



# **An Innovative Approach to Strengthen Air Canada Pension Plans**

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# Summary of Investment Activities

# Latest Actuarial Valuation Results DB Pension Plans

## Canadian Plans (\$19.1B of assets)

	Surplus	Ratio
As of 01.01.2019	\$2.5B <i>(vs. \$2.6B in 2018)</i>	115% <i>(vs. 116% in 2018)</i>

## UK Plan (£318M of assets)

	Surplus	Ratio
As of 12.31.2017	£24.5M <i>(vs. -£21.9M in 2014)</i>	108% <i>(vs. 92% in 2014)</i>

## US Plan (\$137M of assets)

	Deficit	Ratio
As of 01.01.2019 (preliminary)	(\$21.5M) <i>(vs. -\$9.1M in 2018)</i>	87% <i>(vs. 94% in 2018)</i>



# Performance Summary

## Master Trust Fund

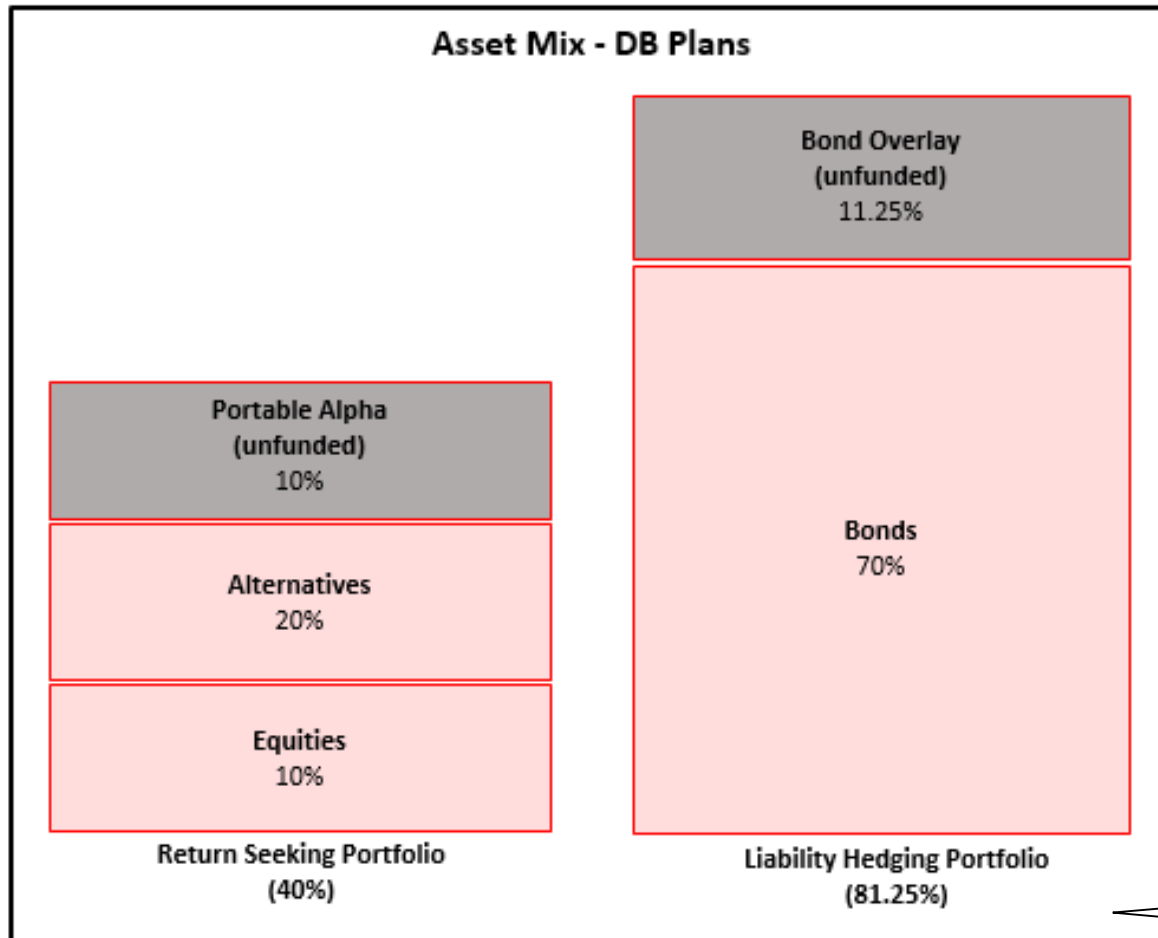
AC Canadian Plans	1 Year	4 Years
MT Fund Performance	2.2%	8.1%
Benchmark	0.6%	4.9%
Value Added	<b>1.6%</b> <b>(\$300M)</b>	<b>3.2%</b> <b>(\$2.2B)</b>

Universe of Peers	1 Year	4 Years
Top Quartile	0.9%	6.6%
Median	0.1%	5.8%
Bottom Quartile	-0.8%	5.3%
<b>Performance Ranking</b>	<b>1st Quartile</b>	<b>1st Quartile</b>

Source: BNY Mellon, Pension Funds above \$1B



# Investment Strategy



- The investment strategy can be split in two components:

**1) Return Seeking**

**Portfolio:** its goal is to generate extra return to keep pension costs at an acceptable level; and

**2) Liability Hedging**

**Portfolio:** its goal is to mimic the behaviour of the pension liabilities, which are sensitive to movements in long-term Canadian interest rates

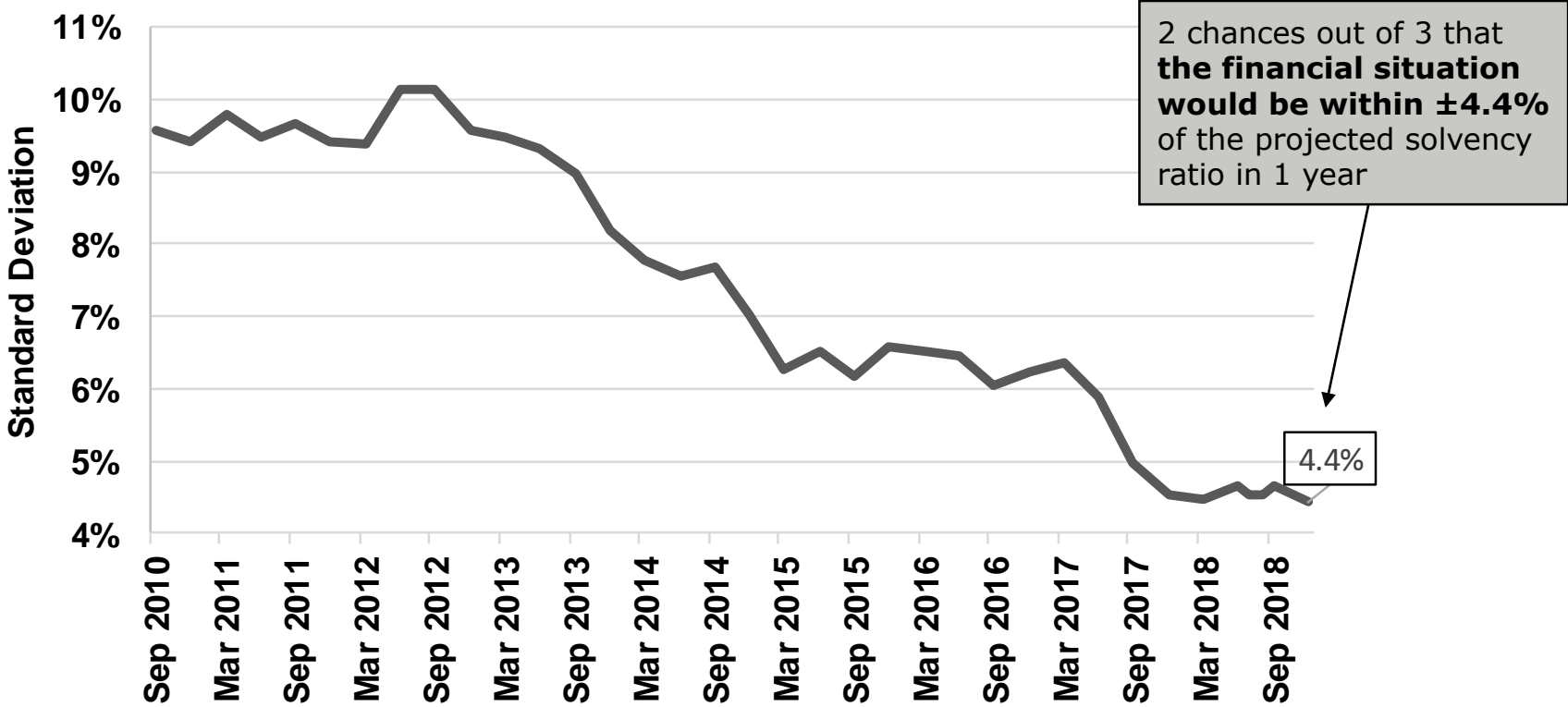
**81.25% will move with the Liabilities**

**Adds to more than 100% due to Overlay for Risk Management and Alpha Program**

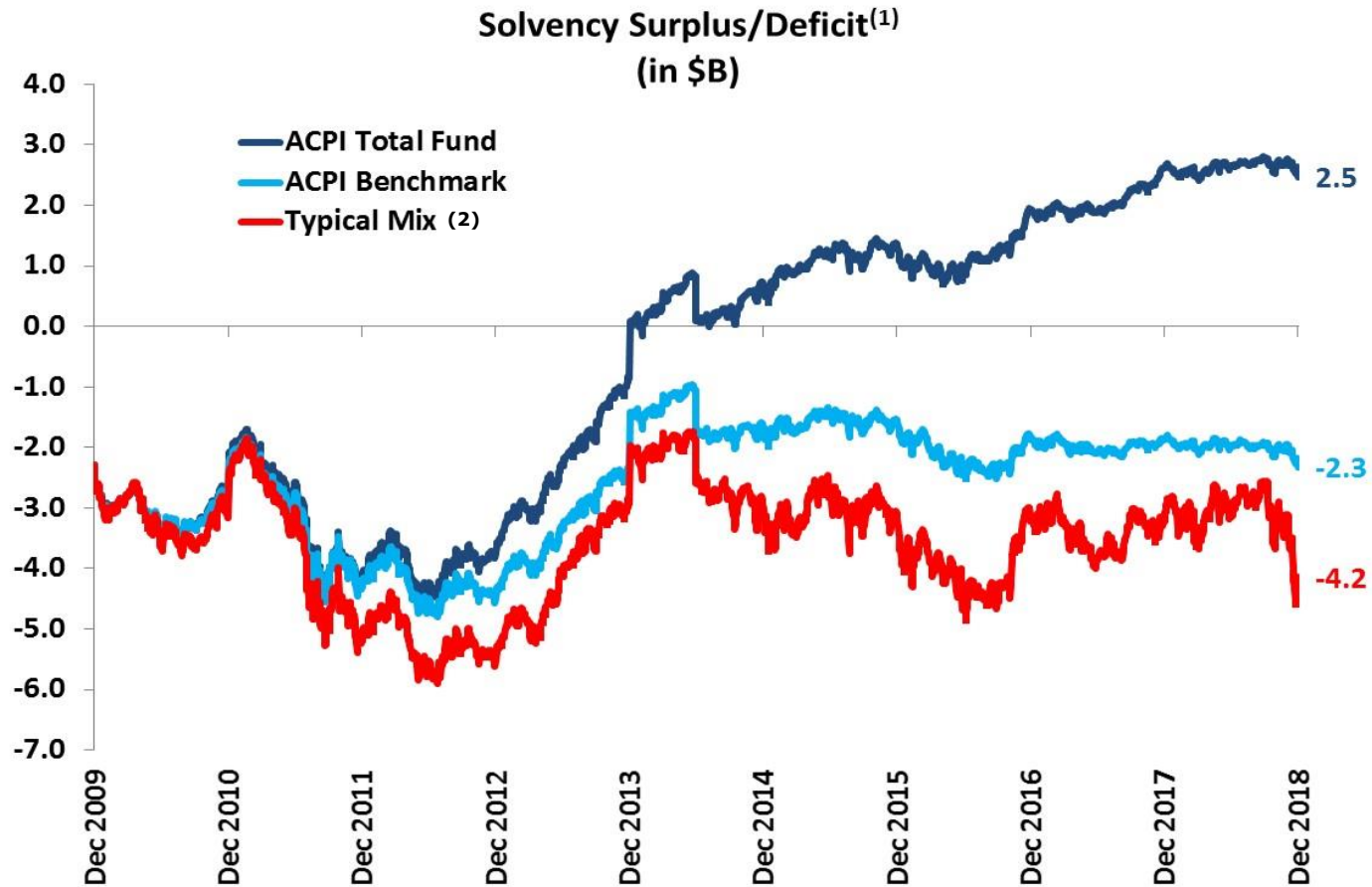


# Risk Assessment

### Current Portfolio Surplus Risk



# Solvency Surplus/Deficit since December 2009



- (1) From 2008 to 2017, year-end solvency figures are as per actuarial valuations. Projections are performed with the liability replicating portfolio and fund returns, adjusted for changes in annuity proxy spreads due to changes in CIA guidelines. The new "Replicating Portfolio Methodology" is used since September 30, 2014. The liabilities as of December 31, 2018 are from the latest actuarial valuation report.
- (2) The typical mix is composed of 2% 3-month T-Bills, 38% FTSE TMX CANADA Overall Universe Bond Index, 30% S&P/TSX Capped Composite Index, 30% MSCI World ex-Canada (in CAD).





# Update on AC Life



# **Air Canada Pension Plans' De-Risking Journey**

## **Guiding principles at the core of Air Canada's pensions**

- Protect plan members' pensions
- Ensure long term sustainability of pension plans

## **This entails that Air Canada must address and mitigate a number of risks related to its DB pension plans**

- Solvency risk
- Investment risk
- Interest rate risk
- Longevity risk



# Next Steps in De-Risking

## Purchasing annuities provides additional security to DB plan members

- Crystallizes investment and interest rate risks reduction
- Addresses DB Plans' longevity risk

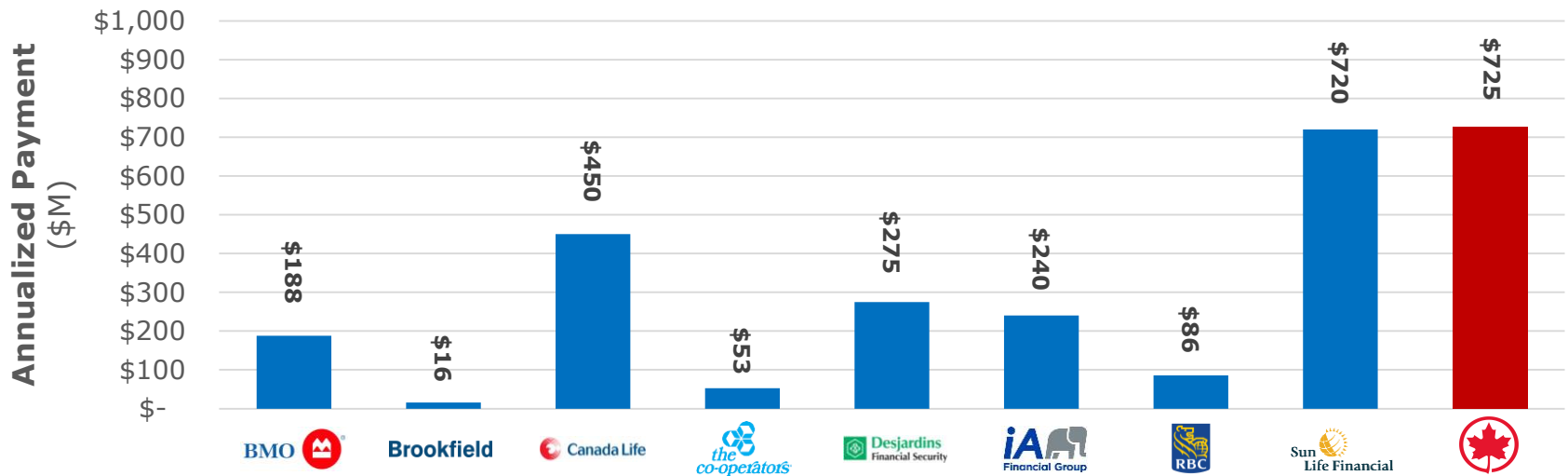
### But...

- Canadian Insurance companies have limited capital available
- Air Canada's DB plans are very big



# Next Steps in De-Risking

Canadian Group Annuity Market - Annuity Payments (2017)



Source: Willis Towers Watson, 2018

- Seeking to buy annuities through these insurers in the traditional way would be challenging, even if available in such large amounts, and unnecessarily costly



# Next Steps in De-Risking

To further Air Canada DB pensions' de-risking strategy, we have to **innovate...**

1. To allow for large but gradual purchase of annuities for our Canadian DB pensioners

**Leads to creation of  
AC Life Insurance Company (ACLI)**

2. Proposed structure: initially purchase annuities from licensed Canadian insurers, which would partially reinsure these annuities with AC's wholly-owned life insurance company



# Additional Protection for Pensioners

## Current

1. Pension plan assets & surplus
2. Air Canada's financial support



## Annuity Purchase under Proposed Structure

3. Well-known Canadian third party life insurance companies
4. ACLI, which will be subject to strict regulatory oversight and capitalized by Air Canada
5. Assuris (the insurer of Canadian life insurers)

**Air Canada essentially adds new levels of protection for pensioners!**



# Advantages of Buy-In Annuities

## Seamless for pensioners

- “Buy-in” annuities:
  - Pension payments continue to be paid by the pension plans to pensioners
  - Pensioners for whom annuities are purchased are still considered members of the plan and are entitled to future improvements, if any
- No action required from pensioners
- Permitted by plan texts and investment policies
- No material impact on solvency surplus of the pension plans

## Additional regulatory oversight

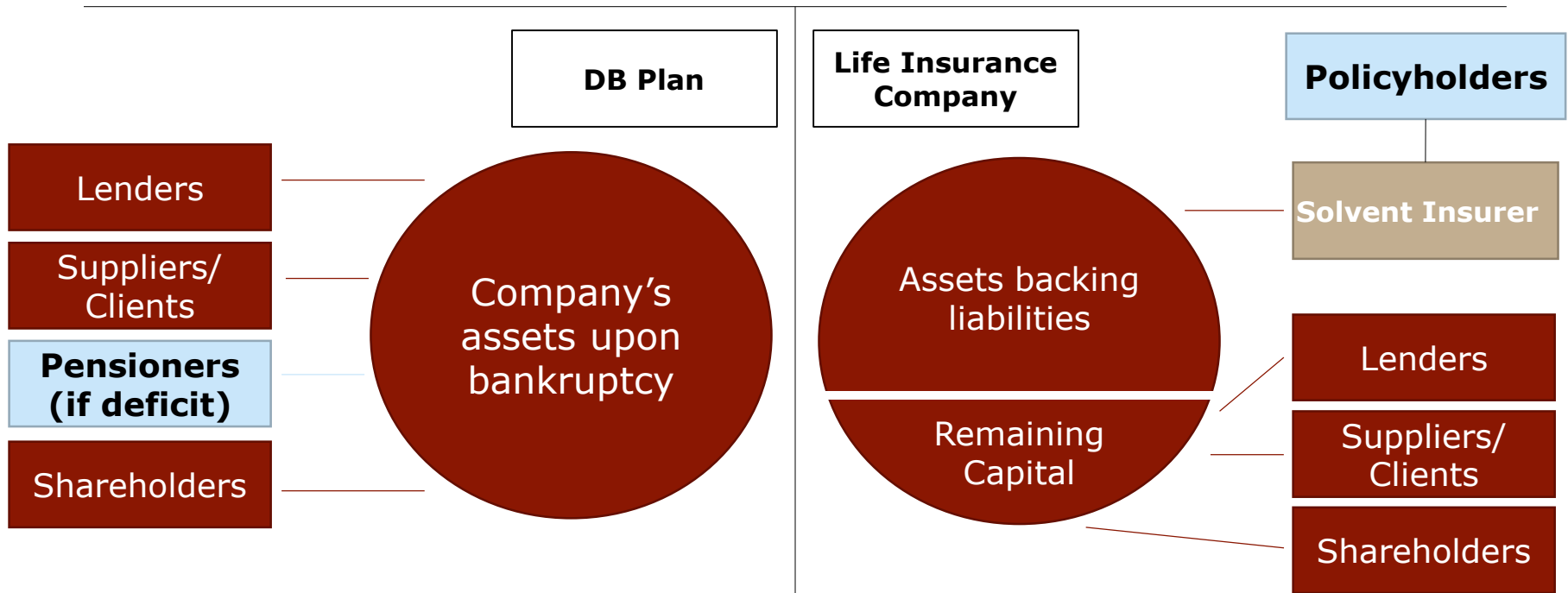
- Office of the Superintendent of Financial Institutions (OSFI) oversight
  - Rigorous regulatory and governance supervision and monitoring
  - Capital requirements monitored quarterly
  - Very strict management of investments and longevity risk

**Gradually crystallizes the reduction of pension plan risk for AC and increases security for Pensioners**



# Policyholders Priority – Pension Plan vs. LifeCo

**Policyholders** have priority over **creditors** in a LifeCo, contrary to **pensioners** in DB plans



Who gets what and how much is usually decided in Courts and can take years

Insolvency of a life insurance company does not mean that there are not enough assets to cover the benefit payments

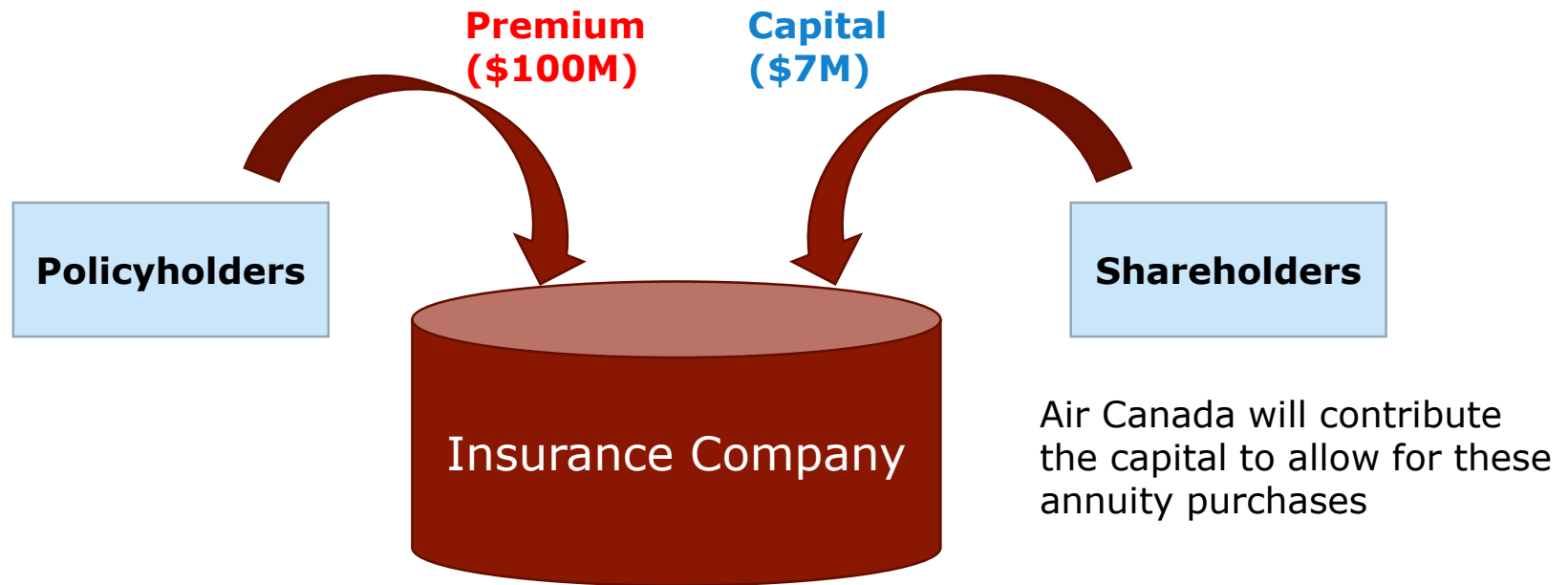
Predetermined mechanism to ensure **policyholders ranks first** in the liquidation



# Regulatory Capital Protects Policyholders

**An insurance company must have the prescribed capital in order to accept new business**

- **Premium** is roughly equivalent to the pension solvency liability and is paid by the Pension Plan for a buy-in annuity purchase
- **Capital** is required to protect against adverse situations and is paid by Air Canada in the form of equity



*Illustrative example of the principle, not actual calculated numbers*

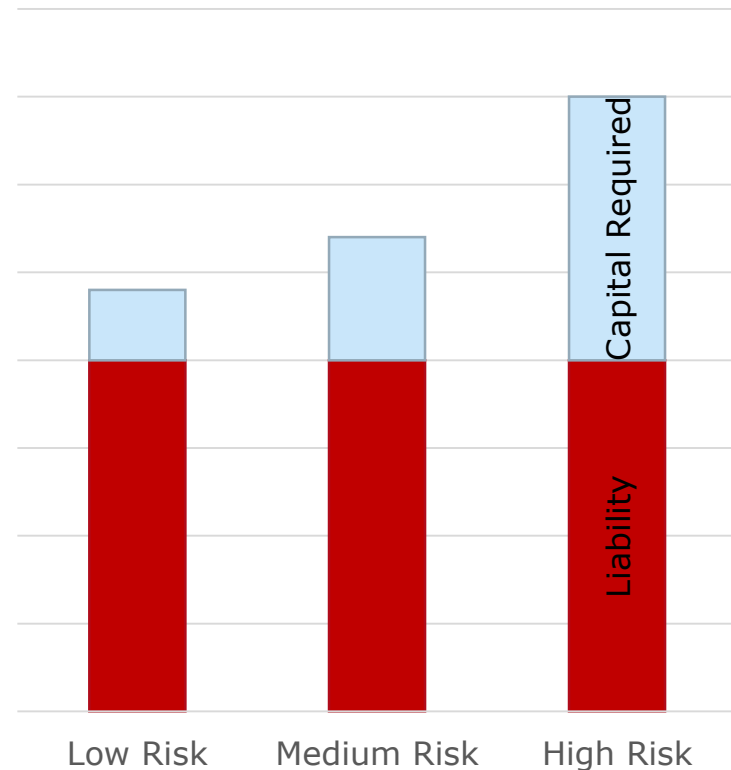




# Regulatory Capital Protects Policyholders

The amount of capital required is a function of the risk taken by the insurance company

- More risk → More capital is required (as prescribed by OSFI)
- For ACLI, risk-taking will be mainly driven by its investment strategy and aims to have a low to medium risk profile
- As ACLI is a new entity, **OSFI required 150% of required capital** for the first 5 years of operations



*Illustrative example of the principle, not actual calculated numbers*

**More risk taken by ACLI does not result in more risk for policyholders given additional required capital, it's mainly more risk for its shareholder**

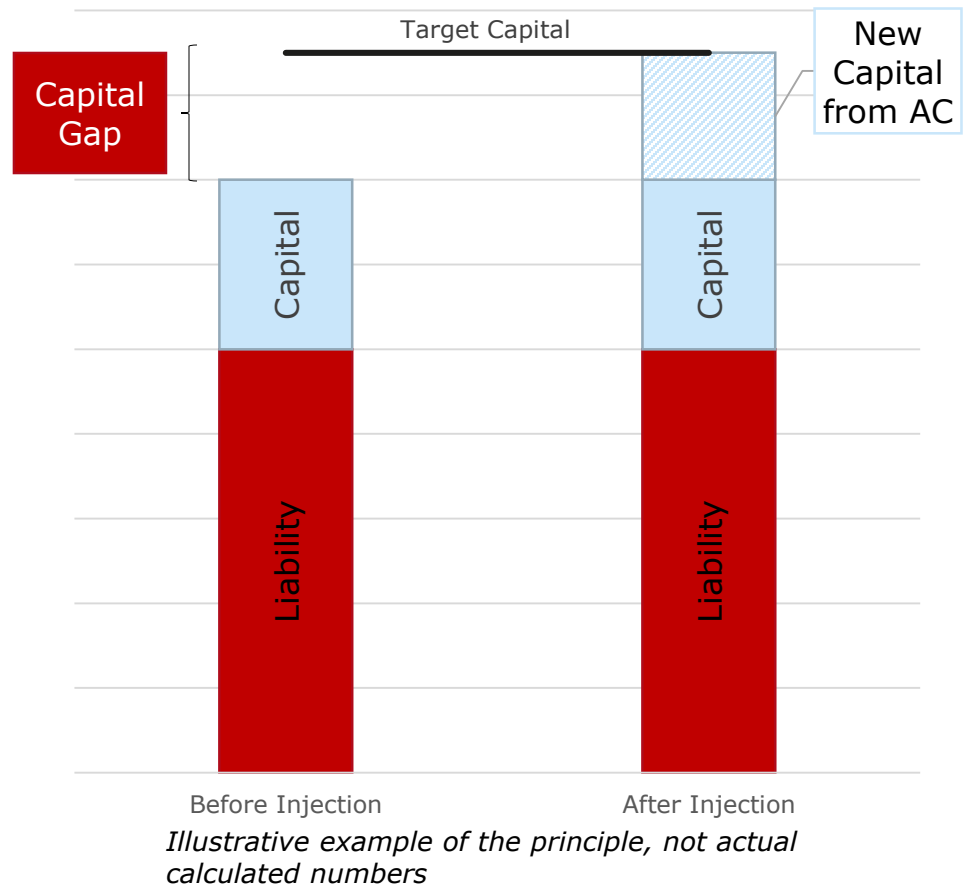


# Regulatory Capital Protects Policyholders

When capital drops below a prescribed target, the insurance company is required to raise more capital: the shareholders need to inject money in the company.

Monitoring of capital is done by OSFI every quarter-end.

An insurance company never wants to be asked by OSFI to raise capital. Instead, through its own risk assessment and internal capital management, it does so before being asked.



# Governance Framework

## Guiding Principles

Fair dealing

Transactions conducted at a fair market value

Compliance with laws

Transactions conducted in accordance with applicable laws and regulations

Maintaining the funding position

Transactions, when executed, not have a material impact on the solvency position of the Plans

De-risking

Transactions will strengthen the security of the DB pensioners' benefits



# Governance Framework

## Structure of Transaction

Fair market value of the liabilities to be determined by a third-party independent insurer

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- Competitive bid process
- Third-party insurer to retain a portion of the liabilities to ensure fair pricing and alignment of interest

## Policies and Guidelines

Robust and documented governance framework

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- Annuity purchase policy and guidelines to establish transactions framework
- Management of potential conflicts of interest would be a cornerstone of the governance framework

## Independent Oversight

Additional security for DB pensions

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- Regulated like other Canadian insurance companies by OSFI
- A committee would, supported by independent advisors confirm compliance with policies and guidelines

*\*As currently envisioned*



# Next Steps

- Obtain Life Insurance License from the Minister of Finance, on the recommendation of the Office of the Superintendent of Financial Institutions (OSFI)
  - Expected to be obtained by the end of 2019
- Hire personnel, implement systems and processes for ACLI
- Initial annuity purchase expected to occur in early 2020
  - Small initial transaction

We set forth an **innovative** and **progressive** approach to DB retirement plan management, which benefits our employees, plan members and pensioners, as well as the company





**Thank you!**

**Questions?**