

Mercer Global Pension Buyout Index

Q2 2020

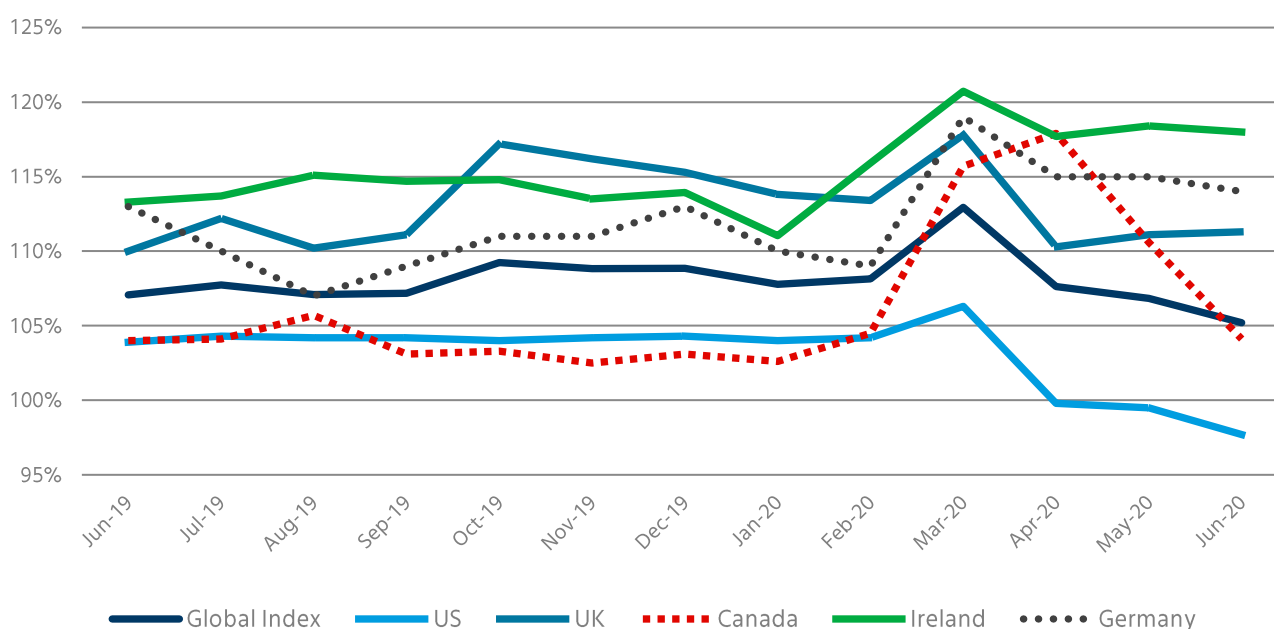


Executive Summary

Mercer Global Pension Buyout Index monitors the general trend in the pricing of bulk pension annuity transactions in the US, UK, Canada, Ireland and Germany.

Pension risk transfer transactions increasingly involve an international element – for example, the sponsoring employer might be seeking to externalise pension risk in multiple countries. Pricing is subject to movements in global financial markets and domestic requirements for insurer reserving. However, country-specific pricing often trends in different directions due to domestic influences, leading to windows of opportunity in one country relative to another.

The chart shows estimated annuity prices from insurers as a percentage of accounting liability in the five countries monitored, for existing retirees in a sample defined benefit pension plan. This is based on up-to-date pricing information provided regularly by insurers in each country.



For example, where a line is at the 110% level, Mercer estimates the average price of a pension annuity transaction for current retirees to be broadly 10% higher than the equivalent accounting liabilities. The Global Index is represented by the solid line, showing the average price of pension annuity transactions as a percentage of accounting liability across the five countries and draws upon information such as country market size.

The Global Index decreased by nearly 8% over the second quarter of 2020. The drop was a result of the downward movements in the indices of all regions, with the steepest being in the US and Canada.

Pension liability has been measured according to local standards. As an example, the cost of insuring pension liabilities in the UK is higher than in the US (relative to accounting liabilities) partly because UK pension liabilities are commonly indexed for inflation and partly due to generous attaching spouses' pensions, both of which increase the liability duration. Insurers also charge an additional premium to take on inflation risk.

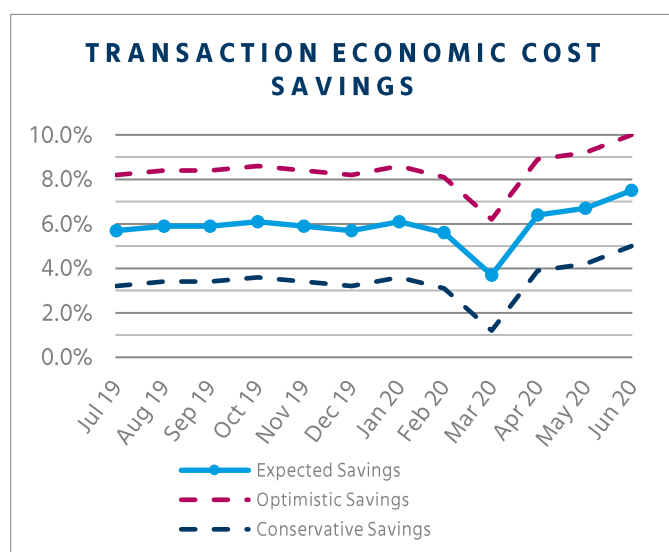
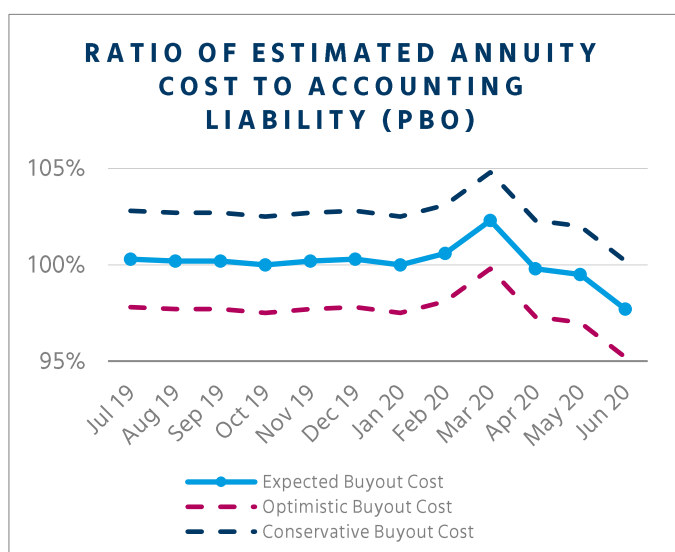
Mercer appreciates the assistance of more than 20 insurers, which provide pricing data every month to allow this report to provide a good indication of the trend in each country.

The information contained in this report is not based on information specific to your circumstances and approximations have been used. Past experience is no guarantee of future pricing and experience may vary for your plan.

United States

The cost of a buyout had been decreasing a number of years ago relative to PBO accounting liabilities; however this relationship has remained relatively stable over the last couple of years. Price transparency allows for greater information from which a plan sponsor can act. The chart on the left shows the relative price to PBO using pricing received from insurers. The chart on the right shows the potential economic savings a buyout generates, reflecting accounting liability and plan maintenance costs less the cost of a buyout.

Beginning June 2020, the index methodology has changed to focus on the most competitive insurers. This better reflects that in a real transaction, the final price paid is typically the lowest bid from among the safest possible insurers. The Buyout Index pricing to PBO ratio is now broadly in line with what we have seen in actual recent client transactions. The historical buyout index values have also been adjusted in the charts below to reflect the methodology change.



At the end of June 2020, if the hypothetical buyout index accounting liability in respect of plan pensioners only was US\$100 million, the buyout cost would be broadly US \$2.3 million lower.

Retaining these pensioners in the plan would incur future maintenance costs of \$5.2 million. This includes future PBGC premiums, administrative costs, and investment costs. As such, a plan sponsor could potentially save a total of \$7.5 million by executing this transaction in the baseline expected scenario.

United States Market News

Two new pension risk transfer annuity providers are prepared to enter the market later in 2020. The total number of active issuers is now eighteen.

Some insurers witnessed downgrades to their insurer financial strength rating “outlook” which is an indication of potential future rating action. These actions were largely related to COVID-19. In general, insurer balance sheets and ratings remain healthy.

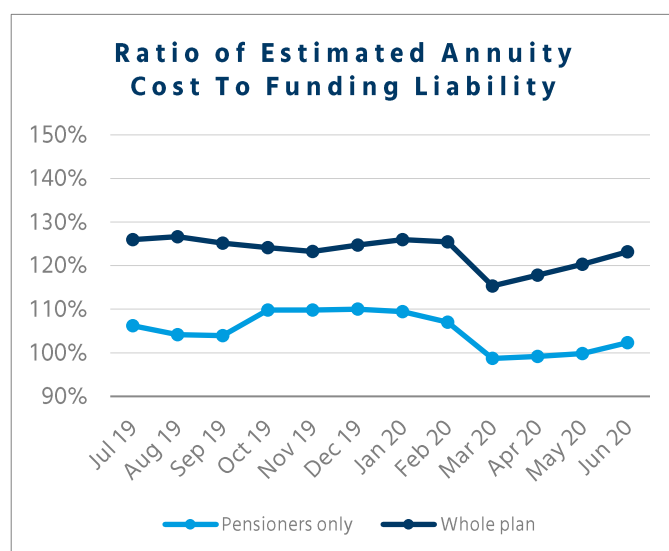
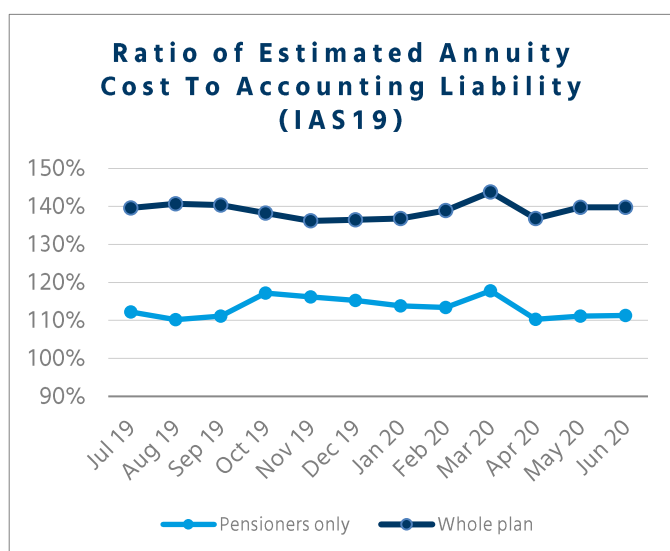
NOTES

The charts are based on a set of liabilities with 750 participants, pension benefit obligations of US\$100 million, cash flow duration of approximately 9 years, and discounted using the Mercer Yield Curve.

The figures in the charts should be used as an indication of the market pricing for annuity placements; actual pricing received will depend on plan-specific factors such as plan provisions, size, and age of the population. At a single point in time pricing between insurers varies materially which may lead to a difference in cost of up to 10%. It is important to note that the insurers who provide pricing do not reflect mortality sensitivity in their illustrative rates, or benchmark to a standard table.

United Kingdom

The charts track the cost of a buyout and buy-in of a representative pension plan against accounting and typical funding liabilities. The plan has pensioner and non-pensioner liabilities, with a weighting towards pensioners. Pensioner and non-pensioner members receive a mixture of flat and increasing pensions in payment, commensurate with an “average” UK pension plan.



At the end of June 2020, if the plan had accounting liabilities in respect of all members of £100 million, the buyout cost would be broadly £40 million higher.

If the accounting liability in respect of plan pensioners only was £100 million, the buy-in cost of pensioners would be broadly £11 million higher.

At the end of June 2020, if the plan had typical funding liabilities (technical provisions) in respect of all members of £100 million, the buyout cost would be broadly £23 million higher.

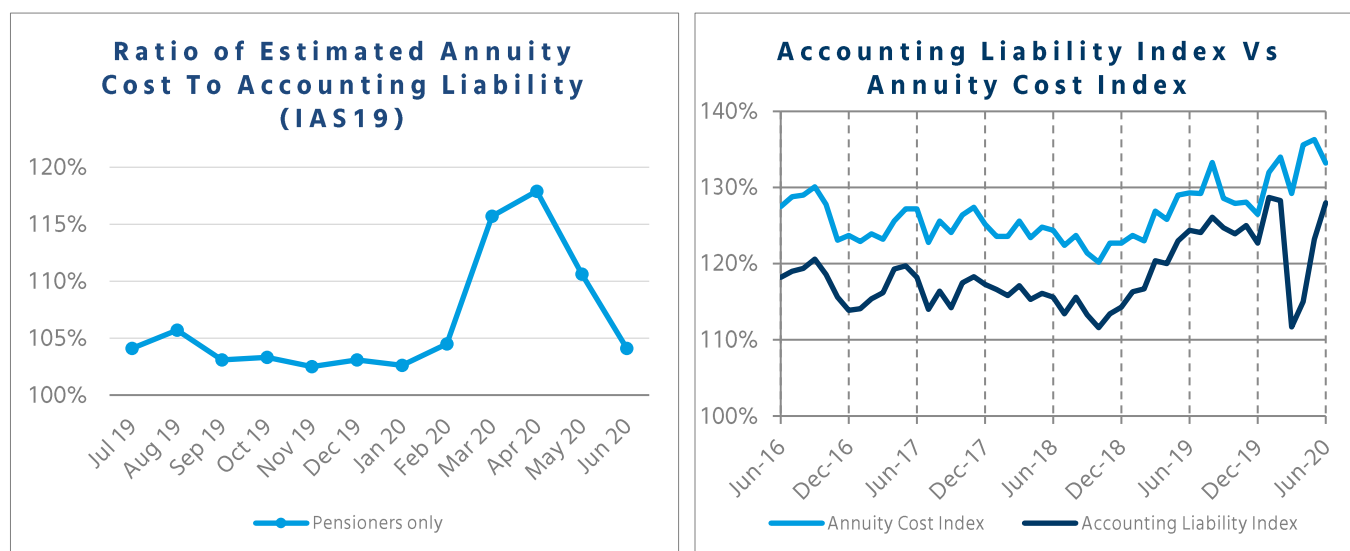
If the typical funding liability in respect of plan pensioners only was £100 million, the buy-in cost of pensioners would be broadly £2 million higher.

United Kingdom Market News

Total premium volumes for 2019 exceeded £40bn, which is the highest annual premium volume ever written (the previous highest being c£24bn in 2018). In 2019, there were 11 individual transactions exceeding £1bn including the largest bulk annuity deal to date, of £4.7bn for the Telent Pension Scheme. The COVID-19 pandemic and related market volatility is having an impact on the ability of some pension plans to complete transactions but it is also presenting opportunities for some, and the insurers are continuing to write new business.

Canada

The charts track the movement in the cost of a group annuity as a percentage of the associated accounting liabilities for a representative sample group of retirees.



During the second quarter of 2020, the Index decreased by 11.6% to 104.1%. This implies that, at the end of Q2 2020, the cost of settling obligations through the purchase of annuities was 4.1% higher than the corresponding accounting liability.

It is also important to consider the absolute cost of settling plan obligations. This can be best accomplished by looking at the movement of each component of the index in isolation. To do so, we look at the yields of long-term government bonds, which drive annuity pricing, and compare them to the yields on AA corporate bonds, which are used to calculate accounting liabilities.

Annuity Cost Index

Yields on long-term federal bonds, assumed to back annuity purchases, decreased by approximately 29 bps throughout the quarter. Annuity pricing worsened in April before becoming more attractive in May and June, ending up more or less at the same point it was at the end of March. The net result was an overall decrease in estimated annuity costs of just under 1.0%.

Accounting Liability Index

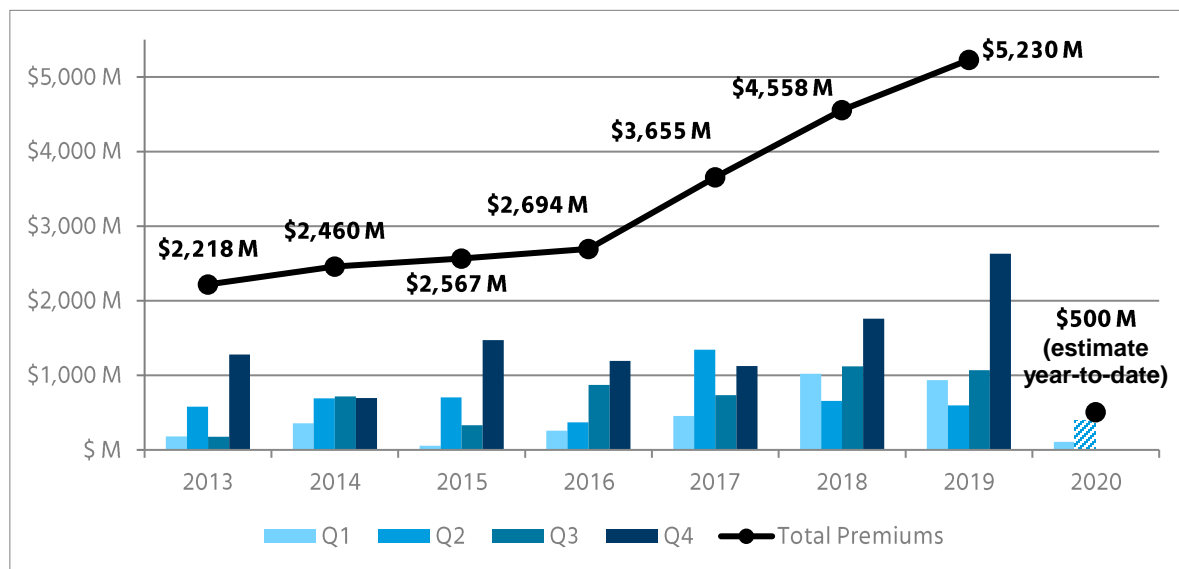
After a steep drop in accounting liabilities in March, accounting liabilities steadily increased throughout the second quarter. This was largely due to the decrease in long term rates combined with the narrowing of credit spreads in corporate bonds, which are assumed to back accounting liabilities. After experiencing a significant decrease in the spring, accounting liabilities have now returned to pre-pandemic levels.

Canadian Global Pension Buyout Index

After leaping to 115.7% at the end of March and then continuing to climb in the month of April, the Index has swiftly returned to just over 100% as at the end of June. However, as was clearly illustrated in early spring, the Index is highly sensitive to movements in both long-term rates and credit spreads and may be at risk of increased volatility while the Coronavirus pandemic continues to run its course.

Canada Market News

After a particularly slow start the year, the market began to rebound in Q2 2020. While still lagging far behind initial projections, Q2 2020 had over \$400M in premiums – a clear sign that the annuity business in Canada was beginning to return to normal. However, with the effects of the pandemic still wreaking havoc on certain businesses and the threat of a potential second wave on the horizon, there is considerable uncertainty as to how active the second half of the year might be.



With over 400 plans having enrolled as of June 2020, the [Mercer Pension Risk Exchange®](#) has established itself as a global tool to help clients meet their de-risking objectives in an efficient and cost-effective manner. Over US\$84B of plan liabilities have been committed to the platform and nearly US\$30B has been successfully secured with insurers. In Canada, more than 60 transactions have been secured through the Exchange with total premiums of approximately CAD\$3.4B.

NOTES

The Index is based on an estimate of settling non-indexed pension obligations through the purchase of annuities and an accounting discount rate based on a proprietary model developed by Mercer to assist our clients with selection of the discount rates used for the purpose of corporate financial reporting. It is provided for a sample group of non-indexed retired members and is only intended to illustrate general trends. The actual premium can vary significantly for individual plans based on a number of factors that may include:

- The plan's benefit structure and timing of its anticipated benefit payments.
- The demographic profile of the plan's participants.
- Market conditions prevailing at the time benefits are distributed and annuities purchased.
- Insurer appetite and capacity for a transaction.
- Which employees, if any, receive and accept an offer to take a lump sum instead of an annuity.

Ireland

During Q2 2020, there was a fall in corporate yields from the highs seen at the end of Q1, whilst Core Eurozone Government bond yields have remained flat over the quarter.

This has resulted in

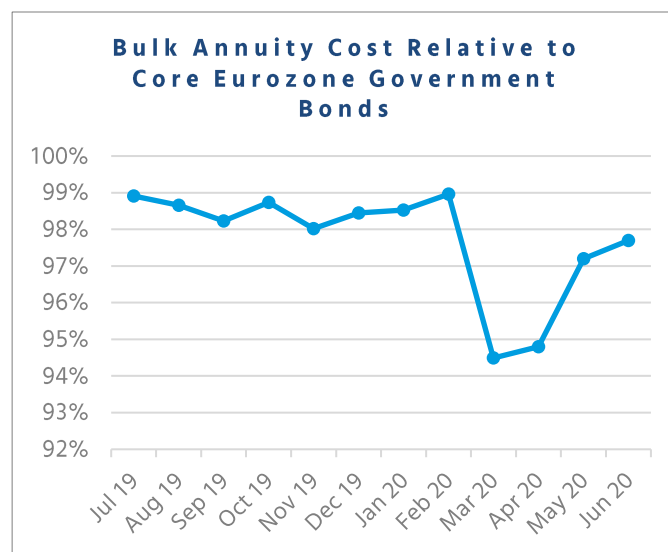
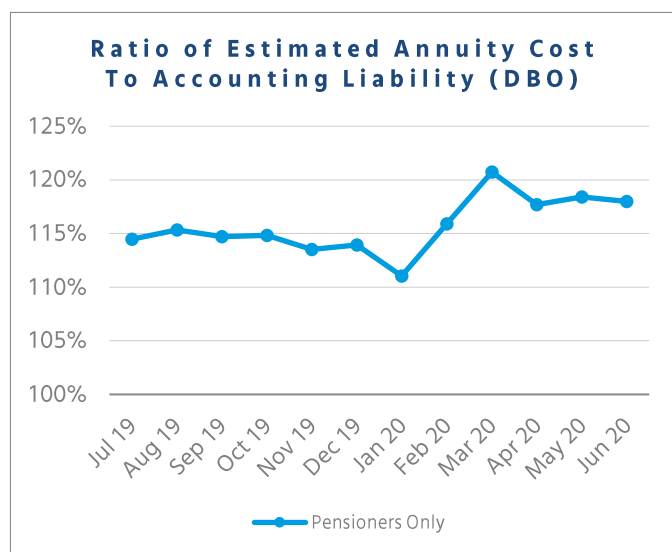
1. An increase in annuity costs relative to the Core Eurozone Government bonds (held by most Irish Pension Schemes)
 - However annuity costs are still c. 2% lower than the funding liability for a scheme holding Core Eurozone Government bonds
2. An increase in accounting liabilities (corporate bond yields used to value obligations)
 - The gap between accounting liability and annuity prices has narrowed as a result

Opportunity

Whilst annuity costs have increased relative to Core Eurozone Government Bonds, Schemes holding such bonds to match pensioner liabilities may still be able to exchange swap their Government Bonds for an annuity policy, thereby improving cashflow matching and adding a longevity hedge, while still realizing a funding gain.

Bulk Annuity Index

The two charts below track the cost of a buyout or buy-in of a representative pension plan against the equivalent accounting liabilities shown on a company's balance sheet and the cost of securing those benefits with Core Eurozone Government bonds.



At the end of June 2020, if the Plan had accounting liabilities in respect of pensioners of €100 million, the cost of a traditional annuity would be broadly €18 million higher.

At the end of June 2020, if a Pension scheme held €100 million of Core Eurozone Government bonds in respect of pensioners, the cost of a bulk annuity would be broadly €2.3 million lower, generating a funding saving for the scheme.

Ireland Market News

Irish life assurance companies use a mix of Core and Semi-Core Eurozone Government bonds as well as corporate bonds and other income generating assets to price annuity policies. Movements in these underlying assets over time can increase or decrease the attractiveness of a bulk annuity transaction for a Scheme or Sponsor. The cost of an annuity policy will also be influenced by the level of activity in the market and hence the ability to generate competitive tension between insurers. The timing of a transaction will be one of the most important decisions that Trustees and scheme sponsors need to make.

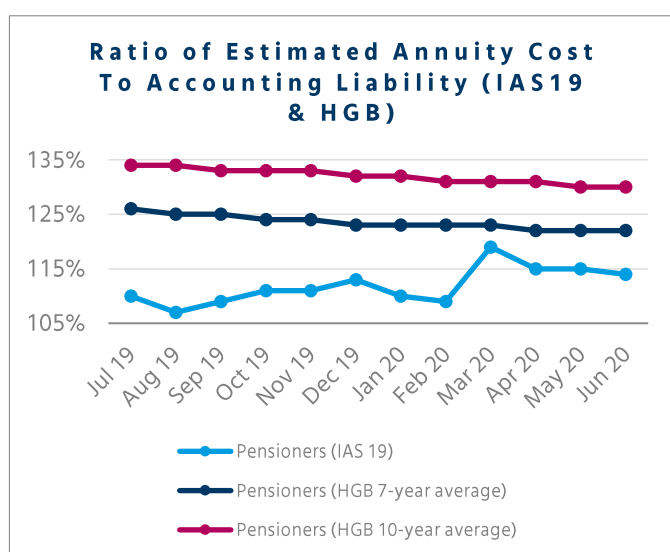
Activity in the bulk buyout market in Ireland has been relatively subdued over the past number of years. However, with many schemes having made good progress towards de-risking their investment strategy we are seeing an increase in interest in bulk annuity transactions as the next stage in this de-risking journey. In particular, current conditions may point to pensioner buy-ins as an attractive investment opportunity for schemes, allowing them to take advantage of attractive annuity pricing without an associated negative P&L impact for their sponsor.

NOTES

The index is provided for a sample mature pensioner population and is indicative only. The benefits secured (and valued as an accounting liability or using AAA Eurozone interest rates) are flat pensions, with no increases in payment. The price differential identified above will also be affected by the nature of the assumptions adopted for the accounting disclosures and benefit projections in particular pensioner longevity as well as the nature of the scheme's benefits and membership, and insurer commercial pricing decisions.

Germany

In Germany, a true buy-out of liabilities is not generally possible as the purchase price is treated as taxable income for the beneficiaries except in the case of the wind-up of the sponsoring company. Here we focus on so-called reinsurance, where the future promised pension payments are insured. The insurance contract is based on an insurance tariff with 0.9 % guaranteed interest rate. The German pension reinsurance market is based on with-profits policies. It is usually not possible to insure future indexation – in general, it is assumed that the with-profits bonuses will broadly compensate for the required level of future indexation, but exact indexation matching is not possible. The accounting liabilities in the table below reference a sample retiree population and are shown on an IFRS basis and the old and new German GAAP (“HGB”) basis. The new German GAAP uses a 10-year average of the discount rate (previously a 7-year average was used).



At the end of June 2020, if the plan's accounting liabilities under local German GAAP (HGB) in respect of pensioners were €100 million, the buyout cost would be broadly € 30 million higher (compared with €31 million higher at 31 March 2020). Under the previous HGB basis, using the 7-year average rate, the buyout cost would broadly € 22 million higher at 30 June 2020 (compared with €23 million higher at 31 March 2020).

If the plan accounting liabilities under international accounting standards (IFRS) in respect of pensioners were €100 million, the buyout cost would be broadly €14 million higher (compared with €19 million higher at 31 March 2020).

Germany Market Opportunities

- There is no minimum funding requirement in Germany, and many retirement obligations remain unfunded. Increasingly we do see companies funding their retirement benefit obligations, and there are now tax incentives (and an 80% reduction in the insolvency protection premium) available in case that benefits are funded using a “Pensionsfonds”
- For the DAX30 constituents, the funding level disclosed in the published accounts was 66% in 2019 (Plan Assets of €270 billion compared to Liabilities of €405 billion)
- Reinsurance is commonly used for deferred compensation plans, which offer a tax-incentivised method of saving for retirement with higher limits on contributions than other methods available as a private individual.

NOTES

The illustrations are based on values used by German life insurers, public information and a representative sample of a retiree population. Due to the applied approximation method the Index is not suitable for any company - and plan-specific pricing.

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Mercer Pension Risk Exchange TM

A GROUNDBREAKING APPROACH TO PENSION RISK MANAGEMENT

Many defined benefit plans are now closed to new employees, but these plans still represent significant obligations for the company to manage alongside its on-going business. In addition to the company specific situation, economic factors are also driving up the demand for annuity transactions; however, the annuity marketplace can be hampered by long execution timelines and lack of price transparency. A plan sponsor requires robust information on the financial position of the company's pension plan, needs an understanding for how key financial metrics are developing over time, and values customized pricing information. This information must be accurate, up-to-date, and easily accessible.

CURRENT BULK ANNUITY MARKET CHALLENGES



UNPREDICTABLE MARKET

Each deal is unique and attracts different insurers. Deal pricing can vary dramatically.



PRICE VOLATILITY

Pricing fluctuates over time but is not visible to plan sponsors.



LACK OF PRICING TRANSPARENCY

Obtaining a price can be difficult and time consuming. Plan sponsors often don't know the price at which they should execute an annuity transaction.

MERCER PENSION RISK EXCHANGE TM

WHAT IS IT?



Access to regular pricing from insurers in order to assess the true market price of a deal.



Helps sponsors execute a deal in a more competitive price environment and in a shorter time frame than is currently possible.



Allows plan sponsors to prepare data and documents in advance, enabling them to proceed quickly when the time is right.



Online and mobile-optimized solution that gives sponsors and trustees access to valuable information anytime and anywhere.

WHAT IS IT FOR?



PLAN
TERMINATIONS

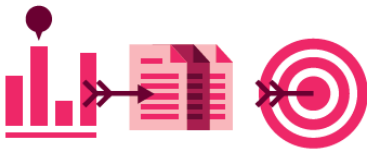


BUYOUTS



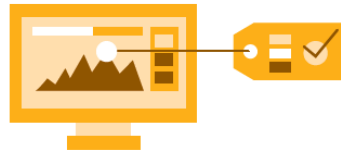
BUY-INS

How Does It Work?



READINESS

Mercer's systematic and disciplined approach finalizes and documents well in advance of the transaction, enabling swift execution. We advise on target price levels and plan metrics that should be monitored, and we establish triggers upon which to act.



DYNAMIC MONITORING

Our pricing platform allows insurers to submit regular bids for specific plans. This enables sponsors to continuously monitor their unique price and specific plan metrics and to execute when market conditions are optimal.



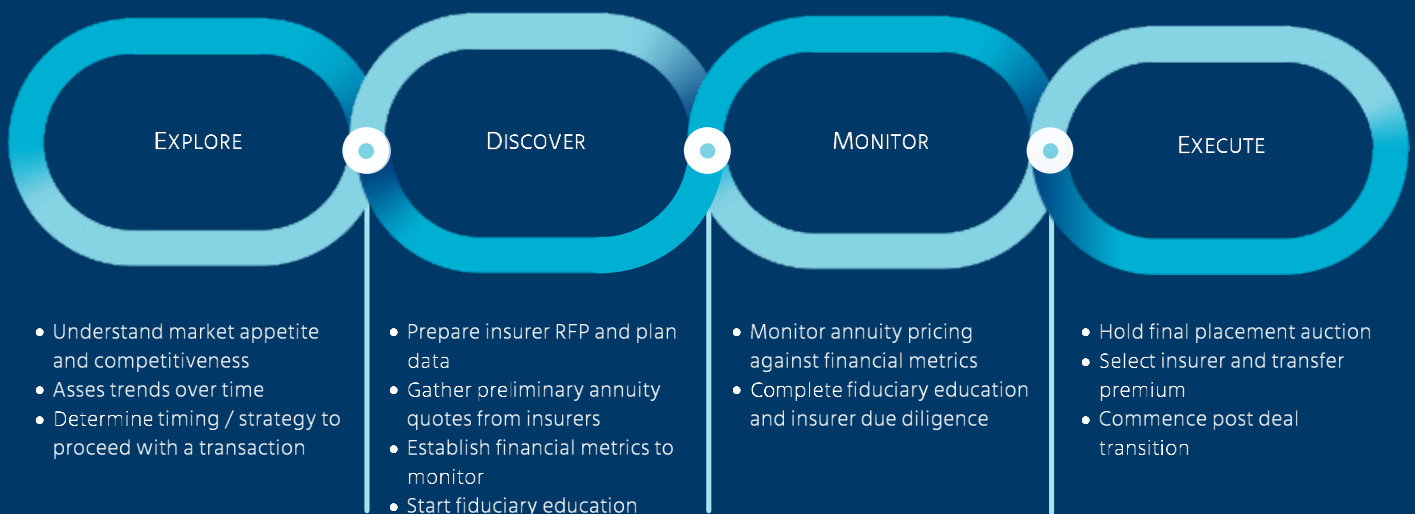
EXECUTION SUPPORT

Provides fiduciary training and insurer due diligence to support the final auction, insurer selection, and transition of responsibilities to the insurer, all while enhancing participant security.

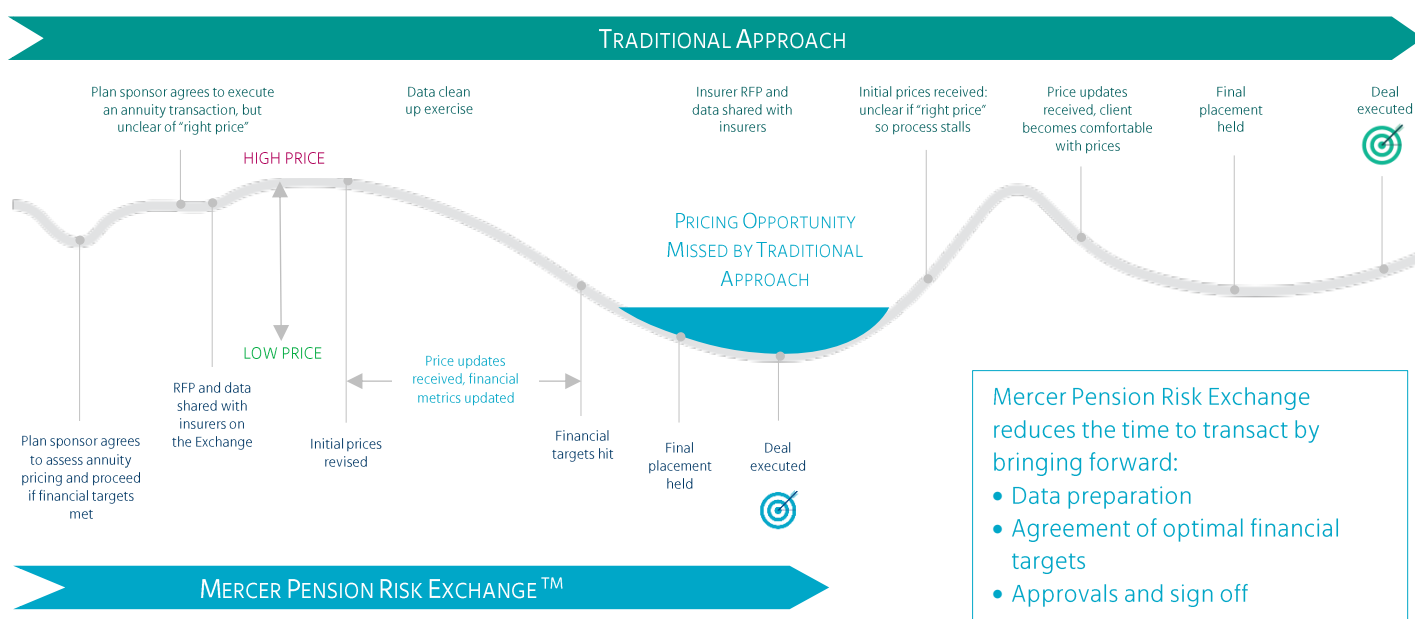
MERCER PENSION RISK EXCHANGE™ SUPPORTS YOU THROUGH EACH STEP OF THE ANNUITY PLACEMENT PROCESS

MERCER PENSION RISK EXCHANGE PROCESS

There are four components of the process. We work with our clients to understand the services that are the most applicable to their current situation, and timeline to execute a transaction. Our approach provides increasing financial certainty as a client moves through the purchase process.



TIMELINE



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