

Pension Risk Transfer

Middle Atlantic Actuarial Club

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Pension Risk Transfer Basics

Pension Risk Transfer (PRT) 101

- Defined benefit (DB) plans are offered by employers to their employees and specify a pension payment (or lump sum) upon retirement
 - Benefit amount is determined by a number of factors including years of service, age at retirement, and salary
- Many associated risks:
 - Longevity risk: Participants live longer than expected
 - Investment risk: Funds set aside for paying benefits fails to achieve expected investment returns
 - Interest rate risk: Interest rate fluctuations will change required sponsor funding contributions
 - Asset/liability risk: Liabilities exceed assets
- There's also the effort and cost of administration of the plan
- Plans can be restructured or participants can be offered lump sums, but we focus on transfers of liabilities and assets to insurance companies

PRT Terminology

- Plan sponsor = The employer which maintains the pension plan
- In-pays/retirees = plan participants who are already receiving monthly payments
- Deferred lives = plan participants who have not yet begun receiving monthly payments
 - Actives = still employed with the plan sponsor
 - Terminated vested = former employee who became vested (i.e. eligible to receive pension payments) before employment terminated with the plan sponsor
- Pension Benefit Guarantee Corporation (PBGC) = A U.S. government agency established in 1974 aimed at protecting retirement incomes from DB plans in the event of sponsor bankruptcy

Pension Risk Management

- Sponsor company could retain risk but minimize
 - Change plan design
 - Asset allocation
 - Diversification and lower volatility
 - Need to understand the cash flows
- Sponsor company could transfer or remove risk, in a number of ways
 - Termination vested lump sum offer
 - Active lump sum program
 - Full plan transfer
- PRT is the transfer of risk from defined benefit pension plans

Plan Sponsor Considerations

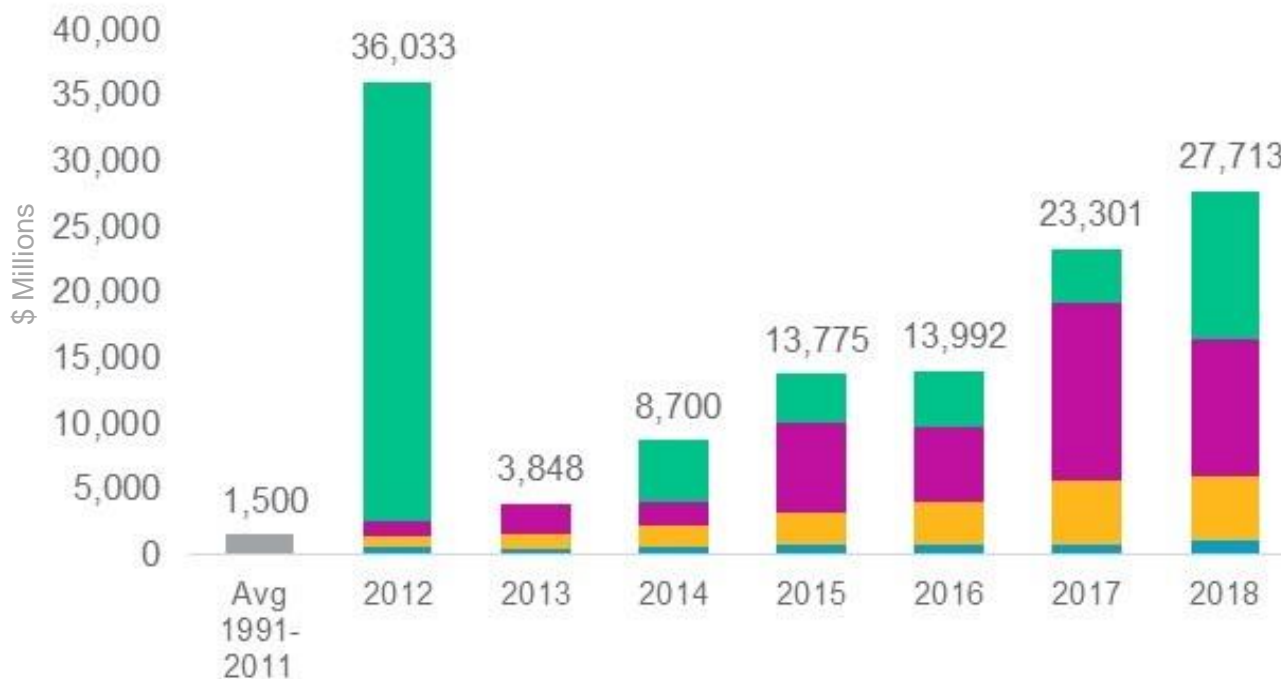
- Vanguard 2019 survey of pension sponsors
 - Nearly two-thirds of respondents stated they intend to make a change to their pension plan
 - Nearly half of those surveyed are expected to execute a risk transfer
- Primary financial objectives
 - 35% said it is minimizing volatility in plan contributions and funding ratio
 - 30% said it is minimizing the long-term cost of the pension plan
 - 25% reported it is obtaining full funding

Source: <https://www.plansponsor.com/db-plan-sponsors-focused-cost-funded-status-concerns/>

PRT Market and Drivers

Annuity Purchase Marketplace

Annuity Purchase Transaction History – 1991 to 2018



1991 – 2011 Source: Estimated LIMRA

2012 – 2018 Source: Willis Towers Watson Pension Risk Transfer Survey; includes history for

16 insurance companies through December 31, 2018. Excludes Weyerhaeuser transaction that closed in Q1 2019 and Bristol-Myers Squibb transaction which was announced but has not yet closed.

■ Small <\$10M ■ Mid \$10M - \$100M ■ Large \$100M - \$1B ■ Jumbo > \$1B

Annuity Purchase Marketplace - Continued

- Total 2018 activity exceeded \$27B. Early indications are that 2019 will have continued growth in the annuity purchase market.
- Eight new insurance companies entered the market since 2014, for a total of 16 insurance companies
- Small Benefit Retiree Annuity Purchase (SB RAP) deals are prevalent
- Willis Towers Watson was the strategic advisor on \$10.8B of transactions in 2017 and \$17.6B in 2018.
- Note that historically 70%+ of the year's transactions are completed after 7/1
- While these figures are significant, this is still a small portion of total DB market of approximately \$2.5 - \$3.0 Trillion

Notable 2018 and 2019 Public Transactions

- FedEx (\$6.0B, 41,000 retirees)
- International Paper (\$2.9B, 68,000 retirees over two transactions 2017-2018)
- Lockheed Martin (buy-out \$1.8B, 32,000 retirees; buy-in \$0.8B, 9,000 retirees)
- Weyerhaeuser (\$1.5B, 28,500 retirees)
- Bristol-Myers Squibb (\$3.8B plan termination of 24,200 participants through lump sums and annuity purchase)

Number of Transactions Greater than \$10M



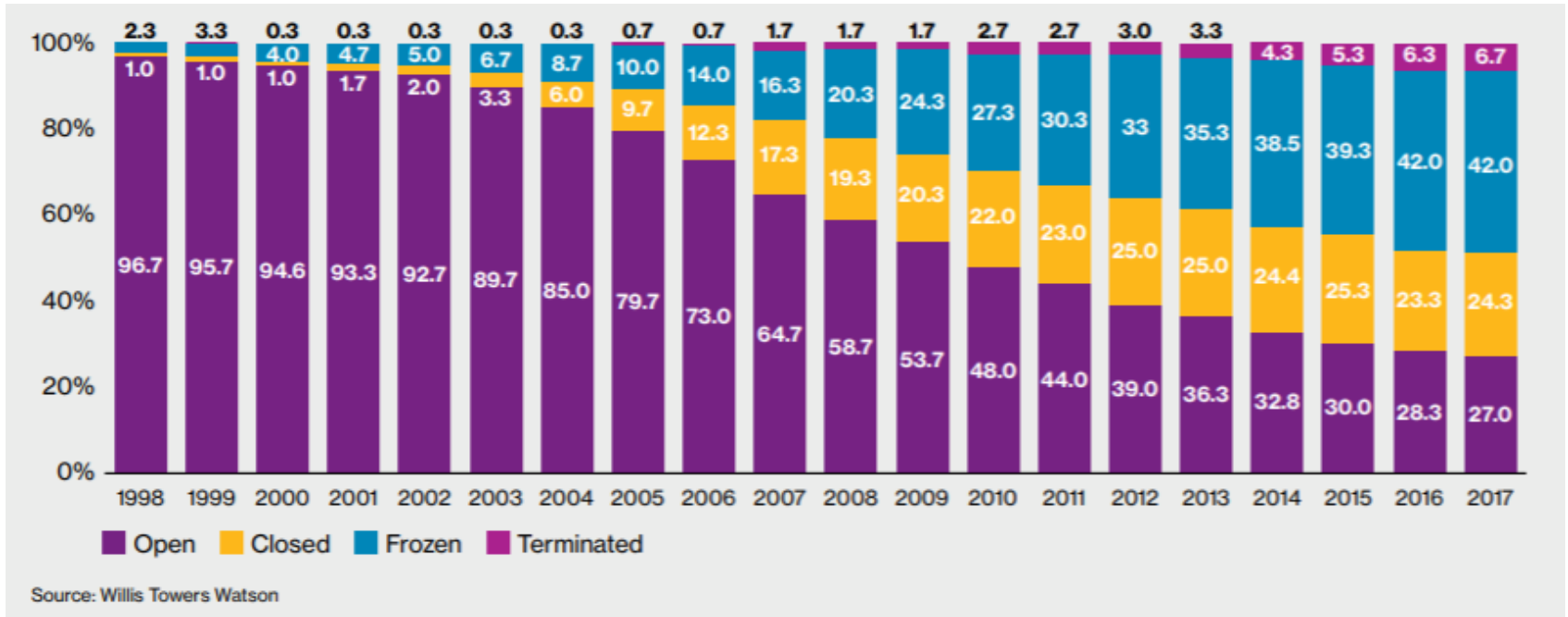
1991 – 2011 Source: Estimated LIMRA

2012 – 2018 Source: Willis Towers Watson Pension Risk Transfer Survey; includes history for 16 insurance companies through December 31, 2018. Excludes Weyerhaeuser transaction that closed in Q1 2019 and Bristol-Myers Squibb transaction which was announced but has not yet closed.

Catalysts for PRT

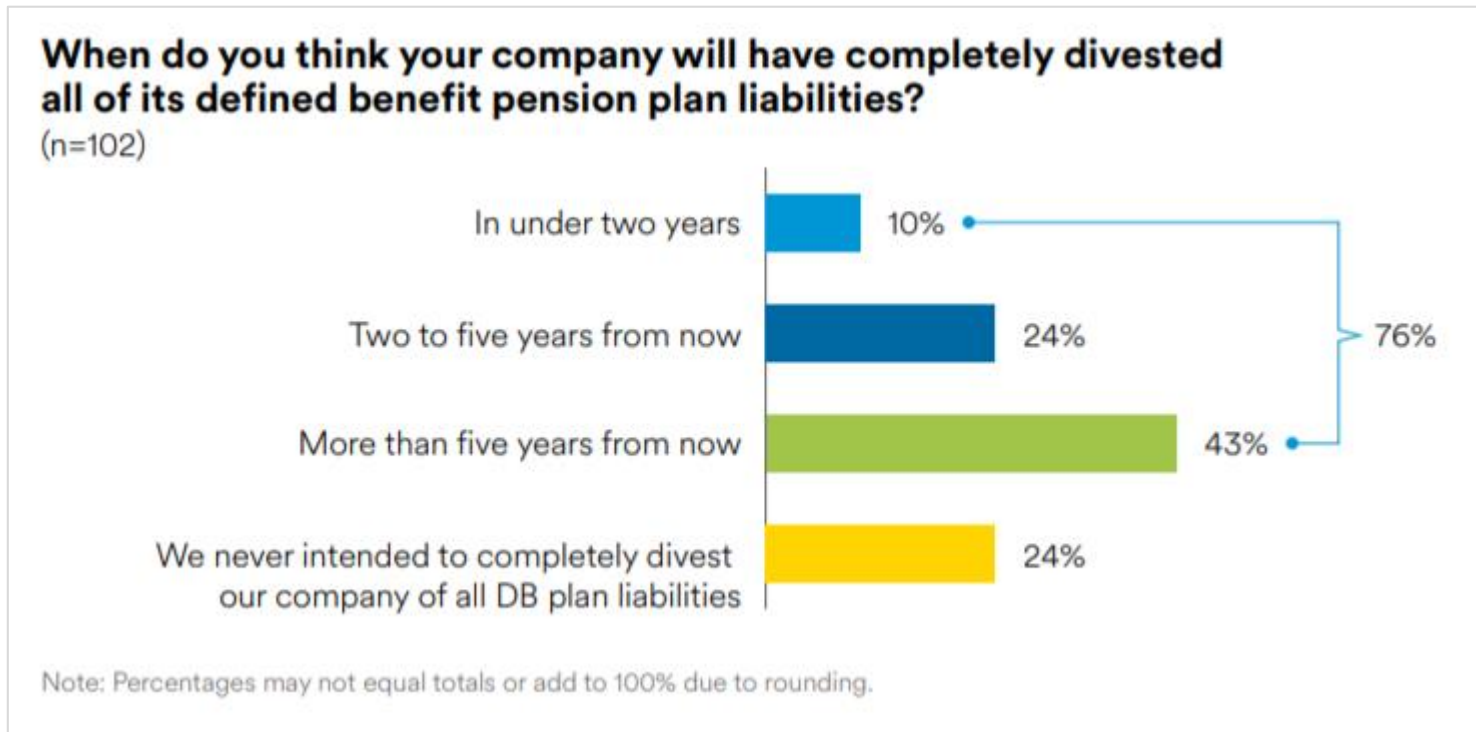
- PBCG premium changes
 - PBCG is not funded by tax revenues
 - Operations are financed by insurance premiums paid by sponsors of DB plans
 - Flat rate premiums (per participant) have steadily increased from 2012 through 2019, more than doubling over this time period
 - Variable premium (per \$1,000 of unfunded vested benefits) have also increased
- Changes in economic and regulatory environment
 - Greater volatility in balance sheet and income statements, as well as in funding requirements
- Growing prevalence of defined contribution plans
- Many Fortune 500 pension plan sponsors are moving towards having fully frozen pension plans that are solely legacy liabilities of the company

Catalysts for PRT - Continued



MetLife's 2019 PRT Poll

- Surveyed 102 U.S. defined benefit plan sponsors
- Most intend to divest all DB plan liabilities at some point in the future, of which 67% said PRT most likely to be used
 - Up from 46% in 2015



Source: 2019 MetLife PRT Survey

MetLife's 2019 PRT Poll

- Among the 67% of DB sponsors considering a risk transfer in the next two years:
 - 77% have evaluated the financial impact of such a transfer
 - 74% have held discussions with key stakeholders
 - 65% reviewed and cleaned up their data
 - 59% have explored the solutions in the marketplace and/or quantified the cost of a pension risk transfer
- 79%, say they are more likely to consider an annuity buyout now that they have witnessed several large corporations taking this action

Sources: 2019 MetLife PRT Survey

<https://www.plansponsor.com/survey-suggests-pension-risk-transfer-activity-will-increase-2019/>

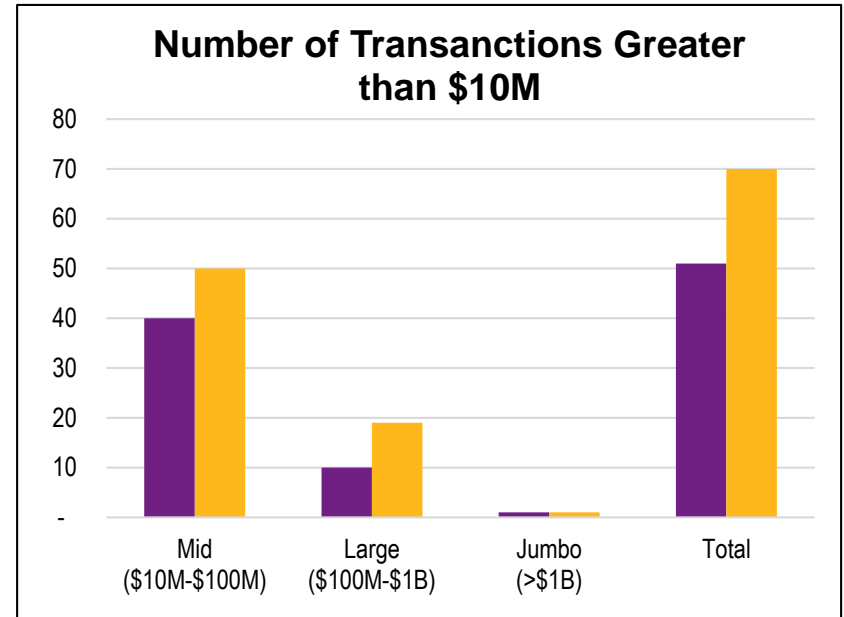
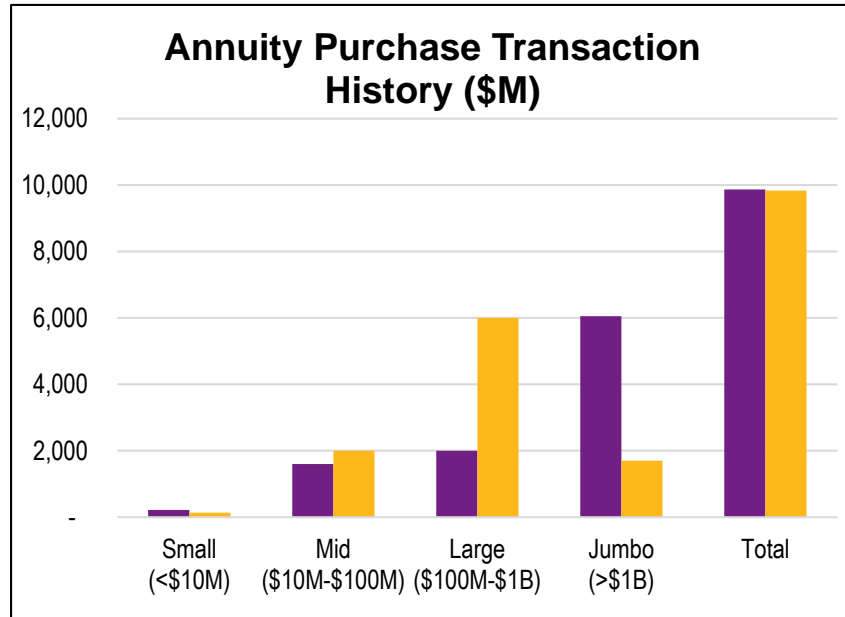
Good chance of continued growth in the PRT market in the future

- Conditions still reasonably favorable
 - Interest rates
 - Plan funded status still strong
- Plan and insurers expectations about liabilities generally in sync
- Plans that have tested the waters with PRT transactions involving small benefit amounts will look to settle more business
- Additional entrants or insurers accepting larger cases or deferred lives

The first half of 2019 shows a decrease in jumbo sized deals, which is offset by a large increase in large size deals

Activity through Q2 2019 has been equal to the first half of 2018 (which included a \$6.0B FedEx transaction)

- As compared to 2018, the first half of 2019 has shown almost a 40% increase in the number of transactions
 - Both number and volume of both mid and large sized transactions has increased over 2018
 - Number of Jumbo sized transactions is flat with decrease in volume due to 2018 FedEx transaction
- As a consequence, despite the FedEx transaction in 2018, on a dollar basis, 2019 is keeping pace with 2018
- Historically 70%+ of the year's transactions are completed after 7/1



■ First half 2018 ■ First half 2019

Source: Willis Towers Watson Pension Risk Transfer Survey; includes history for 16 insurance companies through June 30, 2019. Excludes Bristol-Myers Squibb transaction which was announced but has not yet closed.

PRT Process and Considerations

PRT Process

- Once the plan sponsor is interested in doing a pension risk transfer, an advisor is hired
 - Helps the plan sponsor structure the deal
 - Assesses the interest of insurers in said transaction
 - For large cases, several advisors may be researched before one is selected
- A Request for Proposal (RFP) is then sent to insurers
 - Details some high level plan specifications and benefit structures
 - Includes key dates
 - Terms
 - Census file is also sent
 - In some cases (particularly larger cases), mortality experience data (MED) is also shared
- Multiple rounds
 - Initial round, narrow down insurers
 - Final pricing round, usually about a month later, which leads to the insurer selection
- Group annuity

Policyholder Considerations

- Retirees will begin receiving check and deposits from insurer
- Defined benefit pension plans are regulated by a number of governmental agencies.
 - IRS, the Department of Labor (DOL), and the PBGC
 - Annuity contracts are regulated by state insurance authorities
- Guarantee moves from the Pension Benefit Guarantee Corporation to National Organization of Life and Health Guaranty Associations (NOLGHA)
 - A voluntary, U.S. association made up of the life and health insurance guaranty associations of all 50 states and the District of Columbia
 - Guarantee limits vary by state
 - Some less than PBGC guarantees
- If lump sum is offered, may have a difficult time understanding whether taking a lump sum is a good choice
 - Health, mortality, tax, investment, spousal considerations

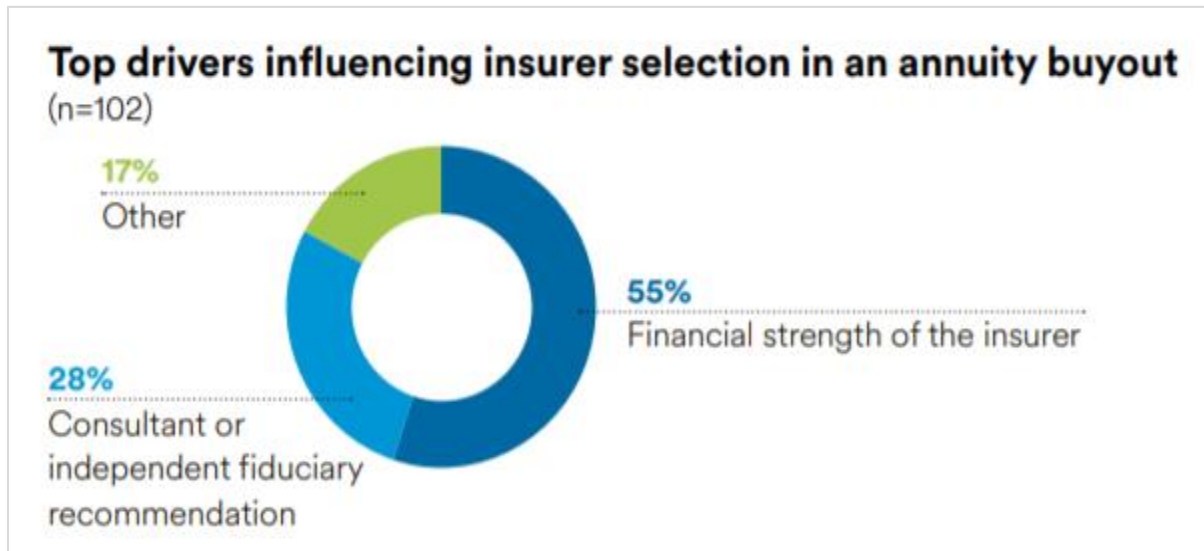
PRT “Players”

- AIG (American General Life)
 - Athene
 - Cuna Mutual
 - Great American
 - Legal & General (Banner Life)
 - Massachusetts Mutual
 - MetLife
 - Mutual of America
 - Mutual of Omaha (United of Omaha)
 - New York Life
 - One America (American United Life)
 - Pacific Life
 - Principal Financial (Principal Life)
 - Prudential Financial (Prudential)
 - Securian (Minnesota Life)
 - Western & Southern Mutual (W&S Life)
-
- Others are at various stages of exploring entering market

PRT Player Considerations

- Need to be competitive on price – key drivers:
 - Investment strategy
 - Capital levels
 - Profit goals
 - Base mortality
- May take a while to get traction in market
 - New entrants can have higher bar
- Plans and their advisors will assess whether insurer meets Department of Labor (DOL) guidelines on “safest available”
- Need administrative capabilities
- Have to consider which segment of market to target

PRT Player Considerations – MetLife PRT Poll



- Nearly all plan sponsors surveyed (97%) say that data privacy and protection of their participants' information is becoming a concern for their company
 - 70% who say they are very concerned about the privacy of their participants' data.

Source: 2019 MetLife PRT Survey

Typical Assistance Requested

- Market entry feasibility
 - Typically includes expanded market landscape, future outlook, PRT bidding process including considerations in being competitive (mostly price), administrative considerations, scale considerations, key pricing issues
 - We can also provide some information on typical number of cases won, including range by company
- Assistance in quotes/transactions
 - Set mortality assumptions
 - Develop plan cash flows
 - Global experience in longevity swaps
 - Other retirement/benefit pension guidance and knowledge
- Providing access to mortality data
 - Purchase PMA
 - Access PMA on case by case basis
- Review of pricing assumptions including benchmarking
- Parallel testing benefit cash flows + pricing system

Willis Towers Watson Pension Mortality Analysis (PMA)

- The Willis Towers Watson Pension Mortality Analysis (PMA) covered data from 27 retirement/benefit plans
 - Based on nearly 4 million life years of exposure
 - Based on more than 135K deaths including over 24K deaths for attained ages 90 and above. We believe the data is largely credible through attained age 99
 - Data was for the period 2009-2013; we separately adjust for historical mortality improvement discussed later
 - Covered non-disabled retired lives and their beneficiaries
- Included in PMA was a series of expected tables developed using predictive modeling techniques (PMA tables) that vary by:
 - Age and Gender
 - Recipient Type
 - Industry
- In addition, Willis Towers Watson has completed work to further refine the industry, applying factors (if applicable) for certain SIC codes categorized as having lighter or heavier mortality within each industry grouping

2019 Willis Towers Watson Pension Risk Transfer Study (WTW PRT Survey)

- In late 2018, Willis Towers Watson performed an industry survey of U.S. pension risk transfer (PRT) pricing assumptions, among leading PRT writers.
- Information was requested on pricing practices and methodologies used in the most recent pricing exercise taking place prior to 6/29/2018
- The survey covered 8 main topical areas:
 - Context of Survey Participants
 - Mortality Assumptions
 - Reserves
 - Capital
 - Investment Assumptions
 - Pricing Methodology
 - Profit Metrics and Targets
 - Expenses
- Results were provided in many cases in range format, including 15th and 85th percentile, calculated using Excel
- We are now utilizing results of the study in benchmarking client PRT pricing assumptions, to provide insight to our clients on the relative competitiveness of their assumptions

Questions and Contact Information

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