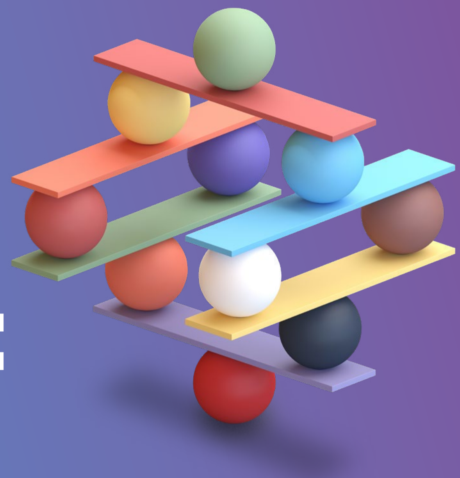
Mercer

Defined Benefit Top Priorities 2022:

Opportunity Knocks



From geopolitical instability to uncertainty of central bank actions to forecasting the on-going impact of COVID-19, plotting a path forward can be difficult.

But if you are managing a defined benefit (DB) plan in Canada, there's a good chance you're seeing a much improved funded position. According to the Mercer Pension Health Pulse (MPHP), the median solvency ratio of the plans in Mercer's client database was 103% as of December 31, 2021.

A strong funded position means that in uncertainty, there is opportunity. Let us walk you through key items to address and actions to take to seize those opportunities, and have your plan in a better position than ever:

- Use surplus effectively
- Reduce costs and increase efficiency
- Re-examine long-standing assumptions
- Consider the whole spectrum of investments
- Look to the future

1. Take stock of your surplus, and use it wisely

If your DB plan is in a strong financial position, you now have an opportunity to potentially reduce cash outlays and risk. You can achieve this through multiple approaches, such as off-cycle valuations, risk transfers and investment strategy reviews.

An off-cycle valuation may allow surplus to be used for a contribution holiday and in Ontario, reduced PBGF premiums, though this opportunity is time-sensitive, as it will require time to perform the work and prepare the required filings.

The Canadian group annuity market has been hot, with the last half of 2021 being the most active six month period in history[1]. For DB plan sponsors interested in annuity purchases, a strong financial position may allow transacting with minimal or no cash outlay, nor negative impact on corporate financial statements.

You may also consider a strategic asset review, where your plan's exposure to market risk is assessed against your objectives and tolerances. Following such a review, the allocation to return seeking assets such as equities versus hedging assets such as fixed income may be either adjusted or validated.

[1]Sources: LIMRA, Mercer. Quarterly activity in the Canadian group annuity market as at September 30, 2021.

2. Inflationary pressures on the horizon

When making decisions about your DB plan, you need to look ahead. That means understanding the impact of inflation on both your liabilities and assets:

- *Liabilities*: Inflation means higher pressure on wages, which will typically lead to higher benefit levels. Plans that have guaranteed cost-of-living allowances will also see higher payouts to plan members.
- *Assets*: Inflation will also impact asset valuations – but possibly in different directions for different asset classes, depending largely on the type of inflationary regime, and the action of central banks to contain it.

In this environment, where many variables are uncertain, scenario analysis can help inform decision-making. At Mercer, we have developed a number of plausible inflationary scenarios, which can be used to test your plan and gauge performance. With this information in hand, we can help build a portfolio that will perform across multiple scenarios, minimizing your risk.

3. Find the right partner to drive efficiency

Managing a business has always been challenging and time-consuming, but during the COVID-19 pandemic, with constantly changing public health rules, staff turnover and other uncertainties, it is more challenging than ever and has placed unprecedented strain on employees.

In 2022, as Omicron surges and ebbs, it may be time to consider delegating the investment management of your plan, to give you and your employees more time to focus on your core business.

The value of a delegated solution is in more than freed management time. The pooled purchasing power of a large organization, like Mercer, can help reduce costs – and a set of professionals at the helm of your plan will ensure that cash flows are managed appropriately and on time, the asset mix is continuously monitored and rebalanced as appropriate, and full support is provided for various reporting and audit requirements.

4. Ensure your assumptions are keeping up with reality

As COVID-19 upended economies, markets and workplaces across the planet, it serves as a reminder to ensure that demographic assumptions that underpin actuarial valuations of DB plans across Canada, such as mortality and retirement, remain appropriate.

For plans which have not done so in a few years, it is prudent to conduct an experience study, reviewing your actuarial assumptions to ensure that they are up-to-date. This will not only give you a more accurate read on your ongoing costs and liabilities, it will reduce your risk of being offside with auditors and regulators as well as provide you with greater leverage with insurance companies in the event of an annuity purchase.

5. Prepare for climate transition

Any investor with a long-term view needs to consider not only what the economy looks like today, but what it will look like tomorrow. In 2022, that also means considering the impacts of climate change – and of governments and businesses' response to it.

Integrating ESG factors into portfolio management is no longer a trailblazing experiment – it is an established approach to reduce risk and seek new possibilities. This also means understanding your exposure to carbon and climate-related risks, and planning for a transition. What opportunities might exist, from infrastructure to clean energy technologies?

6. Consider both public and private markets

With interest rates persistently low, and the spectre of inflation looming, many investors are looking at private markets, such as private equity, private debt, real estate or infrastructure, when it comes to allocating their assets. Real assets and floating rate private debt offer further benefits, such as potential protection against inflation and current income generation.

It is true that there are downsides to private markets – in the main, liquidity. But for a pension plan with a long runway, liquidity concerns may be overstated. A well-managed plan will have reliable metrics about its cashflows many years into the future, and so can assess the merits of less liquid investments from an informed position.

Private markets can be complex to invest in and implement – but options are available that can help mitigate risks and deliver the benefits to your plan, and your plan members.

A path ahead

The path ahead is uncertain – but we know that on it, lies opportunity. Many pension plans are in enviable financial positions. Now is the time to take action – to limit risk, to invest wisely, and to secure your plan's future.

Contact us

To learn more about how we can help make your defined benefit plan ready for the future, [contact your Mercer consultant today].

Reshaping the future.

About Mercer

At Mercer, we believe in building brighter futures.

Together, we're redefining the world of work, reshaping retirement and investment outcomes, and unlocking real health and wellbeing. We do this by meeting the needs of today and tomorrow. By understanding the data and applying it with a human touch. And by turning ideas into action to spark positive change.

For 75 years, we've been providing trusted advice and solutions to build healthier and more sustainable futures for our clients, colleagues and communities.

Welcome to a world where empathy and economics make a difference in people's lives.

Welcome to brighter.

For further information, please visit www.mercer.ca

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How we can help

Continuously rethinking purpose and priorities drives HR transformation. Shaping the future of work requires improved strategies around investment and retirement, health and wellness benefits, talent and communications. We believe in the value of investing in the future to build resilience for your business and your employees.

Investments and retirement require sophisticated solutions. We approach these with a big-picture view that prioritizes long- term financial wellness. We offer research and advice on assessing risk and designing benefits programs while keeping in mind the need to optimize throughout changing times.

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