

COVID-19 longevity scenarios: a bump in the road or a catalyst for change?

This paper discusses how the lingering after-effects of the global COVID-19 pandemic could affect longevity. We introduce four longevity scenarios that pension plans can use to help understand the increased longevity risk introduced by the pandemic and to stress test their funding strategies. These scenarios, together with consideration of other risks such as the strength of the sponsor and investment risk, can help pension plans quantify and communicate the potential ramifications of the coronavirus pandemic as part of their risk management framework.



Introduction

COVID-19 changed our lives in ways none of us could have expected. While our communities are showing impressive resiliency despite protracted stress, death rates are well in excess of those reasonably expected at the beginning of 2020 and we find ourselves in a situation unprecedented in modern times.

Not everyone has been impacted by the pandemic in the same way. Within our local and global communities, COVID-19 has brought to centre stage inherent health inequalities. This diversity in experience is important to remember as we try to understand the world post-COVID. We at Club Vita are hopeful that our disparate experiences will act as a catalyst to drive change in the future of healthcare access and delivery.

The question we receive most often from pension plan trustees and sponsors is 'what does this mean for me?' We've applied our skills and expertise to try to help narrow the range of possibilities by constructing four scenarios. Each scenario allows for the higher mortality during 2020, makes an assumption about how this will continue into the short-to-medium term (including allowance for knock-on impacts such as delayed medical treatments or economic fall-out from the pandemic), and charts a path for outcomes in the longer-term. Given the disparate outcomes for different individuals, we also provide the tools to allow users to adapt these scenarios for their own pension plans. Further details on each scenario and the calculations presented in this paper can be found in the accompanying Technical Appendix.

We hope you find these scenarios useful as you plan for a post-COVID world. We'd love to connect with you if you have any questions or want to explore our research further, so please reach out to us if we can help.

Wishing you a safe and healthy 2021,

Jennifer Haid CFA FSA
CEO, Club Vita



JENNIFER HAID

So, what's the scenario?

Scenario analysis for a pension plan is the process of assessing the effects of hypothetical events on the plan's future financial position. It allows us to assess the financial impact of potential risks arising from a complex system of possibilities, where outcomes are highly dependent on the interactions between many events.

To develop our COVID-19 scenarios,



we first create specific narratives around possible outcomes of the pandemic, considering events that will affect the severity of the pandemic and/or the longer-term outlook for longevity;



we then analyze how the components of these scenarios will affect key drivers of mortality; and finally



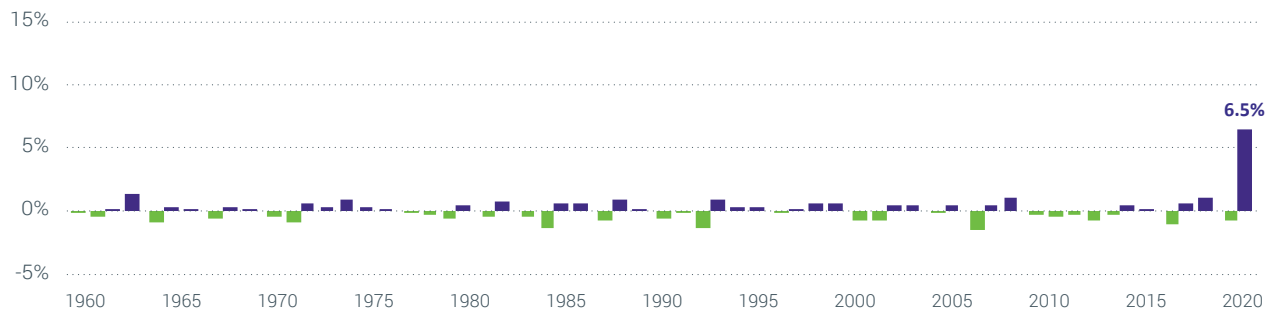
we calculate how the stresses of our key drivers will affect life spans of pension plan participants and the resulting effect on a plan's cashflows and present value of liabilities.

Our aim when constructing these different scenarios is to capture a range of tangible and plausible examples of how the world may emerge. Analyzing the development of your plan's finances under these different scenarios gives insights into the size and scope of the financial outcomes your plan is facing.

How unusual a year was 2020?

In the chart below we show how the number of deaths in Canada has varied from year-to-year, in percentage terms, compared to the underlying trend.¹

CANADA: EXCESS DEATHS VERSUS UNDERLYING TREND

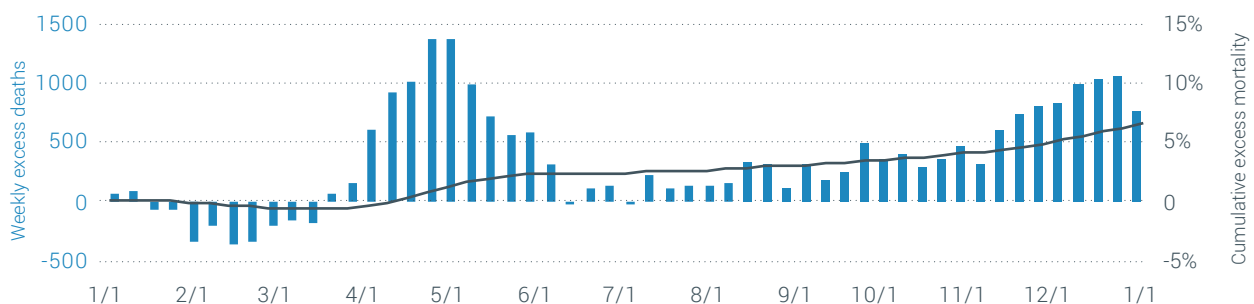


Source: Club Vita calculations based on data from the Human Mortality Database for years through 2018 and Statistics Canada data for 2019 and 2020. The 2020 result has been determined using expected and actual "adjusted" weekly deaths to November 7, 2020 published by Statistics Canada, with expected and actual deaths for the remainder of 2020 extrapolated by Club Vita, taking into account COVID-19 deaths reported by the Government of Canada.

The mortality rate in 2020 was around 6.5% higher than we would have expected at the start of the year. Even if we go back to the 1960s, 2020 is by far the biggest outlier in terms of excess deaths. The excess mortality experienced over 2020 has not been uniform across Canada, with the estimated increase for the Atlantic provinces combined being only around 1-2%, the increase for Québec and Alberta being approximately 8% and the increases for other provinces largely similar to or somewhat lower than the result for Canada as a whole.

The chart below shows how excess deaths in 2020 varied throughout the year. You can clearly see the spike of deaths due to the initial outbreak over late March to early June. After a period of control during the summer, the number of excess deaths again began to climb through the fall, continuing to the end of the year and into 2021.

WEEKLY EXCESS DEATHS DURING 2020 (CANADIAN POPULATION)



Source: Club Vita calculations based on Statistics Canada weekly adjusted deaths (i.e., actual deaths adjusted for late reporting) and expected deaths to November 7, 2020, with the weekly actual deaths for the remainder of the year estimated as expected deaths increased based on excess non-COVID-19 deaths experienced over the eight weeks prior plus actual reported COVID-19 deaths.

2020 was an exceptional year and a tragic one for many families in our communities. However, when thinking about pension plan finances, the impact of 2020 in isolation on liabilities will be small. This is because we only expect a very small fraction of pension plan participants to die each year, so even increasing this number by 10% or more leads to only a modest change to future cashflows. What is more important is the knock-on impact of COVID-19 on future improvements in life expectancy in 2021 and beyond.

¹ See the Technical Appendix for further details of how we calculated the underlying trend.

How will COVID-19 impact mortality in 2021 and beyond?

We have identified several key drivers that are likely to influence mortality rates in 2021 and beyond.



Immediate increase in deaths due to COVID-19

The latter part of 2020 saw good news in the development of several vaccines, but bad news in relation to a strong second wave of COVID-19 infections as well as the emergence of new strains of the virus which appear to spread more easily.

This driver considers factors that include the efficacy of vaccines, take-up rates, improvements in treatments for COVID-19 and continued adherence to social distancing measures. It includes the risk of mutation leading to a faster spreading or more deadly virus as well as reduced effectiveness of vaccine programs.



Disruption to non-COVID-19 medical care

During 2020, healthcare systems have been severely strained, and many individuals have not received the treatment they would have prior to the pandemic. This driver considers how long this disruption could last and what its impact could be on mortality rates in the short-to-medium term.



Changes to health and care systems

The pandemic has highlighted shortcomings in our health and care systems and exposed the high level of health inequality in our societies. Could the pandemic act as a catalyst to improve the existing public health environment – for example with an increased focus on preventative measures and improving population health? In addition, the pandemic has driven innovation in the healthcare system and in vaccine technology. Could this innovation help drive change in the longer term?



Global recession

On the other side of the coin, a long-lasting recession caused by the pandemic will limit the amount that governments, employers and individuals are able to spend on healthcare and on encouraging or making lifestyle changes which are associated with positive health outcomes. This driver captures the impact of a long-lasting economic downturn on the health of the population.

Variation by socioeconomic grouping

Different people have been affected by the pandemic in different ways. There is a range of factors that contribute to the risk of catching the disease, such as ability to work from home, population density or proximity to a local outbreak. There is another range of factors that affect how badly someone suffers once they catch the disease, such as pre-existing medical conditions, lifestyle risk factors and the level of healthcare available. Sadly, many of the factors contributing to a more severe impact of COVID-19 are most prevalent in the more disadvantaged sections of society. Inequalities are not unique to COVID-19, impacting outcomes from a whole range of diseases. Disadvantaged individuals will suffer most from cutbacks but *may* benefit most from public health initiatives arising from the pandemic.

We therefore also consider how each of our key drivers will vary by socioeconomic grouping.

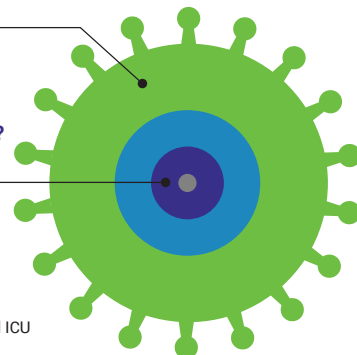
Who will catch the disease?

- Population density
- Living near a travel hub
- Type of work

Who will be worse affected?

- Pre-existing conditions
- Age profile
- Lifestyle risk factors
- Poorer healthcare

- Catch the disease
- Need hospital treatment
- Need ICU
- Die



Introducing our scenarios

Outcomes for our different key drivers will often be interconnected. For example, the successful development and deployment of an effective vaccine during 2021 should serve to reduce deaths from COVID-19, limit disruption to other services and constrain the economic damage caused by a long-lasting pandemic.

We have combined our drivers into four holistic scenarios, representing a range between optimistic and pessimistic outcomes in relation to longevity relative to pre-pandemic expectations.² We have presented the impact of these scenarios based on two hypothetical pension plans, one providing pensions indexed to inflation and another without any indexation. The larger liability impacts for the indexed plan versus the non-indexed plan are a result of the impact of longevity assumption changes increasing as discount rates decrease (i.e., the discount rate net of pension increases is lower for the indexed plan).



BUMP IN THE ROAD

COVID-19 has a short and isolated effect and, after a marked increase in deaths due to the pandemic in 2020 and 2021, trends return to the pre-pandemic rate, although with a couple of “lost years” of longevity improvement that will never be recovered.



CHANGE IN LIABILITIES

-0.6% INDEXED PLAN

-0.5% NON-INDEXED PLAN



INNOVATION IN ADVERSITY

We experience not only a swift recovery from the pandemic, but lessons learned during the outbreak of COVID-19 act as a catalyst for longer term improvements in health and longevity, particularly for individuals from lower socioeconomic groups who have been most impacted by the pandemic.



CHANGE IN LIABILITIES

+1.4% INDEXED PLAN

+1.0% NON-INDEXED PLAN



LONG ROAD TO RECOVERY

Challenges both to the efficacy and take up of the vaccine mean that society and the economy are left dealing with lingering effects of the pandemic for a prolonged period. The 2020s will be a decade of sluggish economic growth and low improvements in life expectancy.



CHANGE IN LIABILITIES

-1.8% INDEXED PLAN

-1.5% NON-INDEXED PLAN



HEALTHCARE DECLINE

The effectiveness of vaccine programs is limited by emerging mutations and adverse publicity limiting the uptake. The subsequent waves prove more deadly than those in 2020 and mortality rates remain elevated for much of the 2020s, creating a prolonged economic recession. Healthcare enters a downward spiral as our systems struggle to provide regular care during the ongoing pandemic.



CHANGE IN LIABILITIES

-3.9% INDEXED PLAN

-3.1% NON-INDEXED PLAN

² Other intermediate and indeed more extreme outcomes are of course possible.

BUMP IN THE ROAD

In this scenario, COVID-19 has a short and isolated effect. After a marked increase in deaths due to the pandemic in 2020 and 2021, we largely return to the pre-pandemic trajectory, although with a couple of “lost years” of longevity improvement that will never be recovered.



We assume that mortality is elevated in 2020 and 2021 (to a lesser degree) as a direct consequence of COVID-19. Following the successful rollout of the vaccine we return to the previous trend in longevity improvements from 2022 onwards, albeit with no “catch up” of lost ground (i.e., somewhat elevated mortality from 2022 onwards compared with pre-pandemic expectations).

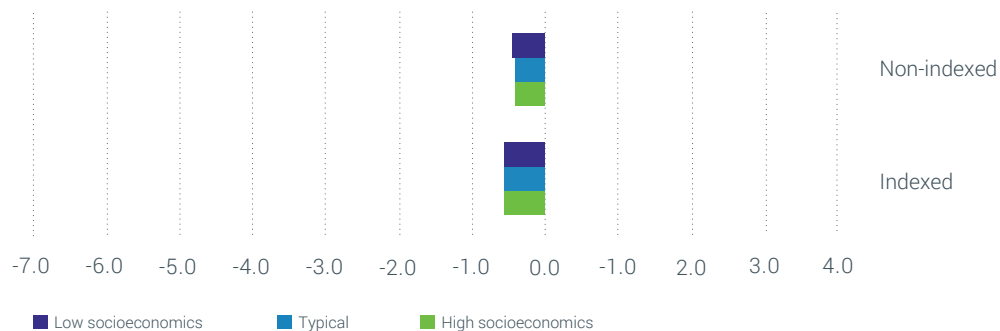
We note that this scenario incorporates the minimal possible set of events that we consider plausible in the future, so provides for a better comparator for assessing the impact of our other scenarios than the pre-2020 assumption.

The charts below show impacts for our “typical” plans, consistent with the prior page, as well as for variations of these plans after shifting the assumed socioeconomic mix higher and lower. The impacts for the low and high socioeconomic plans provide insight into how the scenario varies based on socioeconomic level but these are not meant to imply that they capture the full range of socioeconomic mix among Canadian pension plans. Further details can be found in the Technical Appendix.

LIABILITY IMPACTS BUMP IN THE ROAD



DURATION IMPACTS (MONTHS) BUMP IN THE ROAD



INNOVATION IN ADVERSITY

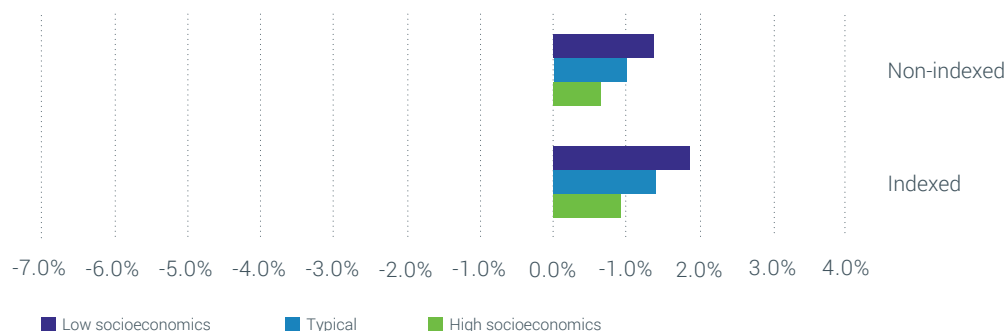
This scenario envisages not only a swift recovery from the pandemic, but also that lessons learned during the outbreak of COVID-19 act as a catalyst for longer term improvements in health and longevity.

We assume that the roll-out of vaccines proves successful during 2021, and direct COVID-19 deaths will be much lower from 2022 onwards. This release in pressure, in combination with a focused initiative on catching up on lost ground, means that disruption to non-COVID medical care is limited in impact beyond the first few years of this decade. This period of catch-up will be enabled by the emergence of a “V-shaped” economic recovery, with individual and public finances largely returning to pre-pandemic levels (albeit with large public finance deficits having accumulated during the pandemic).

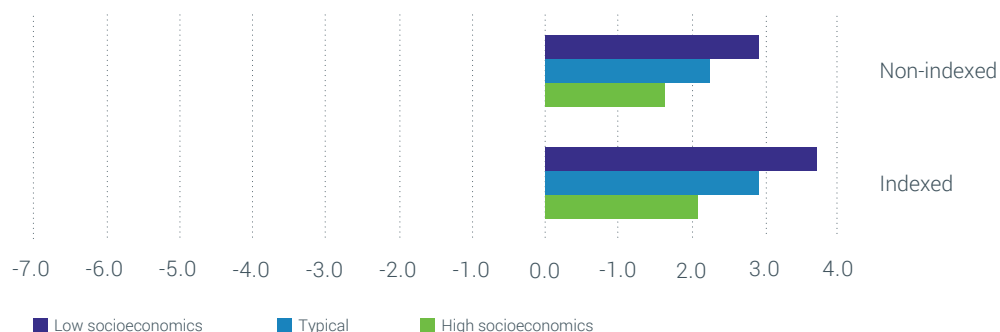
Once that lost ground has been recovered, the experience of the pandemic spurs on improvements in the way healthcare is delivered, with significant enhancements to long-term care. In addition, intensive efforts will be made to reduce the level of health inequalities that the pandemic has exposed. These aftereffects will lead to a sustained period of above average longevity improvements during the mid-to-late 2020s and early 2030s. These improvements will be enjoyed across the population, but lower socioeconomic groups will benefit the most due to the concerted drive to reduce health inequalities.



LIABILITY IMPACTS INNOVATION IN ADVERSITY



DURATION IMPACTS (MONTHS) INNOVATION IN ADVERSITY



LONG ROAD TO RECOVERY

In this scenario we assume challenges both to the efficacy and take up of the vaccine mean that society and the economy are left dealing with lingering effects of the pandemic for a prolonged period.

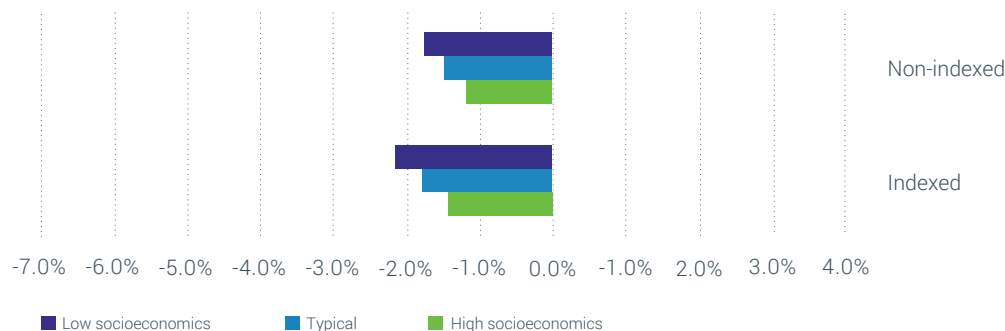
The 2010s have seen low levels of longevity improvement in many countries. Commentators have placed some of the blame for this slowdown on the lingering impact of the 2008 financial crisis. The financial crisis and ensuing spending cuts may have led to increased health inequalities over the same period, with the less affluent feeling the effects of strained finances more severely. This scenario anticipates that we will continue to see very low levels of longevity improvements during the 2020s and into the early 2030s as economic growth continues to falter and governments and employers continue to tighten the purse strings.

While reducing over time due to the emergence of effective vaccines, we will continue to see excess mortality driven by COVID-19 throughout the first half of this decade. Associated disruption to non-COVID medical care also continues to impact mortality rates throughout the decade. However, by the end of the decade we will have largely caught up and have reached a new state of equilibrium.

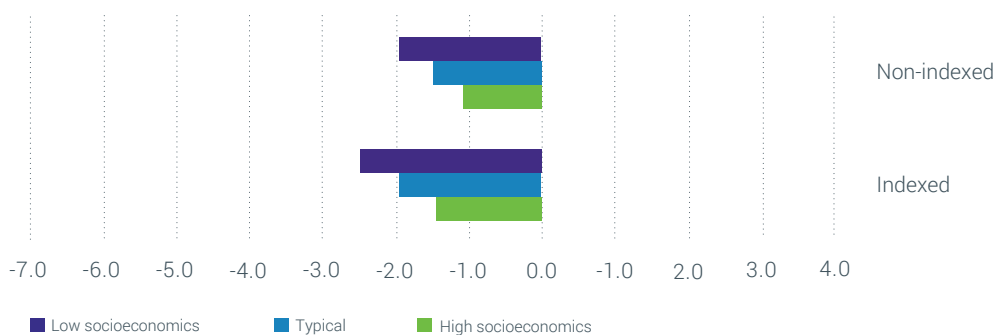
Individuals in lower socioeconomic groups will suffer the brunt of these cutbacks, either directly through a change in their personal circumstances (for example losing their job) or through cutbacks in employer-provided or public healthcare.



LIABILITY IMPACTS LONG ROAD TO RECOVERY



DURATION IMPACTS (MONTHS) LONG ROAD TO RECOVERY



HEALTHCARE DECLINE

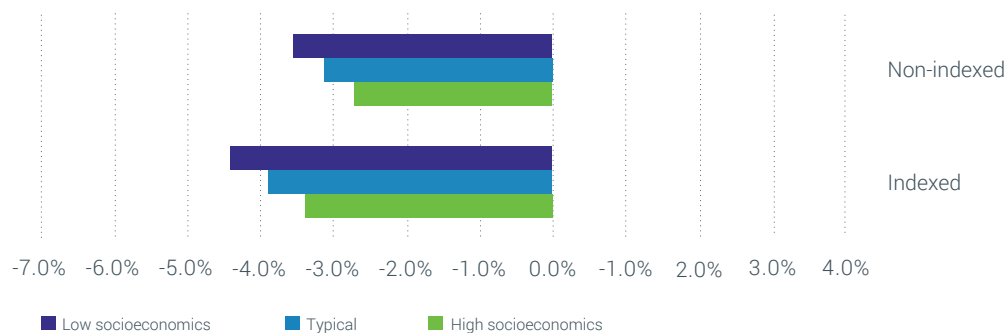
Initial optimism around vaccine programs proves unfounded, with adverse publicity limiting uptake and emerging new mutations limiting effectiveness. We will continue to see persistent waves of high COVID-19 mortality throughout the coming decade. Early 2021 will see mortality rates in excess of those seen during the first wave as hospital capacities are breached. Healthcare systems continue to be overwhelmed by each wave, with ongoing massive disruptions to non-COVID-19 medical treatments and no periods of catch up possible.



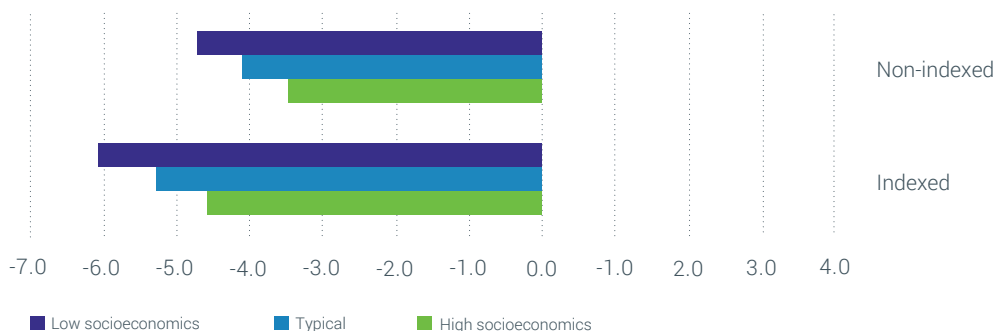
As the backlog becomes untenable, deficits build and as the economy continues to suffer, existing preventative measures (e.g., cancer screening services, health checks to spot cardiovascular disease and diabetes) are scaled back or increasingly rationed. This leads to a rise in undiagnosed or untreated conditions and elevated mortality from cancers, heart disease and degenerative mental diseases over the coming decades.

An increasing proportion of individuals will reach retirement in poor health, putting further strain on healthcare systems. Ultimately, COVID-19 will prove the catalyst which leads to high quality healthcare becoming increasingly a luxury item, leading to further growth in health inequality. Increases in life expectancy will stall or even go into reverse for some sections of the population.

LIABILITY IMPACTS HEALTHCARE DECLINE

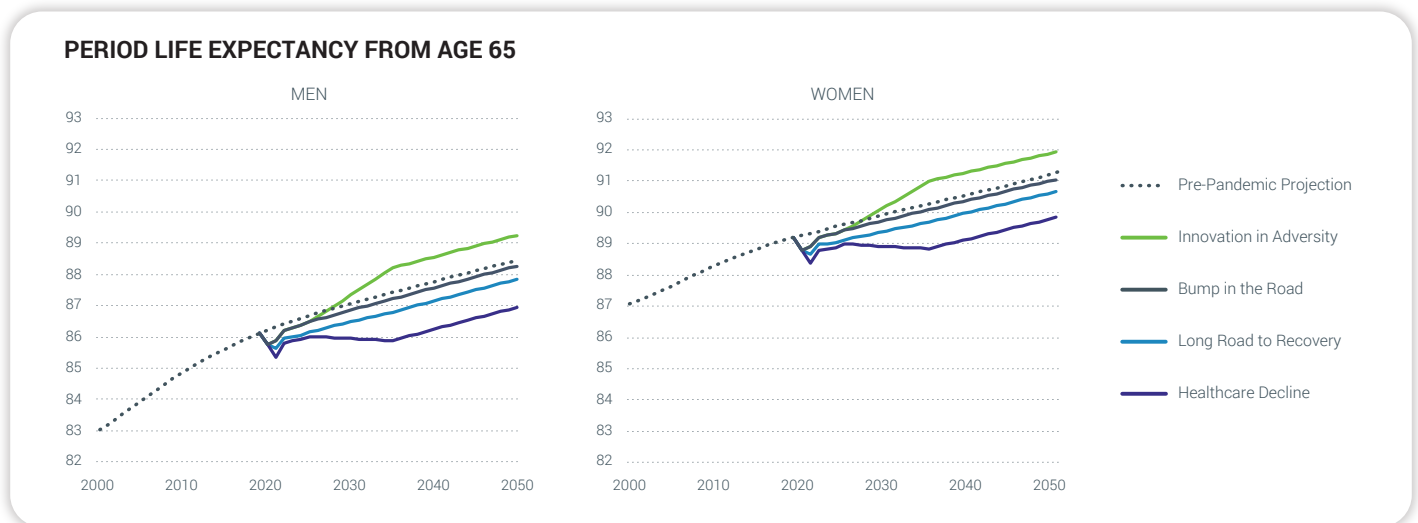


DURATION IMPACTS (MONTHS) HEALTHCARE DECLINE



Comparison of Scenarios

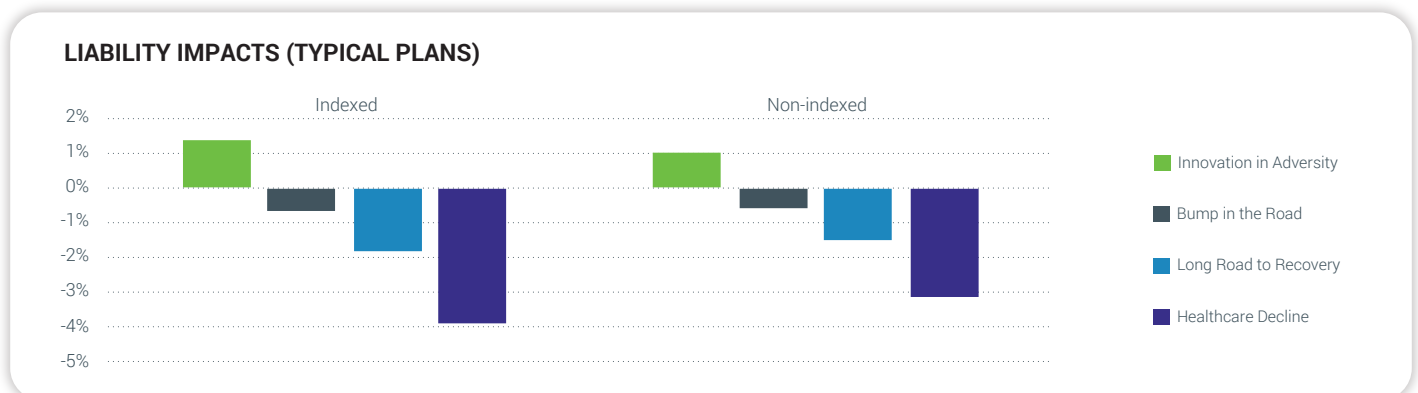
The charts below show period life expectancy³ from age 65 projected into the future under each of our scenarios next to an assumed “typical” pension plan assumption.⁴ We also show pre-2020 life expectancies smoothed in line with this typical assumption.



Period life expectancy is calculated for each year using the number of deaths occurring in that year. The extreme number of deaths experienced in 2020 and expected in 2021 mean that we see a sharp decline in period life expectancy in these years. None of our scenarios expect this level of excess deaths to continue past 2021, so period life expectancy would be expected to bounce back to some degree. This serves as a warning when constructing future life expectancy assumptions using data from 2020 and 2021.

Our most positive longevity scenario is our *Innovation in Adversity* scenario – with a significant gap in life expectancy opening up by 2035 compared to our *Healthcare Decline* scenario. Values are shown for a typical pension plan. For a more affluent mix of lives, the gap between scenarios will be smaller because the size of the impact of each scenario is highest for the lowest socioeconomic group and the impact reduces as socioeconomic status increases. Conversely, the gap will be larger for a less affluent mix of lives.

For typical indexed and non-indexed pension plans, the liability impact ranges from around a 1-1.5% increase to a 3-4% reduction. This range increases for plans with less affluent mixes of lives. These impacts only consider longevity risk and will be compounded or offset by any related outcomes in financial markets.



³ Life expectancy is shown on a period basis (i.e., prior to any allowance for future improvements). Please note that the projected life expectancy for individuals aged 65 will be higher when allowing for improvements; it is these projected (or “cohort”) life expectancies that underpin the liability impacts shown in this paper.

⁴ Our assumed typical assumption is the Canadian Institute of Actuaries MI-2017 improvement scale.

Interaction with other risks

In this paper we have focused on how the COVID-19 pandemic could affect the longevity of participants of defined benefit pension plans. However, when stress testing the funding strategies of your pension plan it is important to consider the holistic effects of a scenario on all risks to a plan. The events described in the scenarios in this paper will also have material effects on other plan risks, for example:

- **Funding and accounting bases:** any damage to the world economy is likely to affect investment returns, bond yields and rates of inflation, with knock-on effects for liability calculations.
- **Investments:** in addition to the significant movements in asset prices seen early in 2020, investment returns may directly correlate to how underlying businesses are affected by the pandemic.
- **Strength of sponsor:** some industries have been severely adversely affected by the pandemic, other industries less so and some have even benefited from the situation. The financial strength of government agencies will also be linked to tax revenues, that will be affected by the wider economy.

With so many variables still unknown, we cannot know for sure what the final impact of the COVID-19 pandemic will be, but with such an upheaval to everyday life as witnessed in 2020 and the start of 2021, we are likely to be talking about it for quite some time. We hope the scenarios we set out in this paper provide a helpful start to understanding the demographic risks introduced by the pandemic.

If you'd like to discuss COVID-19 longevity scenarios, or any wider aspect of longevity risk and the effects on your pension plan, please feel free to get in touch with Richard Brown at richard.brown@clubvita.net.

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Reliances and Limitations

In this research paper (the "Research"), Club Vita Canada Inc. ("CV") has provided to the Canadian pension industry a discussion around some potential impacts of COVID-19, including the impacts on defined benefit pension plans and a number of illustrative scenarios for how life expectancy may evolve in the future. The scenarios are not intended to represent the complete range of possible outcomes for pension plans. They are intended to be used by pension plans considering stress testing their funding strategies, as well as facilitating wider discussions on the potential impact of COVID-19. Further technical details of the calculations presented in this paper can be found in the accompanying Technical Appendix. The Research is based upon CV's understanding of legislation and events as of February 2021 and therefore may be subject to change. The Research is CV's high-level analysis of potential future scenarios and is not, nor is it intended to be, specific to the circumstances of any particular pension plan. The Research should not be construed as advice and therefore not be considered a substitute for specific advice in relation to individual circumstances and should not be relied upon. Where the subject of the Research refers to legal matters please note that CV is not qualified to give legal advice, therefore we recommend that you seek legal advice if you are wishing to address any of the legal matters discussed in this research. Please be advised that CV (or its respective licensors) does not accept liability for errors or omissions in the Research and CV (or its respective licensors) does not owe nor shall accept any duty, liability or responsibility in regards to the use of the Research, except where we have agreed to do so in writing. © 2021. The Research contains copyright and other intellectual property rights of CV and its respective licensors. All such rights are reserved. You shall not do anything to infringe CV's or its licensors' copyright or intellectual property rights. However, you may reproduce any of the charts and tables contained herein and quote materials from this report, provided the source of the material is clearly referenced by stating "Reproduced with permission from Club Vita Canada Inc. You must not rely on this material and Club Vita Canada Inc. does not accept any liability for it." If you are seeking to use the information contained in this research sometime after it was produced, please be aware that the information may be out of date and therefore inaccurate. Please consult the Club Vita website for publication updates or contact enquiries@clubvita.net.



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