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The New Pace of PRT

What sits on a companyâ??s balance sheet for a very long time, is highly complex, and costs a bunch to maintain? The answer: a pension plan. In fact, there are currently more than $3 trillion in U.S. plan assets held by private-sector pension plans.

Sound like a heavy responsibility? It is. And it is precisely why sponsors of defined benefit (DB) plans have been reviewing their plansâ?? statuses and costs with an eye toward managing risk, says Arthur Scalise, New York City-based director of actuarial services at CAPTRUST.

A form of pension risk management known as *pension risk transfer (PRT)* is the process of transferring a defined benefit planâ??s risk away from an employer who sponsors a pension plan. It represents â??a shift from an asset-only risk focus to managing pension plan assets and liabilities, while minimizing volatility generated by the planâ??s surplus risk,â?• Scalise says.

Risk transfer or de-risking transactions addressing pension plan risks can include, for example, the purchase of annuities from an insurance company that transfers liabilities for some or all plan participants; the payment of lump sums to pension plan participants that satisfy the liability of the plan for those participants (either through a one-time offer or a permanent plan feature); and the restructuring of plan investments to reduce risk to the plan sponsor.

Moreover, with an estimated total volume between $38 billion and $40 billion in U.S. pension transactions, the 2021 PRT market exceeded 2020â??s record of $27 billion and its highest value to dateâ??$36 billion in 2012.

So â?¦ Why Are So Many Plan Sponsors Checking Out PRT?

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The current interest rate environment is a tailwind for pension risk transfer, says Scalise. â??It is at the top of the leader board when it comes to reasons for plan sponsors to initiate a PRT.â?• Favorable interest rates have helped many pensions get close to full funding. â??That is a core gauge of a planâ??s healthâ??a measure of plan assets relative to liabilitiesâ??and it hasnâ??t looked this good since before the 2008 financial crisis,â?• he says.

Another biggie making PRTs more attractive? Pension plan participants living longer. According to a recent analysis by Club Vita, mortality rates have been improving much more quickly for U.S. pension plan participants than for other Americans (around 0.8 percent per year higher among those who are over 65 years old). This increase in longevity, particularly for a very large population of pension plan participants, can increase plan costs. According to Scalise, if this pace documented in this analysis continues, the existing life expectancy gap between pension plan participants and the U.S. population will widen by one year by the late 2020s.

And donâ??t forget the historically favorable annuity buyout marketâ??another influence nudging plan sponsors to offload retiree liabilities. Data from the Milliman Pension Buyout Index tells us retiree buyout costs dropped to record lows by the end of 2020 (competitive rates dropped from 103.3 percent at the beginning of 2020 to 99.3 percent at the beginning of 2021), and stayed low through all of 2021 (with competitive rates between 99.3 percent and 100.2 percent).

Might we also suggest that smaller plan sponsors are finding validation in the actions of larger corporations? For example, there is no shortage of plan sponsors who say pension risk management transactions completed by major Fortune 500 corporations increase the likelihood that they would consider offloading pensions to insurers themselves, says Scalise. â??Large and mid-sized corporations tend to follow in the footsteps of Fortune 500 companies because those are typically the first movers.â?•

How Should Plan Sponsors Be Thinking About PRT?

â?•For plan sponsors who are curious, or who feel that PRT may be in the pension planâ??s future, taking preparatory steps today can shorten the implementation timeline,â?• Scalise says.

Most importantly, â??the plan sponsor can determine whether PRT fits the organizationâ??s goals,â?• Scalise says. â??However, the fiduciary duty to participants takes precedence over the companyâ??s bottom line.â?•

The length of time it takes to complete a pension risk transfer will vary by plan; however, the entire process may take 18 to 24 months, Scalise says. However, even if no immediate action is taken to execute a PRT strategy, plan sponsors can still prepare themselves in case they have to revisit the issue down the road. If the plan sponsor does decide to consider a change, Scalise has a handful of questions to think about before making any moves.

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- Who will be on the companyâ??s internal team that will manage the process?
- Will the PRT process include specialty consultants such as actuaries, investment bankers, annuity placement providers, or legal counsel?
- Is the companyâ??s valuation data clean and up to date? Can final accrued benefits be validated, and missing participants located?
- Who will evaluate request for proposal (RFP) responses submitted by the insurers, and ultimately select the annuity provider?
- What would the communication strategy be to senior management, plan participants, retirees, etc.? What about externally to the public and other interested parties?

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