

Pension Indices by LifeWorks

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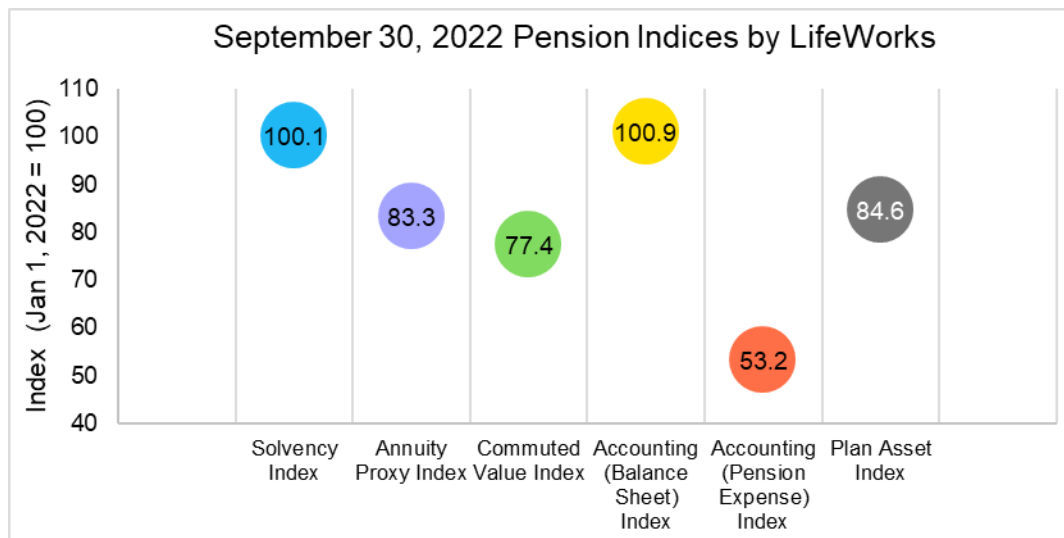
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The Pension Indices by LifeWorks, released monthly, condense the journey that pension plans have experienced during the year into a few key statistics. More importantly, they also provide an early indicator of the challenges and opportunities that are yet to come for plan sponsors and administrators to help with the monitoring and management of their pension plans.

Highlights:

- Over the month of September, the funded position of a typical pension plan declined on both a solvency basis and an accounting basis.
- The investment return was -2.8% for the month for a representative pension plan portfolio. The return for the first nine months of the year for the plan was -15.4%.
- The Canadian equity index finished the month with a weak return of -4.3%. Also, returns for Canadian bond indices were negative as yields increased for bonds of all durations. Short-term Government of Canada bond yields increased by 0.15% during the month, whereas long-term Government of Canada bond yields increased by approximately 0.07%
- Market expectations for long-term inflation (the break-even inflation rate) were approximately 1.65% at the end of September, which represents a 0.13% decrease from the end of August.
- The accounting pension expense index saw a drop in September, as the discount rate increased.



In September, the global developed and emerging equity markets index, the MSCI ACWI, dropped 5.1% in Canadian dollar terms. The Canadian equity index, the S&P/TSX Composite, finished the month with a weak return of -4.3%.

Returns for Canadian bond indices were negative as yields increased in September. Corporate credit spreads experienced an increase for bonds of all durations. Non-indexed short-term Government of Canada bond yields increased by 0.15% during the month, whereas long-term Government of Canada bond yields increased by 0.07%.

Market expectations for long-term inflation (the break-even inflation rate) were approximately 1.65% at the end of September, which represents a 0.13% decrease from the end of August.

“September saw pensions hit the front pages in the UK, and for all the wrong reasons. Following the release of the new UK government’s mini-budget, long-term bond yields increased at an unprecedented pace, effectively producing “1 in 100” year events two days in a row. The Bank of England took action, buying 65 billion pounds of UK bonds to help slow down the market rout. One of the main drivers for the Bank of England’s actions were concerns about the solvency of UK pension plans.

Many pension plans in the UK operate leveraged liability-driven investment (LDI) funds which they use to hedge interest rate risk. The extreme movement in bond yields led to pension plans having to sell their government bond holdings, and any other liquid assets they had, to meet emergency collateral calls from their LDI investments. Pension plans were effectively running out of cash. If the Bank of England had not intervened, it could have resulted in a downward spiral of prices with ever more forced sellers. A true systematic risk.

“This is an opportunity for Canadian pension plans to take stock and consider the lessons that can be learned from the UK’s predicament”, says Julianna Spiropoulos, Partner and Head of Investment Strategy, Asset and Risk Management at LifeWorks. “While leveraged LDI structures in Canada are different than the UK, it is critical to understand the structure and risks of your LDI program, including liquidity requirements, in all potential market environments. Despite recent events in the UK, LDI strategies (including those with leverage) are very successful risk management tools. Like any investment, LDI strategies require thorough due diligence but are a great way for pension plans, particularly those that are closed and/or mature, to lower their funding and accounting risks.”

The graphs below show the month-to-month evolution of each index.

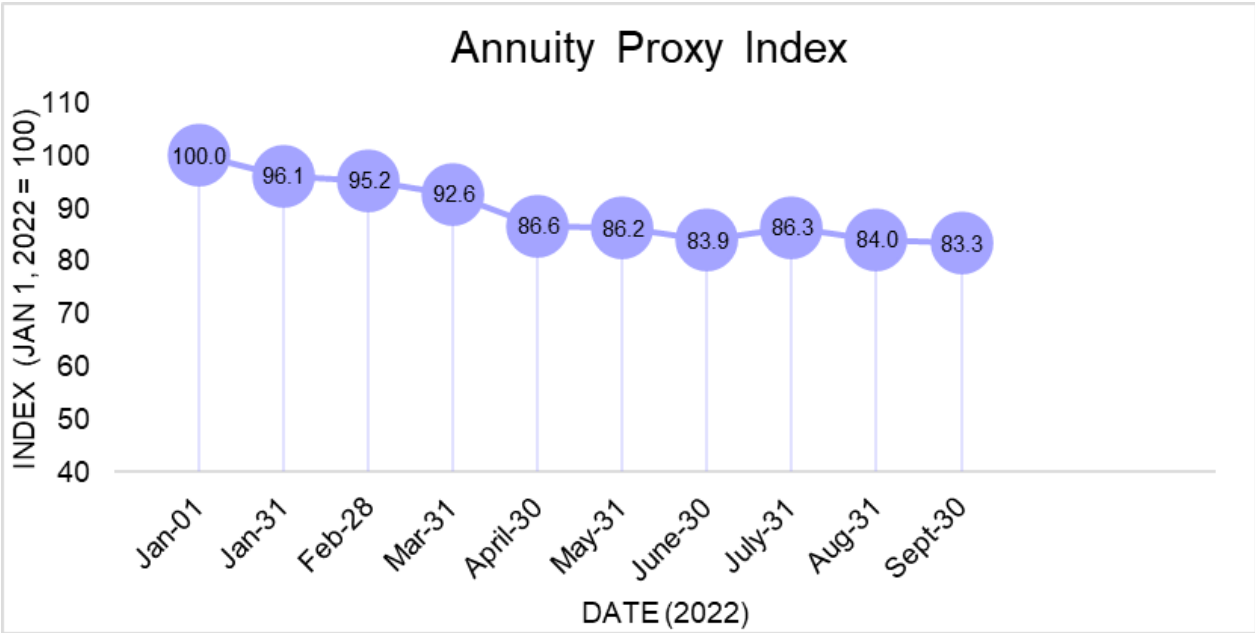
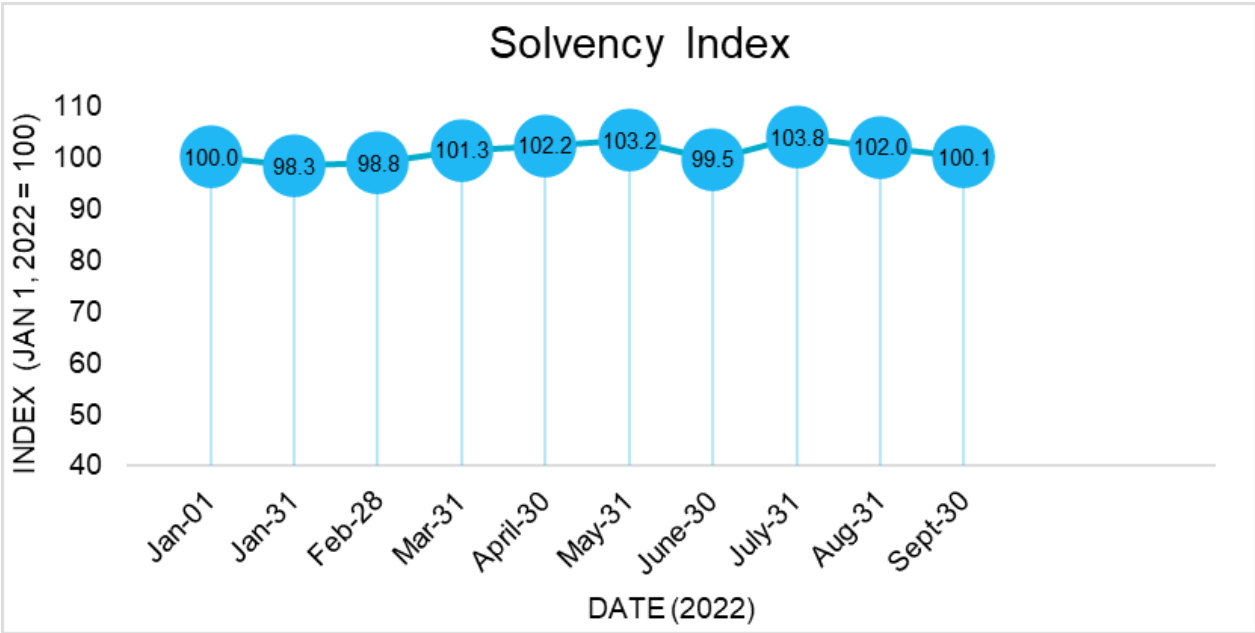
Definitions

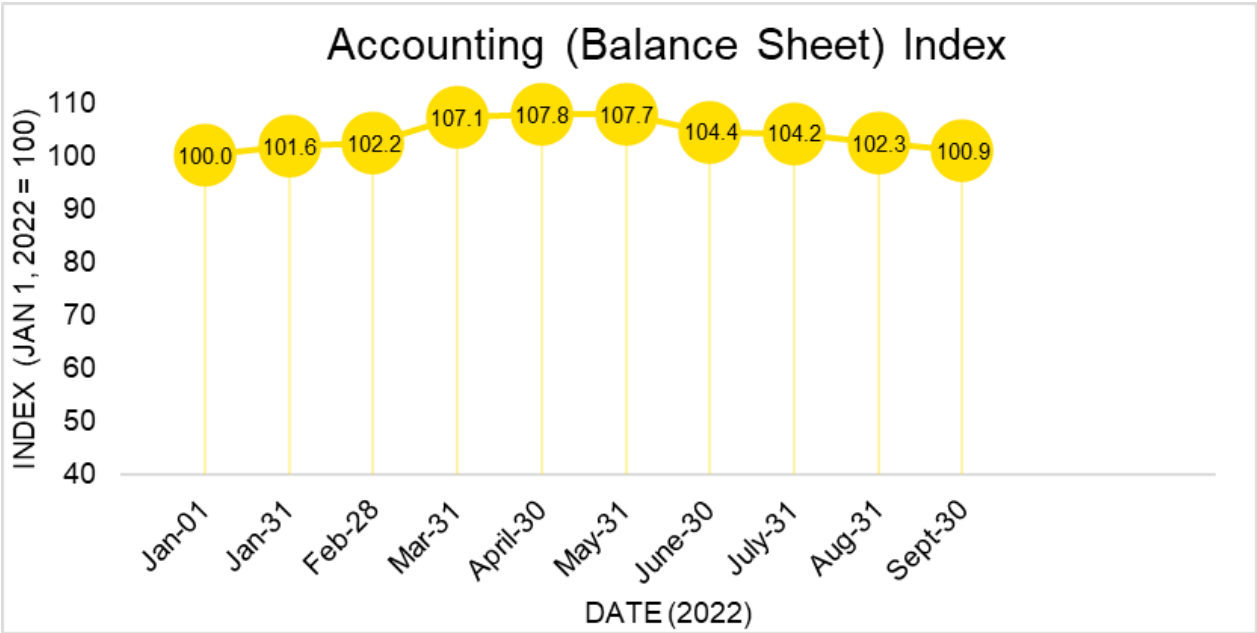
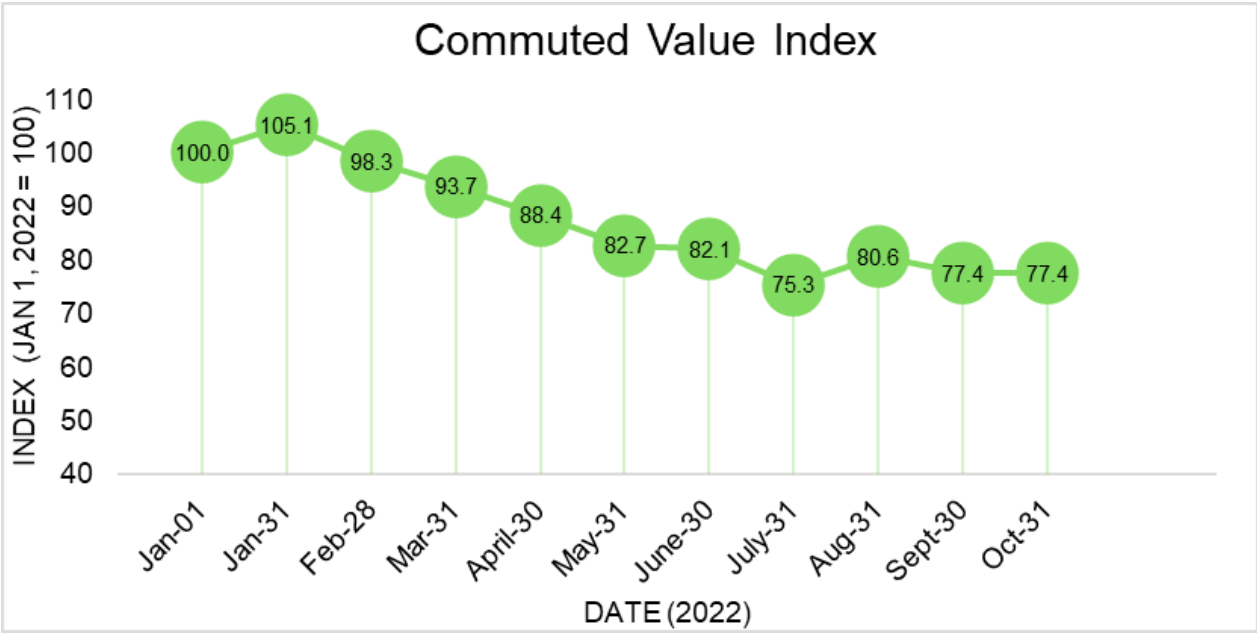
Solvency Index	Provides an indication of changes in the solvency funding level of an average pension plan since the start of the year
Annuity Proxy Index	Provides an indication of changes in the estimated annuity purchase premium since the start of the year for obligations with a medium duration
Commuted Value Index	Provides an indication of changes in commuted values for members of an average pension plan since the start of the year
Accounting (Balance Sheet) Index	Provides an indication of changes in the accounting funding level of an average pension plan since the start of the year
Accounting (Pension Expense) Index	Provides an indication of changes in the following year’s pension expense since the start of the year
Plan Asset Index	Provides an indication of changes in asset levels for an average pension plan since the start of the year

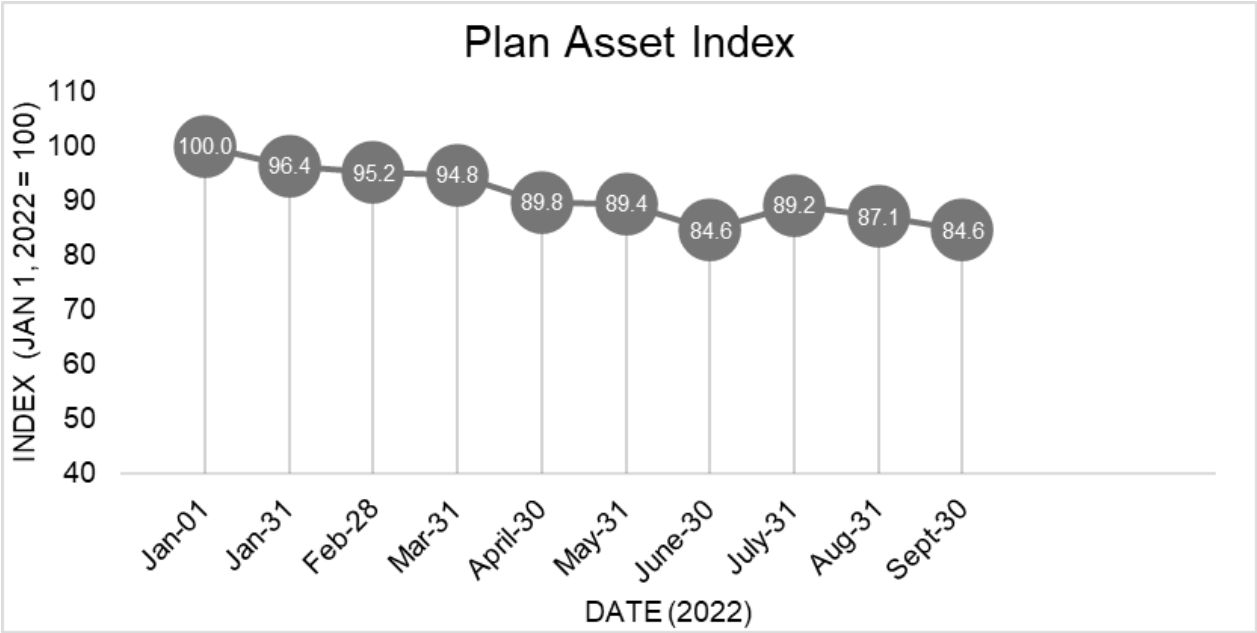
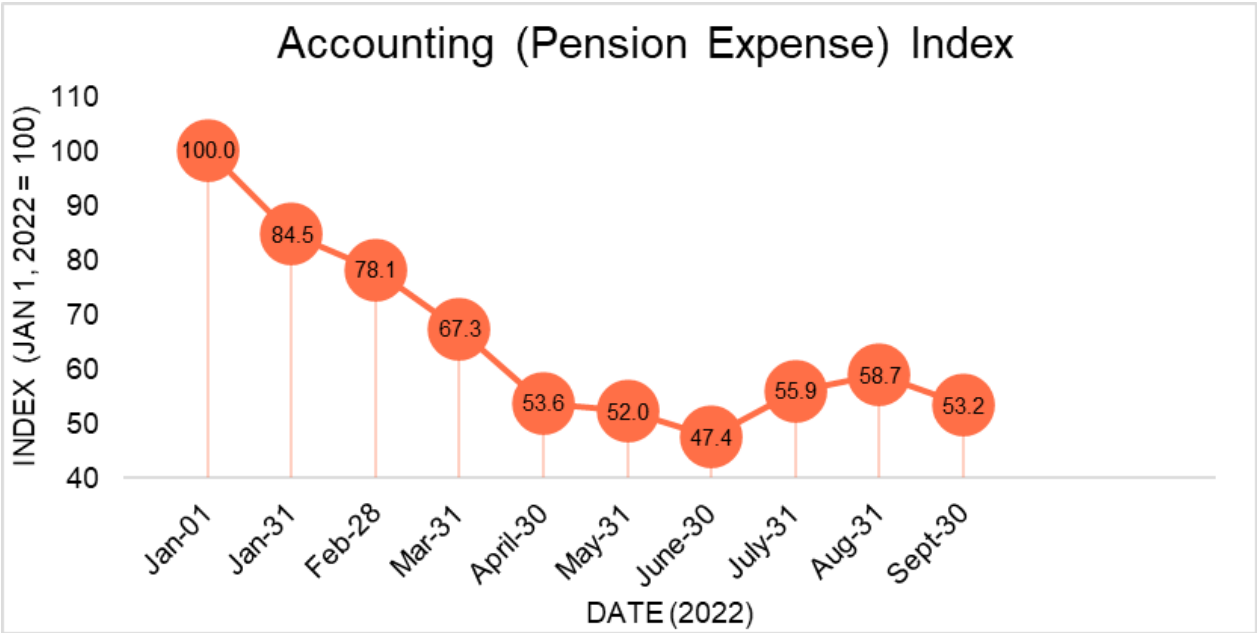
Notes on methodology

- The indices show the monthly progression of various indicative pension measures since the start of the calendar year.
- Each index is reset to 100 on January 1.
- The monthly *Asset Index* is calculated based on a LifeWorks Benchmark portfolio, 50% equities and 50% fixed income (2% in 91-day T-Bills, 24% FTSE TMX Canada Universe, 24% FTSE TMX Canada LT, 25% S&P/TSX, 25% MSCI ACWI).
- The plan liabilities are for a medium duration pension plan.
- The monthly *Solvency Index* reflects estimates of solvency liabilities using the latest available Canadian Institute of Actuaries (CIA) annuity purchase discount rate guidance at each month end.

- The monthly *Commuted Value Index* reflects an estimate of a commuted value for an average plan member using the method for calculating commuted values set out in the CIA's actuarial Standards of Practice.
- The monthly Accounting Indices reflect estimates of accounting liabilities using a discount rate derived from the LifeWorks AA Corporate Bond Yield Curve.









About LifeWorks

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