plan's interest rate risks, they could remain exposed to credit spread variations and yield curve changes. These fluctuations can result in tracking gaps between assets and liabilities, leading to unexpected shortfalls.

It is important to note that many Canadian pension plans continue to bear a significant amount of equity risk. In the event of a downturn in equity markets, even those plans that are currently fully funded could face limitations on their annuity purchase opportunities. This highlights the need for proactive risk management and the consideration of alternative strategies to mitigate potential volatility and protect funded positions.

Evolution of CAD$100 invested at 2023-01-01 in market indices.



1. Source: FTSE.
2. Source: Bloomberg.
3. Source: Bloomberg and Bank of Canada.
4. Source: MSCI.

Annuity purchase market outlook.

Market activity

The year 2023 was characterized by a consistently high level of competitiveness and activity in the annuity purchase market. This was mainly driven by a combination of favorable economic conditions, proactive collaboration between insurers and consultants, innovation, and transparent processes. In this dynamic environment, certain insurers gained momentum by securing significant wins in targeted transactions throughout the year, leading to a more balanced distribution of market shares among insurers compared to past years. Similarly to previous years, the latter half of the year saw a significant increase in the number of quotes, indicating a heightened level of business but also commitment to this market from insurers.

Insurers demonstrated great flexibility in handling complex deals, particularly through structured time-bound exclusive partnerships, negotiated via the TELUS Health Pension Risk Transfer Team team where appropriate to client needs. This development is particularly beneficial for plans with specific needs, such as those with a high proportion of deferred members, inflation-linked indexation provisions, and smaller-sized plans in general. This collaboration showcased insurers' ability to adapt and meet the diverse demands of the market.

In August, Canada Life made the decision to exit the annuity purchase business, reducing the number of participating insurers in Canada from nine to eight. However, it's important to note that this decision will not impact their existing in-force business, which includes the administration of annuitant benefits and support for buy-in annuities seeking to convert to a buy-out annuity in the future.

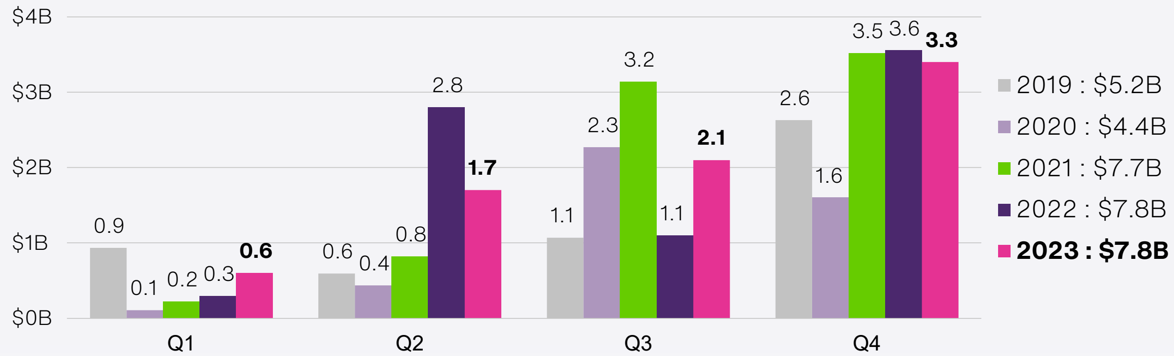
Quarterly statistics (LIMRA).

According to the official LIMRA statistics for 2023, the market volume for this year matched the record set in 2022 and reached a total of around $7.8 billion. It is worth noting that it is anticipated that the number of quotes processed throughout the year will have increased from 2022 to 2023. This growth not only demonstrates the commitment of insurers to annuity purchases, but also highlights the continued interest of pension plan sponsors in transferring their plans' risks.

Analyzing the market activity for 2023, the total volume for the first half of the year amounted to $2.4B, while the second half contributed $5.4B. Notably, Q4 alone accounted for $3.3 billion of the total market volume, further emphasizing the concentration of market activity in the latter part of the year. This trend aligns with the pattern observed in recent years, where the group annuity market tends to experience heightened activity towards the end of the year. Additionally, of the total volume of purchases, 65% were buy-out annuities, while 35% were buy-in annuities.

Looking ahead to 2024, market observers anticipate a substantial surge in market volume compared to 2023. This projection is attributed, in part, to the postponement of certain large quotes from 2023 to 2024.

Transaction volume



Timing and preparedness.

Conversations with insurers in 2023 revealed that the demand for annuity purchases surpassed insurer's capacity to transact. Given the limited control that plan sponsors have over the annuity market conditions, it is crucial for them to collaborate with their consultants to carefully evaluate investment and de-risking strategies that are fully within their control. In this regard, tools such as Liability Driven Investment (LDI), opportunistically timed longevity hedging (see de-risking section below) and a lump-sum window can be employed to effectively manage and mitigate risks until the opportunity to purchase annuities becomes available.

To enhance plan sponsor preparedness, the TELUS Health Team utilizes modeling tools such as PFaroeDB™. This sophisticated platform empowers plan sponsors to make informed decisions by leveraging the team's ability to assess real-time market data, conduct comprehensive risk and reward analysis, and monitor daily updates of plan funding positions and risk metrics with automated alerts when sponsor defined triggers are hit.. Through this process, the sponsor acquires a thorough understanding of the current position of their DB pension plans in relation to their objectives. This enables TELUS Health to efficiently guide plan sponsors in developing effective strategies towards purchasing annuities in the most opportune conditions.

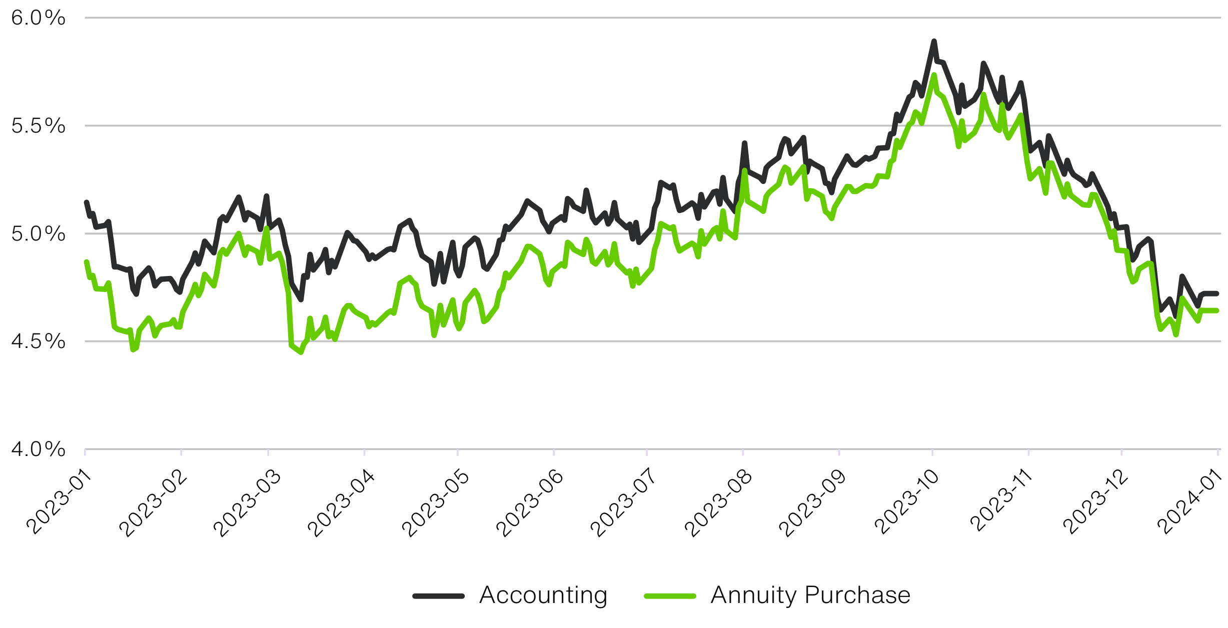
TELUS Health | PFaroe™DB

PFaroeDB is a powerful platform designed for consultants, asset managers, and defined benefit pension plans. With its user-friendly dashboard, customizable asset modeling, and comprehensive reporting capabilities, PFaroeDB simplifies complex processes and automates tasks. The platform incorporates market-leading analytics for pension plans, allowing users to monitor funding levels, assets, liabilities, and perform risk analysis. PFaroeDB provides visible benefits by meeting regulatory requirements, simplifying communication of complex ideas, and helping users achieve their goals. Over 4,400 pension plans with nearly $2,500 billion in assets have already benefited from PFaroeDB worldwide. The members of the TELUS Health team are eager to engage in discussions with plan sponsors about the tailored benefits that their consultants' use of PFaroeDB can offer to address plan's specific needs.

Discount rates

As of the end of 2023, the annual accounting discount rate for typical pension plans stood at approximately 4.7%[1], while the annual annuity purchase discount rate was around 4.6%[2]. The recent significant increase in both rates, combined with the narrowing gap between them since last quarter, presents a favorable environment to purchase annuities from an accounting perspective.

2023 annual daily rates for an medium 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 December 31, 2023 for a medium duration annuity purchase (10 years).

Other remarks

Longevity risk

Longevity risk involves the uncertainty of mortality within a group and the risk of mortality evolving differently than projected. It is a critical factor in pension plan risk management, impacting funded status and contribution requirements. Previously unforeseen events, like the COVID-19 pandemic, have introduced heightened uncertainty and volatility in long-term trends, posing significant challenges for actuaries in accurately assessing and projecting future mortality rates.

Currently, pensioner mortality is evaluated using the Canadian Pensioner Mortality Table in conjunction with a mortality improvement table such as MI-2017 or CPM-B. However, a new Canadian mortality improvement scale is expected to be introduced in 2024. This forthcoming change may impact mortality assumptions and liabilities for pension plans going forward, although the exact magnitude of this update's impact is difficult to predict at present.

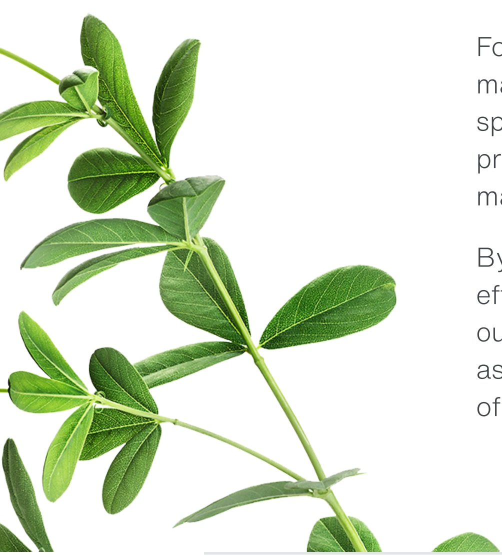
De-risking alternatives

Annuity purchases are widely recognized as one of the most effective means for plan sponsors to mitigate risks associated with their pension plans. However, certain plan-specific or market constraints may limit the availability or appeal of this option for some sponsors. In such cases, alternative solutions exist to hedge key risks, including interest rate risk, inflation risk, and longevity risk.

To effectively hedge interest rate and inflation risks, sponsors can construct an investment portfolio designed to replicate the cash flow profile of pension liabilities. This strategy, known as Liability Driven Investment (LDI), typically involves a mix of government and corporate bonds, along with inflation-linked securities if inflation risk hedging is desired. While most LDI strategies provide good hedging, some can end up producing a significant tracking error. Careful monitoring is required with these strategies.

For longevity risk, established and emerging solutions exist in the Canadian market. The most well-known approach is longevity insurance, where a plan sponsor and an insurer enter into an agreement to hedge longevity risk. Other providers are seeking to bring capital market derivative options into play, which may be simpler and more flexible but less robust as a hedge.

By combining an LDI strategy with a longevity hedge, plan sponsors can effectively mitigate interest rate risk, inflation risk, and longevity risk, achieving outcomes comparable to annuity purchases. This approach can be implemented as either an interim or ongoing solution, depending on the specific objectives of the plan sponsor.



Exclusive deals trends

During the year, the TELUS Health PRT team has been actively working on securing exclusive deals with insurers, which will benefit pension plans with unique requirements. These ongoing discussions and work aim to establish the right process and best good practices for these types of deals. This will allow the team to cater to the specific needs of plan sponsors, particularly for plans with specific timing requirements, unique plan provisions, less attractive demographic profiles, or smaller size purchases. These deals can also happen when there is already a preferred insurer by the Plan Sponsor. To determine the suitability of this type of transaction, plan sponsors are encouraged to engage in strategic discussions with their consultants, who can provide valuable insights and guidance.

Let’s create a
healthier future together.

Learn more

TELUS® Health