Economic and Regulatory Climate May Spur Pension Risk Transfer Agreements

Faced with a shifting economic and regulatory environment, many senior finance executives are considering transferring pension risk using group annuities.

For several decades now, much of corporate America has been looking for ways to shed the increasing costs and uncertainty of sponsoring traditional, defined benefit (DB) pension plans. Freezing plans—halting the accrual of future benefits—has been a popular strategy, but plan sponsors who do that can still be on the hook for funding benefits that have accrued and overseeing plans for decades to come as plan participants and beneficiaries continue to draw benefits.

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Changes in the economic and regulatory environment are prompting an increasing number of plan sponsors to consider a more immediate solution: transferring some or all of their pension benefit obligations to an insurance company with the purchase of group annuities. In a May 2017 survey of 80 senior finance executives at companies that sponsor defined benefit pension plans, more than 4 in 10 respondents said their firms had already completed a pension risk transfer. The survey was conducted by CFO Research in cooperation with Prudential Financial. Among DB plan sponsors who have not yet purchased an annuity, nearly half said they have discussed the strategy with an outside provider or advisor, and one in five said they expect to purchase a group annuity in the next two years.

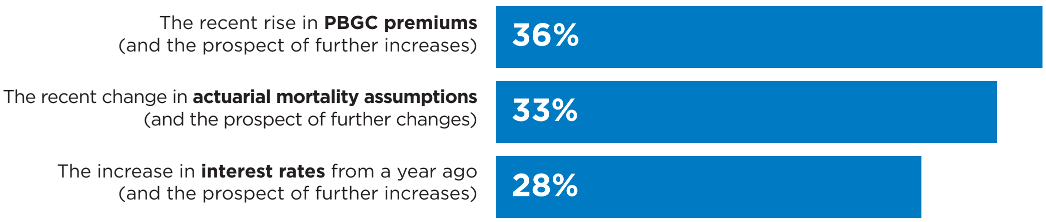
Using group annuities to transfer pension risk to an insurer has become increasingly popular over the past half decade, with companies collectively lessening their pension benefit obligations by billions of dollars each year. In a typical transaction, the plan sponsor transfers to the insurer securities and cash equal in value to the benefit obligation the sponsor wishes to shed—usually a portion of its total obligation, since shedding the entire obligation at one time could be prohibitively expensive. Once executed, this transaction transfers the pension liability from the plan sponsor's balance sheet to the insurer's balance sheet, and the insurer becomes responsible for paying all future pension benefits to plan participants covered by the agreement.

Plan sponsors who've undertaken these transactions are widely satisfied with them; among the survey respondents whose companies have done them, 83 percent said they were satisfied with all aspects of their agreements and 72 percent said they were likely to do more such transactions to further whittle down their pension liabilities.

Among the developments driving this turn to pension risk transfers are actual and anticipated changes in the regulatory and economic environment. Fifty-five percent of survey respondents said that if Washington enacts tax reforms that lower corporate tax rates, their companies will very likely use the tax savings to increase funding of their defined benefit pension plan, and execute either a full or partial liability transfer via a group annuity.

Meanwhile, 36 percent of survey respondents said that recent increases in the per-participant premiums their plans pay to the Pension Benefit Guaranty Corporation, and the prospect of further increases, are making it much more likely that their companies will consider a group annuity purchase in the near term. "If you take a significant number of participants out of your plan, you can really save on PBGC premium expense," says Bruce Swain, executive vice president and chief financial officer for Crawford & Co., a provider of claims management solutions for insurance companies and self-insured entities. Crawford recently completed a group annuity transaction covering about 5 percent of its pension benefit obligations.

FIGURE 1.
Regulatory and Economic Factors Influencing Group Annuity Purchases (percentage of respondents agreeing that a specific event makes it much more likely that their company will consider a group annuity purchase in the near term)



Multiple responses allowed.

Nearly as many survey respondents—33 percent—said a recent change in actuarial mortality assumptions, and the prospect of further changes, also make it much more likely that their organizations will consider such a purchase. (See Figure 1.) Finally, more than one-in-four respondents—28 percent—said they are being pushed in that direction by the increase in interest rates from a year ago, as well as prospects for further rate increases. By contrast, 9 percent said tax reform allowing for the repatriation of profits held oversees would motivate them to pursue such an agreement.

Four in 10 survey respondents said that if they do a transaction, they will begin with a partial transfer of their pension liabilities. Complete transfers can be challenging because to make the agreements work for insurers, plan sponsors must fully fund the benefit obligation they're transferring to the insurance company. Most corporate pension plans today are not fully funded. Only 18 percent of survey respondents said their organizations would likely borrow or issue debt to more fully fund their plan prior to a risk transfer.

John Reynolds, vice president of global accounting for glass container manufacturer Owens-Illinois Inc., which also has transferred a portion of its pension risk to insurers using group annuities, says his firm's strategy has been to target liabilities for retirees first, since they're the least expensive group to annuitize, and secondarily to focus on retirees receiving low monthly payments. "That way," he says, "you get the biggest benefit, since a portion of your PBGC premium is charged on a per-capita basis."

Brady Connor, president and chief investment officer of Verizon Investment Management Company, a subsidiary of Verizon Communications that manages the company's retirement plan assets, says his company was anticipating rising PBGC fees and higher liabilities associated with changes in mortality tables when it transferred some of its pension liabilities to an insurer in 2012. Today, many companies find themselves confronting similar concerns. The per-participant PBGC premium for plan years that began in 2017 was $69 for single-employer plans. That was up from $64 a year earlier. The fee is scheduled to increase to $74 for plan years beginning in 2018, and $80 for plan years beginning in 2019.

"You're sitting there with a liability that you know is priced at a certain level today, but on a forward-looking basis it is going to be much more expensive than what you're carrying it on your books at today," Connor says. "The ability, with a group annuity purchase, to lock in at today's value for that liability, versus the growing future value of that liability, is important. Along with fact that people are living longer, this was a key factor in our decision to transfer some of our pension risk to a third party."

ABOUT THE SURVEY

This year marks the seventh annual survey that CFO Research has conducted in cooperation with Prudential Financial, Inc. These surveys provide insights into senior finance executives' current thinking about their companies' retirement and benefits programs.

As part of this year's survey, 80 senior finance executives were asked questions that were specifically focused on pension risk transfer. Among executives whose companies have already purchased a group annuity for their pension plan, we aimed to shed light on the reasons they did so, and to gauge their level of satisfaction after having concluded a pension risk transfer. Among executives whose companies have not yet executed a pension risk transfer, we aimed to gauge their knowledge of these instruments and the various economic and tax-related issues that might influence attitudes and plans for future agreements.

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