MassMutual

Institutional Solutions –
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White paper

The Benefits of a Pension Risk Transfer

Why settling your pension liability with an insurer can benefit you and your employees.

Massachusetts Mutual Life Insurance Company (MassMutual®)

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Pension Risk Transfer Continues to Be a Popular Derisking Solution

Many plan sponsors continue to choose pension risk transfer transactions as a means of derisking their pension plan as evidenced by sales volumes reported by LIMRA. Sales of group annuity buy-outs offered through insurance companies reached $41.3 billion in 2023 among 763 transactions — 28% more than the $29.9B figure achieved in 2019 (Fig. 1).[1]

Pension Buy-out Industry Sales (billions)

(Fig. 1) Sources: December 31, 2019 and December 31, 2023, LIMRA Secure Retirement Institute, *Group Annuity Risk Transfer Survey* (2019 4th Quarter and 2023 4th Quarter Reports)

Moreover, the increased sales volumes indicate that plan sponsors are now more familiar with PRT as a means to derisk their pension plans. While this experience can lead to improved understanding and execution, the regulated duties involved beckon sponsors, together with their expert PRT advisers and consultants, to thoughtfully explore key considerations when planning to derisk through a group annuity contract.

In this paper, we'll discuss:

- The drivers of the growth of the PRT market,
- The benefits associated with PRT transactions, and
- Key considerations for plan sponsors and their consultants when selecting an insurer.

Key Drivers of PRT Market Growth

The costs associated with funding and administering a defined benefit plan are significant and sensitive to external factors — making costs difficult to predict and hard to manage. Pension plan funding is subject to a variety of risks, such as interest rate risk, market risk, and longevity risk. These risks can affect the costs of funding the benefits. In addition, pension plans are required to pay premiums to the Pension Benefit Guarantee Corporation (PBGC), the federal agency backstopping the pensions of most American private sector workers, and that cost continues to climb.

Managing the overall costs associated with legacy pension plans while delivering on the commitment of lifelong income have long been the key drivers of pension derisking solutions. And, it's no surprise that Pension Risk Transfer (PRT) transactions are a desirable derisking solution for many.

Why?

A PRT group annuity contract will replicate the benefits available through the pension plan, and PRT annuity contracts offer the only means under federal law to fully eliminate a plan's and plan sponsor's pension obligations while continuing to provide a lifetime (or longer) payment stream to plan participants. What's more, recent market conditions have given lift to funded status for most pension plans — better positioning them to be derisked through an annuity purchase.[2]

Let's take a deeper dive into the financial dynamics and the costs and risks associated with a pension plan.

Risks and Costs Affecting Pension Funded Status

Market Risks

Interest rate risk: Interest rates have a direct impact on pension liabilities, and rate volatility makes related pension costs equally uncertain. A review of the interest rate market and its effects on pension liabilities during 2016–2019 compared to 2020–2023 illustrates this point quite well:

Between January 1, 2016, and December 31, 2019, the rate environment had been relatively steady with the 10-year treasury par yield curve rate ("the rate") **fluctuating less than 2 points** ranging between 1.37% and 3.24% during the period. Likewise, pension cost management was relatively steady in contrast to the four years that would follow.[3]

From January 1, 2020, through December 31, 2023, rates volatility more than doubled, with rates **fluctuating more than 4 points** ranging from as low as 0.52% to as high as 4.98% — highs not seen in over 10 years.[3] The upside during this period is that liabilities have an inverse relationship to interest rates, so the increase in rates caused liabilities to decrease. However, it's important to note that the reciprocal is true (pension liabilities will increase when rates fall).

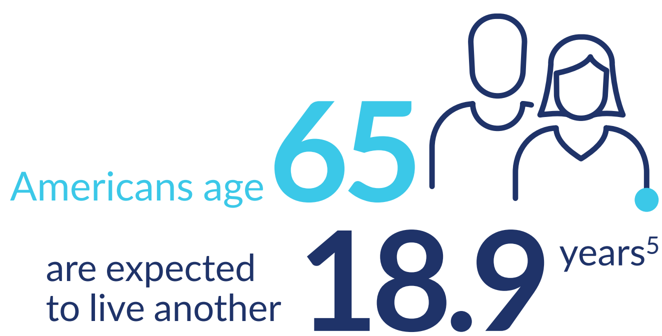
Equity risk: Pension plan assets that are invested in the equity market are subject to market risk. Equity markets have soared in recent years, helping equity-heavy pension asset values increase. However, equity markets have significant volatility, so it's important to be prepared for downs as well as ups.[4]

Collectively, higher interest rates and positive equity market performance have led to improved funded statuses for many plans at this time. However, the correlation between asset returns and pension liabilities means that there remains significant risk associated with downside scenarios.

Longevity Risk

Funded status is not the only factor that's been improving. Life expectancy generally has been improving as well.

Although life expectancy trended slightly lower in recent years, the trend has begun to improve again.[5] According to the National Center for Health Statistics 2024 report, Americans aged 65 were expected on average to live another 18.9 years in 2022 — up from 18.4 years in 2021.[5]



While a blessing for society overall, improved life expectancy increases pension costs by extending the term of the pension payments to retirees.

PBGC Premiums

The federal Pension Benefit Guaranty Corporation (PBGC), a U.S. government agency, backstops most benefits promised by private employer-sponsored pension plans. The agency funds its obligations by collecting pension insurance premiums, set by Congress, from plan sponsors. Congress is the "key determinant of whether PBGC has enough money to pay all benefits in the future, or whether the agency runs a deficit."[6]

The PBGC Flat-Rate premium has increased over 25% from 2019 to 2024 and, according to the PBGC, "From 2020–2023, all premium rates and the variable rate premium (VRP) cap were subject to indexing. Starting in 2024, the VRP rate will no longer be indexed. All other premium rates and the VRP cap will continue to be indexed after 2023."[6,7]

PER PARTICIPANT RATE FOR FLAT-RATE PREMIUM FOR THE PAST FIVE YEARS

2019	2020	2021	2022	2023	2024
$80	$83	$86	$88	$96	$101

Source: October 13, 2023, Pension Benefit Guarantee Corp. (PBGC), Premium Rates, https://www.pbgc.gov/prac/prem/premium-rates

While already a sizable expense, the indexing in the Flat-Rate premium will likely lead to these becoming more costly for plan sponsors in the future.

Now that we've reviewed some of the key risks and costs associated with sponsoring a pension plan, let's review the benefits of a PRT buy-out transaction.

The Benefits of PRT

Increasing and hard-to-predict pension costs have led many employers to conclude that they, and their employees, would be well served by shifting defined benefit plan obligations to life insurers who focus on risk management as their primary purpose. With extensive experience managing risks, many life insurers are professional long-term risk managers and annuity providers. Most insurers are well equipped to handle equity market, interest rate, longevity, and the other risks associated with managing pension liabilities.

The capabilities and expertise that insurers possess allow them to guarantee payment of the plan liabilities at a fixed price, and insurers are set up to administer the payments and serve the annuitants until the pension obligations are completely satisfied. Once a PRT is complete, the plan sponsor has eliminated the costs and risks associated with the transaction from their purview, and the covered plan participants will continue to receive the benefits promised through the insurer.

Simply put, a PRT solution can be a win-win scenario for plan sponsors and pension plan participants alike.

Key Considerations when Evaluating Insurers

While the decision to derisk a plan is a business decision (a so-called "settlor" function), the selection of an insurer for a pension transfer is a fiduciary act. The plan fiduciary making the insurer selection has legal responsibilities, including the need to perform due diligence on the insurers as part of the annuity selection process.

Department of Labor Interpretive Bulletin 95-1 ("IB 95-1") provides the plan fiduciary with guidance for how to select the "safest annuity available."[8] Under IB 95-1, a fiduciary must evaluate a number of factors relating to a potential annuity provider's claims-paying ability and creditworthiness. Importantly, reliance solely on ratings provided by rating agencies would not be sufficient to meet this requirement.

The bulletin outlines the following aspects that should be considered when selecting an annuity provider:

- The quality and diversification of the insurer's investment portfolio
- The size of the insurer relative to the annuity purchase
- The level of capital and surplus held by the insurer
- The insurer's other lines of business and liabilities that they are exposed to
- The structure and terms of the annuity contract

It's important to note that IB 95-1 also states, "It may also be in the interest of the participants and beneficiaries to choose a competing annuity of the annuity provider offering the safest available annuity is unable to demonstrate the ability to administer the payment of benefits to the participants and beneficiaries."[8] Thus, performing due diligence on an insurers ability to properly administer payments is another essential consideration when evaluating your choices.

Experience tells us that it can be challenging for a plan fiduciary to differentiate between insurers based on these criteria, and the process for soliciting quotes for annuity purchases can be complicated. For these reasons, most sponsors seek the help of expert PRT advisers and consultants to facilitate engagement with prospective insurers, as well as aid in determining the safest available annuity provider.

To provide a better understanding of what factors to consider, following is a list of key questions that aim to help plan fiduciaries and their pension risk transfer advisers and consultants vet the available insurers:

Key considerations when evaluating insurers

1. What is the insurer’s **financial strength** profile?
   - What are their ratings?
   - What is the insurer’s corporate structure and how could it affect their long-term strategic view?
   - What is the value the transaction compared to the capital of the insurer?
2. What is the insurer’s **expertise**?
   - Is Pension Risk Transfer core to the insurer’s business model?
   - How many years of experience do they have?
   - What is the size and number of transactions handled; what market does the insurer serve?
3. How does the insurer demonstrate commitment to **delivering** on the promises made to the annuitants?
   - Does the insurer provide annuity services in house, or is administration outsourced?
   - Does the insurer invest in its annuitant services, including capabilities and technology?
   - Do they have a comprehensive initial and ongoing communications plan?

Summary

While pension plans make important promises to workers in retirement, they are expensive and risky for plan sponsors, and can weigh on a company's bottom line. As a result of the market conditions of recent years, many plans are in a financially sound position to remove that encumbrance from the company's financial results. PRT is a custom solution through which plan sponsors can step away from the pension plan, eliminate the ongoing costs from the company's books, and transfer the future financial risks and administrative burdens to an insurer that will deliver on the promise to the retirees.

About MassMutual

At MassMutual, we offer plan sponsors and intermediaries confidence by helping ensure their fiduciary duties and pension obligations are satisfied. As a mutual company run for the benefit of its participating policyholders, we offer confidence through our enduring financial strength, our annuity solutions expertise, and our passion for helping people secure their future and protect the ones they love.

As a mutual company, MassMutual operates for the benefit of its members and participating policy owners. MassMutual is managed with a focus on policyowners' long-term interests and are not subject to the expectations of Wall Street analysts or stockholders. Throughout its history, this focus on the long term has helped MassMutual provide financial and retirement security to millions of people.

MassMutual earns among the highest financial ratings in the industry and has followed a prudent investment strategy for more than 170 years. This approach has given our policy owners confidence that we'll deliver on our long-term commitments to them.

Our strength and stability are recognized by the following ratings:

A.M. Best Company: A++
(Superior; top category of 15)

Fitch Ratings: AA+
(Very Strong; second category of 21)

Moody's Investors Service: Aa3
(High Quality; fourth category of 21)

Standard & Poor's: AA+
(Very Strong, second category of 21)

Ratings apply to Massachusetts Mutual Life Insurance Company and its subsidiaries, C.M. Life Insurance Company, and MML Bay State Life Insurance Company. Ratings are as of 10/01/2024 and are subject to change.

We would appreciate the opportunity to discuss your needs together with you and your pension risk transfer consultant.

To learn more about how MassMutual can assist with your pension risk transfer needs, visit us at **www.institutional.MassMutual.com/pension-risk-transfer** or contact us at **PensionRiskTransfer@MassMutual.com.**

[1] December 31, 2019 and December 31, 2023, LIMRA Secure Retirement Institute, *Group Annuity Risk Transfer Survey.*

[2] February 13, 2024, PLANSPONSOR, Rising Discount Rates Continue Pension Funding Improvement, Reported by Matt Toledo, https://www.plansponsor.com/rising-discount-rates-continue-pension-funding-improvement/

[3] September 18, 2024, U.S. Department of the Treasury Daily Treasury Par Yield Curve Rates, https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_yield_curve&field_tdr_date_value=2016;

[4] September 18, 2024, Board of Governors of the Federal Reserve System, Transcript of Chair Powell's Press Conference Opening Statement September 18, 2024, https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20240918.pdf

[5] March 2024, Centers for Disease Control and Prevention, National Center for Health Statistics, Mortality in the United States, 2022 (NCHS Data Brief No. 492, March 2024) https://www.cdc.gov/nchs/data/databriefs/db492.pdf

[6] September 27, 2024, Pension Benefit Guarantee Corp. (PBGC), Pension Insurance Premiums Fact Sheet, https://www.pbgc.gov/about/factsheets/page/premiums

[7] October 13, 2023, Pension Benefit Guarantee Corp. (PBGC), Premium Rates, https://www.pbgc.gov/prac/prem/premium-rates

[8] September 29, 2024, 29 CFR § 2509.95-1 Interpretive bulletin relating to the fiduciary standards under ERISA when selecting an annuity provider for a defined benefit pension plan. https://www.ecfr.gov/current/title-29/subtitle-B/chapter-XXV/subchapter-A/part-2509/section-2509.95-1

Notes

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