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## **EXPLANATORY REPORT**

# **Guidance for Assumptions for Hypothetical Wind-Up and Solvency Valuations Update – Effective September 30, 2023, and Applicable to Valuations with Effective Dates on or after September 30, 2023, and no later than June 29, 2024**

January 8, 2024

# Guidance for Assumptions for Hypothetical Wind-Up and Solvency Valuations Update – Effective September 30, 2023, and Applicable to Valuations with Effective Dates on or after September 30, 2023, and no later than June 29, 2024

## Committee on Pension Plan Financial Reporting

### Document 224002

*Ce document est disponible en français.*

The actuary should be familiar with relevant other guidance. They expand or update the guidance provided in an educational note. They do not constitute standards of practice and are, therefore, not binding. They are, however, intended to illustrate the application of the *Standards of Practice*, so there should be no conflict between them. The actuary should note however that a practice that the other guidance describes for a situation is not necessarily the only accepted practice for that situation and is not necessarily accepted actuarial practice for a different situation. Responsibility for the manner of application of standards of practice in specific circumstances remains that of the members. As standards of practice evolve, other guidance may not reference the most current version of the *Standards of Practice*, and as such, the actuary should cross-reference with current standards.

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## Preamble

The Committee on Pension Plan Financial Reporting (PPFRC) is issuing this explanatory report to provide members with additional information and details on the analysis done for the guidance outlined in the [educational note supplement](#) dated October 24, 2023, (*Guidance for Assumptions for Hypothetical Wind-Up and Solvency Valuations Update – Effective September 30, 2023, and Applicable to Valuations with Effective Dates on or after September 30, 2023, and no later than June 29, 2024*) issued as a supplement to the [educational note](#) dated March 23, 2023.

## Your feedback

Questions or comments regarding this explanatory report may be directed to the [chair of the PPFRC](#).

## 1. Application of the March 23, 2023, educational note

The guidance from the PPFRC, outlined in the March 23, 2023, educational note, concluded that for valuations with effective dates on or after December 31, 2022, (but no later than June 29, 2024) 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 discount rate would be determined as the unadjusted yield on GoC real-return long-term bonds (CANSIM series V39057) increased arithmetically by a fixed spread.

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). If applicable, the mortality assumption would be adjusted to reflect adjustments for sub- or super-standard mortality. The guidance outlined in the March 23, 2023, educational note 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 23, 2023, educational note for guidance with respect to the selection of assumptions for hypothetical wind-up and solvency valuations with effective dates on or after September 30, 2023, and no later than June 29, 2024.

## 2. Guidance for non-indexed pensions

Based on the analysis provided in Appendix A, the PPFRC concluded that, effective September 30, 2023, the cost of purchasing non-indexed annuities would be estimated based on the process outlined in the March 23, 2023, educational note and the following table:

Annuity duration	Duration based on 5.58% discount rate	Unadjusted CANSIM V39062* as at September 30, 2023	Spread above V39062	Discount rate as at September 30, 2023
Low	7.4	3.88%	+180 bps	5.68%
Medium	9.3	3.88%	+170 bps	5.58%
High	11.1	3.88%	+160 bps	5.48%
<b>Mortality table:</b> CPM2014 combined with mortality improvement scale CPM-B with no adjustments for sub- or super-standard mortality.				

\*Unadjusted average yield on GoC marketable bonds with maturities over 10 years (CANSIM V39062).

For valuation dates on and after September 30, 2023, the duration of the group and the resulting spread would be determined using a 5.58% discount rate, and the discount rate would be determined using the actual CANSIM V39062 rate as at the valuation date.

Annuity purchases for groups with durations lower than the low duration or higher than the high duration are fairly infrequent. Groups with durations higher than the high duration would tend to have a significant proportion of deferred vested members. The PPFRC believes that groups with a larger proportion of deferred vested members would generally have higher pricing, all else being equal, due to added administrative costs and risk premiums that insurers would incur in assuming these obligations. As at September 30, 2023, the PPFRC continues to believe that a reasonable approach to derive the spread for very high duration annuities is to decrease the spread by approximately 0.1% (10 bps) for each one-year increase in duration above the duration of the high duration block (11.1 as at September 30, 2023). Other approaches may also be reasonable.

### 3. Guidance for indexed pensions

Based on the analysis provided in Appendix A, the PPFRC concluded that, effective September 30, 2023, the cost of purchasing a group annuity where pensions are fully indexed to the rate of change in CPI would be estimated based on the process outlined in the March 23, 2023, educational note and the following table:

Unadjusted CANSIM V39057* as at September 30, 2023	Spread below V39057	Discount rate as at September 30, 2023
2.06%	-20 bps	1.86%
<b>Mortality table:</b> CPM2014 combined with mortality improvement scale CPM-B with no adjustments for sub- or super-standard mortality.		

\*Unadjusted yield on GoC real-return long-term bonds (CANSIM V39057).

### 4. Actual annuity pricing

The purpose of this explanatory report 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 March 23, 2023, educational 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, of which actuaries may wish to be mindful when communicating advice related to future hypothetical wind-up and solvency valuations.

## 5. Additional comments

The PPFRC intends to continue monitoring group annuity pricing on a quarterly basis. Actuaries may use the spreads indicated above for non-indexed and indexed pensions effective September 30, 2023, for valuations with effective dates on and after September 30, 2023, and no later than June 29, 2024, pending any future guidance or other evidence of change in annuity pricing.

## Appendix A – Methodology in developing guidance as at September 30, 2023

### Data

The PPFRC requested hypothetical quotes as at September 30, 2023, from the same insurance companies on the same illustrative blocks of business used to develop the December 31, 2022, guidance outlined in the March 23, 2023, educational note. Consistent with the analysis performed at previous quarter ends, the hypothetical quote information was supplemented with data on the pricing of actual group annuity purchases and bona fide quotations in cases where the transaction did not proceed during the third quarter of 2023, as provided by several actuarial consulting firms. The total volume of data collected during the third quarter of 2023 for buyout and buy-in group annuity purchases in Canada was approximately \$2.2B. There was limited quantitative data obtained on actual indexed annuity purchases or bona fide quotations in cases where the transaction did not proceed during the third quarter of 2023.

### Mortality basis

The assumed mortality table and assumed future mortality improvements used to establish the discount rate guidance in this explanatory report are the CPM2014 combined with mortality improvement scale CPM-B with no mortality adjustments, irrespective of the basis used by insurers when submitting quotes.

### Analysis – non-indexed annuities

In establishing the guidance, the PPFRC has given weight to the hypothetical quotes and to the data collected on actual annuity purchases and bona fide quotations. Summary data in respect of the three central non-indexed illustrative blocks is the same as the data shown in Appendix A of the March 23, 2023, educational note, with the exception of the durations.

The durations of the three central illustrative blocks are as follows:

Duration	Low	Medium	High
Duration as at September 30, 2023	7.4	9.3	11.1

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 in this explanatory report) of 5.58%, which is equal to the CANSIM V39062 yield of 3.88% as at September 30, 2023, plus 170 bps. The mortality assumptions as outlined in the March 23, 2023, educational note were also used. Note that the durations of the illustrative blocks will change over time as discount rates change.

The table below provides the implicit discount rates as at September 30, 2023, underlying the average of the three most competitive hypothetical quotes, determined in conjunction with CPM2014 combined with mortality improvement scale CPM-B with no mortality adjustments, and the spread of these implicit discount rates over the CANSIM V39062 yield. Comparable information is also shown as at June 30, 2023.

<b>Average of the three most competitive hypothetical quotes</b>			
<b>Duration</b>	<b>Low</b>	<b>Medium</b>	<b>High</b>
<i>September 30, 2023</i>			
<b>Discount rate</b>	5.74%	5.58%	5.43%
<b>Spread over CANSIM V39062</b>	+186 bps	+170 bps	+155 bps
<i>June 30, 2023</i>			
<b>Discount rate</b>	4.91%	4.73%	4.65%
<b>Spread over CANSIM V39062</b>	+177 bps	+159 bps	+151 bps

The spread over CANSIM V39062, based on the average of the three most competitive hypothetical quotes, increased for all three duration illustrative blocks from June 30, 2023.

#### **Analysis – fully CPI-indexed annuities**

A subset of the contributing insurers also provided hypothetical quotes for the illustrative blocks on a CPI-indexed basis as at September 30, 2023, of which at least two indicated they may be willing to transact on their hypothetical quotes at the three durations.

Information on pricing was considered from the insurers willing to transact. To ensure confidentiality, the information for this explanatory report has been suppressed:

<b>Average of the most competitive hypothetical quotes</b>			
	<b>Number of hypothetical quotes in the average</b>	<b>Discount rate</b>	<b>Spread over CANSIM V39057</b>
<b>September 30, 2023</b>	--	--	--
<b>June 30, 2023</b>	--	--	--

Based on the average of the most competitive hypothetical quotes, the absolute value of the spreads relative to the unadjusted yield on GoC real-return long-term bonds (CANSIM V39057) for the medium-duration illustrative block was unchanged from June 30, 2023.

While there is some indication that the pricing of CPI-indexed annuities may also vary by duration, the PPFRC has concluded that there are insufficient data at this stage to introduce this level of refinement. Consequently, the guidance contained herein is applicable to CPI-indexed annuities regardless of their duration.

The quantitative data obtained on actual fully indexed annuity purchases and bona fide quotations in cases where the transaction did not proceed during the third quarter of 2023 was limited.

In developing the guidance, the PPFRC considered all of the information received.



## Appendix B – Summary and links for historical guidance

The following is a summary of the historical guidance issued by the PFFRC. 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/ explanatory report	Mortality table	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
<a href="#">Sep 30, 2023</a>	CPM2014Proj	7.4: + 180 bps	9.3: + 170 bps	11.1: + 160 bps	-20 bps
<a href="#">Jun 30, 2023</a>	CPM2014Proj	7.7: + 180 bps	9.8: + 170 bps	11.7: + 160 bps	-20 bps
<a href="#">Mar 31, 2023</a>	CPM2014Proj	7.8: + 160 bps	9.9: + 160 bps	12.0: + 160 bps	-20 bps
<a href="#">Dec 31, 2022</a>	CPM2014Proj	7.7: + 160 bps	9.7: + 160 bps	11.7: + 160 bps	-20 bps
<a href="#">Sep 30, 2022</a>	CPM2014Proj	7.8: + 140 bps	9.9: + 150 bps	11.9: + 150 bps	-40 bps
<a href="#">Jun 30, 2022</a>	CPM2014Proj	7.8: + 130 bps	9.9: + 150 bps	11.9: + 150 bps	-60 bps
<a href="#">Mar 31, 2022</a>	CPM2014Proj	8.2: + 120 bps	10.5: + 140 bps	12.8: + 140 bps	-40 bps
<a href="#">Dec 31, 2021</a>	CPM2014Proj	8.7: + 100 bps	11.3: + 120 bps	13.9: + 120 bps	-40 bps
<a href="#">Sep 30, 2021</a>	CPM2014Proj	8.6: + 100 bps	11.1: + 120 bps	13.6: + 130 bps	-50 bps
<a href="#">Jun 30, 2021</a>	CPM2014Proj	8.6: + 100 bps	11.2: + 120 bps	13.7: + 130 bps	-50 bps
<a href="#">Mar 31, 2021</a>	CPM2014Proj	8.5: + 100 bps	11.1: + 120 bps	13.6: + 130 bps	-50 bps
<a href="#">Dec 31, 2020</a>	CPM2014Proj	8.9: + 120 bps	11.6: + 140 bps	14.3: + 150 bps	-50 bps
<a href="#">Sep 30, 2020</a>	CPM2014Proj	8.9: + 130 bps	11.6: + 150 bps	14.3: + 160 bps	-50 bps
<a href="#">Jun 30, 2020</a>	CPM2014Proj	8.8: + 140 bps	11.6: + 160 bps	14.3: + 170 bps	-50 bps
<a href="#">Apr 30, 2020</a>	CPM2014Proj	8.9: + 130 bps	11.7: + 140 bps	14.5: + 150 bps	-70 bps
<a href="#">Mar 31, 2020</a>	CPM2014Proj	8.7: + 150 bps	11.4: + 160 bps	13.9: + 170 bps	-70 bps
<a href="#">Dec 31, 2019</a>	CPM2014Proj	8.6: + 110 bps	11.2: + 120 bps	13.7: + 120 bps	-70 bps
<a href="#">Sep 30, 2019</a>	CPM2014Proj	8.7: + 120 bps	11.3: + 130 bps	13.9: + 130 bps	-70 bps
<a href="#">Jun 30, 2019</a>	CPM2014Proj	8.7: + 100 bps	11.4: + 110 bps	14.0: + 110 bps	-70 bps
<a href="#">Mar 31, 2019</a>	CPM2014Proj	8.6: + 100 bps	11.2: + 110 bps	13.8: + 110 bps	-70 bps
<a href="#">Dec 31, 2018</a>	CPM2014Proj	8.5: + 100 bps	11.0: + 110 bps	13.4: + 110 bps	-70 bps
<a href="#">Sep 30, 2018</a>	CPM2014Proj	8.4: + 80 bps	10.9: + 90 bps	13.3: + 90 bps	-80 bps
<a href="#">Jun 30, 2018</a>	CPM2014Proj	8.5: + 80 bps	11.1: + 90 bps	13.5: + 90 bps	-70 bps
<a href="#">Mar 31, 2018</a>	CPM2014Proj	8.5: + 70 bps	11.1: + 80 bps	13.6: + 90 bps	-70 bps
<a href="#">Dec 31, 2017</a>	CPM2014Proj	8.6: + 70 bps	11.1: + 80 bps	13.6: + 90 bps	-70 bps
<a href="#">Sep 30, 2017</a>	CPM2014Proj	8.5: + 60 bps	11.1: + 70 bps	13.5: + 80 bps	-70 bps
<a href="#">Jun 30, 2017</a>	CPM2014Proj	8.6: + 60 bps	11.2: + 80 bps	13.8: + 90 bps	-70 bps
<a href="#">Mar 31, 2017</a>	CPM2014Proj	8.5: + 70 bps	11.0: + 100 bps	13.5: + 110 bps	-60 bps
<a href="#">Dec 31, 2016</a>	CPM2014Proj	8.5: + 70 bps	11.0: + 90 bps	13.5: + 100 bps	-60 bps
<a href="#">Sep 30, 2016</a>	CPM2014Proj	8.7: + 80 bps	11.4: + 110 bps	14.0: + 120 bps	-70 bps
<a href="#">Jun 30, 2016</a>	CPM2014Proj	8.6: + 90 bps	11.3: + 120 bps	13.8: + 130 bps	-70 bps
<a href="#">Mar 31, 2016</a>	CPM2014Proj	8.5: + 90 bps	11.1: + 120 bps	13.6: + 130 bps	-70 bps
<a href="#">Dec 31, 2015</a>	CPM2014Proj	8.5: + 60 bps	11.1: + 100 bps	13.6: + 110 bps	-70 bps
<a href="#">Sep 30, 2015</a>	CPM2014Proj	8.4: + 80 bps	11.0: + 110 bps	13.4: + 120 bps	-70 bps

<a href="#">Jun 30, 2015</a>	UP94Proj	8.3: - 20 bps	10.9: + 30 bps	13.6: + 60 bps	-120 bps
<a href="#">Mar 31, 2015</a>	UP94Proj	8.5: + 0 bps	11.3: + 30 bps	14.0: + 60 bps	-120 bps
<a href="#">Dec 31, 2014</a>	UP94Proj	8.2: + 0 bps	10.9: + 30 bps	13.5: + 60 bps	-120 bps
<a href="#">Sep 30, 2014</a>	UP94Proj	8.1: + 0 bps	10.6: + 30 bps	13.2: + 50 bps	-120 bps
<a href="#">Jun 30, 2014</a>	UP94Proj	8.0: + 0 bps	10.5: + 40 bps	12.9: + 60 bps	-110 bps



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