Why the time is ripe for pension risk transfers

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With approximately $3 trillion in projected benefit obligations — and average funding ratios hovering around 80% — corporate pension plans are increasingly turning to pension risk transfer (PRT) strategies to remove those risks. MetLife's Wayne Daniel, senior vice president and head of U.S. pensions, digs into the factors driving the risk transfer trend.

|Q.| What kind of momentum are you seeing right now in the pension risk transfer market?

|A.| The market is extremely buoyant and we expect that to continue for some time. Only a small portion of existing corporate pension liabilities, roughly 5%, has been de-risked through transfers to insurers. Our recent MetLife 2017 Pension Risk Transfer Poll found that nearly nine out of 10 plan sponsors (87%) expect PRT activity in 2017 to be at least as, or even more, robust than the record $14 billion we saw in 2016.

The costs and complexities of running a plan are making it exceedingly more difficult for plan sponsors to manage their pension liabilities. In our survey, the two top catalysts for risk transfer cited by plan sponsors were increasing insurance premiums assessed by the Pension Benefit Guaranty Corp. and new mortality tables issued by the IRS. Given these market dynamics, we would expect to see significant flow of corporate pension liabilities through the PRT pipeline over the next decade.

|Q.| How are these deals structured? What kinds of deals are getting the most attention and assets?

|A.| Nearly all current PRT deals are partial risk transfers — for both open and closed plans. When you look at the full buyout cost of a pension liability, most plans cannot afford the significant cash contribution required. Plan sponsors often go to market in tranches, transferring only a portion of their overall liability at any given time. This approach allows plan sponsors to avoid potential capacity issues in the market and have greater control over the design, sequencing and cost of the liability transfer program.

We are also seeing plan sponsors be very strategic in deciding which participant benefits may be transferred at any given time, such as annuitizing only obligations for 'retirees-in-pay.' Transfers may also focus on retirees with higher average ages, because the duration of the liability is shorter and more easily matched with liquid fixed income assets. Participants with small average benefit amounts are prime candidates for risk transfer — the cost to the plan of keeping these liabilities, in terms of administrative expenses and rising PBGC premiums, is relatively

high compared to the small level of the participant benefit. With these smaller benefit amounts, the economics of risk transfer can be very compelling.

|Q.| What if plan sponsors are already using derisking strategies like asset-liability management (ALM) or liability-driven investing (LDI)? Can they use PRT as well?

|A.| We view derisking not as a single action but as a series of complementary actions that may stretch over a number of years. For example, data cleanup is often a multi-year process: that is, making sure the plan has good data not just on retirees, but also on the deferred participant population and any contingent or dependent beneficiaries.

What's your prediction for PRT volume in 2017?

9%
Don't know

5%
Less than 2016

24%
About the same as 2016

63%
Greater than 2016

87%
Greater or about the same

Note: Percentages may not total 100% due to rounding.
Source: MetLife's 2017 Pension Risk Transfer Poll

Likewise, aligning assets and liabilities using LDI or ALM principles can be viewed as an essential preparatory step, as it can take years to design and implement. Once a pension plan has embarked along this path, the emphasis on high-quality fixed income assets (i.e., publicly traded, highly liquid, highly rated) creates portfolios that are ideal for transfer to an insurer's balance sheet. If the ALM

program has been effective, these assets may also be ideal in terms of duration and cash-flow-matching characteristics against specific retiree liabilities. Such initiatives put plan sponsors on a more solid footing for when they are ready to move forward with liability derisking, especially pension risk transfer.

Multi-billion-dollar jumbo PRT deals, like those seen with General Motors and Verizon in 2012, set a precedent for asset-in-kind transfers. Since then, insurers have developed a better sense of the mechanics of asset-in-kind transfers, and now it is not uncommon to see such transfers as part of a $100 million or $200 million deal.
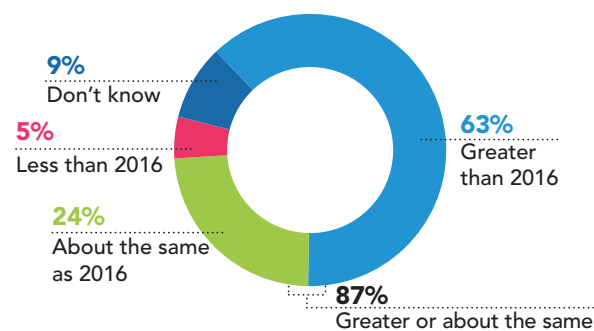
|Q.| What are plan sponsors looking for from insurers in terms of protecting the interests of participants?

|A.| You could say that a big part of any insurer's business portfolio is longevity risk: that is, assuming, pooling, and managing longevity risk to provide financial security for all of the company's policyholders including, in the case of PRT, annuitants and their beneficiaries. Fiduciaries want that experience. They are looking for the highest levels of financial strength. They need insurers to meet all the criteria set out in the Department of Labor's Interpretive Bulletin 95-1.

But honestly, all those aspects of the business are increasingly feeling like table stakes. Plan sponsor due diligence is increasingly emphasizing bespoke areas. Because, while participants will be receiving exactly the same benefit as they were before, their experience of the transfer needs to be seamless. Plan sponsors want to know: Can you take on tens of thousands of new policyholders with the complexity and specific risk profile of my participants? What about data security and customer privacy? What kind of communications and customer service capabilities do you bring to the table? Can you handle the enormous administrative tasks, like sending out tens of thousands or even hundreds of thousands of tax forms?

In addition to governance and fiduciary concerns, plan sponsors insist on knowing that, once the transaction is done, the insurer has all the capabilities necessary to make participants feel like they have landed in a safe harbor. ∎

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