News From Aon

As asset rally stalls, Canadian pension solvency declines in second quarter, falling off post-crisis record

- Aon's Median Solvency Ratio for defined benefit plans decreased to 94.8%
- Canadian pension solvency declined by almost two percentage points from Q1

TORONTO (July 5, 2017) – As Canadian equities suffered and the Bank of Canada signalled that monetary accommodation might be ending, the median solvency ratio of Canadian defined benefit (DB) pension plans in the second quarter fell from the post-recession high set in Q1, according to Aon's latest quarterly median solvency ratio survey.

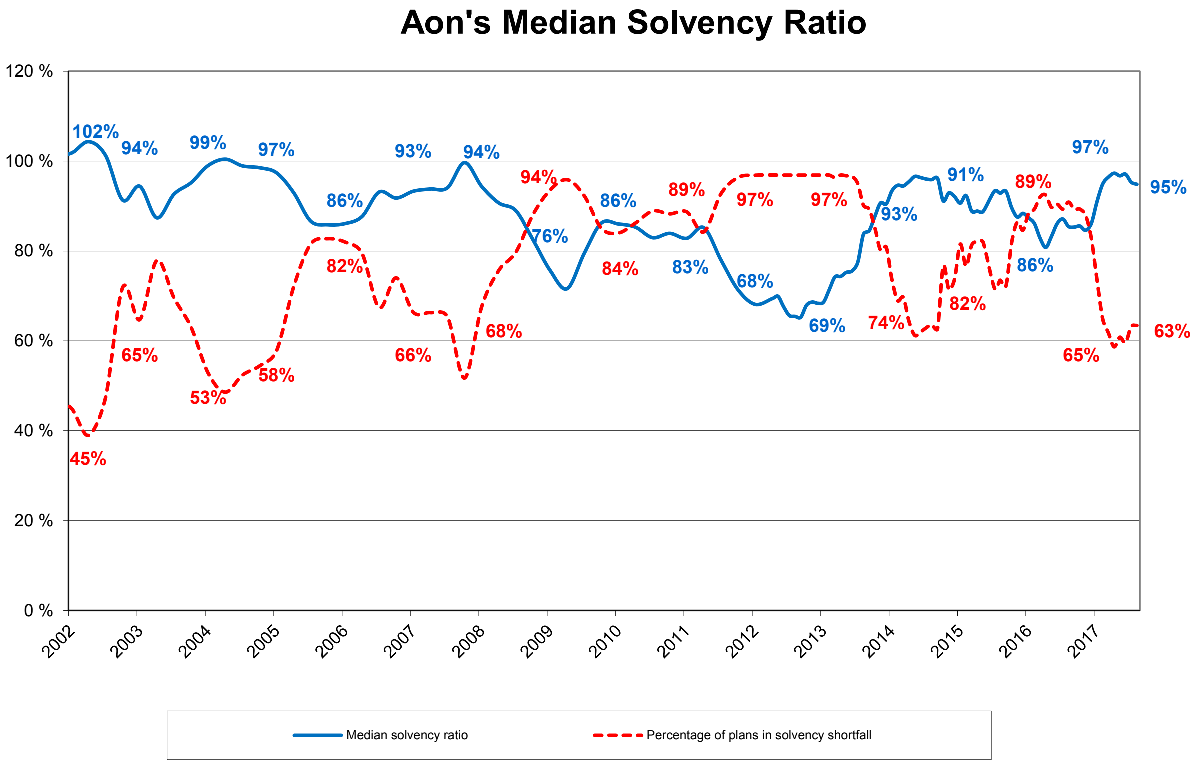
The decline in solvency in the second quarter of 2017 was driven by falling interest rates and offset slightly by asset returns. Despite weak performance across all asset classes in June, the average Canadian pension plan was still able to post a return of 1.6% over the quarter. Meanwhile, following hawkish remarks by Bank of Canada officials in June, markets now expect interest rates to rise before the end of the year. In response, bonds sold off, also lowering pension returns, although the corresponding rise in yields should support solvency positions going forward.

Quotes:
"We were concerned last quarter that the market conditions leading to record solvency levels might not last long, and it looks like our concern has played out in markets, especially in June," said William da Silva, Senior Partner and Retirement Practice Director at Aon Hewitt. "For pension plan sponsors, the takeaway now is the same, only more urgent: with plans still in strong financial shape, they should consider steps to manage and optimize the risks within their plans. These don't have to be big, transformational changes – even small changes to investment policy can hedge out certain risks and put plans in better position to respond to shifting conditions, if they are made in the context of a broader risk management focus. With various changes in funding rules across the country, it's more important than ever to ensure that any action sponsors take is based on an understanding of how the rules impact their plans' overall risk positioning."

"For much of the past year, capital markets were in a Goldilocks state, but the landscape changed in June," said Ian Struthers, Partner and Investment Consulting Practice Director at Aon Hewitt. "The equity rally appears to have softened in June, while central banks, including the Bank of Canada, seem in the mood to raise interest rates. That's a big change after a decade of extraordinary monetary stimulus, and markets will have to adjust. Strong equity valuations may be in retreat, and the potential for higher rates could be the stimulus for much higher market volatility. We saw the strength of a well-diversified portfolio this quarter, and if our expectations for volatility emerge, diversification will be even more important to managing risk going forward."

Key Facts:
- Aon's median solvency ratio as of June 30, 2017 was 94.8%, down from 96.7% as of April 1, 2017.
- Almost 37% of plans were fully funded as of June 30, down from 39% of plans as of April 1.
- Annuity purchase interest rates were down by 6 bps over the quarter. These rates are an input in calculating pension plan liabilities and their decline negatively impacted pension plan solvency over the quarter.
- Pension assets posted a return of 1.6% during the quarter; in the previous quarter, asset returns were 3.2%.
- For the second quarter in a row, Emerging Markets stock performance led all other equity classes, with a return of 3.5% in Q2. International (MSCI EAFE) equities and Global (MSCI World) stocks also performed relatively well, returning 3.3% and 1.3%, respectively. U.S. equities were barely positive (0.4%) through the quarter. (All returns in Canadian dollar terms.)
- Canadian stocks have marked the worst performance among tracked equity indices for two consecutive quarters in 2017, returning -1.6% through Q2.
- Alternative asset returns were lower on the quarter, with global real estate flat and infrastructure up 1.1%.

- Amid renewed expectations of rising interest rates, bond yields rose dramatically in the last week of June. The Canada 10-year benchmark bond yield rose by 24 bps. As a result, bond returns saw sharp declines in June, although they ended the quarter positive (FTSE TMX Long Term Bonds, 4.1%; FTSE TMX Universe bonds, 1.1%).



About Aon's median solvency ratio survey
Aon's median solvency ratio measures the financial health of a defined benefit plan by comparing total assets to total pension liabilities in the event of plan termination. It is the most accurate and timely representation of the financial condition of Canadian DB plans because it draws on a large database and reflects each plan's specific features, investment policy, contributions and solvency relief steps taken by the plan sponsor. The analysis of the plans in the database takes into account the index performance of various asset classes, as well as the applicable interest rates to value liabilities on a solvency basis.

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About Aon
Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

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