Global Pension Risk Survey 2019

Canada Survey Findings

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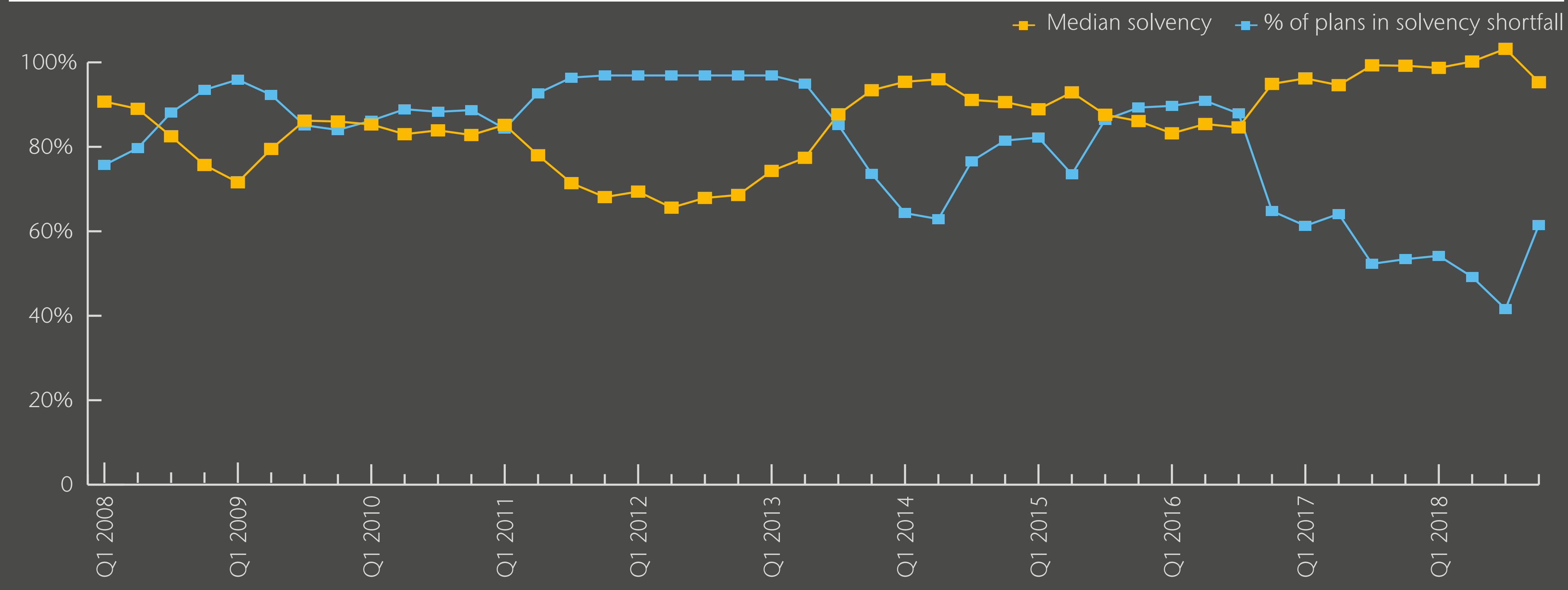
Executive summary

Executive summary

Welcome to the Canadian findings of our 2019 Global Pension Risk Survey. The survey is part of a global series of surveys that follows defined benefit (DB) plan sponsors' risk management attitudes and practices around the world. We carry out the Global Pension Risk Survey every two years and looking back over the last decade we can see how the pensions landscape has developed.

Since the global financial crisis in 2008, pension plans in Canada have been making slow progress towards returning to fully funded status. In 2018, Aon's median solvency ratio crossed the 100% threshold for the first time in over a decade, only to fall back to 95.3% at the end of the year due to falling bond yields and equity market volatility. For those looking to adjust the risk profile of their plan, this made 2018 both the best of times and the worst of times depending on how quickly they were able to react.

Aon Median Solvency Ratio 2008–2018



Aon's Median Solvency Ratio Survey measures the financial health of defined benefit plans by comparing defined benefit plans' solvency assets to solvency liabilities to calculate their solvency funded ratio. It draws on a large database of DB plans and reflects each plan's specific features, investment policy, contributions and solvency relief measures.

Survey demographics at a glance

150 Canadian respondents to the 2019 survey

41% of respondents had **fewer than 500 members**

16% of respondents had **over 10,000 members**

Wide range of asset sizes covered.
From sub-$100m to over $1bn of assets

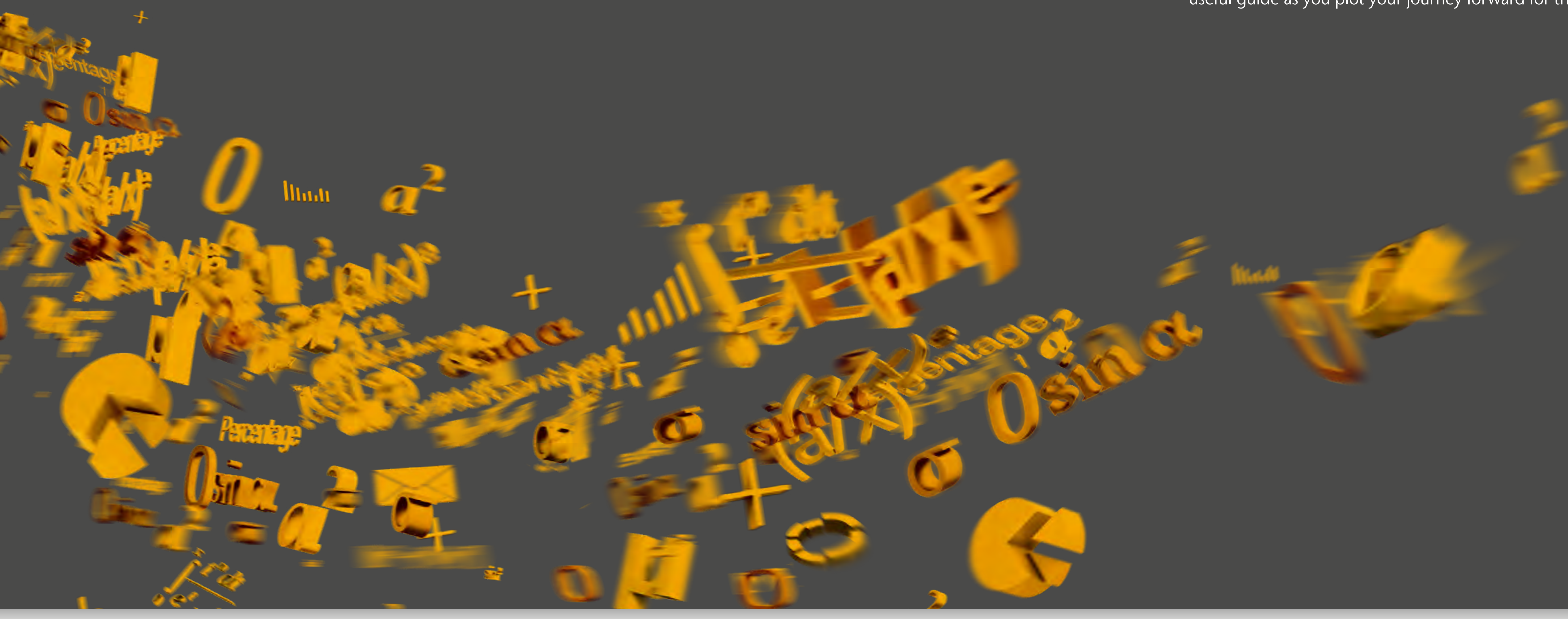
Cross-section of public and private sector organizations.

In spite of the market volatility in 2018, or perhaps as a direct consequence, we have seen a big increase in the number of plan sponsors working towards a long-term goal of sustainability. The number of risk settlements among private sector sponsors was smaller than expected given that most plans would have crossed the 100% solvency funding threshold in 2018, a good proxy for plan settlement costs. This is an area where risk monitoring, longevity and long-term objectives are particularly important.

The investment trends of more global diversification and use of alternatives continued in this year's survey responses with illiquid alternatives and foreign real estate being of particular interest. Regulatory change also had an impact on investment strategy, particularly for Quebec plan sponsors. As the range of sophisticated investment solutions continues to grow and governance requirements become more demanding, it is also not surprising that delegated assets under management grew by another 50% since the 2017 survey.

In addition to examining the impact of funding reform on plan sponsor investment and funding strategy, this year's survey looks at the issue of cyber risk for pension plans for the first time. As an emerging risk, it is an increasing threat to modern businesses and pension plans are not exempt from it. Our survey responses show that much work remains to be done in this area in the coming years.

Many thanks to all of you who participated in this year's survey by sharing your past actions and future plans. The pension landscape continues to change so we hope you will find this report to be a useful guide as you plot your journey forward for the next few years.



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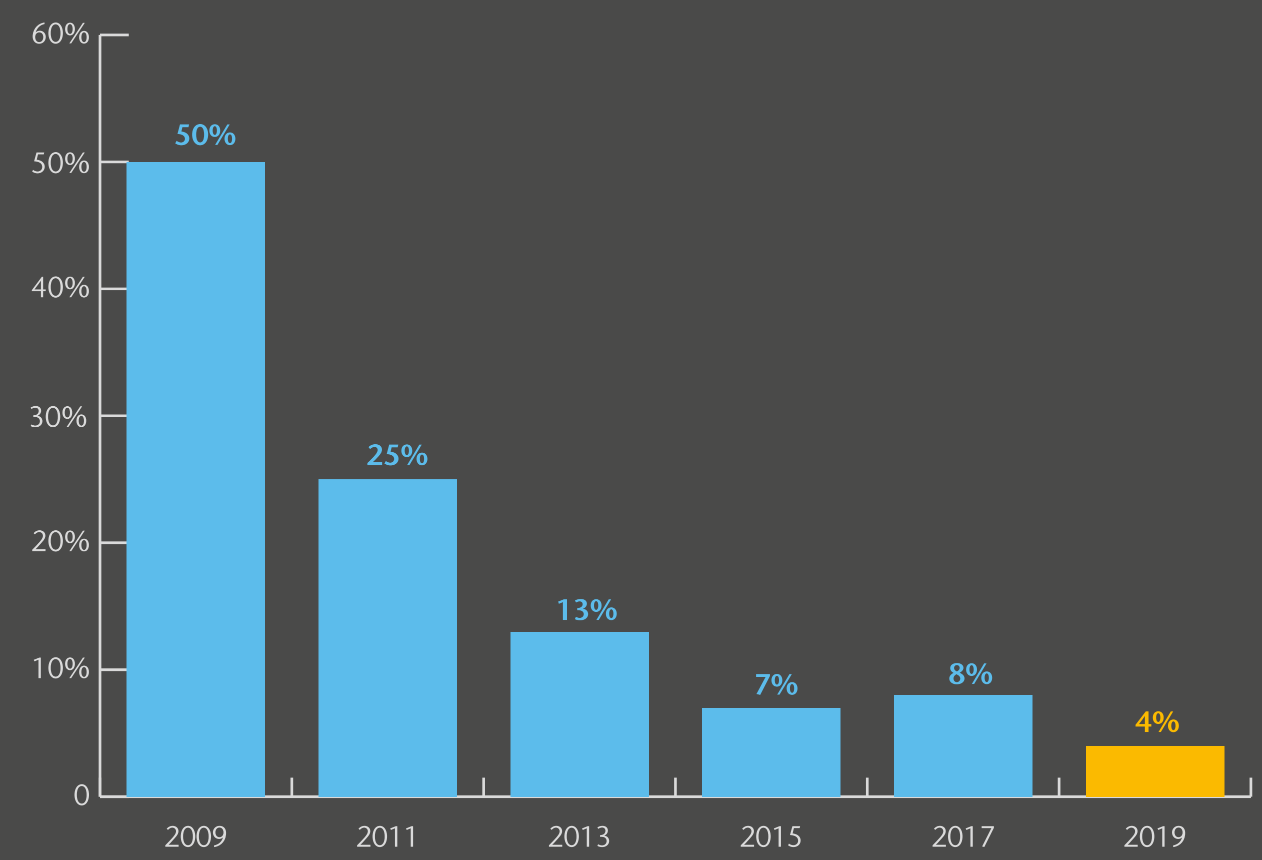
Long-term objectives

Long-term objectives

In our risk survey, we explore the long-term objectives plan sponsors have for their pension plans, including strategies and how robust they are, the time frame for these objectives, and determining factors impacting these objectives.

One very clear trend that we find over the last 10 years is that plan sponsors are no longer operating without a long-term objective. In 2009, half of sponsors did not employ one compared to nearly all sponsors that subscribe to one today. What this tells us is that operating in alignment with the overall objective is key and sponsors recognize that they are certainly remiss without one.

Proportion of plan sponsors without a long-term objective



Key findings

46% reduction of plan sponsors without a long-term objective

Sustainability identified as the lead strategy for reaching long-term goals

23% increase among **public plans** preferring sustainability

Additional strategies identified for private sector plans

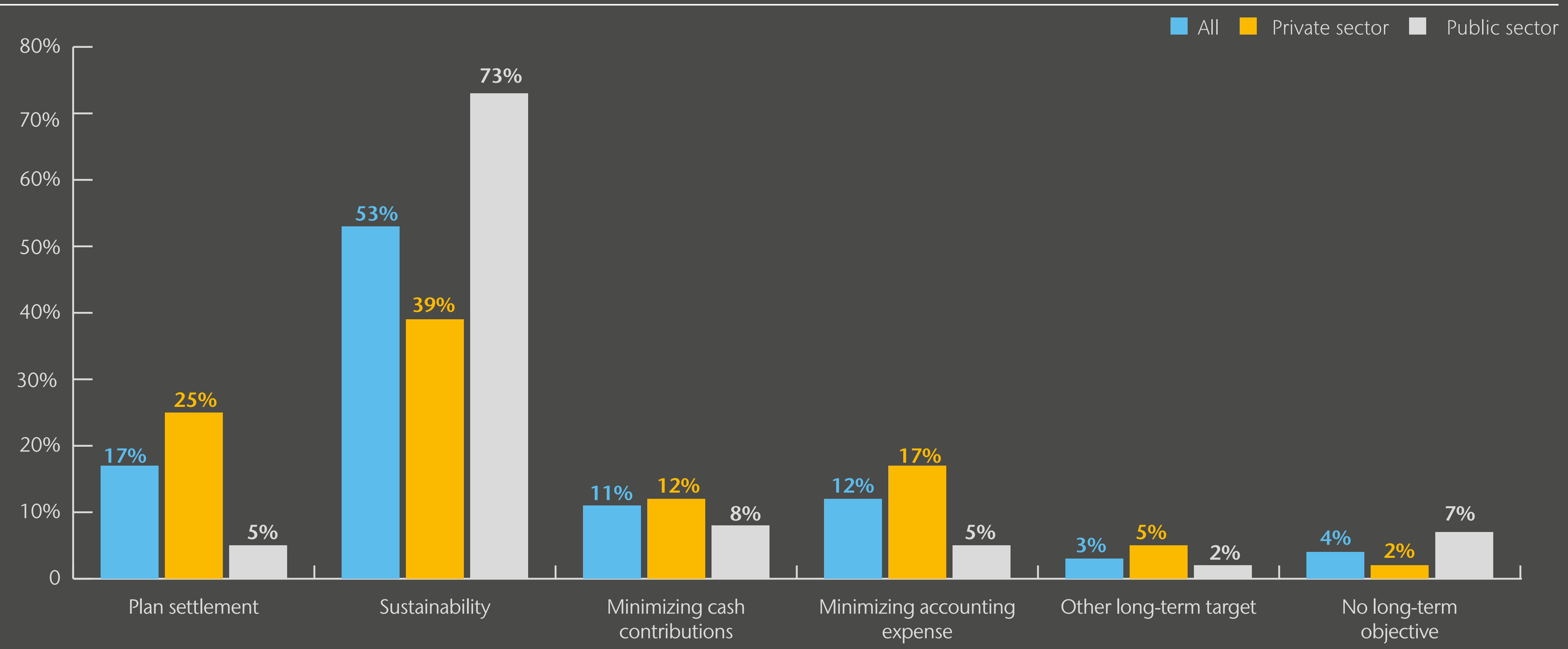
Plan settlement | Minimizing accounting expense

2/3 of sponsors describe their long-term strategy as robust or basic

Sponsors with a long-term plan identify sustainability (i.e., having an affordable level of contributions with low volatility) as their lead strategy in reaching their long-term goals (53%). And, this is no different when we look at the responses across both sectors: private (39%) and public (73%). Where we see a marked difference in the responses from the two sectors is when it comes to plan settlement and minimizing accounting expense. These long-term strategies are of little interest in the public sector where the emphasis is clearly on sustainability. In the private sector, however, plan settlement is a more common strategy, typically associated with plans that have been closed for many years.

In comparison with past responses, a couple of major movements that become apparent include: a significant drop among those are pursuing another long-term target (20% in 2017 vs. 3% in 2019) and a jump among public sector sponsors who say sustainability is their preferred choice (50% in 2017 vs. 73% in 2019).

Long-term strategy



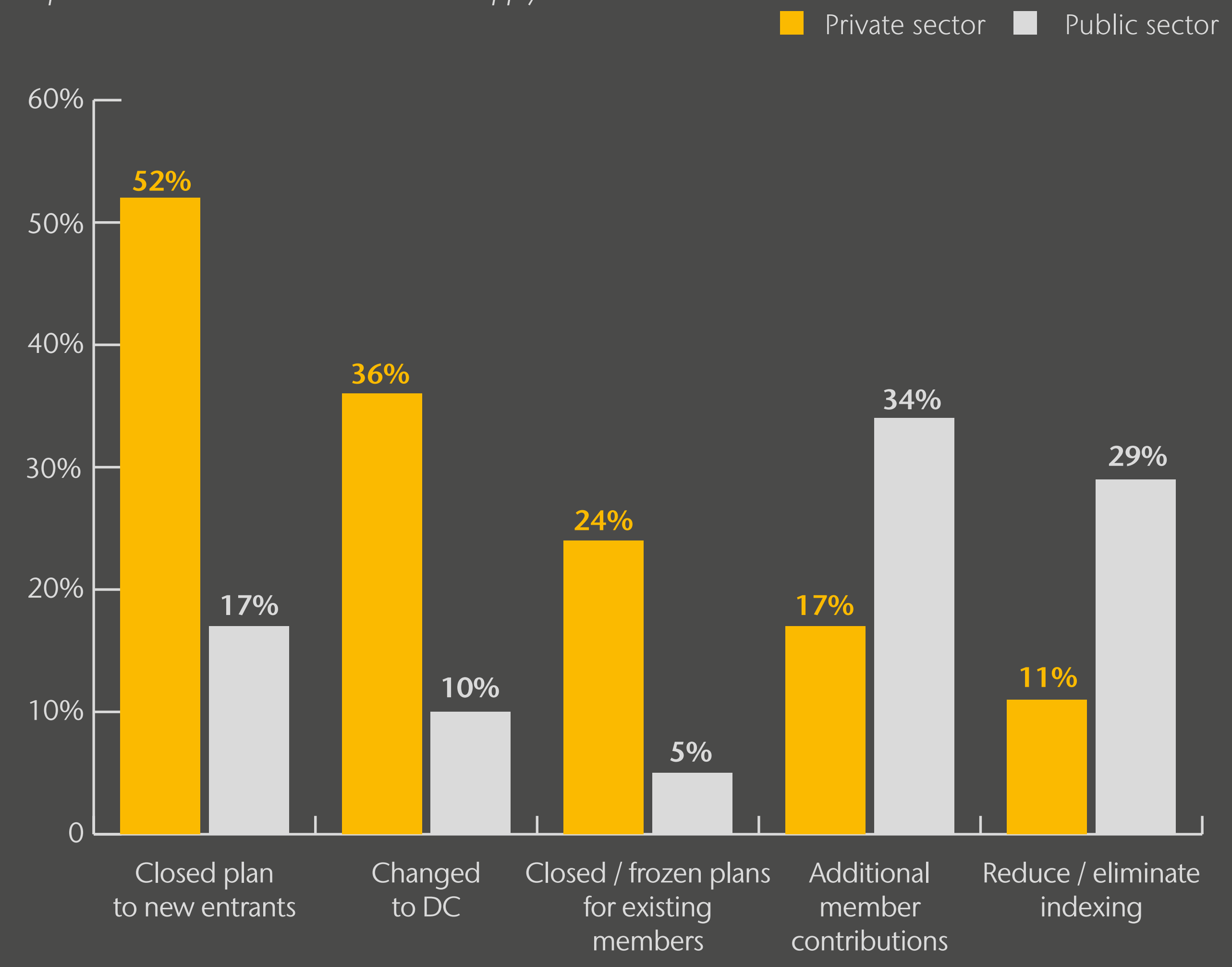
Managing benefits and liabilities

Managing benefits and liabilities

The gap in public versus private sector responses is maybe most apparent in their approach to managing pension plan benefits. While there is nothing wildly different between the 2019 and 2017 responses for each sector, we note a few not-so-subtle shifts that have taken place in the public sector, such as additional member contributions (23% increase), reduced pension benefit levels (13% increase) and changing to DC (6% increase).

Key benefit management actions

Respondents were asked to select all that apply.



Key findings

Difference in approach to managing plan benefits very apparent between **private and public sector plans**

Private sector | Public sector

Completed steps

Closing / freezing plans for existing members

24% | 5%

Reducing / eliminating indexing

11% | 29%

Forward-looking steps

Closing plans to new entrants

14% | 3%

Moving to DC plan

15% | 3%

Reducing / eliminating indexing

4% | 19%

Managing risks in the DB and DC world

Over the last decade, our risk survey findings show that the move away from DB to other types, such as DC / CAPs, remains a top strategy for managing pension risk. While this helps plan sponsors, particularly when it comes to cost volatility, sponsors face other risks that come with this change. In our study of CAP members we found that many Canadian CAP members are delaying retirement, and it seems that is because they cannot afford to retire earlier.

If these trends continue, employers can face negative implications for the workforce, such as reduced career advancement opportunities for mid-level employees and higher benefit costs for older employees. And "an even more fundamental issue[:] the lack of planning and knowledge around retirement savings and income — which is a big call to action for employers, who need to do more to educate members, provide access to financial services and equip them with holistic strategies for retirement readiness." *Rosalind Gilbert, Associate Partner in Aon's Retirement Practice.*

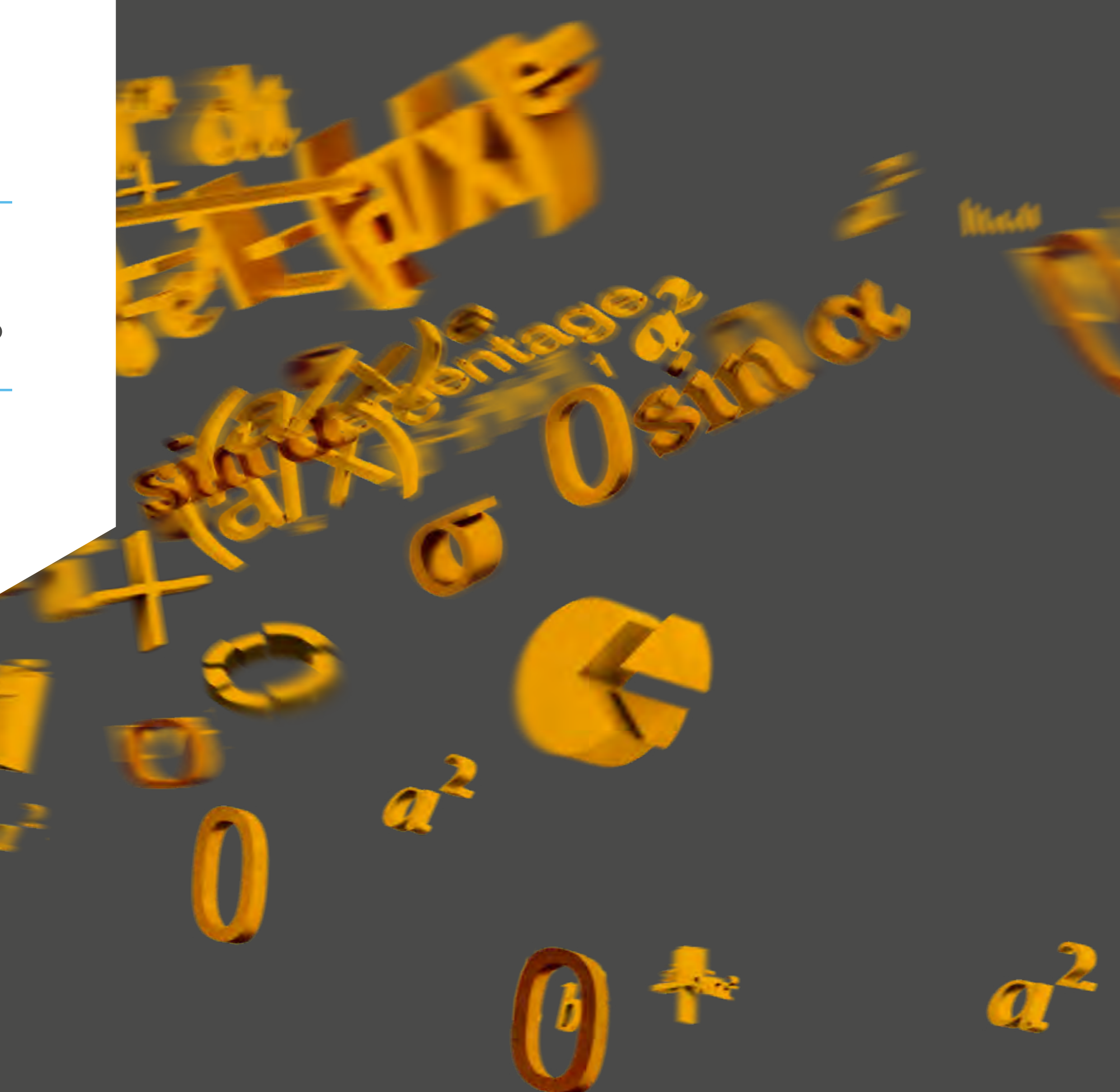
Find out more: 2018 Global DC and Financial Wellbeing Employee Survey — Canada

30% do not think they will ever reach full retirement

27% expect to fully retire over the age of 67

54% are concerned about not having enough to retire when they want to

51% are worried about outliving their savings



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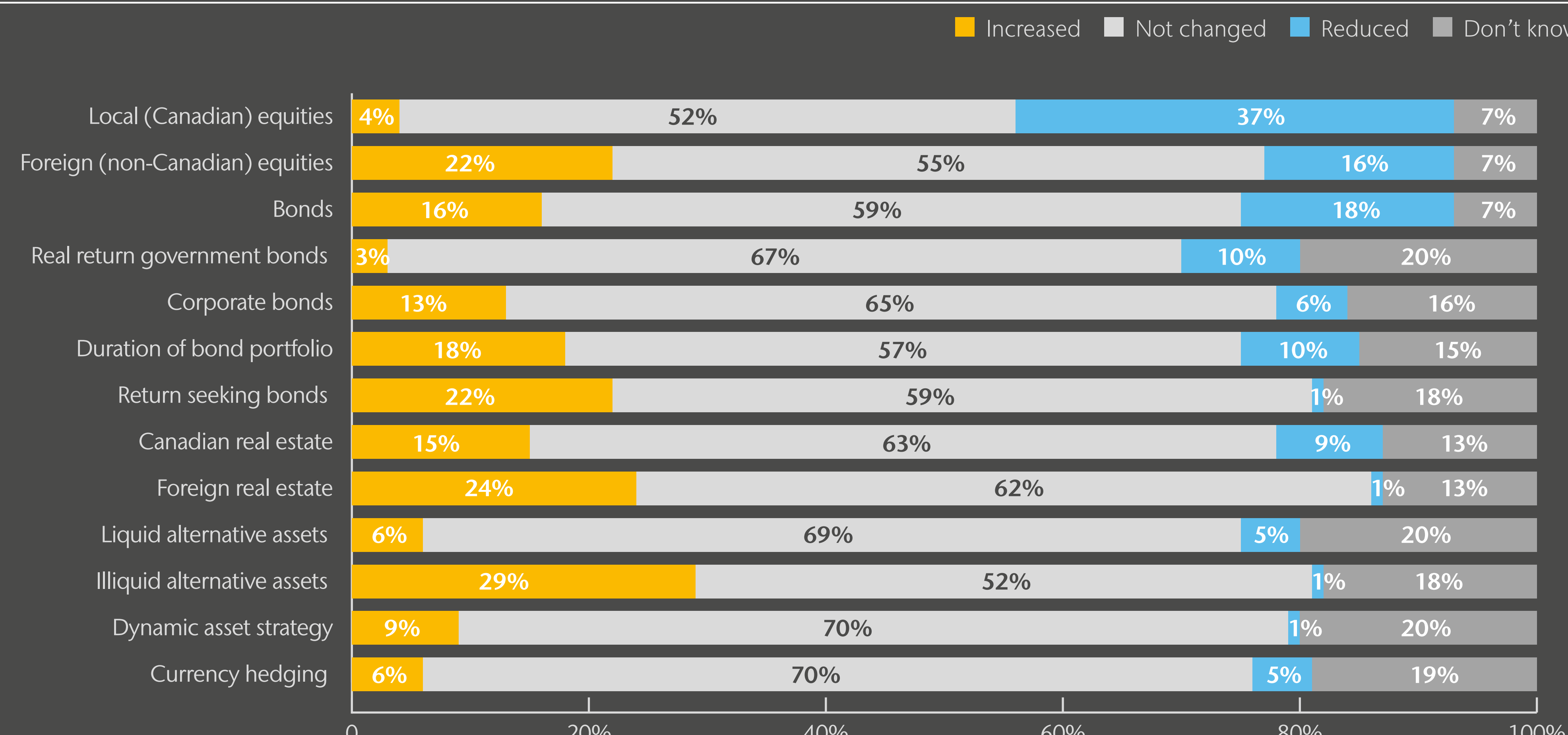
Investment strategy

Investment strategy

Trending with previous years, sponsors remain deeply committed to diversifying their investment portfolio and striving towards better choices to ultimately reach higher standards.

At the time when the survey was conducted, solvency positions of Canadian defined benefit plans had plunged after reaching all-time highs throughout the year. The sour mood that gripped financial markets in late 2018 did not leave Canadian pension plans unaffected. Sponsors, no doubt, were wanting stronger diversification as a way to better protect their portfolios. With this, key shifts in portfolios over the past 12 months include a move away from traditional asset classes and towards alternatives, particularly foreign equities, real estate and illiquid alternatives (such as private equity, private debt, infrastructure, and other real assets). The low interest rate environment has also left some plan sponsors seeking strategies to reach better and decent returns as we find a willingness to take on more credit in their fixed income portfolio. This portfolio positioning includes an increase in exposure to return seeking bonds (22%) and corporate bonds (13%).

Investment strategy changes made in the last 12 months



Key findings

A move away from **traditional asset classes** → Towards **alternative asset classes**

22% increased exposure to return seeking bonds

13% increased exposure to corporate bonds

In the next 12 months sponsors to continue increasing exposure to:

Illiquid assets | **Foreign real estate** | **Return seeking bonds**

More than 1/2 of respondents who are not increasing illiquid allocation already have a high allocation

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Delegating investment decisions

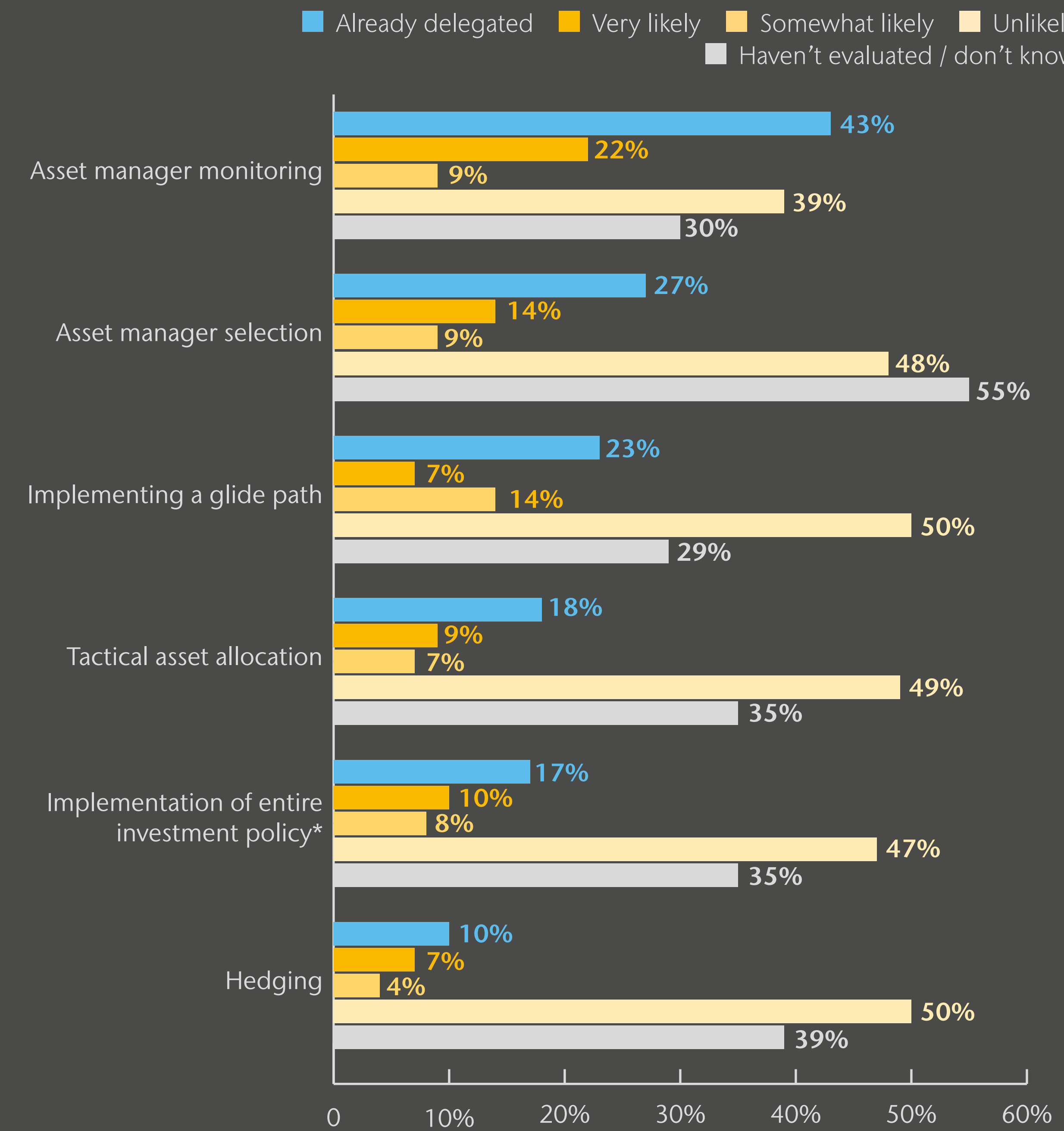
Delegating investment decisions

With layers of complexity in the markets and sophisticated investment solutions, it's unsurprising that sponsors are turning to these solutions and delegating a few, if not all, investment functions over to an external provider. The numbers remain strong showing that there is still an appetite to delegate investment decisions. Yet, we are observing a soft trend among sponsors in scaling back on these decisions since 2017.

The interest in moving forward with these decisions follows an upward trajectory from 2017 except for modest drops in implementing a glide path, tactical asset allocation and hedging.

Delegation of investment decisions

Respondents were asked to select all that apply.



*The implementation of an entire investment policy may sometimes be referred to as Outsourced CIO (OCIO) and includes asset manager monitoring and selection, tactical asset allocation, hedging, liquidity management, rebalancing, and dynamic policy execution (if applicable).

Key findings

Interest in delegating investment decisions **continues to increase**

Private and public sector sponsors share a similar approach to delegation

Current delegation of glide path implementation

Private sector
27%

Public sector
17%

Click for more depth

Click for more depth

Delegated investment solutions

In the current environment of volatility, traditional solutions for investment strategy, plan design, and governance no longer meet the needs of many organizations. Plan sponsors need an experienced partner to help mitigate risks and effectively execute investment strategies. Delegated Investment Solutions allow pension plan sponsors to delegate the day-to-day investment decision-making and implementation to a third party. For example, as of March 31, 2019, the Aon's Delegated Investment Solutions business reached $151 billion (USD) in assets under management (AUM) across 10 countries, including Canada.

Aon's Delegated Investment Solutions

AUM: $151 billion (USD)

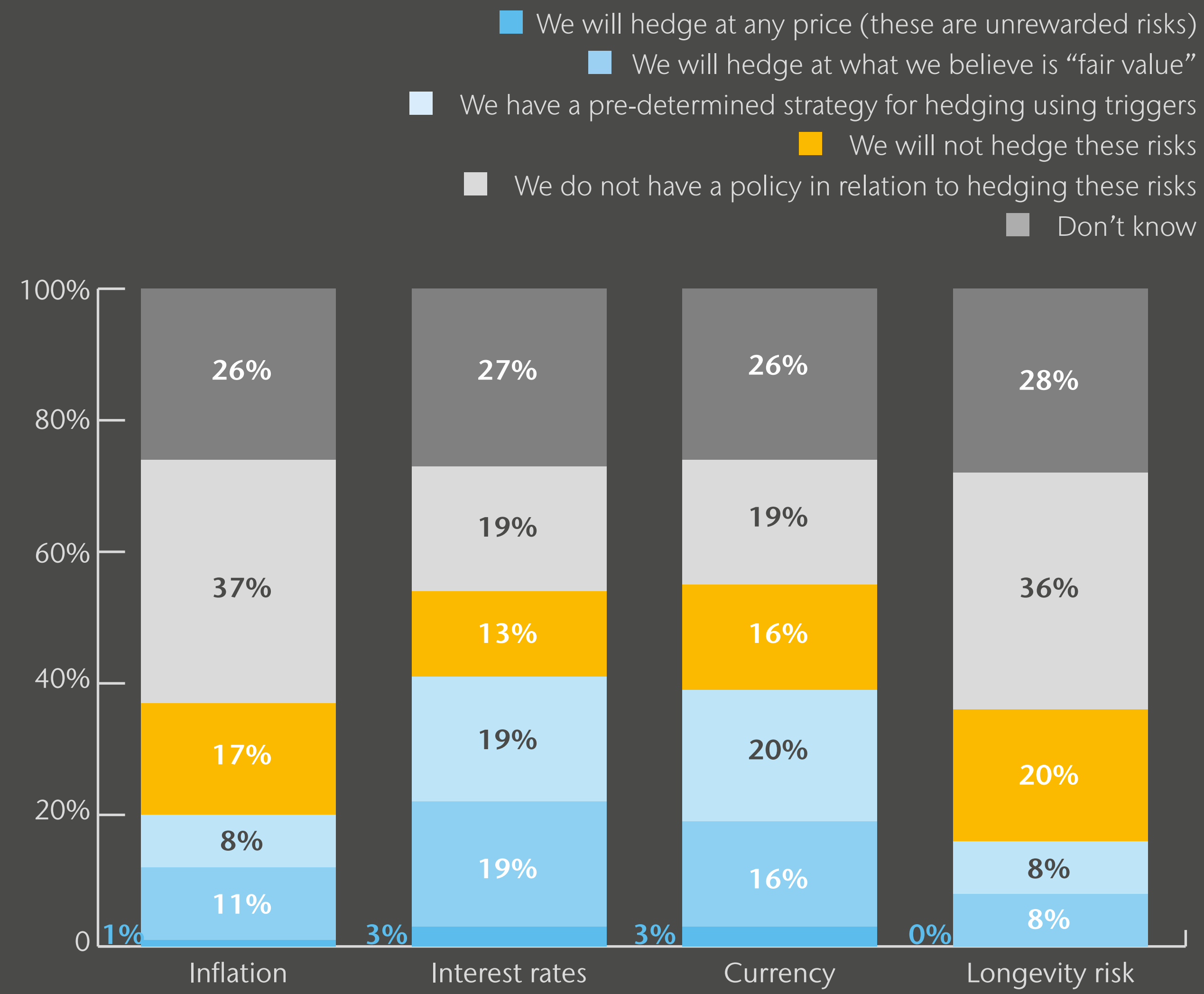
Across 10 countries

Hedging pension risk

Hedging pension risk

Consistent with 2017 results, we find a cost threshold exists beyond which sponsors are not willing to hedge pension risks. The most notable change in attitudes since the last survey is with respect to those who stated they will not hedge their risks. The proportion not willing to hedge has come down in all four risk categories, with three of the four categories (inflation, interest rates, currency) showing reductions of 6% or more. This is an important shift in attitudes which, if it continues in the future, will result in more time and effort spent on developing appropriate hedging policies.

Attitudes toward hedging pension plan risk



Key findings

Proportion of sponsors not willing to hedge has **reduced across all four risk categories since 2017**

3 out of 4 risk categories show **reductions of 6% or more** to proportion unwilling to hedge

45% measure their own mortality experience

48% do not adjust mortality assumptions based on own mortality experience

32% **of public sector plans** use trigger-based hedging strategies for currency

Focus on longevity

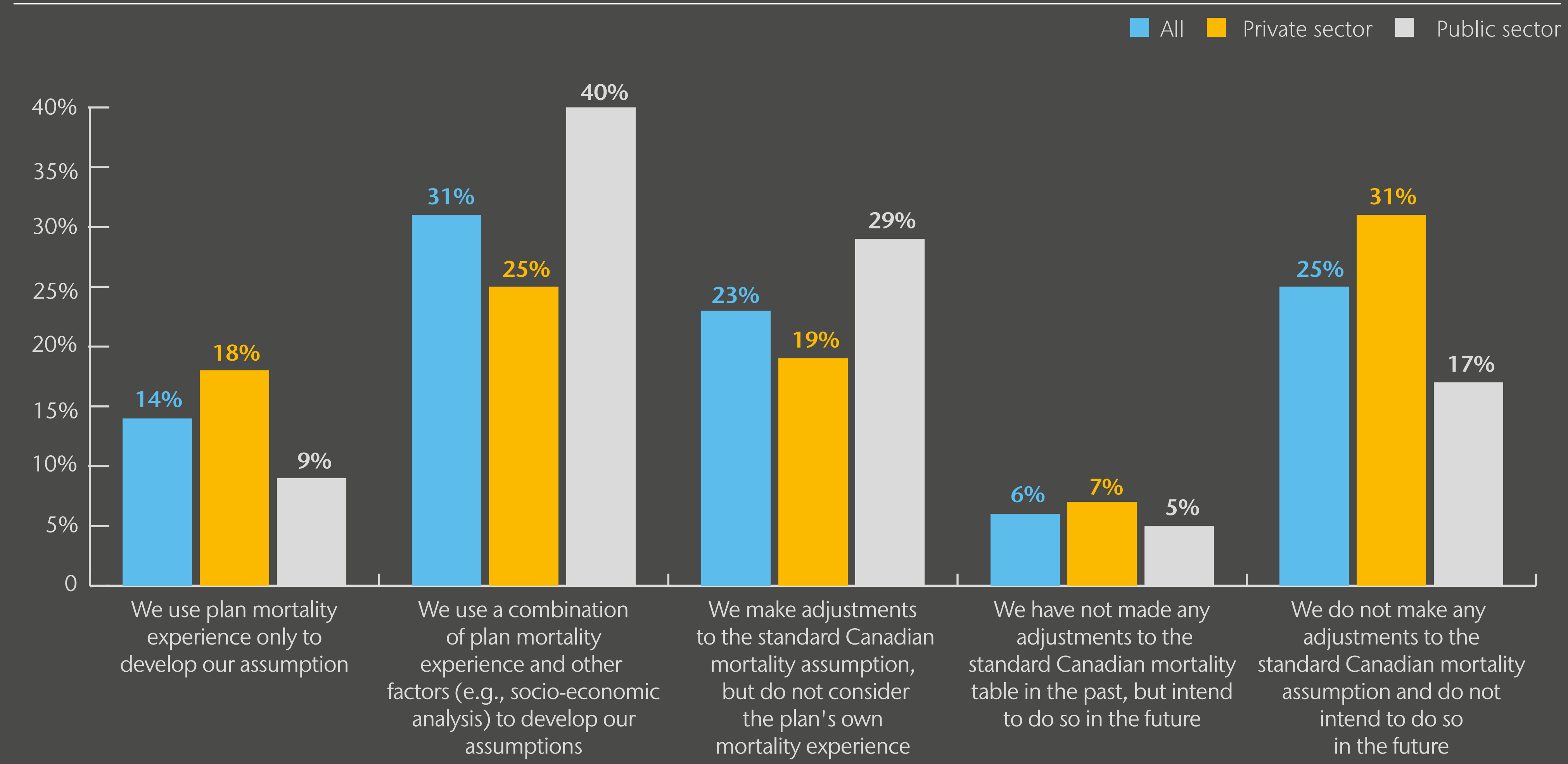
Since the 2017 survey, the Canadian Institute of Actuaries (CIA) published their Task Force Report on Mortality Improvement regarding expected improvements in life expectancy. The report includes a new mortality improvement assumption (known as MI-2017) that is based on recent Canadian data and revised expectations of what long-term mortality improvements may be. In December 2017, the CIA also released an Educational Note on the selection of mortality assumptions for pension plan valuations. The guidance provided by the CIA is that given the recent nature of both studies either the old (CPM-B) or the new (MI-2017) scale may be used.

The release of MI-2017 combined with continued innovations in measuring the current mortality characteristics of DB plans have put longevity risk squarely on the agenda of DB plan sponsors across the country. Pension committees are considering the merits of the two scales in order to select one that is consistent with the circumstances of their own plan and their funding philosophy. Now there are additional considerations with respect to the long-term rate of longevity improvement and the sensitivity of a plan's costs to variations in this more subjective assumption. These developments have had a significant influence on the frequency and nature of discussions regarding longevity risk. Whether DB plan sponsors are intending to settle their plan liabilities or are working towards long-term sustainability, the robust measurement and management of longevity risk is of equal importance.

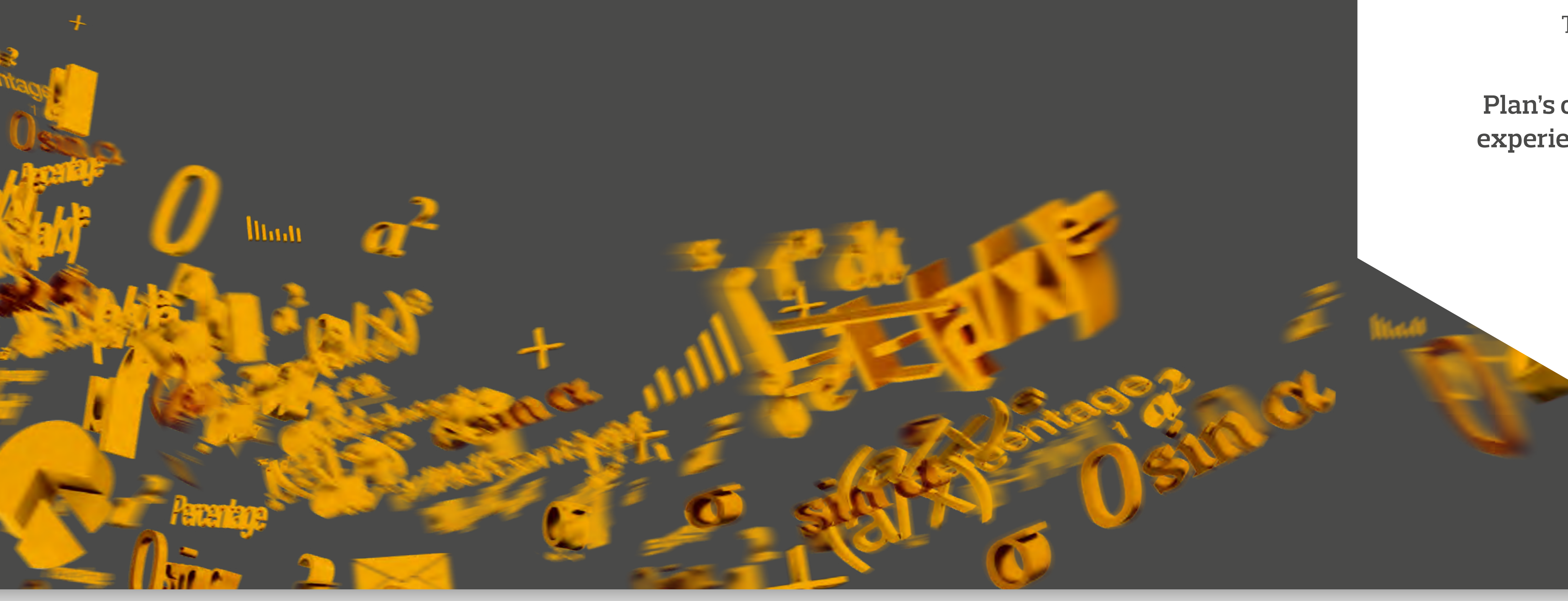
When we compare the attitudes toward hedging longevity risk revealed in the 2017 and 2019 surveys, we see there has been little movement with respect to establishing formal hedging plans. While the number saying they will not hedge longevity risk has decreased from 23% to 20% this year, there was also a drop in those reporting that they will hedge this risk, moving down from 21% to 16%. These trends are the same whether considering just private sector plan sponsors or public sector sponsors.

We anticipate that things will have changed by the time the next survey is conducted. By then, enough time will have gone by that plans will have had at least one actuarial valuation since the release of MI-2017 and will start turning their attention from current mortality assumptions to the uncertainty inherent in future assumptions.

Approaches for setting the mortality assumption



A large proportion (45%) of plan sponsors now measure their own mortality experience to develop plan-specific mortality tables. The largest plans have sufficiently-sized retiree populations that they can develop tables based entirely on their own mortality experience; 14% of survey respondents indicated this is the methodology they employ. Most plan sponsors do not have enough plan mortality experience to develop a credible table based entirely on experience. In this case, they can supplement their own experience with socio-economic data such as is provided by the Aon Longevity Model (described to the right). 31% of survey respondents indicated this is the methodology they employ to develop their mortality assumptions. We consider best practice in setting mortality assumptions to include some reflection of a plan's own experience and retiree population, so it is surprising to see that 48% of respondents do not intend to follow this approach.



The Aon Longevity Model

As longevity remains a real concern among Canadians worried about outliving their retirement savings, plan sponsors are looking for more data points to help them manage this risk. The Aon Longevity Model combines plan experience with location-based data, one of the most reliable predictors of life expectancy, to provide sponsors better insights into their plans' longevity risk. First of its kind in Canada, this tool is in partnership with our Longevity Datapool Service to offer in-depth mortality and benchmarking data specific to the plan so that sponsors can make better decisions.

The Aon Longevity Model

Plan's own experience + **Socio-economic analysis** *(based on postal codes)*

Monitoring pension risk

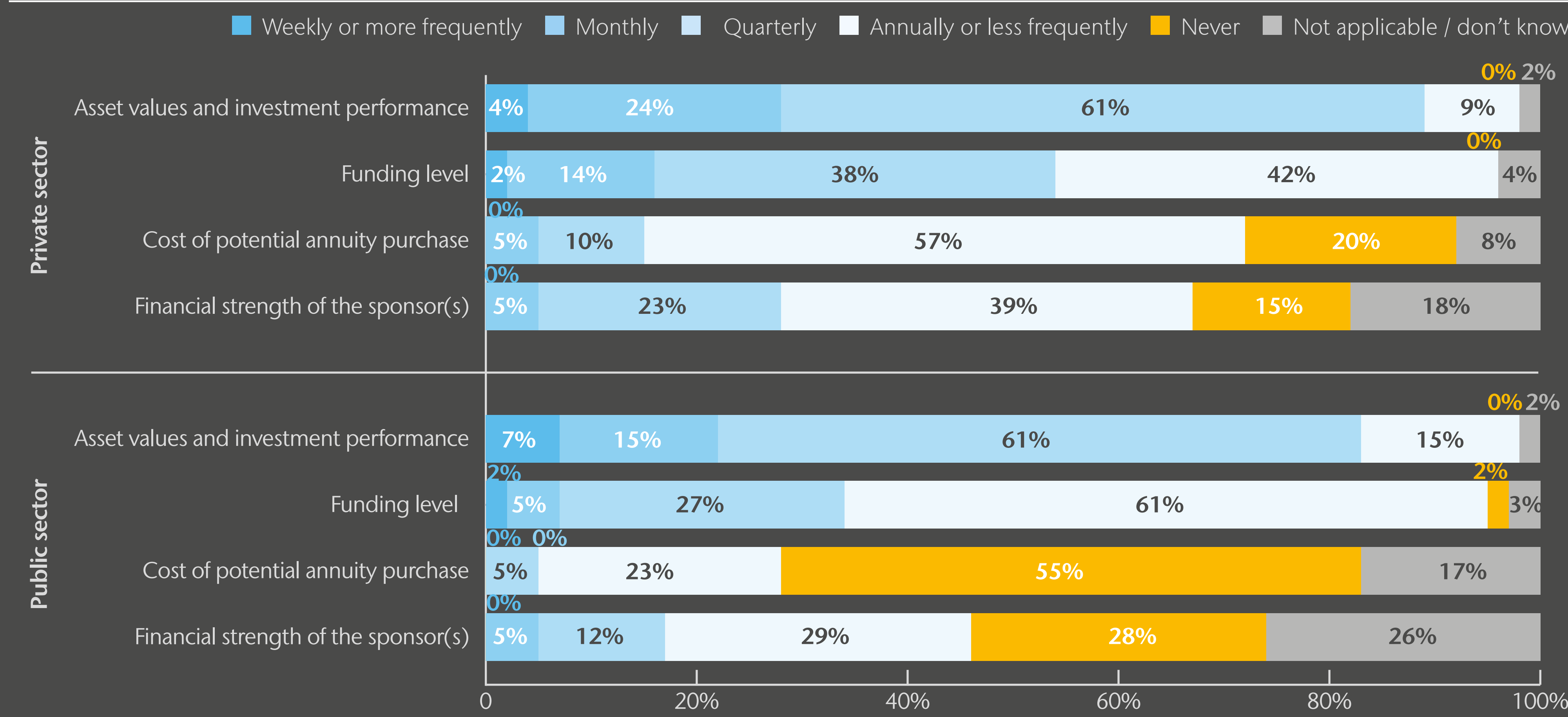
Monitoring pension risk

Monitoring practices

The 2019 survey takes a new approach to assessing pension risk monitoring practices by asking for the frequency of monitoring risks in four key areas. Not surprisingly, asset values and performance are monitored most frequently, with 25% monitoring them more frequently than quarterly. We were pleasantly surprised to see that 46% of respondents are monitoring their plan funding level on a quarterly or more frequent basis. Annual monitoring is still the most common practice, but we expect that this will change by the time the next survey is conducted.

It is not surprising to see that public sector sponsors are not monitoring annuity purchase costs. However, in the private sector we noted earlier that 26% of private sector sponsors are likely to pursue a buy-in or buy-out over the next 12–24 months. Clearly the level of monitoring in this area will need to increase for these sponsors if the volatility we saw in 2018 continues in the future. If not, the time to reach this goal will be extended or the sponsor will end up paying relatively more than was necessary.

Review practices for pension risk



Key findings

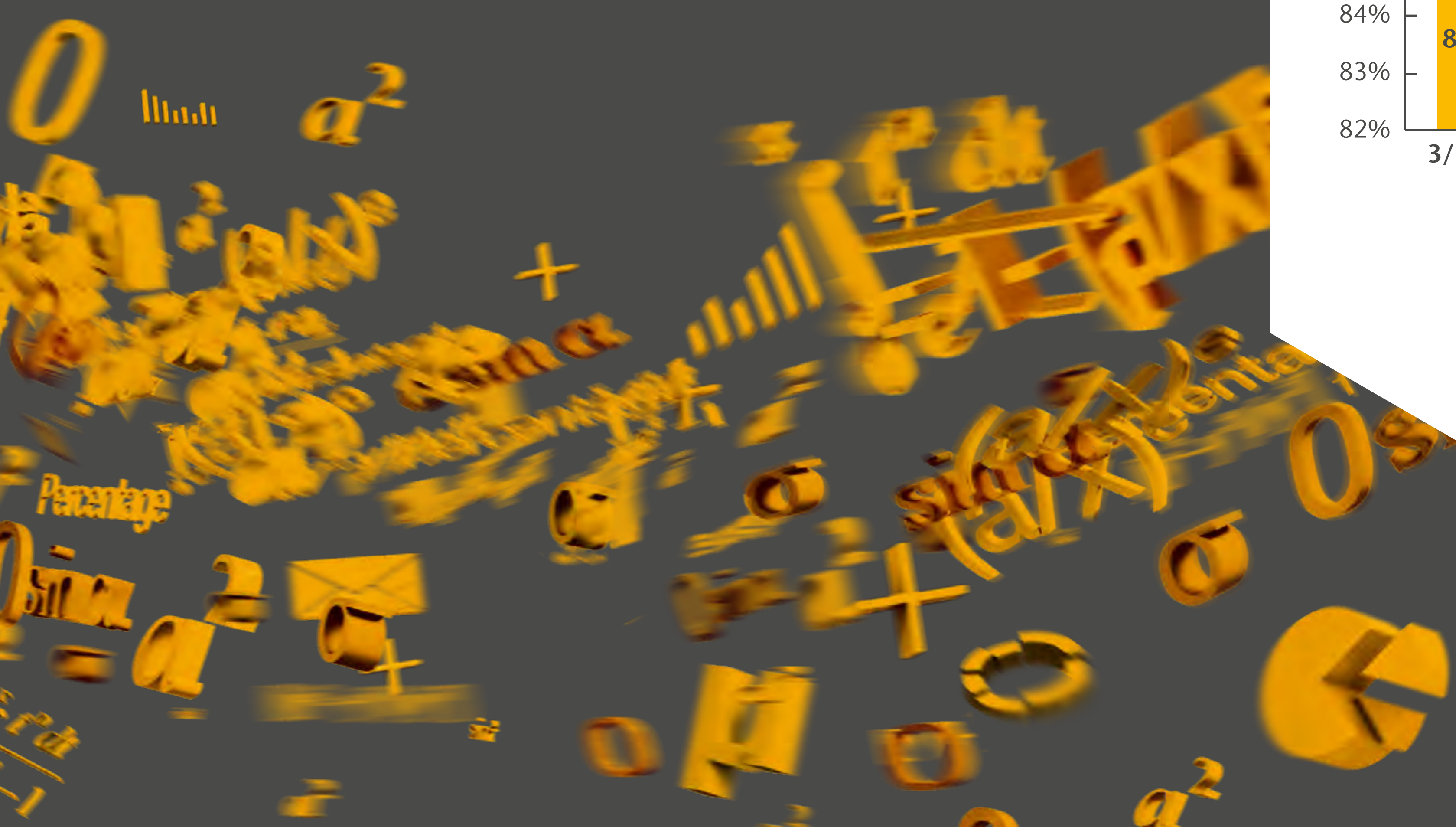
Most common
risk monitored
Asset values and performance

46%
monitor plan funding level on at least a quarterly basis

Annual monitoring
most common practice

28%
of private sector plans monitor the financial strength of sponsors on a regular basis

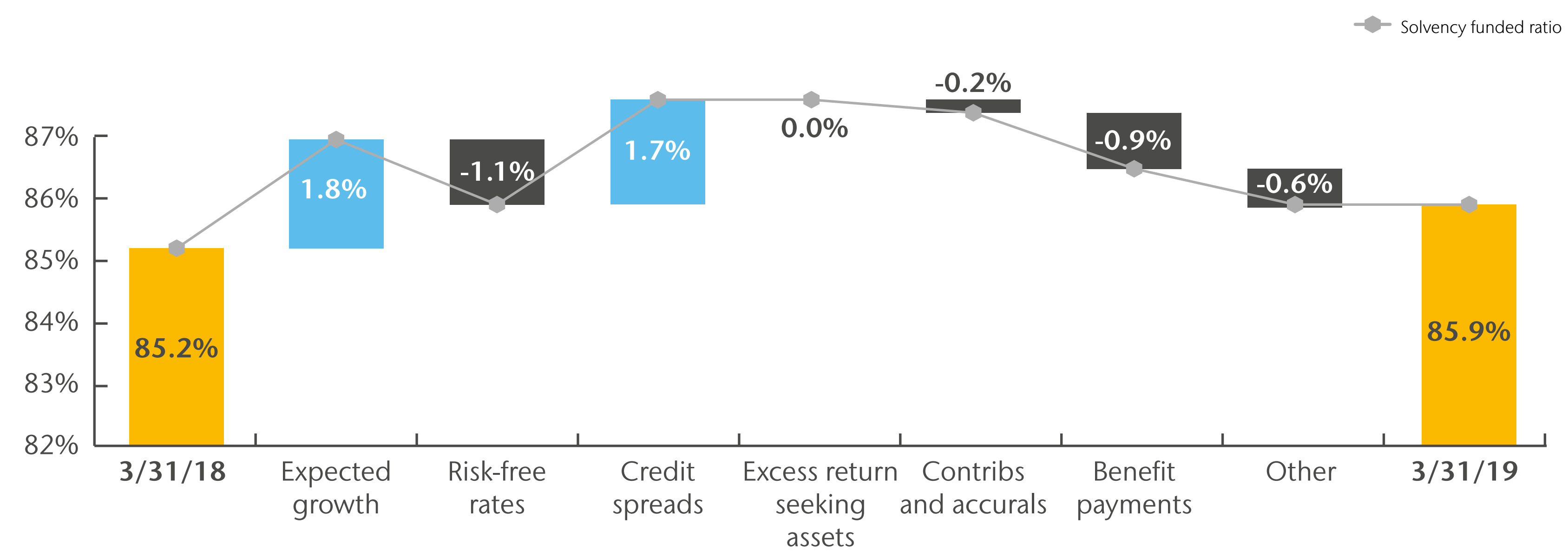
The financial strength of the plan sponsor(s) is an important factor when plans are wound up and have insufficient assets to pay the promised benefits. In the UK, the strength of the employer covenantis an important consideration in the level of funding required by a plan's trustees. While this isn't the same in Canada, there is more attention being paid to fate of pensioners when sponsors go bankrupt, so we wanted to find out whether financial strength is being monitored by plan sponsors. The responses show that in the private sector 28% of plans are monitoring the strength of the sponsor on a regular basis, which is easier for publicly traded employer sponsors than others. Even some public sector plans are monitoring sponsor financial strength.



Aon's Risk Analyzer

Today's volatile investment and valuation environment is challenging defined benefit plan sponsors to better monitor the financial risk of their programs. Aon's Risk Analyzer is a real-time pension financial and risk management tool. It strengthens sponsors' ability to manage funded status risk with integrated pension risk management functionality. Aon's Risk Analyzer tool combines the latest technology with actuarial and investment expertise to help plan sponsors holistically manage risk in their retirement plans.

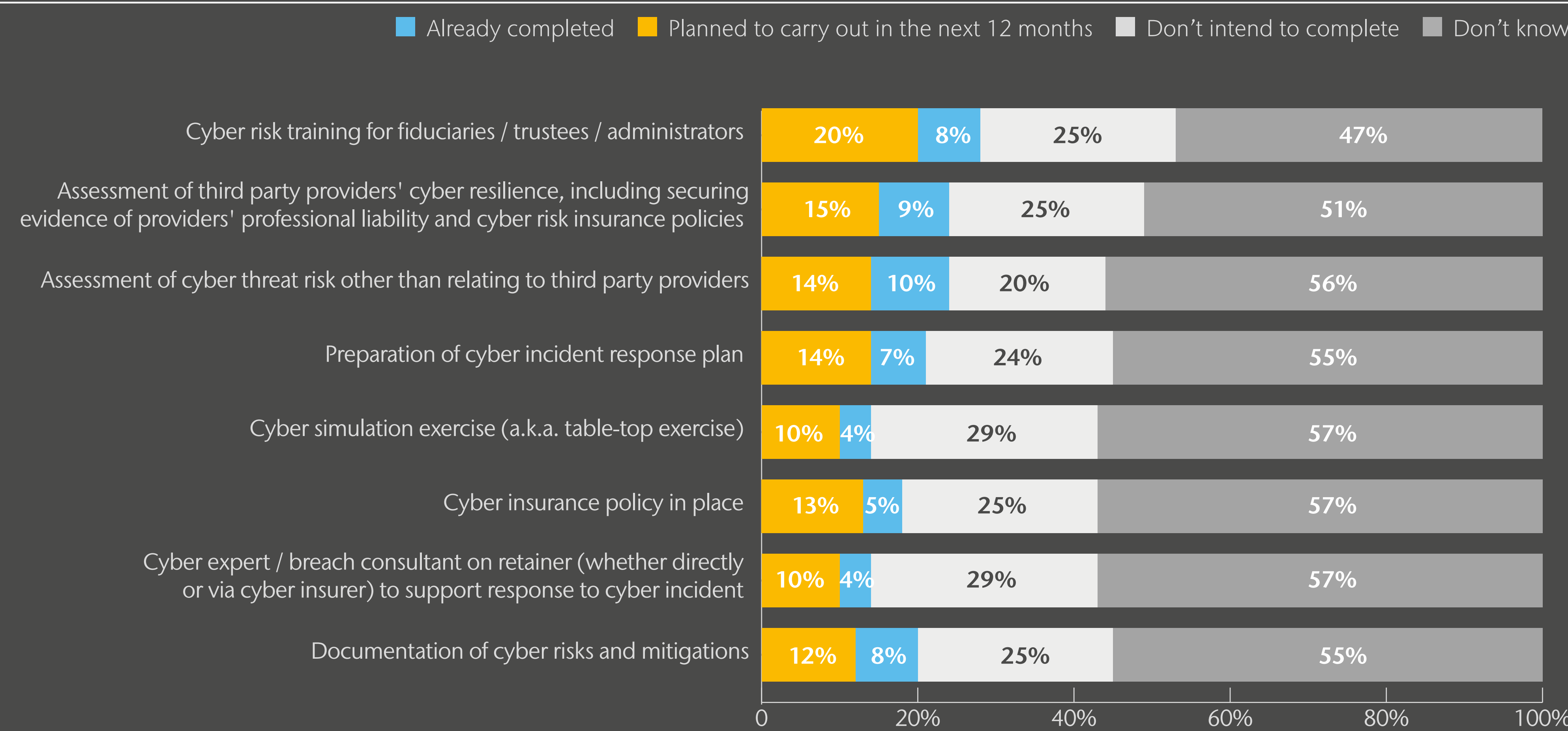
Find out more.



Cyber risk

Cyber risk

Cyber risk management protocols



Cyber risk is relatively unknown in the pensions world; only 1% of respondents indicated that their plan had experienced a cyber attack. As an emerging risk, it is an increasing threat to modern businesses and pension plans are not exempt from it either. Unsurprisingly, 9% did not know if they had experienced a cyber attack and half of sponsors report not knowing the protocols in place.

Very few respondents (12%) have documentation on cyber risks and mitigations in place and slightly more (15%) have conducted assessments of third party providers' cyber resilience. We find many plans have yet to take action and a sizeable number are not intending to act in the near future. Over the coming years we expect more plans to provide cyber risk training and develop policies setting out measures to help prevent cyber attacks and limit the damage should they occur.

Key findings

Only 1% had experienced a cyber attack

9% did not know if they had experienced a cyber attack

1/2 did not know the protocols in place

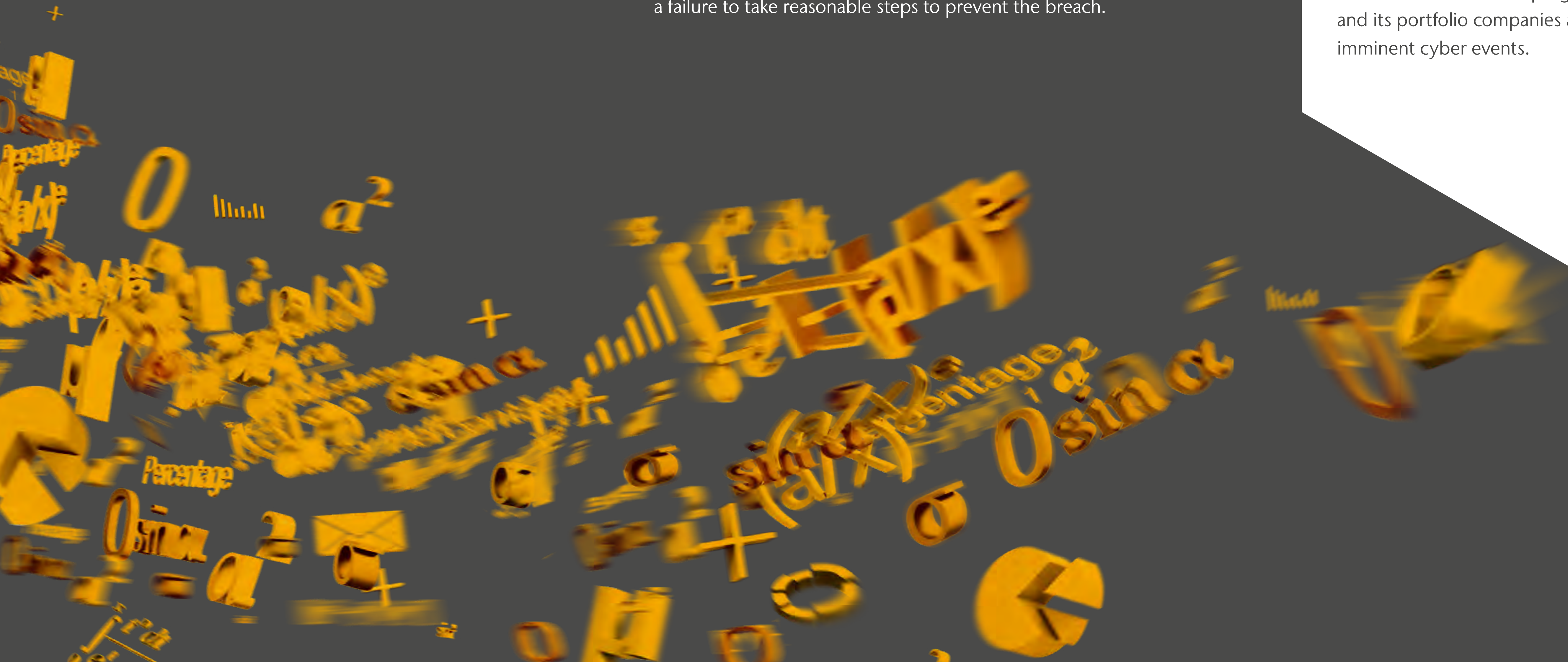
Only 12% have documentation of cyber risks and mitigations in place

Cyber risk

Adequately protecting a pension fund and its portfolio companies from cyber risks is also crucial to maintain plan member confidence in the fund and avoid the reputational damage that can arise following a cyber breach. In order to address cyber risk holistically, pension funds should be aware of the nature and severity of potential threats to their network security, understand their vulnerabilities, implement measures that allow them to transfer and store confidential information securely and ensure that all plan providers are doing the same. The exercise of understanding and quantifying cyber risk should be paired with a review of existing and available insurance programs to ensure that both the fund and its portfolio companies are able to respond and be resilient to imminent cyber events.

For pension funds, cyber risk can manifest in a breach of systems facilitating investment risk management, unauthorized access of confidential investment details or the unauthorized disclosure of beneficiaries' confidential information. In addition, many pension funds have another indirect cyber exposure through their existing and potential portfolio holdings, where a cyber breach could impact business operations and, as a result, the market valuation of the portfolio company and the fund's assets.

Pension funds will want to seriously consider this risk exposure, as the impact of a cyber breach can be far-reaching and go well beyond the initial costs of crisis management. A breach also has the potential to attract regulatory scrutiny and / or result in litigation. If a pension fund fails to protect confidential information and it is found that a pension fund manager did not exercise adequate care and / or due diligence to prevent the breach, the fund manager may be found to have breached his / her fiduciary duty and be liable for the losses. Where it is a fund's portfolio company that is the victim of a cyber breach, an action may be brought against the entity, individual directors, the board or the executive alleging a failure to take reasonable steps to prevent the breach.



Canadian developments

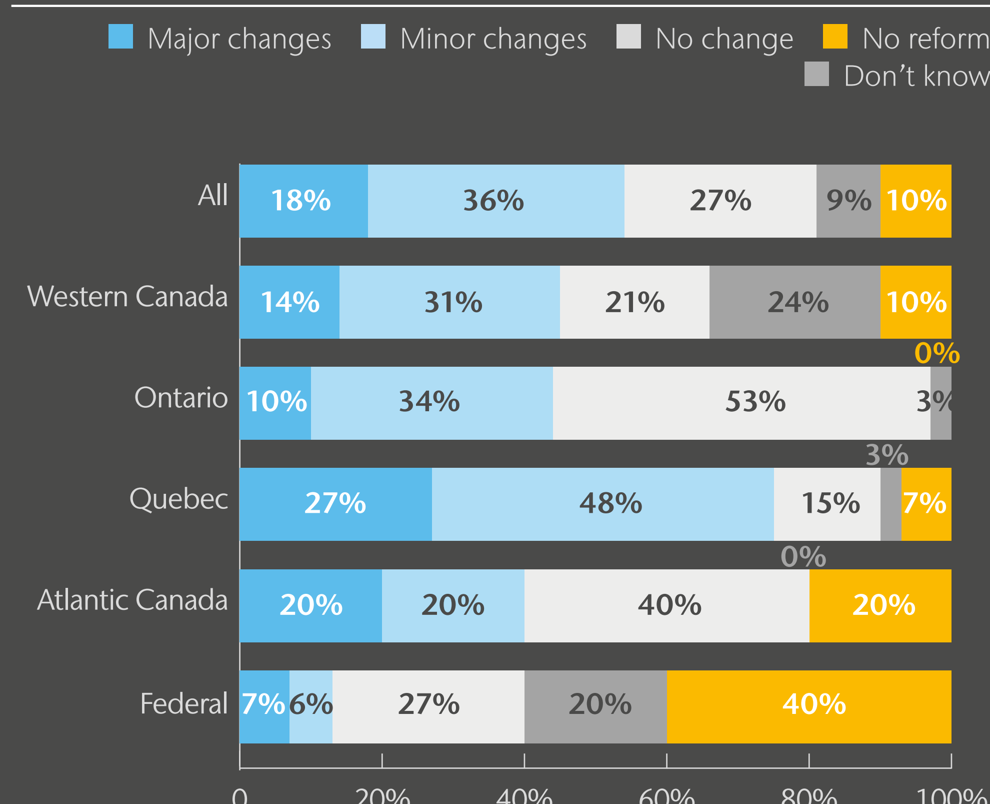
Canadian developments

Over the past years, Canada's provincial pension regulators have implemented important changes to pension plan funding rules for corporate plan sponsors. At the time of writing the 2017 report, Ontario had just proposed their changes, and as we write the 2019 report, BC has released their report on the stakeholder committee process on solvency funding review.

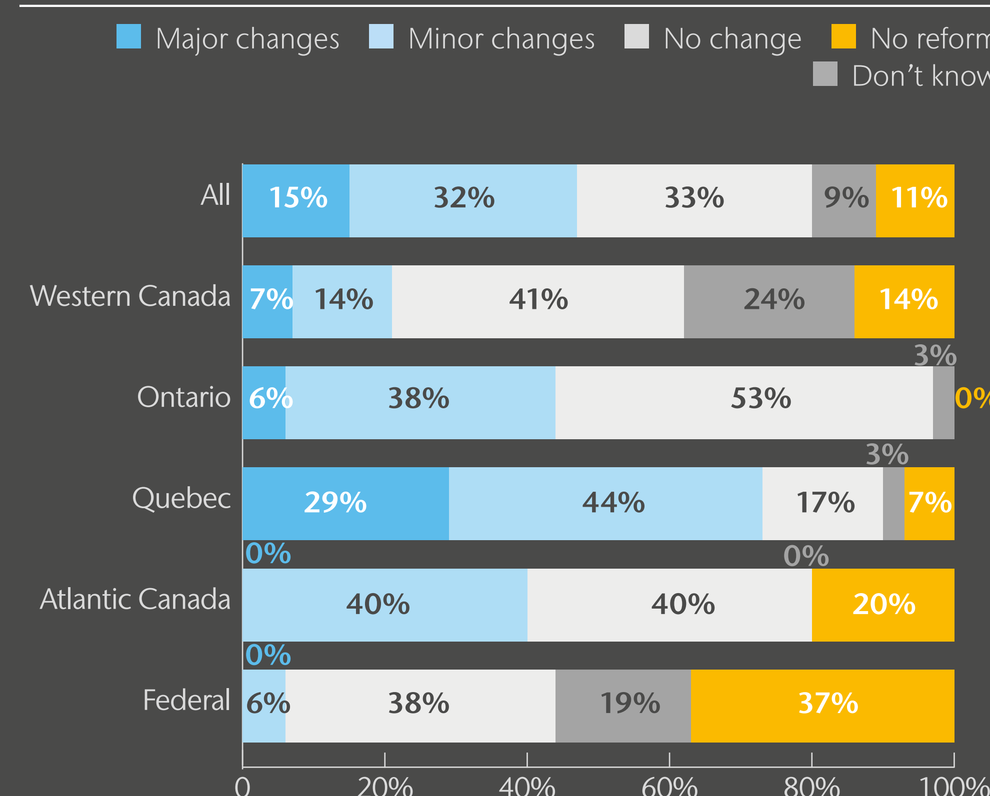
The reform adopted by the provinces of Quebec and Ontario essentially shifts the emphasis from solvency funding to going-concern funding. In doing so, the new funding legislation substantially reduces the volatility of pension plan funding contributions, an objective which many plan sponsors previously sought to achieve through their investment strategy (higher fixed income allocation, liability-hedging portfolio and risk reduction strategies are examples of prevalent investment strategies).

In the wake of these changes, the majority of Quebec sponsors intend to make changes on both fronts: 75% for funding strategy and 73% for investment strategy. Ontario sponsors are also assessing their strategies—44% for funding strategy and 44% for investment strategy. The Western provinces are at different stages with funding reform and have not received any definitive reform proposals to react to at the time the survey was being conducted.

Impact of pension reform on funding strategies by region



Impact of pension reform on investment strategies by region



Key findings

Quebec and Ontario reforms shift emphasis to going-concern funding

Intended changes based on reform

	Quebec	Ontario
Funding level	75%	44%
Investment strategy	73%	44%

Most common
investment strategy change

Increased allocation to alternative asset classes for diversification

Click for more depth

Click for more depth

Case studies

These new funding rules (Ontario and Quebec) have important ramifications on the investment strategy of many pension plans, such as adverse deviation having to be funded based on the pension plan asset allocation. In our work with plan sponsors in reviewing their investment strategy, we have found some choosing to re-risk on account of the new funding rules.

Case 1

The financial industry plan sponsor opted to rework the investment portfolio of the pension plan that was open to new entrants by adopting a strategy more aligned with the new rules where the going-concern basis favours an absolute return approach. The overall allocation to fixed income was significantly reduced and used to invest in alternative assets, especially real assets (real estate and infrastructure), which offer a greater return potential and better diversification. Bond portfolio duration was also adjusted downward given that interest rate risk management was less of an issue without the obligation to fund the solvency basis. The changes to the investment strategy enabled to improve the results of all risk / reward key financial criteria, including a reduction of about 13% of the financing cost for the next 10 years.

Case 2

The resources industry plan sponsor amended their dynamic risk-reduction strategy (“glide path”). Instead of the current linear glide path which increased the allocation to fixed income incrementally as the solvency funded ratio improved, the sponsor decided to initially re-risk and delay the risk reduction (increase the allocation to fixed income) once the plan was close to being fully funded, i.e., when the solvency ratio will reach 95%. The new strategy provides an expected return ~0.5% higher than before, which should help to improve the funding ratio in the coming years. This enhancement to the investment strategy was made possible as a result of reduced contribution volatility under the new funding rules.

Industry developments

As the pensions and investment industry continues to evolve, it’s not surprising that plan sponsors are constantly challenged to stay up to date on changes to pension legislation and regulation which can be time-sensitive and difficult to understand.

Aon’s Legislative Update (LegUp) offers retirement and pension plan sponsors an easy way to help keep apprised of industry developments that impact organizations. Our legal experts review the full range of pension industry developments and extract only those most critical to sponsors. Updates are provided that are tailored to sponsors’ unique needs by assessing the plans, jurisdiction, and industry to help ensure ongoing compliance. Each update explains how the issue concerns each sponsor’s retirement savings program and highlights key action items.

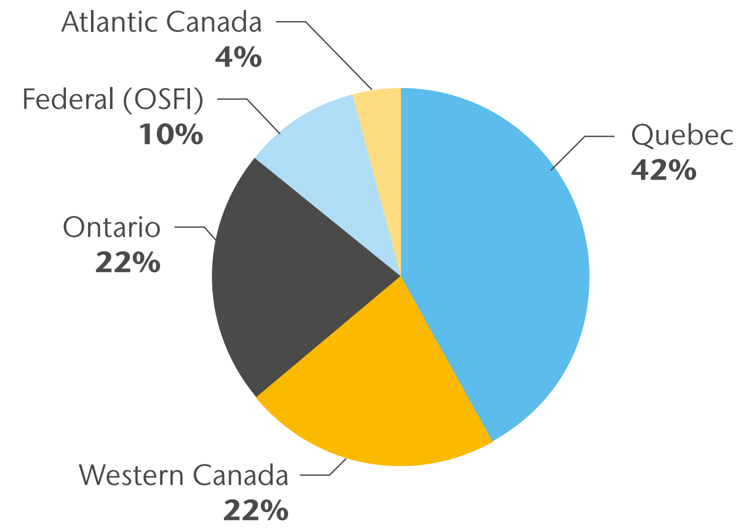
Find out more.

Executive summary

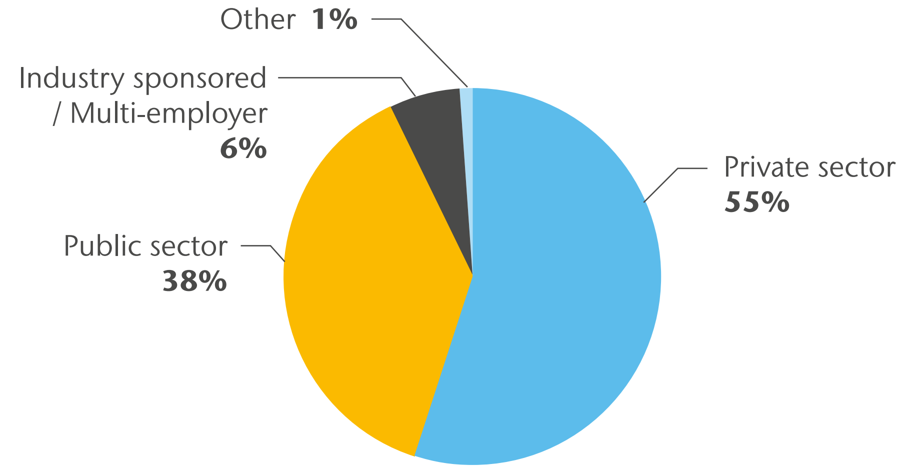
In more depth

The 2019 Global Pension Risk Survey was conducted in February in Canada. Our survey covers the responses of 150 organizations that offer a defined benefit pension plan to their employees. The respondents represent a cross-section of public and private sector organizations and plan size by membership and assets in Canada.

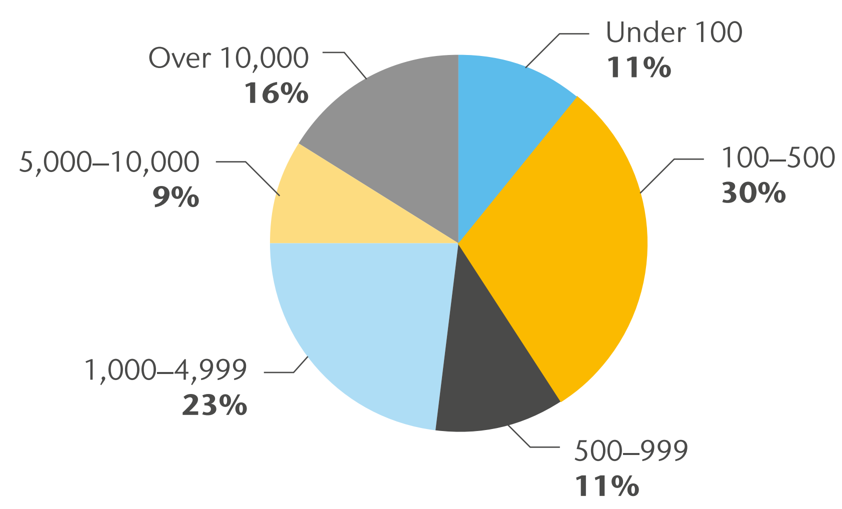
Jurisdiction of plan registration



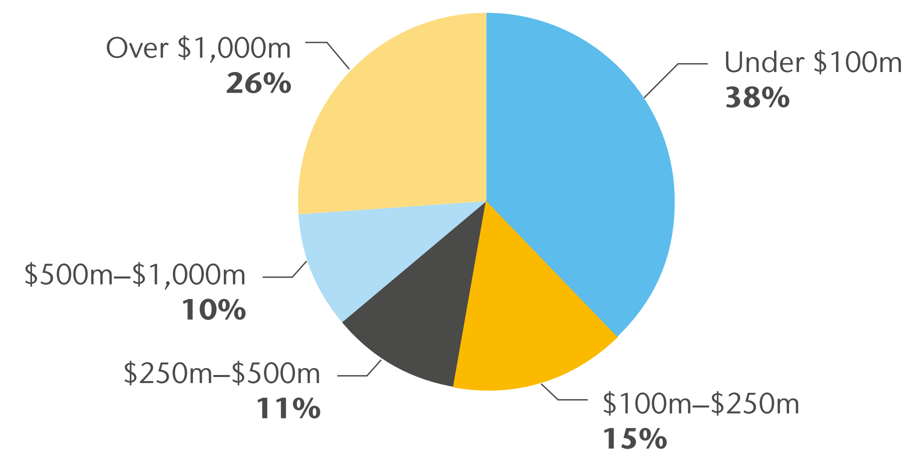
Business sector



Plan membership (actives and inactives)



Pension assets



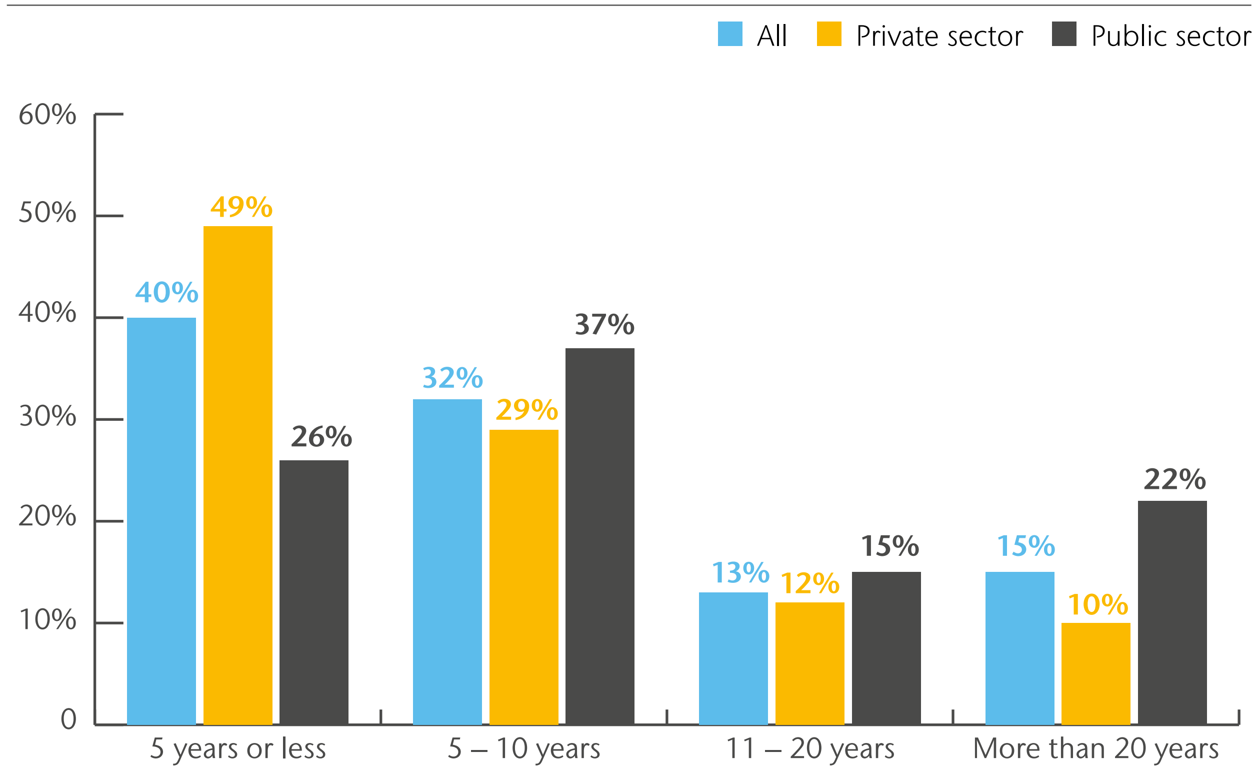
Long-term objectives

In more depth

Time horizons

When we look at the time frame within which sponsors anticipate reaching their long-term objective, we find a modest rise (an increase of 5%) on both ends of the spectrum — five years or less and over 20 years. This is consistent among private sector organizations (close to 5%); and for the longer time horizon among public sector organizations (an increase of 8%). The volatile market conditions at the end of 2018 may have driven sponsors to be more cautious about reaching their goal so quickly while private sector sponsors in Ontario and Quebec may feel more optimistic about reaching their goal faster with the changes to minimum funding requirements.

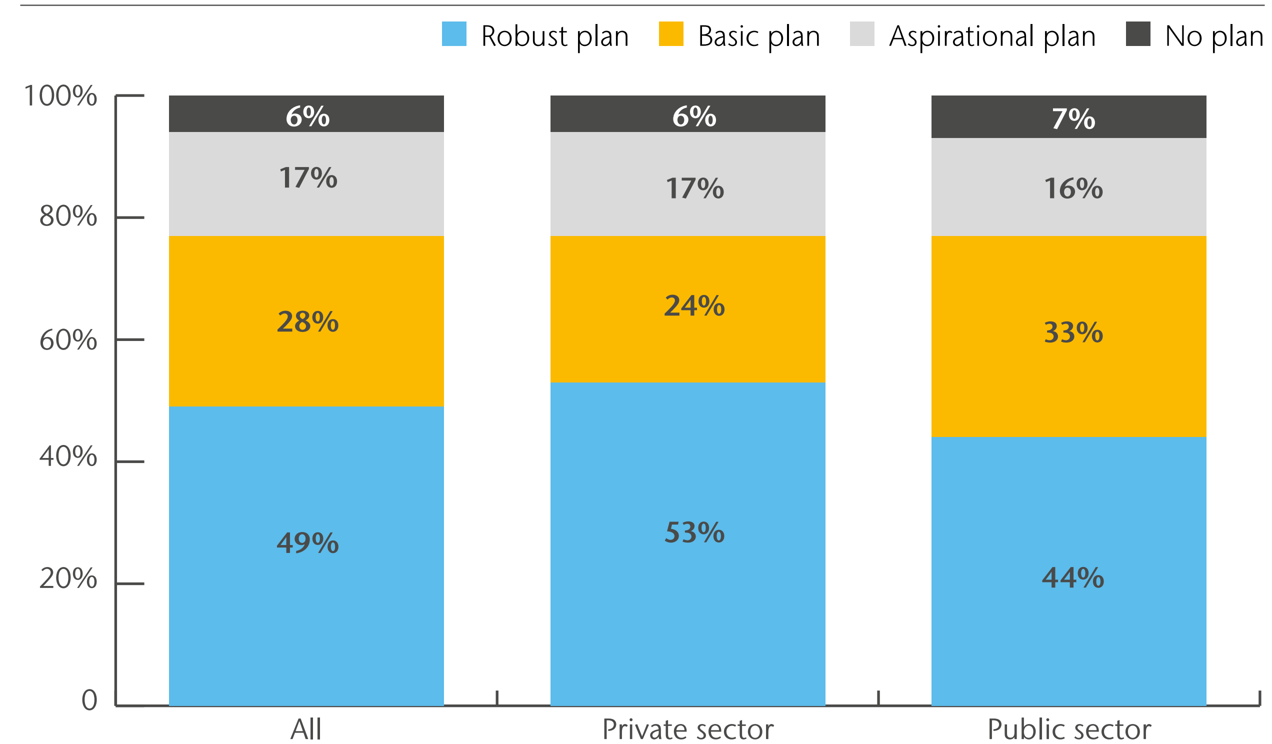
Time frame to reach long-term goal



Objectives

Overall, the 2019 results are consistent with those in 2017 and that two-thirds of plan sponsors describe their long-term strategy as robust or basic. The only departure from the 2017 trends is that more private sector sponsors have moved from an aspirational or no plan towards a robust plan (14% increase).

Plan sponsors' description of their long-term strategy



- **Robust plan** is one which is documented and is the process of being executed
- **Basic plan** is one which has the intent documented and the plan is being finalized
- **Aspirational plan** is one which has the intent documented but work has not started on the plan

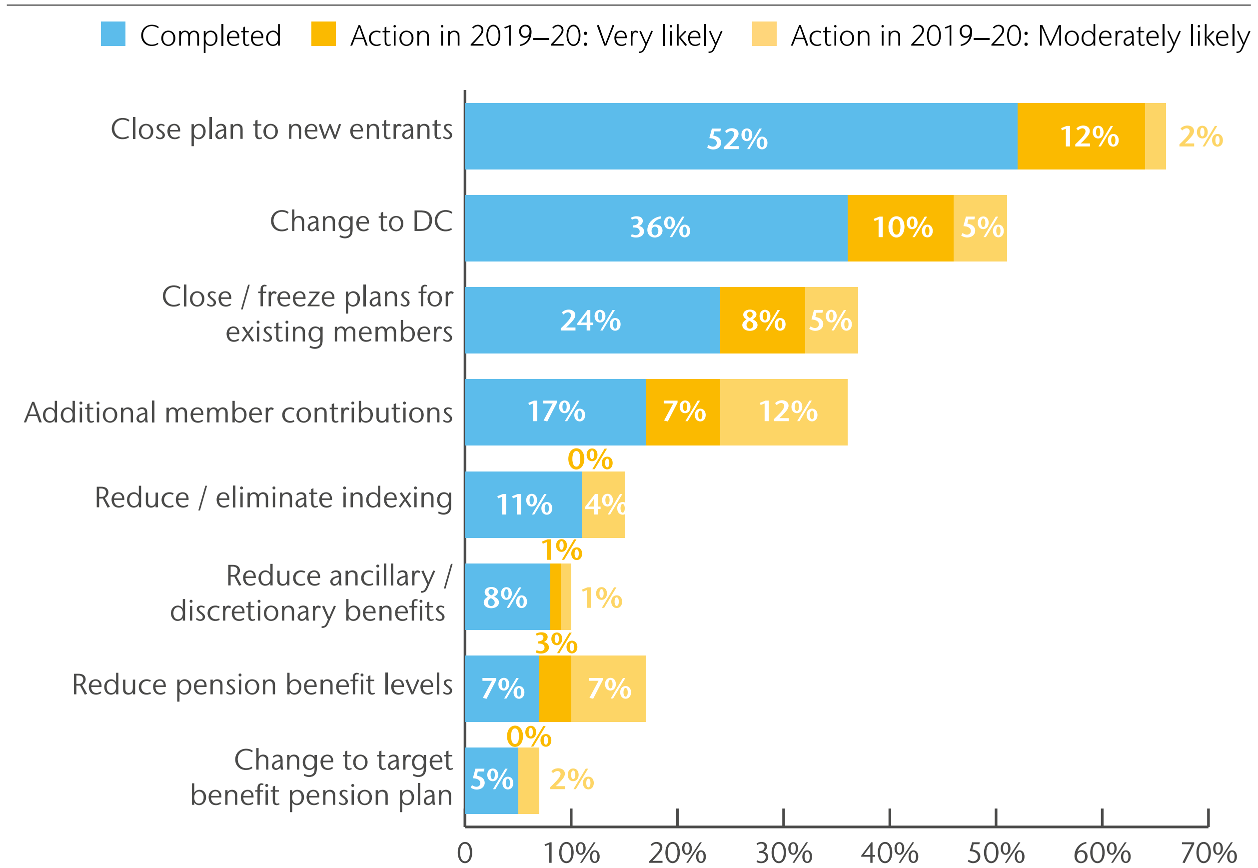
Managing benefits and liabilities

In more depth | Page 1 of 2

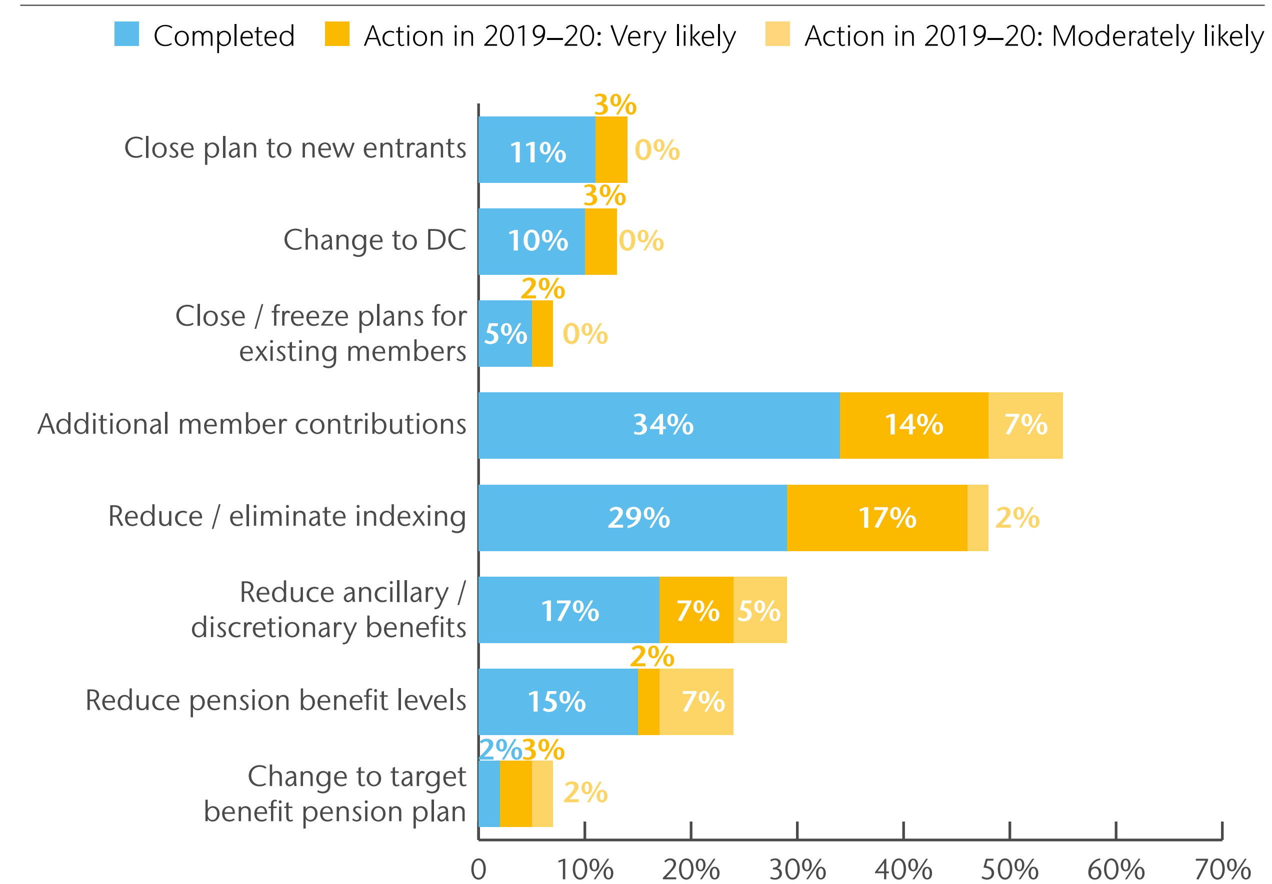
The split between sector responses continues with respect to future actions to manage pension benefits. Looking back at the steps that have already been taken, the divergences are greatest in closing / freezing plans for existing members (24% private vs. 5% public) and reducing / eliminating indexing (11% private vs. 29% public). And for forward-looking steps: closing plans to new entrants (14% private vs. 3% public), moving from a defined benefit to defined contribution plans (15% private vs. 3% public), reducing / eliminating indexing (4% private vs. 19% public) and reducing ancillary / discretionary benefits (2% private vs. 12% public).

In addition, we find that private sector sponsors plan to take more significant steps in closing plans to new entrants (12% increase). Although public sector sponsors are not leaning towards taking this measure, what's interesting is that they are scaling back on making changes to their pension benefits. For example: 43% in 2017 said they were likely to raise member contributions compared to 21% in 2019; additionally, 32% in 2017 planned to reduce ancillary / discretionary benefits compared to 12% in 2019. The increase in actions taken in these areas has clearly resulted in fewer sponsors indicating there is more work to be done.

Plan benefit changes — private sector



Plan benefit changes — public sector



Managing benefits and liabilities | In more depth | Page 2 of 2

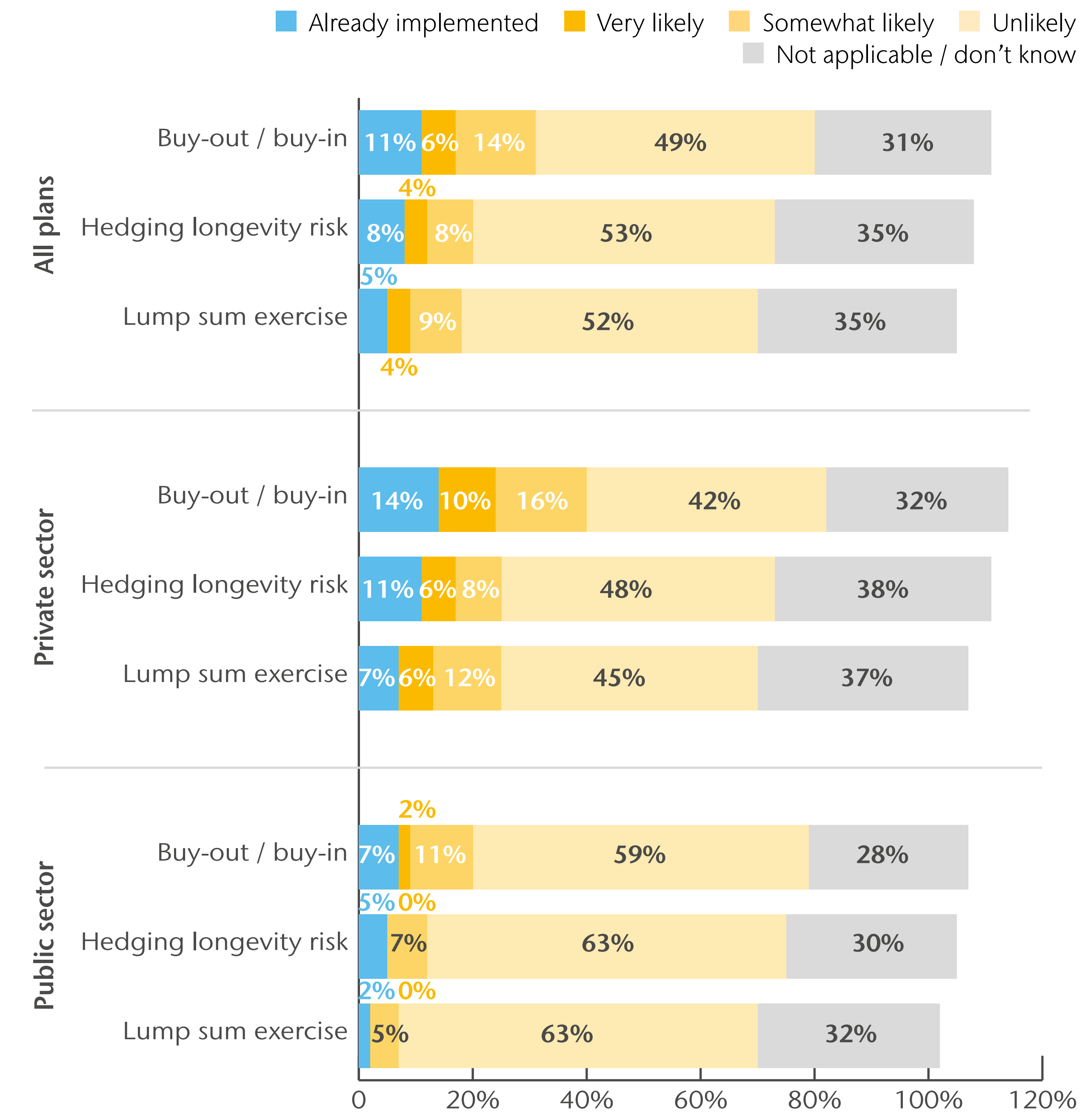
De-risking strategies

In keeping with 2017 trends, private sector sponsors favour annuity purchase for removing liabilities. Fourteen percent have acted on this, and another 26% plan to do so.

On the flip side, public sector sponsors did not purchase annuities in 2017, but in the present survey we find a modest 7% to have taken this measure in reducing their liabilities. Moreover, an additional 13% are looking to do so over the next 12–24 months. Some of this is explained by different opportunities to pursue buy-ins in the Quebec municipal plan sector.

Across both sectors, the number of sponsors considering hedging longevity risk has reduced over the past two years — dropping by 9% among private sector sponsors and 21% among public sector sponsors. It is somewhat surprising that there isn't more interest in longevity hedging in the public sector where the long-term goal of sustainability and the large size of many of the plans would seem to make them ideal candidates. Perhaps they are waiting to see if there will be more activity in this area before taking the plunge themselves.

Liability management



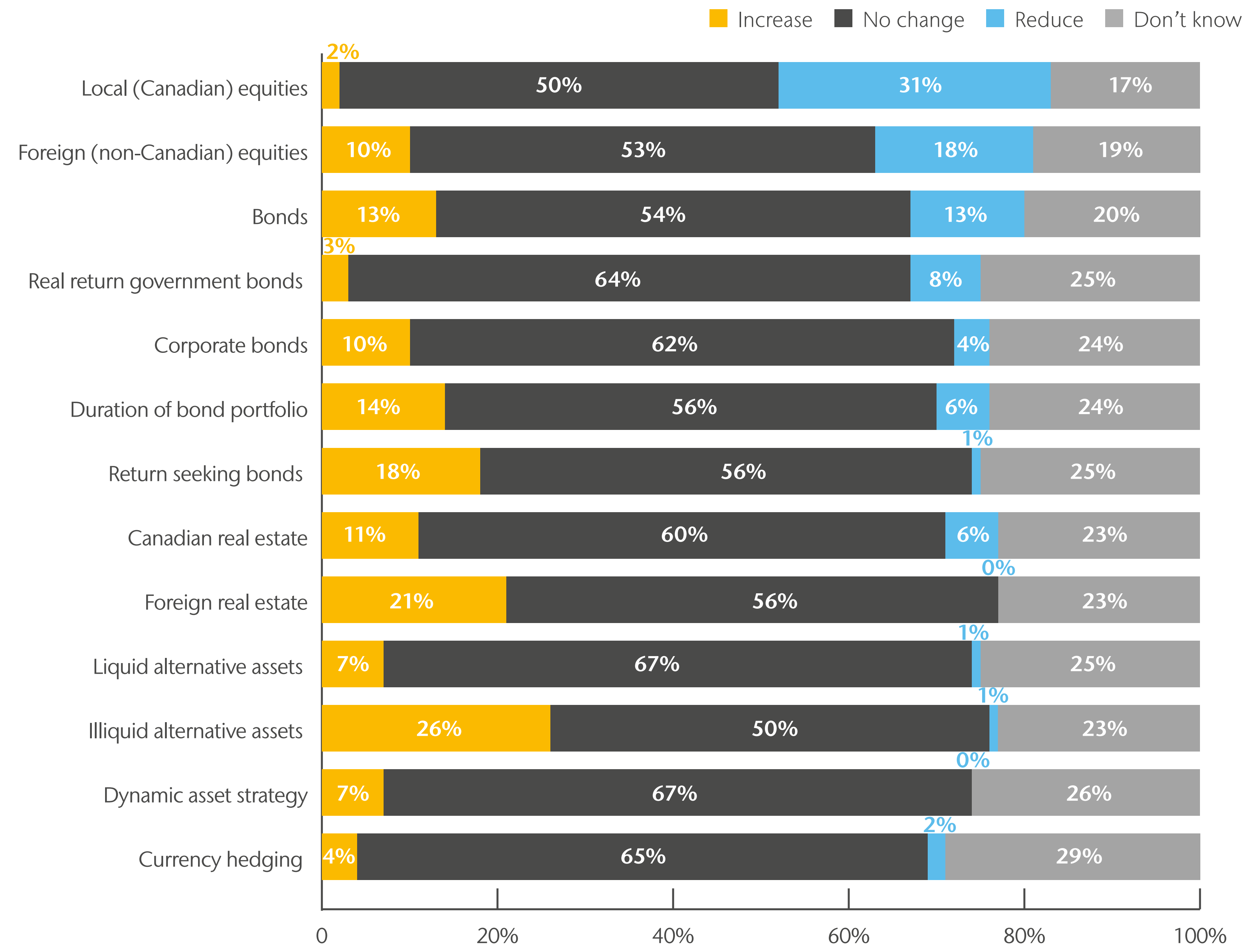
Investment strategy

In more depth | Page 1 of 3

Further changes to investment strategy

Looking ahead, sponsors are keen to continue increase their exposure to illiquid assets, foreign real estate and return seeking bonds while dialing down on equities (both local and foreign).

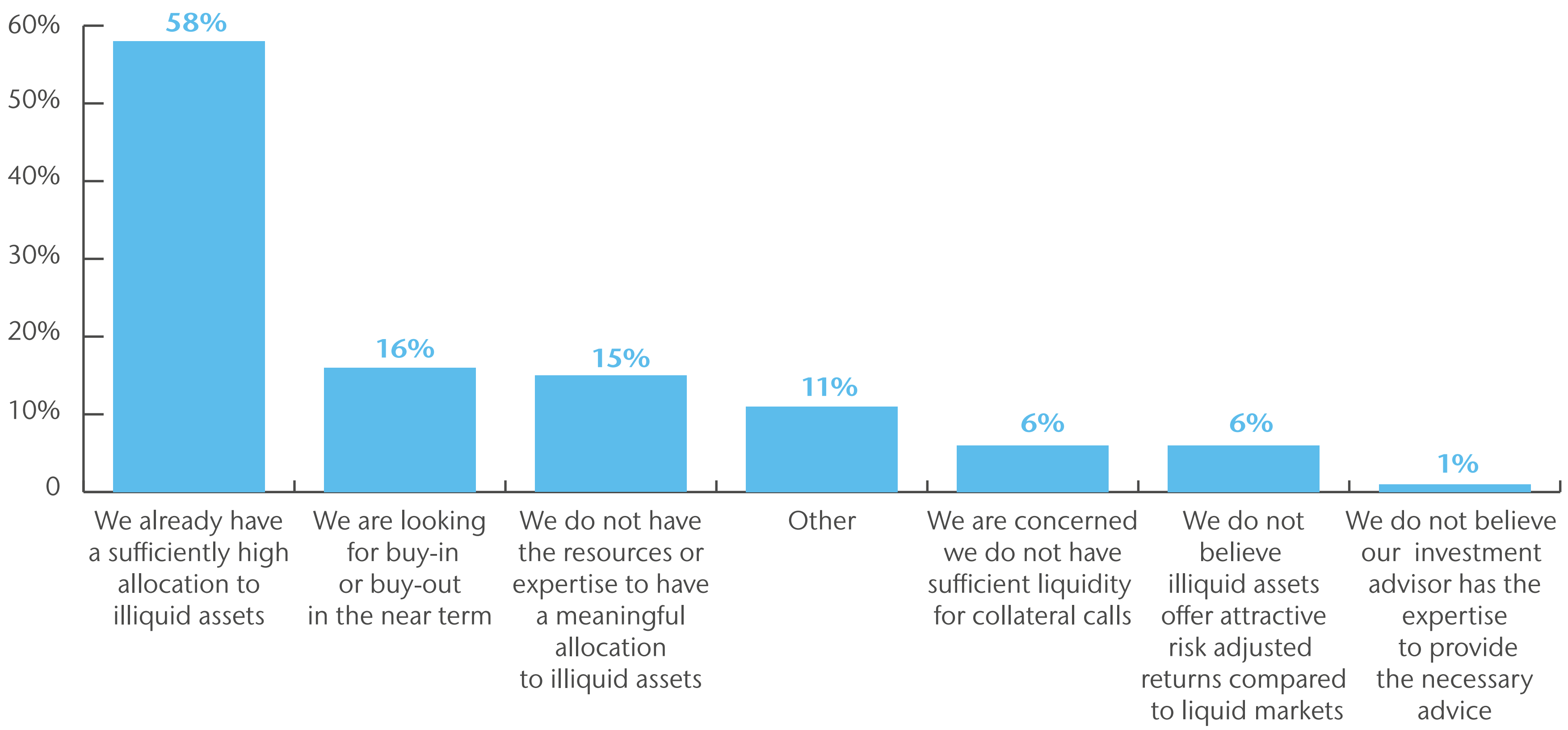
Investment strategy changes to be made in the next 12 months



Given the trend in optimizing illiquid assets, we asked sponsors who said they were not looking to increase their allocation to comment why. We found that more than half have already been agile in responding to market changes and have tapped this asset mix accordingly.

Reasons for not increasing allocation to illiquid alternative assets

Respondents were asked to select all that apply.



Global real estate

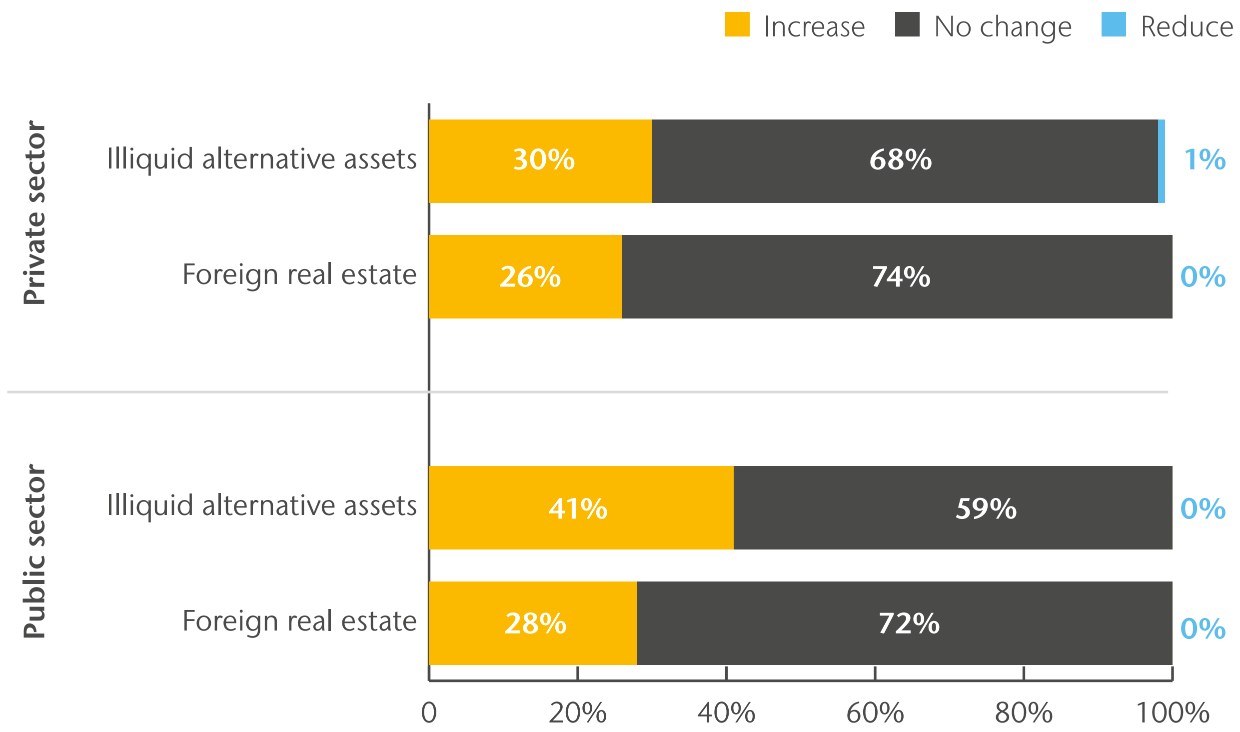
The investable universe in global developed markets has increased to $32.4 trillion (USD) in assets, of which Canada makes up 2.4%. This asset class is growing in popularity and bringing more investors to optimize the stable and sustained income (expected net return of 6–7%) and diversify their portfolios further across geographies and asset classes and away from equities and local biases.

Amid the growing popularity of investing in global real estate, AHIM & Townsend will soon be offering an open-end, direct global real estate solution tailored for Canadian investors. This solution will capitalize on prevailing market conditions, investment themes and manager expertise and will be accessible via a Canadian dollar denominated, domestic pooled structure. Anticipated launch is at the end of 2019.

Investment strategy | In more depth | Page 3 of 3

As plan sponsors are having to navigate in an increasingly complicated market landscape and to adapt to the changing investment environment, we find they are looking to diversify into real assets such as real estate and infrastructure and shift their strategies to avoid home biases to improve long-term outcomes. The trend is pretty much the same in the private and public sector.

Global approach for diversification continues



Case study

In 2018, we developed the Real Assets investment portfolio for a $5 billion (CD) Canadian DB pension plan. The client's plan portfolio was initially set at 10% to Real Assets with a long investment horizon and goal of investing the assets to obtain a superior risk adjusted return while presenting minimal risks to the stakeholders.

The first step involved educating the plan's investment committee members on Real Estate and Infrastructure asset classes so that they could clearly understand what benefits can be gained from investing in real assets in alignment with the firm's specific investment objectives. Additionally, the committee was better positioned to make decisions going forward, such as determining whether a global approach would be most optimal for exposure to real assets.

Next, further collaboration with the committee was focused on the implementation specifics, covering everything from open versus closed ended fund structures and the process as well as risks associated with investing in them (time horizon, liquidity constraints, costs). In the end, the committee chose to implement a globally diversified Real Asset portfolio by selecting three global infrastructure and highly regarded regional (Europe, U.S., and Asia) real estate funds that complemented each other. This portfolio pivot is expected to significantly reduce volatility of the overall portfolio and improve the risk adjusted return on the plan's assets.

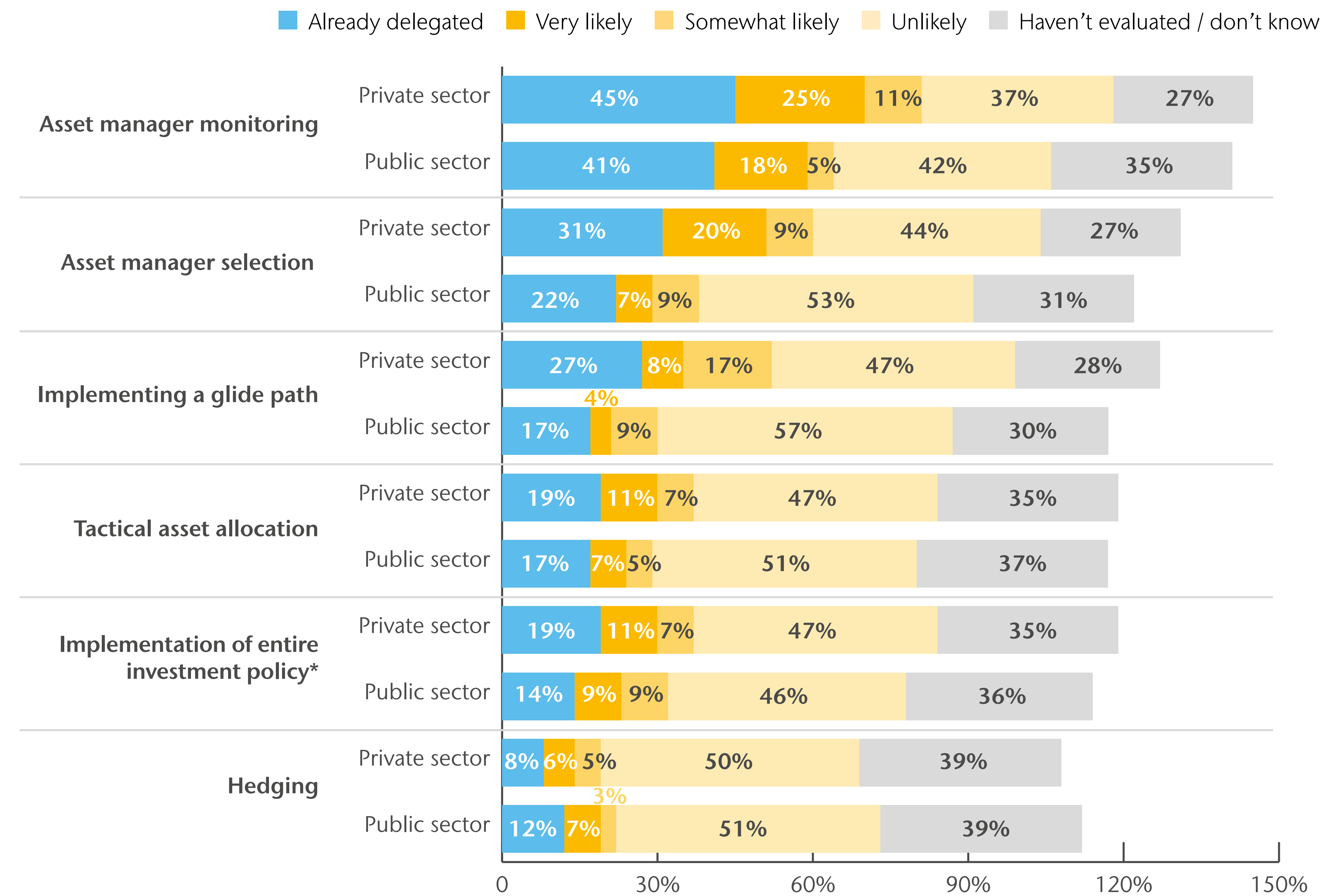
Delegating investment decisions

In more depth

Similar to 2017 findings, private sector and public sector sponsors share a similar approach towards delegating investment functions across the spectrum except for implementing a glide path where the gap slightly widens (already delegated: 27% private vs. 17% public). Looking forward, private sector sponsors are more interested than their public sector counterparts in delegating these functions: asset manager monitoring, asset manager selection, and implementing a glide path.

Delegation of investment decisions by sector

Respondents were asked to select all that apply.



*The implementation of an entire investment policy may sometimes be referred to as Outsourced CIO (OCIO) and includes asset manager monitoring and selection, tactical asset allocation, hedging, liquidity management, rebalancing, and dynamic policy execution (if applicable).

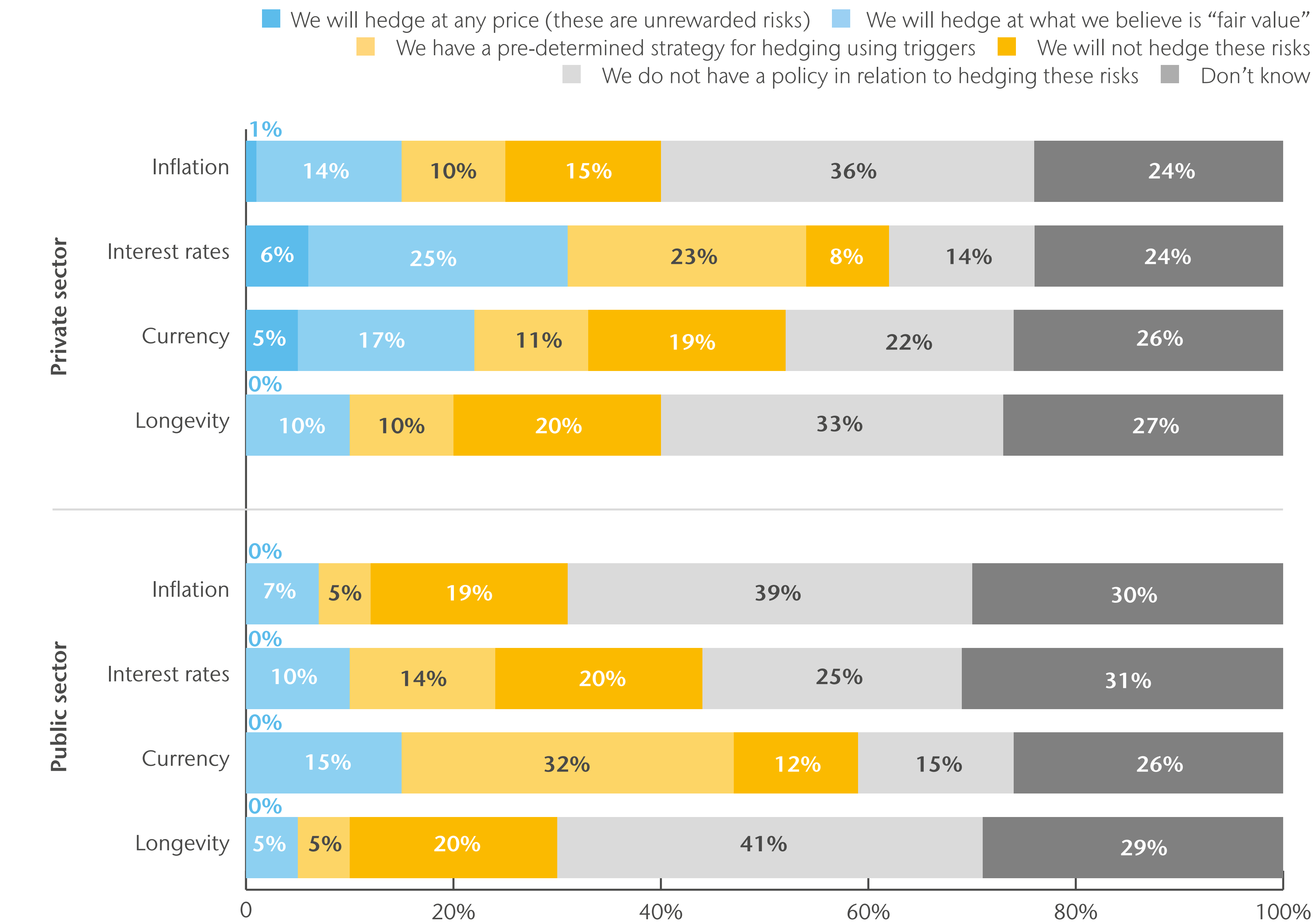
Hedging pension risk

In more depth

A closer look at how the sectors stack against each other in hedging their risks shows that the point of difference lies in their likelihood to hedge at what is believed to be fair value to hedge interest rates (25% private vs. 10% public) and triggers set up to hedge currency (11% private vs. 32% public).

In 2017, we observed that public sector plans were more likely to have a pre-determined strategy to hedging using triggers, whereas this has now levelled across the sectors. The contrast between the sectors with respect to currency risk is still striking. Thirty-two percent of public sector plans compared with 11% private sector plans have trigger-based strategies for currency hedging. Although unclear, this may be explained by larger public sector plans employing more sophisticated methods in monitoring currency movements and adjusting their currency hedging at pre-determined trigger points. It is also possible that large public sector plans have more exposure to various currencies than plans in the private sector.

Attitudes toward hedging pension plan risk by sector



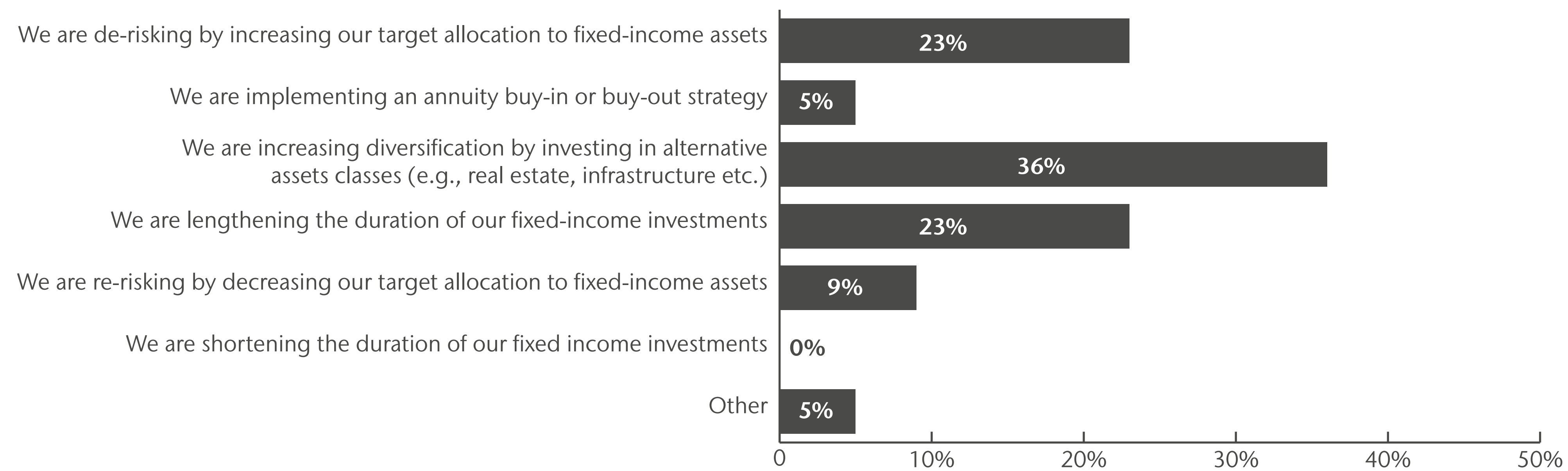
Return to summary

Canadian developments

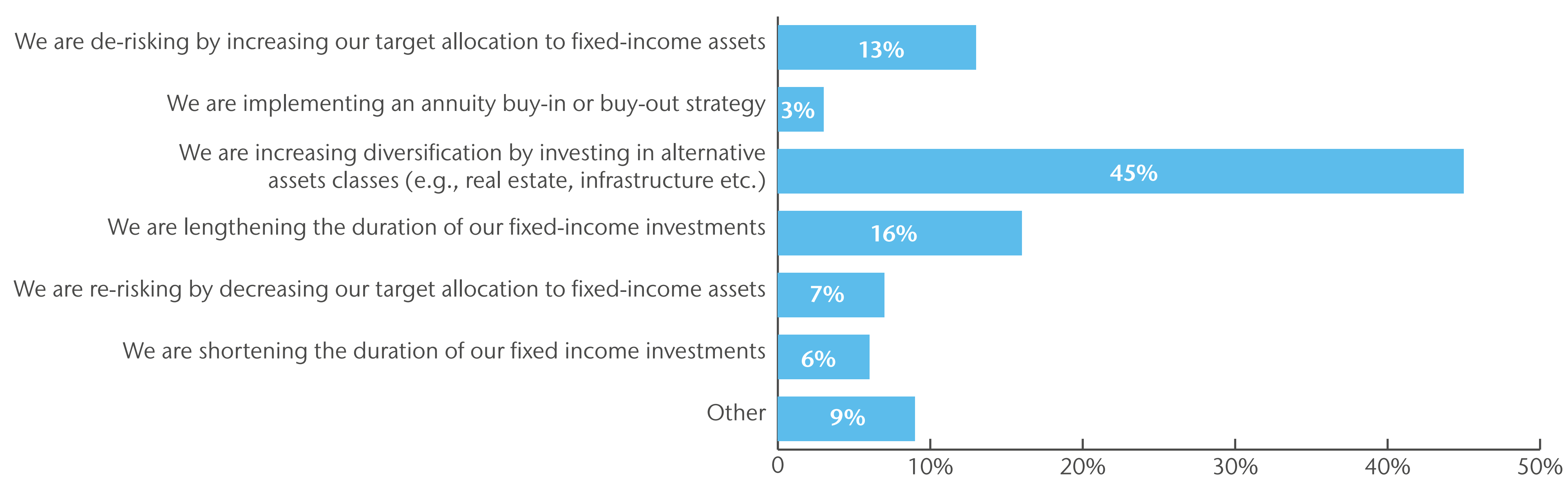
In more depth | Page 1 of 2

For those who have made changes to their investment strategy, the majority lies with Quebec sponsors having made various changes and to a smaller extent Ontario sponsors. The bulk of the changes involves increasing the allocation to alternative asset classes for greater diversification (45% and 36% respectfully), followed by increasing the exposure to interest rates by either lengthening the duration of fixed-income investments or increasing the target allocation to fixed-income assets.

Changes to investment strategy — Ontario



Changes to investment strategy — Quebec



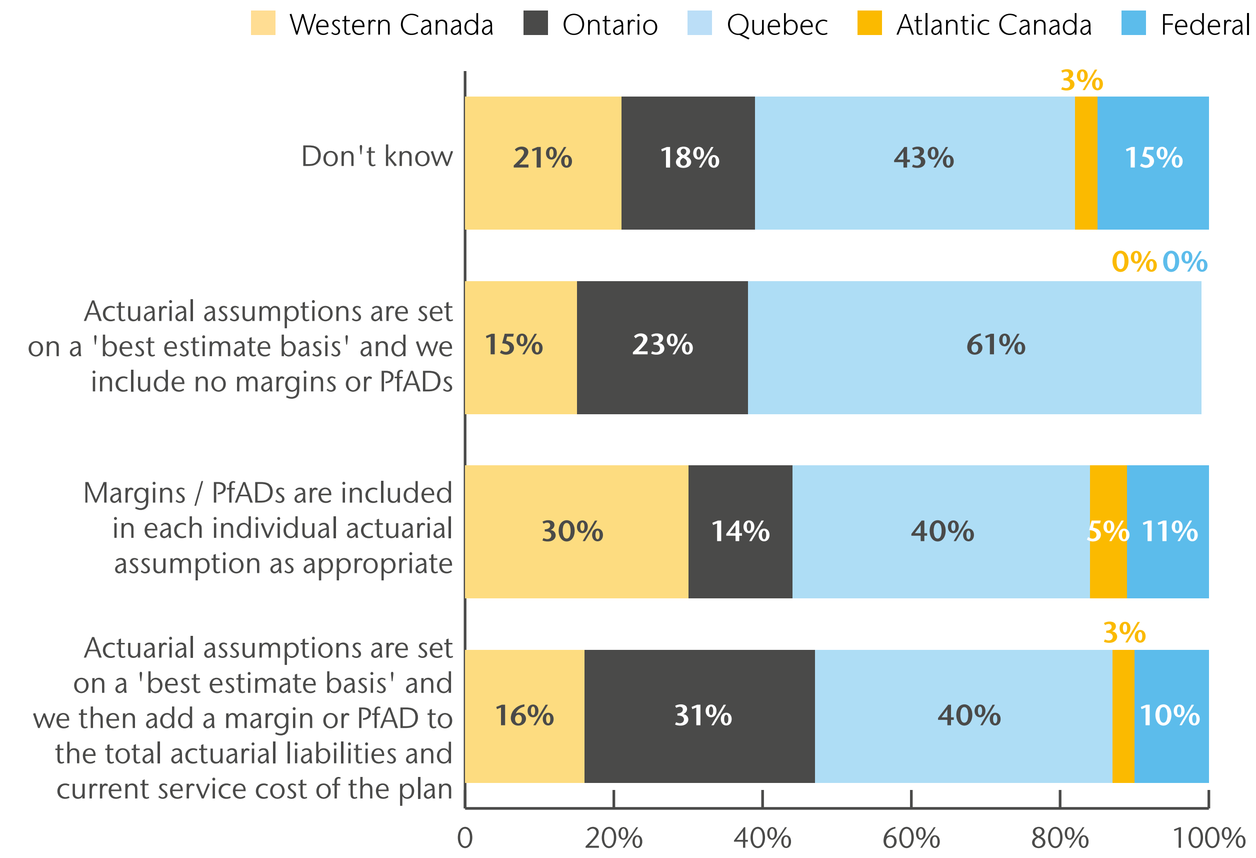
Margins in going-concern valuations

The pension reform changes in Quebec and Ontario introduced the term "provision for adverse deviation" or PfAD into the vocabulary of many pension committees and boards that may not have been familiar with the term previously. Given the increasing emphasis on margins, or PfADs, we added a question to the 2019 survey to understand how plan sponsors are including them in their going-concern valuations.

The most common response is that sponsors are using best estimate assumptions with an explicit PfAD added to their liabilities and current service cost. This approach provides the most transparency with respect to margins and in our view is preferable to the second most common response which includes margins in individual assumptions, "as appropriate". This approach can also make it very difficult to assess just how big the total PfAD is that is being held.

With the importance that has been placed on PfADs in Quebec and Ontario, we were surprised to see how many respondents indicated they weren't sure how they were being included in their valuations. These responses will undoubtedly decrease as more time goes by and sponsors become more familiar with the new funding rules.

Margins and PfADs in going-concern valuations



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