The Ins and Outs of Pension Risk Transfer

By Mark Paracer
Associate Research Director
LIMRA Secure Retirement Institute

Plan sponsors offload the longevity, regulatory, and other significant risks associated with the pension plan through a practice called Pension Risk Transfer.

Sponsors of defined benefit (DB) plans operate in a very challenging environment. Regulatory changes, low interest rates, increased longevity, and stock market volatility have made offering a DB pension increasingly difficult. At the same time, Pension Benefit Guaranty Corporation (PBGC) premiums and administrative costs have increased, presenting another challenge.

Although plan sponsors use many strategies to address these concerns—freezing current DB plans, offering lump-sum payouts, or switching to liability-driven investment (LDI) strategies—an increasingly popular option is to partner with an insurance company. These companies are generally in a much better position to absorb risk than the average employer. Plan sponsors offload the longevity, regulatory, and other significant risks associated with the pension plan through a practice called Pension Risk Transfer (PRT).

PRTs handled by insurers most often take two forms: buy-outs and buy-ins. A pension buy-out occurs when plan sponsors purchase single-premium group annuity products, sold by insurers, in order to transfer some or all of the liabilities associated with their pension plans. By eliminating (or limiting) the pension liability from the employer's balance sheet with a buy-out, plan sponsors are no longer subject to (or enjoy reduced) administrative costs, including PBGC premiums and other costs associated with keeping the DB plans on the books. A pension buy-in occurs when a plan sponsor purchases an insurance policy that closely matches the liabilities of the plan. In contrast to a buy-out, the plan trustee or employer holds the contract as a plan asset and retains overall plan liability. Plan sponsors can also turn a buy-in into a buy-out at any time.

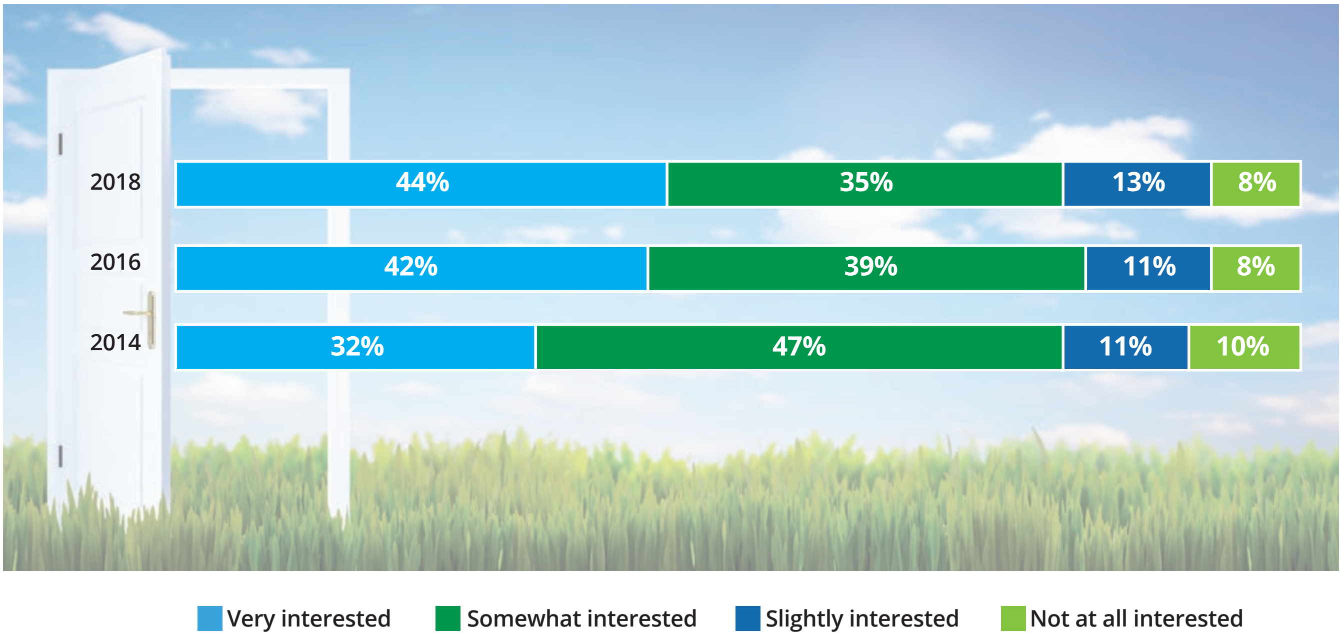
Plan Sponsor Interest in PRTs

There are more than $3 trillion in assets in private sector pension plans. As the PRT market has matured, both familiarity with and interest in these products have grown among plan sponsors. According to a LIMRA Secure Retirement Institute study, as of 2018 more than 4 in 10 plan sponsors that also offer a DC plan are "very" interested in PRT, marking a 12 percentage-point increase from plan sponsors surveyed in 2014 (Figure 1).

While most sponsors are looking to de-risk their pensions, not all are interested in PRT products. Just over

Figure 1

Plan Sponsor Level of Interest in PRTs



Based on 324 traditional DB plan sponsors in 2014, 258 traditional DB plan sponsors in 2016, and 199 traditional DB plan sponsors in 2018. Data exclude plan sponsors who already transferred their traditional pension plan liabilities through a risk transfer product.

Source: 2018 Plan Sponsor Survey, LIMRA Secure Retirement Institute, 2018.

20 percent of companies with a DB plan indicate they have little or no interest in PRT, for a variety of reasons (Figure 2). The top reason DB plan sponsors are not interested in PRT products (cited by 42 percent) is because they already address their pension risks through alternative means. However, while lump-sum payouts and LDI strategies can reduce some risk, they do not address all forms of pension risk. Sponsors should be encouraged to complete a comprehensive risk analysis to understand the strengths and weaknesses of their risk control strategies.

Another reason given for lack of interest in PRT is the perceived high cost of purchasing an annuity (30 percent). Whether the cost is high, actuarially speaking, depends on many factors, but transactions do require a large up-front payment. Some companies may not have the funding required for a PRT immediately available. Today's low-interest-rate environment could offer opportunities for financially healthy businesses, in order to fund a PRT, to take a bank loan to top off the funding of their plans and pay the insurance premium. This offers them the ability to de-risk and allows them a more controlled, manageable payback period.

Lack of knowledge (26 percent) about PRT remains a top three reason for lack of interest. For a company to make the right decision, they need a good understanding of their plans, the options, and solutions available. Insurance companies that can help educate CFOs on different ways to structure a PRT deal and the impact to the balance sheet may be well positioned to earn their business.

Figure 2

Reasons Plan Sponsors Are Not Interested in PRT Products

Top seven reasons

	2018	2016
Address risks through alternative means	#1, 42%	#3, 27%
High cost of purchasing annuities	#2, 30%	#4, 23%
Don't know enough about PRT	#3, 26%	#1, 40%
Negative perception of stockholders	#4, 21%	#7, 17%
Recommendation of plan advisor consultant	#5, 14%	#5, 19%
Funding ratio too low	#6, 12%	#6, 17%
Low interest rate	#7, 12%	#2, 27%

Based on 48 traditional DB plan sponsors in 2016, and 43 traditional DB plan sponsors in 2018 who are "not at all/not very interested" in PRT. Multiple responses allowed.

Source: 2018 Plan Sponsor Survey, LIMRA Secure Retirement Institute, 2018.

Big Deals and Increased Buy-Outs

PRTs are not new—they have existed since the passage of ERISA in the mid-1970s—and LIMRA has tracked the PRT market for more than 30 years. However, the industry has evolved dramatically since being reinvigorated by a surge in activity in 2012. Two *massive* single-premium buy-outs for portions of GM's and Verizon's pension plans, combined with other sales that year, pushed activity to nearly $36 billion. For 20 years or more preceding that era, PRT activity was muted, with total transferred assets hovering around $1 billion to $3 billion annually. This turning point foreshadowed a dramatic shift in the perception and popularity of PRTs.

Though assets transferred in 2013 fell nearly 90 percent from the peak, totaling $3.8 billion, 2013 sales still represented the second-highest total recorded since 1990 (Figure 3). Since that time, the market has seen increased sales each year, with a compound annual growth rate of nearly 38 percent. In response to the growing demand for PRT products, several insurers have recently entered this marketplace. As of 2019, 17 companies report PRT sales in our benchmark, up from 11 in 2012.

The steadily increasing popularity of PRTs is even *more* apparent when observing the total number of transactions over time (Figure 4). In 2013, following the jumbo deals in 2012, the industry combined to finalize 217 PRTs. The following year, that total grew to 278, and increased every year since. In 2018, the market saw 488 completed PRT transactions, more than double the total observed five years prior. After a strong second quarter, 2019 is again on pace to eclipse the previous year's total.

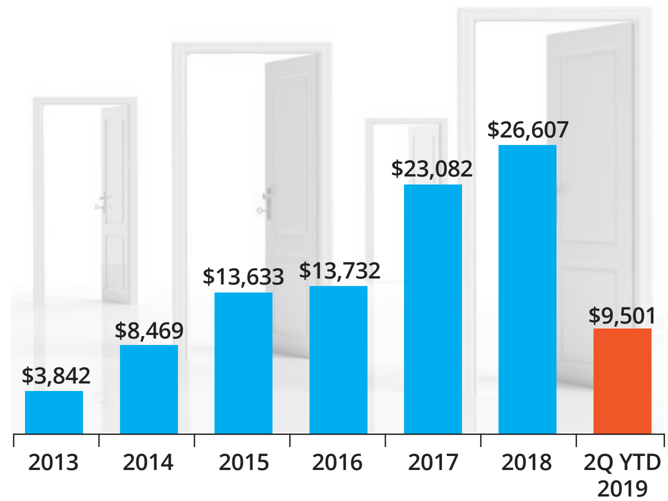
Buy-Ins Are Also Increasing

Historically, nearly all of the PRT deals in the United States have been buy-outs, as a buy-out can help sponsors reduce the headcount and thus lower PBGC premiums that are based per participant. Buy-in contracts, on the other hand, stay as assets of the plan and do not reduce headcount or PBGC costs. However, buy-in transactions can help companies lock in a cost and protect the plan liabilities from interest rate changes, market volatility, and mortality. Companies can convert to a buy-out when

Figure 3

Single-Premium Buy-Out

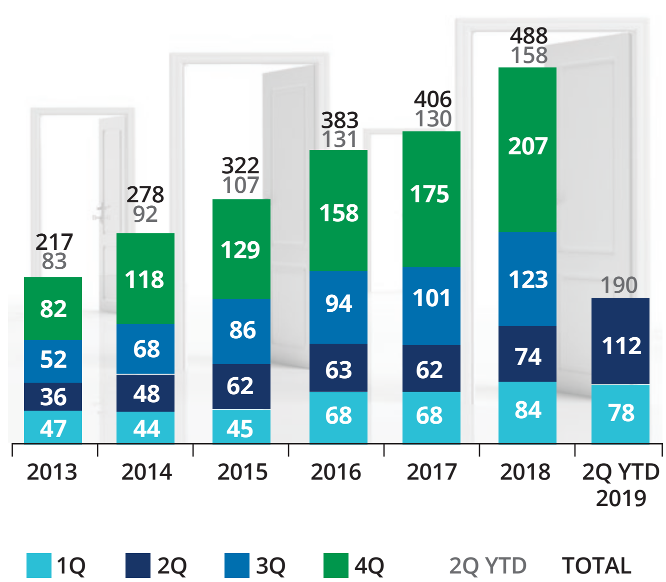
$ in billions



Source: Group Annuity Risk Transfer Survey, LIMRA Secure Retirement Institute, 2019.

Figure 4

New Contracts, Single-Premium Buy-Out



Source: Group Annuity Risk Transfer Survey, LIMRA Secure Retirement Institute, 2019.

it makes sense. While there have been only 18 buy-in contracts issued in the United States since LIMRA began tracking them in 2011, the second quarter of 2019 marks the fifth consecutive quarter with at least one buy-in contract sold (Figure 5). The market is also approaching $1 billion in buy-ins for the second straight year, possibly marking the beginning of a trend to watch going forward. As the buy-in market grows, some of the earlier-sold contracts have begun to convert into buy-outs.

8 out of 10 DB plan sponsors are very or somewhat interested in PRT deals, seeing them as an attractive de-risking opportunity to relieve their pension liabilities.

The Future Is Bright

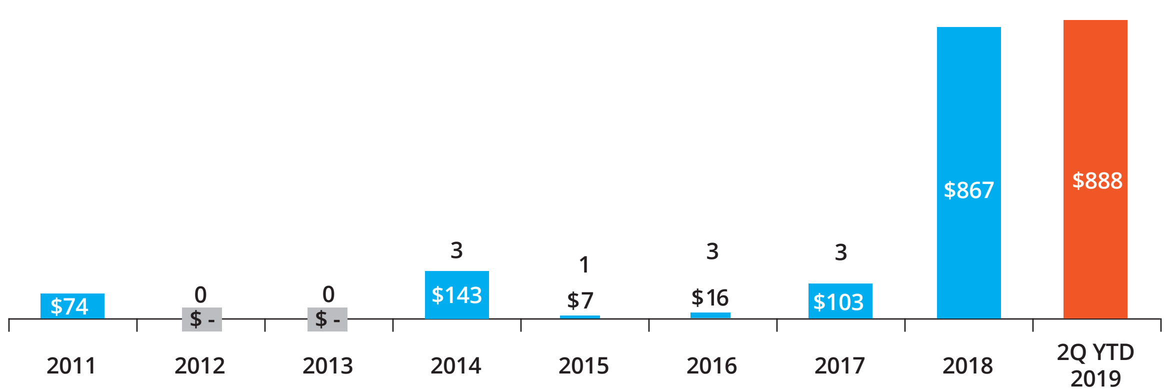
Many factors contribute to a challenging enviroment for pension plan sponsors, including interest rate changes, stock market volatility, increasing longevity of plan participants, and rising PBGC premiums. Lump-sum payouts, LDI, and other alternative means address some but not all of these risks. A PRT can be a more comprehensive solution.

Demand is strong for PRT products. Currently 8 out of 10 DB plan sponsors are very or somewhat interested in PRT deals, seeing them as an attractive de-risking opportunity to relieve their pension liabilities. We have already witnessed sponsors acting on that sentiment, as single-premium pension buy-out sales reached $26 billion in 2018, the highest year for sales on record (excluding the jumbo deals in 2012). All evidence indicates that the future of the PRT market will be positive, and we fully expect that the PRT market will continue to grow.

Figure 5

Single-Premium Buy-In Assets and Number of Contracts

$ in millions



Source: Group Annuity Risk Transfer Survey, LIMRA Secure Retirement Institute, 2019.

Interest rates and market changes will undoubtedly affect the funding levels of plans and may affect the timing of when it makes sense to execute a deal. While it is difficult to anticipate when a massive deal will come through, we expect the number of transactions will continue to rise throughout 2019 and beyond. With just over $10 billion and over 160 contracts in new PRT business so far this year, we predict final 2019 sales should come in between $20 billion and $25 billion, which is just short of 2018 totals. As the PRT market continues to evolve, companies looking to position themselves in this space can rely on the LIMRA SRI for key industry metrics and insights.

Mark Paracer is responsible for conducting research on retirement plans. He currently is the project director on the Stable Value, Group Annuity Risk Transfer, and In-Plan Income Guarantees benchmarks. He also runs the Stable Value, Retirement Plan, and Retirement Plan Asset Retention study groups. Prior to joining LIMRA in 2012, he spent 15 years in a variety of roles including competitive intelligence, operations, marketing, sales, and product development in the mutual fund, life insurance, and banking industries. He received his B.A. in economics from the University of New Hampshire. He can be reached at mparacer@limra.com.

As the PRT market continues to evolve, companies looking to position themselves in this space can rely on the LIMRA SRI for key industry metrics and insights.