News From Aon

As interest rates rise, Canadian defined benefit pension solvency in third quarter hits highest level in 10 years

- Aon's Median Solvency Ratio for defined benefit plans increased to 99.3%
- Canadian pension solvency at highest level since the financial crisis

TORONTO (October 3, 2017) – As the Bank of Canada raised its target overnight rate twice and bond yields soared in the third quarter, the median solvency ratio of Canadian defined benefit (DB) pension plans hit a new post-recession high, according to Aon's latest quarterly median solvency ratio survey.

The improving financial health of Canadian pension plans was driven by rising bond yields, which effectively lowered plan liabilities, even though a stronger Canadian dollar adversely impacted asset returns. Bonds also sold off through the period, but the corresponding decline in liabilities more than offset the impact on solvency.

Quotes:
"Rising interest rates are good news for Canadian pensioners and the plans they will rely on in retirement, and so there was plenty of good news for them in the third quarter, as most Canadian DB pension plans experienced marked improvements in financial health," said William da Silva, Senior Partner and Retirement Practice Director at Aon Hewitt. "Canadian DB plans are now enjoying the best median solvency level in a decade, and that positions them well to prepare for the future. For many plan sponsors, rising rates will trigger changes in their plan glidepaths, so they will need to monitor developments very closely over the next several months. And as asset mix changes, sponsors should be sure to understand how that will impact their funding strategies. This will be a key theme as 2017 winds down and we head into 2018."

"There is surprisingly little fear in markets right now, and despite geopolitical risk and high asset valuations, plans have benefited from the trend toward improving solvency," said Ian Struthers, Partner and Investment Consulting Practice Director at Aon Hewitt. "The good news is that we expect only modest rises in bond yields and this reduces the risk of a reset in asset values. That said, there are very few asset classes where valuations are not at record highs, so smart diversification and a strong understanding of portfolio risk profile are important. As we have seen over the past quarter, volatility can come from lots of places, such as the Canadian dollar. It is always wise to build a roof when the sun is shining. Pension plans are benefiting from a Goldilocks state of a bull market in equities and rising yields. History suggests that won't last forever."

Key Facts:

- Aon's Median Solvency Ratio as of Oct. 2, 2017 was 99.3%, up from 94.8% as of June 30. The Q3 ratio is at its highest since Q3 2007, when solvency stood at 99.7%.
- Almost half – 47.7% – of plans were fully funded as of Oct. 2, up from 37% of plans as of June 30.
- Benchmark bond yields rose over the quarter, with Canada 10-year yields up 35 bps and Canada long bond yields up 34 bps. Higher yields lowered pension plan liabilities, and positively impacted pension plan solvency over the quarter.
- Pension assets posted a return of 0.1% during the quarter; in the previous quarter, asset returns were 1.6%.
- Emerging Markets (+3.9%) and Canadian equities (+3.7%) led equity class returns in the quarter, followed by international MSCI EAFE (+1.5%), Global MSCI World (+1.0%) and U.S. equity (+0.6%). Canadian dollar appreciation in the quarter suppressed non-domestic equity performance in CAD terms.
- In fixed income, rising yields drove down bond portfolio performance. FTSE TMX Universe bonds were down (-1.8%) on the quarter, as were FTSE TMX Long Term bonds (-4.1%).
- Global real estate and infrastructure returns ended the quarter in the red, by -2.2% and -1.1%, respectively, in Canadian dollar terms.

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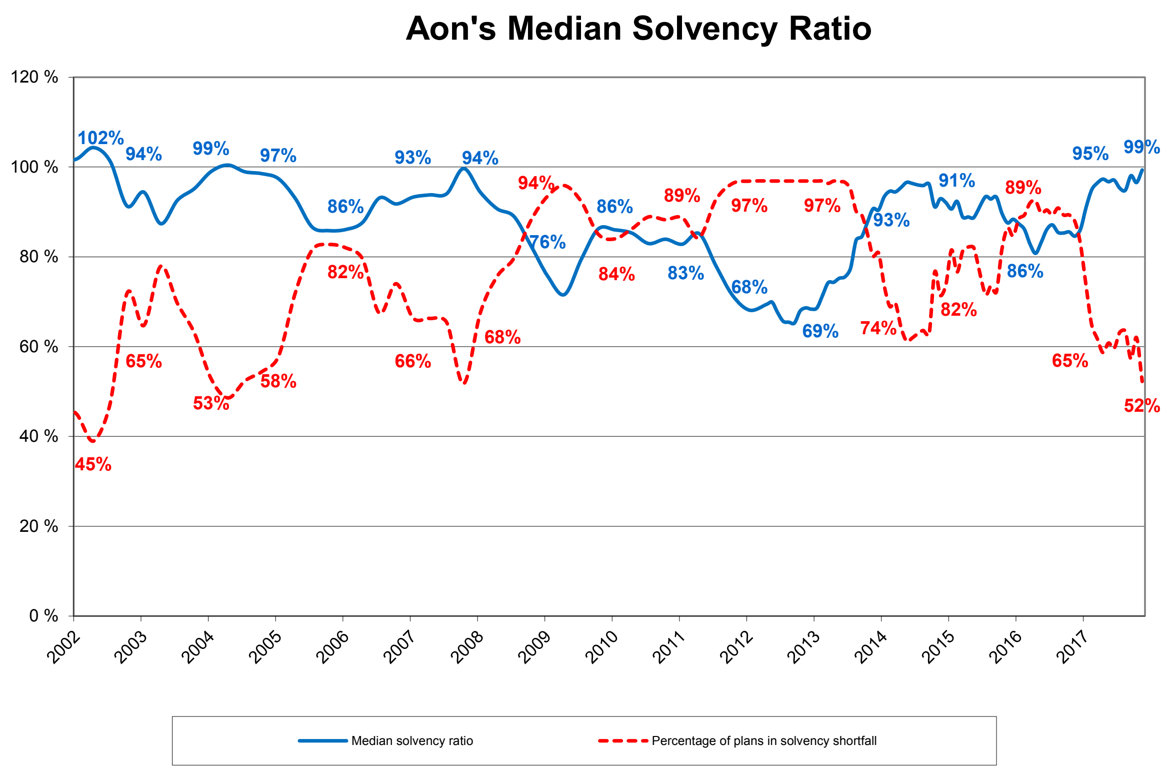

About Aon's Median Solvency Ratio survey

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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