

MEMORANDUM

To: All Pension Actuaries

From: Faisal Siddiqi, Chair
Standards and Guidance Council
Mark Mervyn, Chair
Committee on Pension Plan Financial Reporting

Date: May 14, 2019

Subject: **Educational Note Supplement: Guidance for Assumptions for Hypothetical Wind-Up and Solvency Valuations Update – Effective March 31, 2019, and Applicable to Valuations with Effective Dates Between March 31, 2019 and December 30, 2019**

Document 219059

The Committee on Pension Plan Financial Reporting (PPFRC) conducted its quarterly review of group annuity pricing conditions as at March 31, 2019. It determined that a revision to its previous guidance regarding assumptions for hypothetical wind-up and solvency valuations is **not** required for valuations with effective dates on or after March 31, 2019 (but no later than December 30, 2019) with the exception of updates for the duration points for low, medium, and high. The previous quarterly and annual guidance was provided in the [educational note](#) dated March 18, 2019 and applied for valuations with effective dates on and after December 31, 2018 (but no later than December 30, 2019).

Additional information is contained in this educational note supplement. The guidance contained in this educational note supplement is consistent with the [preliminary communication](#) dated April 24, 2019.

Due Process

The Policy on Due Process for the Approval of Guidance Material Other than Standards of Practice and Research Documents was followed in the development of these revisions.

Contact Information

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FS, MM

Validity of March 18, 2019 Educational Note

The most recent annual guidance from the Committee on Pension Plan Financial Reporting (PPFRC) concluded that for valuations with effective dates on or after December 31, 2018 (but no later than December 30, 2019), an appropriate discount rate for estimating the cost of purchasing a non-indexed group annuity would be determined as the unadjusted average yield on Government of Canada (GoC) marketable bonds with maturities over 10 years (CANSIM series V39062) increased arithmetically by a spread determined based on the duration of the liabilities. For estimating the cost of purchasing a group annuity where pensions are fully indexed to the rate of change in the Consumer Price Index (CPI), the spread would be determined as the unadjusted yield on Government of Canada real-return long-term bonds (CANSIM series V39057). The discount rates are to be used in conjunction with the 2014 Canadian Pensioners' Mortality Table (CPM2014) combined with mortality improvement scale CPM Improvement Scale B (CPM-B) and if applicable, would be adjusted to reflect adjustments for sub- or super-standard mortality (CPM2014Proj). This guidance was based on hypothetical quotes provided by insurance companies on illustrative blocks of business, supplemented by data from certain actuarial consulting firms on actual group annuity purchases and bona fide quotations.

Except as noted below, actuaries would continue to reference the March 18, 2019 [educational note](#) for guidance with respect to the selection of assumptions for hypothetical wind-up and solvency valuations with effective dates between December 31, 2018 and December 30, 2019.

Non-indexed Annuity Proxy

Previous Quarterly Guidance

The most recent quarterly and annual guidance from the PPFRC concluded that for valuations with effective dates on or after December 31, 2018 (but no later than December 30, 2019), an appropriate discount rate for estimating the cost of purchasing a non-indexed group annuity would be determined using CANSIM series V39062 increased arithmetically by between 100 to 110 basis points (bps).

This guidance was based on hypothetical quotes as at December 31, 2018, supplemented by group annuity data for the fourth quarter of 2018.

Analysis

The PPFRC obtained hypothetical quotes as at March 31, 2019 from the same insurance companies on the same illustrative blocks of business used to develop the previous guidance and group annuity data. The durations of the three central illustrative blocks are as follows:

Duration	Low	Medium	High
Duration at March 31, 2019	8.6	11.2	13.8

For the purpose of this guidance, the durations of the illustrative blocks shown above were determined using the discount rate guidance for the illustrative block with medium duration (as described below) of 2.93% which is equal to the CANSIM V39062 yield of 1.83% at March 31,

2019 plus 110 bps. The mortality assumptions as described in the annual note were also used. Note that the durations of the three illustrative blocks will change over time as discount rates change. The hypothetical quotations at December 31, 2018 and March 31, 2019 may be summarized as follows:

Average of the Three Most Competitive Hypothetical Quotes (Using CPM2014Proj Mortality Tables)						
	December 31, 2018			March 31, 2019		
	Low duration	Medium duration	High duration	Low duration	Medium duration	High duration
Discount rate	3.15%	3.25%	3.29%	2.79%	2.86%	2.89%
Spread over CANSIM V39062	+ 102 bps	+ 112 bps	+ 116 bps	+ 96 bps	+ 103 bps	+ 106 bps

The spread over CANSIM V39062 based on the average of the three most competitive hypothetical quotes marginally decreased over all durations, since the previous quarter. However these spreads were still relatively consistent with the previous guidance. Furthermore, the average spreads for actual purchases and bona fide quotations during the quarter were generally in line with the previous guidance, particularly on a weighted average basis.

Based on the above information, the PPFRC concluded that a revision to the guidance is not required. In establishing the guidance, the PPFRC gave consideration to the hypothetical quotes and to the data collected on actual annuity purchases and bona fide quotations.

Guidance for Non-indexed Pensions

The PPFRC concluded that effective March 31, 2019, the cost of purchasing non-indexed annuities would be estimated based on the process outlined in the annual note for 2019, and the following table to determine the appropriate spread above unadjusted CANSIM V39062:

Illustrative block	Duration based on 2.93% discount rate	Spread above unadjusted CANSIM V39062
Low duration	8.6	+ 100 bps
Medium duration	11.2	+ 110 bps
High duration	13.8	+ 110 bps

CPI-Indexed Annuity Proxy

Previous Guidance

The most recent guidance from the PPFRC concluded that for valuations with effective dates on or after December 31, 2018 (but no later than December 30, 2019), an appropriate discount rate for estimating the cost of purchasing a group annuity where pensions are fully indexed to the rate of change in the Consumer Price Index (CPI) would be the unadjusted yield on CANSIM series V39057 reduced arithmetically by 70 bps.

Analysis

A subset of the contributing insurers also provided hypothetical quotes for the illustrative blocks on a CPI-indexed basis as of March 31, 2019, of which at least three indicated they may be willing to transact on their hypothetical quotes at the three durations. The hypothetical quotations as at December 31, 2018 and March 31, 2019, for the medium-duration illustrative block where insurers indicated that they may be willing to transact on their hypothetical quotes may be summarized as follows:

Average of the Most Competitive Hypothetical Quotes (Using CPM2014Proj Mortality Tables)		
	December 31, 2018	March 31, 2019
Number of hypothetical quotes in the average	3	3
Discount rate	0.01%	- 0.26%
Spread over CANSIM V39057	- 77 bps	- 72 bps

Based on the average of the three hypothetical quotes, the spreads below the unadjusted yield on CANSIM V39057 for the medium-duration illustrative block became less negative during the quarter. Similar to the previous quarter, the absolute value of the spread on the low and high duration blocks were both higher than for the medium duration block. In addition, significant variation between the hypothetical quotes was observed.

The PPFRC was provided with limited quantitative data on actual fully- or partially-indexed annuity data for the first quarter of 2019.

Guidance for Fully CPI-Indexed Pensions

Based on the pricing received, the PPFRC has concluded there is insufficient data to warrant a revision to the previous guidance. An appropriate proxy for estimating the cost of purchasing a group annuity where pensions are fully indexed to the rate of change in the CPI would be estimated based on the process outlined in the annual note, and using an interest rate equal to the unadjusted yield on CANSIM series V39057 (0.46% as at March 31, 2019) reduced arithmetically by 70 bps.

Actual Annuity Pricing

The purpose of this educational note supplement is to provide actuaries with guidance related to establishing assumptions for hypothetical wind-up and solvency valuations. The pricing for an actual group annuity purchase depends on many factors as outlined in the annual note, with the result that the actual price may differ from the guidance provided herein. Spreads versus GoC long-term bonds for group annuity pricing can be volatile, which actuaries may wish to be mindful of when communicating advice related to future hypothetical wind-up and solvency valuations.

Retroactive Application

If an actuary has already prepared a funding valuation report with an effective date on or after March 31, 2019, before the publication of this guidance, the actuary would consider paragraphs 1710.36 through 1710.43 of the Standards of Practice to determine whether it is necessary to withdraw or amend the report.

Additional Comments

The PPFRC intends to continue monitoring group annuity pricing on a quarterly basis. Actuaries may use the spreads indicated above for valuations with effective dates on and after March 31, 2019, up to December 30, 2019, pending any future guidance or other evidence of change in annuity pricing.

Appendix A – Summary and Links for Historical Guidance

The following is a summary of the historical guidance issued by the PPRC. The summary is provided for reference, and actuaries are directed to refer to the respective published educational note or educational note supplement.

Educational Note/ Supplement	Mortality table ¹	Non-indexed Immediate and Deferred <i>Duration: Spread relative to unadjusted CANSIM V39062</i>			Fully CPI-Indexed <i>Spread relative to unadjusted CANSIM V39057</i>
		Low duration	Medium duration	High duration	All durations
Mar 31, 2019	CPM2014Proj	8.6: + 100 bps	11.2: + 110 bps	13.8: + 110 bps	- 70 bps
Dec 31, 2018	CPM2014Proj	8.5: + 100 bps	11.0: + 110 bps	13.4: + 110 bps	- 70 bps
Sep 30, 2018	CPM2014Proj	8.4: + 80 bps	10.9: + 90 bps	13.3: + 90 bps	- 80 bps
June 30, 2018	CPM2014Proj	8.5: + 80 bps	11.1: + 90 bps	13.5: + 90 bps	- 70 bps
Mar 31, 2018	CPM2014Proj	8.5: + 70 bps	11.1: + 80 bps	13.6: + 90 bps	- 70 bps
Dec 31, 2017	CPM2014Proj	8.6: + 70 bps	11.1: + 80 bps	13.6: + 90 bps	- 70 bps
Sep 30, 2017	CPM2014Proj	8.5: + 60 bps	11.1: + 70 bps	13.5: + 80 bps	- 70 bps
Jun 30, 2017	CPM2014Proj	8.6: + 60 bps	11.2: + 80 bps	13.8: + 90 bps	- 70 bps
Mar 31, 2017	CPM2014Proj	8.5: + 70 bps	11.0: + 100 bps	13.5: + 110 bps	- 60 bps
Dec 31, 2016	CPM2014Proj	8.5: + 70 bps	11.0: + 90 bps	13.5: + 100 bps	- 60 bps
Sep 30, 2016	CPM2014Proj	8.7: + 80 bps	11.4: + 110 bps	14.0: + 120 bps	- 70 bps
Jun 30, 2016	CPM2014Proj	8.6: + 90 bps	11.3: + 120 bps	13.8: + 130 bps	- 70 bps
Mar 31, 2016	CPM2014Proj	8.5: + 90 bps	11.1: + 120 bps	13.6: + 130 bps	- 70 bps
Dec 31, 2015	CPM2014Proj	8.5: + 60 bps	11.1: + 100 bps	13.6: + 110 bps	- 70 bps
Sep 30, 2015	CPM2014Proj	8.4: + 80 bps	11.0: + 110 bps	13.4: + 120 bps	- 70 bps
Jun 30, 2015	UP94Proj	8.3: - 20 bps	10.9: + 30 bps	13.6: + 60 bps	- 120 bps
Mar 31, 2015	UP94Proj	8.5: + 0 bps	11.3: + 30 bps	14.0: + 60 bps	- 120 bps
Dec 31, 2014	UP94Proj	8.2: + 0 bps	10.9: + 30 bps	13.5: + 60 bps	- 120 bps
Sep 30, 2014	UP94Proj	8.1: + 0 bps	10.6: + 30 bps	13.2: + 50 bps	- 120 bps
Jun 30, 2014	UP94Proj	8.0: + 0 bps	10.5: + 40 bps	12.9: + 60 bps	- 110 bps
Mar 31, 2014	UP94Proj	7.7: + 50 bps	10.1: + 80 bps	12.3: + 100 bps	- 100 bps
Dec 31, 2013	UP94Proj	7.6: + 50 bps	9.9: + 70 bps	12.1: + 80 bps	- 110 bps
Sep 30, 2013	UP94Proj	7.6: + 60 bps	9.9: + 80 bps	12.2: + 90 bps	- 100 bps
Jun 30, 2013	UP94Proj	7.8: + 40 bps	10.2: + 60 bps	12.5: + 70 bps	- 120 bps

¹ "CPM2014Proj": 2014 Canadian Pensioners' Mortality Table (CPM2014), combined with mortality improvement scale CPM Improvement Scale B (CPM-B) with no adjustments for sub- or super-standard mortality; "UP94Proj": UP94 mortality table, combined with mortality improvement scale AA on fully generational basis.