Group Annuity Contracts for Pension Risk Transfer

American Academy of Actuaries Webinar

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American Academy of Actuaries

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Presenters

MODERATORS

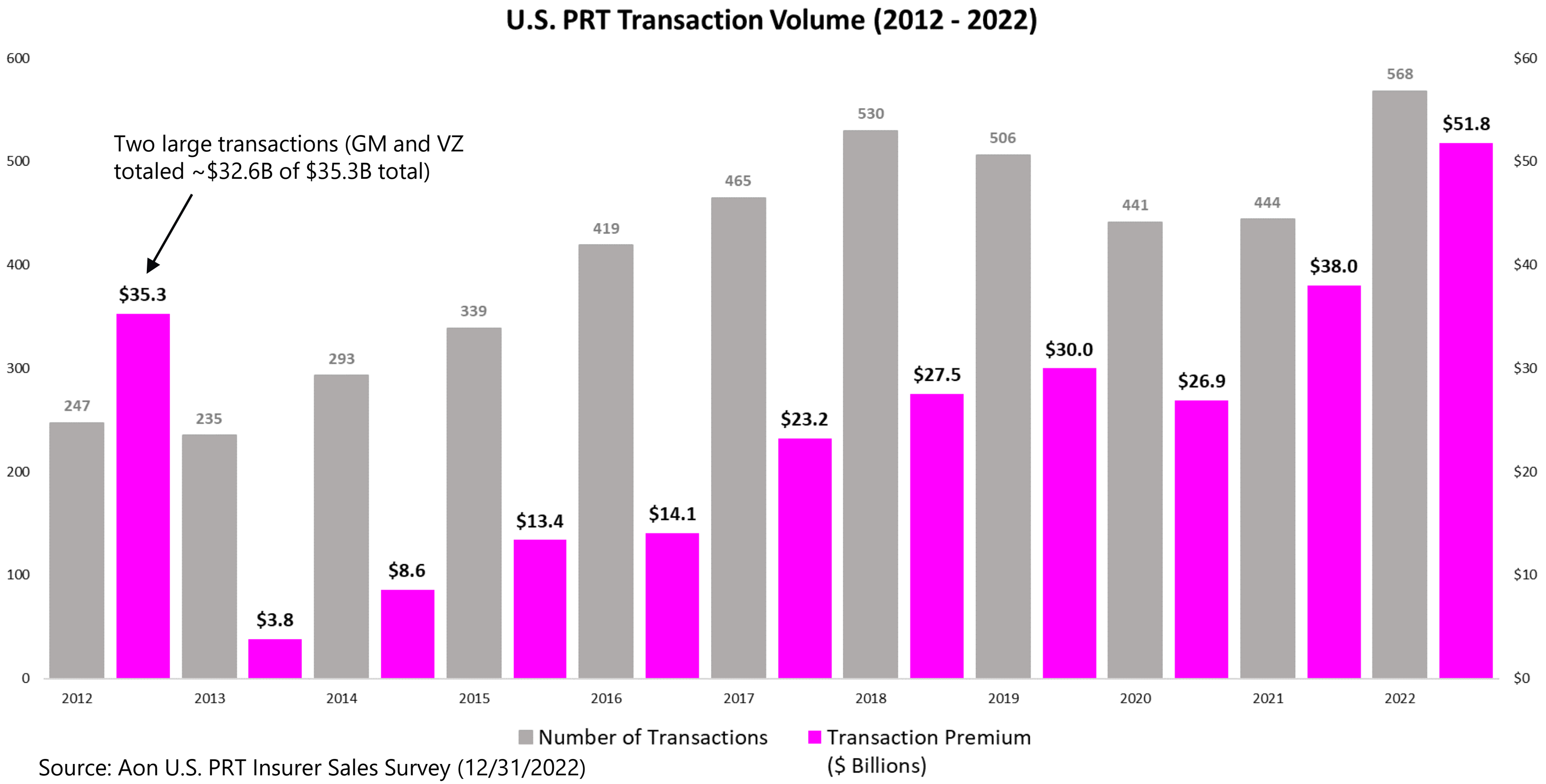
Brent Dooley, MAAA, FSA
Member, Annuity Reserves and Capital Working Group Member, Research Committee
Grace Lattyak, MAAA, FSA, EA
Vice Chairperson, Pension Committee

SPEAKERS

Patricia Matson, MAAA, FSA
Chairperson, Asset Adequacy and Reinsurance Issues Task Force
Michael D. Heard, FLMI
EVP & Chief Operating Officer, National Organization of Life & Health Insurance Guaranty Associations (NOLHGA)
William P. O'Sullivan
Senior Vice President & General Counsel, NOLHGA
Denise Sisk
Managing Director, State Street Global Advisors

U.S. Pension Risk Transfer (PRT) Market

- **$1.32 trillion** in total assets for top 100 largest U.S. public defined benefit pension plans (12/31/2022)*
- **99.3%** year-end 2022 funded status for top 100 largest plans vs. 72.6% @ November 2012*
- **51.4%** average plan allocation to fixed income in 2022, followed by equities (25.0%) and other (23.6%)*
- **$51.8 billion** in PRT transactions during 2022, buoyed by a competitive PRT market and increasing plan funded statuses



Source: Aon U.S. PRT Insurer Sales Survey (12/31/2022)

*Source: Milliman 2023 Corporate Pension Funding Study and Milliman November 2012 Pension Funding Index

What are the different types of PRT transactions?

- **Pension plan de-risking strategies include**
  - **<u>Paying Lump Sums:</u>** Direct payment to the participant of the full plan obligation. Plan benefits are no longer guaranteed by the PBGC. Can be conducted without purchase of a PRT contract or used in conjunction with PRT as part of a phased de-risking strategy.
  - **<u>Purchasing a Buy-Out (most common PRT contract in U.S.)</u>**: Direct obligation to pay benefits moves from the pension plan to the insurer, which administers the benefits. PRT contract or certificate <u>replaces</u> the pension plan's obligations. Plan benefits are no longer guaranteed by the PBGC.
  - **<u>Purchasing a Buy-In (significantly less common in U.S.)</u>**: Direct obligation to pay benefits remains with the pension plan, which holds the PRT contract as a <u>pension plan asset</u> that matches the plan's benefit liability. Plan benefits remain guaranteed by the PBGC.
  - **<u>Purchasing Longevity Reinsurance (nonexistent in U.S.)</u>**: Reinsurer provides coverage for only the longevity risk while pension plan retains all asset-based risks. More common contract type in some other countries (e.g., United Kingdom).
- **Buy-Out PRT transactions are typically structured in one of two forms**
  - **<u>Lift-Out</u>**: A specific subset of the total pension plan population is transferred to the insurer. Pension plan size is reduced, but the plan remains a going concern.
  - **<u>Plan Termination</u>**: All remaining benefits are transferred from the pension plan to one or more PRT insurers, and the pension plan is wound-up. Any plan asset deficiencies/(excess assets) must be funded by sponsor/(revert to the sponsor).

What are the different types of PRT transactions (cont.)?

- **PRT contracts may be written from…**

General Account

Separate Account

PRT: U.S. Insurers' Perspective

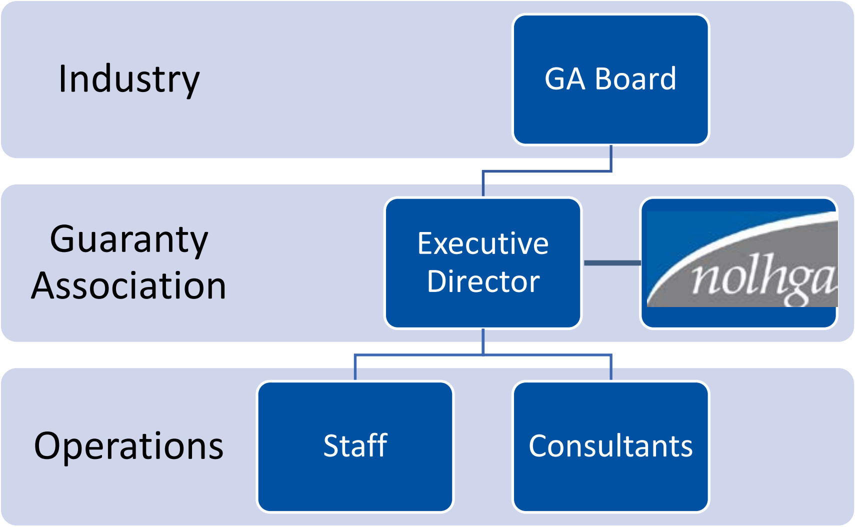
- **Traditional retiree-only buy-out PRT deal can be viewed as a large block of immediate payout annuities**
  - Larger plans typically provide credible plan-specific mortality experience used in pricing, while smaller plans may be priced using pooled industry data or using industry/geographic-driven mortality models
  - Liability duration of 8-12 years is typical, depending on plan demographics; most cashflows fall within the investable horizon
  - Typically backed with a large allocation to high-quality public fixed-income assets
  - Allocations to private credit, structured securities, and alternative assets are also typical
- **Diverse group of ~20 U.S.-based insurance carriers write PRT coverages today, varying along key dimensions including**
  - **Ownership structure:** Includes publicly traded companies, mutuals, and private-equity-backed insurers
  - **PRT business mix:** Some carriers target the smaller-end of the market (<$100mm), many operate in the mid- to large-size market ($100mm to $1B), and several will write jumbo transactions (>$1B)
  - **Asset allocations and asset risk tolerances:** Vary considerably across insurers and can include material allocations to more complex assets (e.g., asset-backed securities, etc.)
  - **Benefits underwritten:** Some companies only write simple retiree-only contracts, while others will write coverage on deferred annuitants and/or more complex benefit features
  - **Risk retention/usage of reinsurance:** Some carriers retain all risk, while others reinsure domestically or internationally
  - **Administrative capabilities:** Range from fully administered in-house to completely outsourced to third-party providers

PRT: Insurance Regulatory Perspective

- **U.S. life and annuity Insurers are subject to state regulation regarding the reserves and capital they hold**
  - **Base Statutory Reserves**: Base statutory reserves are determined according to the present value of projected future benefits using prescribed mortality and interest rates (VM-22) that do not directly consider the actual supporting assets or actual annuitant mortality profile
  - **Asset Adequacy Analysis:** Base reserves are tested to ensure that the actual supporting assets are adequate to support the liabilities under a "moderately adverse" standard, often using a "Cashflow Testing," a projection of assets and liabilities using assumptions specific to the business
  - **Statutory Risk-Based Capital Requirements:** Capital requirements today are largely factor-based for asset/credit risks (C1), insurance risks (C2), and other/business (C0/C4) risks, with a modeling-based approach for some market risks (C3)
  - **Credit for Reinsurance**: Ceding companies are only allowed to take statutory reserve credit when specific requirements are met (e.g., based on collateral available, nature of the reinsurance counterparty, structure of reinsurance, etc.)
  - **Regulatory review:** State regulators conduct periodic risk-based solvency reviews, market conduct exams, issue-focused industry data calls, etc. to monitor insurer health and assess emerging issues/concerns
- **These statutory reserving and capital requirements for PRT contracts are rapidly evolving**
  - **Principle-Based Reserving and Capital for Market Risk (C3)**: VM-22 and C3 Phase 1 are currently undergoing revisions to require a principle-based approach to determining statutory reserves and portions of their statutory capital for market risks
  - **Actuarial Guideline 53**: Actuarial guideline clarifying asset adequacy analysis requirements that "helps identify reserve adequacy and claims-paying ability in moderately adverse conditions, including conditions negatively impacting cashflows from complex assets"

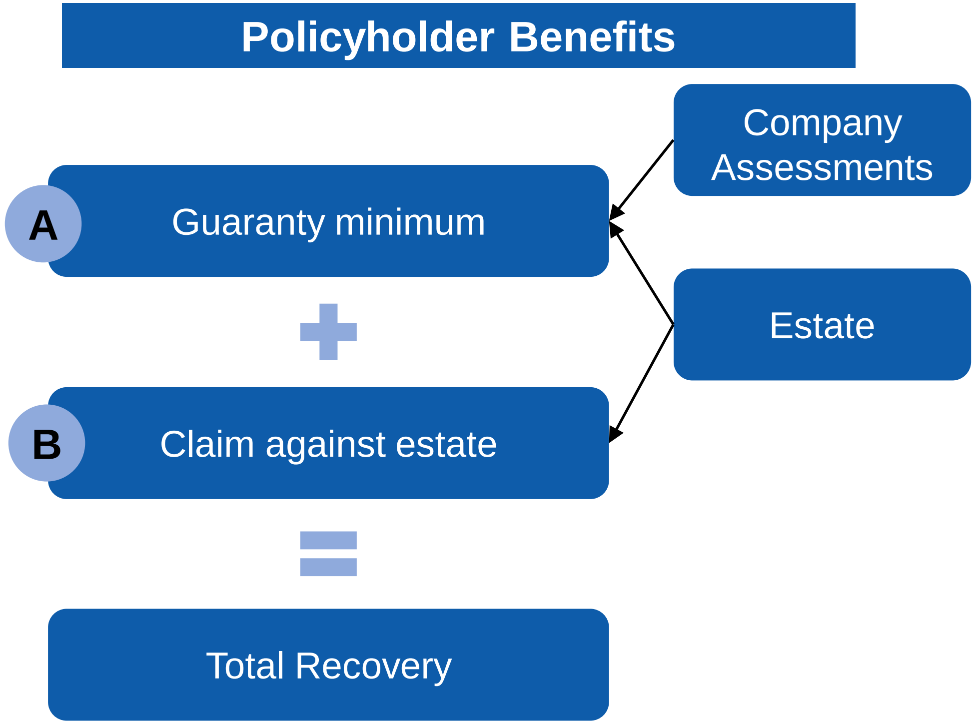
The Life & Health Insurance Guaranty System

- 52 **guaranty associations (GAs)** are separate legal entities, **created by statute**, to protect policyholders & beneficiaries
- Each GA is subject to **supervision** by the insurance commissioner of its jurisdiction
- Insurers **licensed** to market covered lines of business in a jurisdiction must be members of the GA of that state
- Each state GA is governed by a **Board of Directors**, made up mostly of industry members
- Each association has an **Executive Director**
- 51 state GAs are members of **NOLHGA**
  - Voluntary association made up of the state GAs
  - **Mission**: support its member guaranty associations in…
    - protecting policyholders in multi-state insolvencies
    - responding to related external developments



Proven Insurance Guaranty System Financial Safety Net

- Consensus for system developed in late ’60s/early ’70s
- NAIC Models—Separate L/H and P/C GAs and systems
- Core Mission: To work with receivers to deploy estate assets and GA funds to deliver to consumers a specified, guaranteed **minimum level** of financial protection against insurer insolvencies.
- NOT a failed insurer “bailout” mechanism
- A post-funded system (post-liquidation order)
  - Retain funds that would be paid into policyholder protection fund
  - Protect the reputation of the industry (“keeping the promises…”)



Guaranty Association Coverage Considerations

Licensed Insurer

- Issuing insurer must be licensed in state

Annuity Certificates

- GAs cover certificates issued under group annuity contracts

Residency of Certificate Holder

- GAs provide coverage for resident certificate holders in their state

GA Coverage Limits

- Limit is present value of annuity benefits; applied on a per annuitant basis

- At least **$250,000** in present value of annuity benefits for each covered life under payout annuities.
- 14 states extend that coverage level to **$300,000** or more
- 4 of those states extend that coverage to **$500,000**

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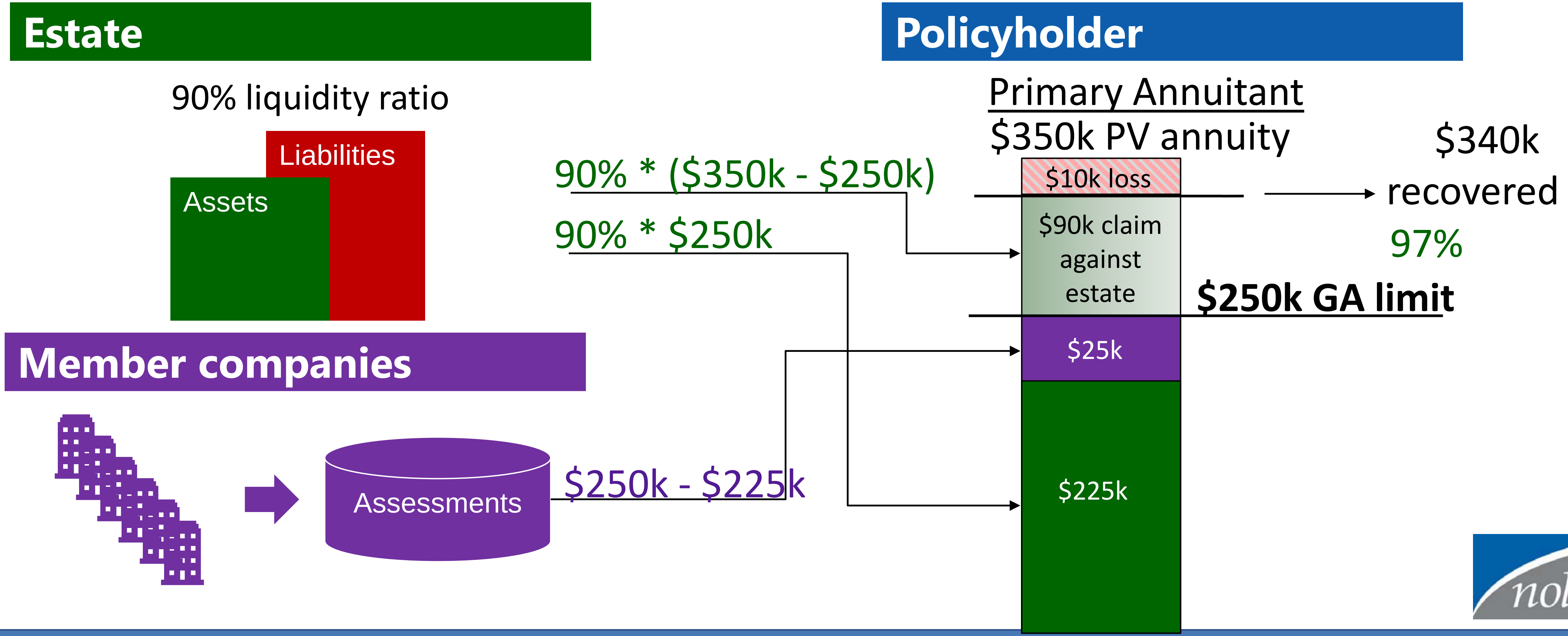
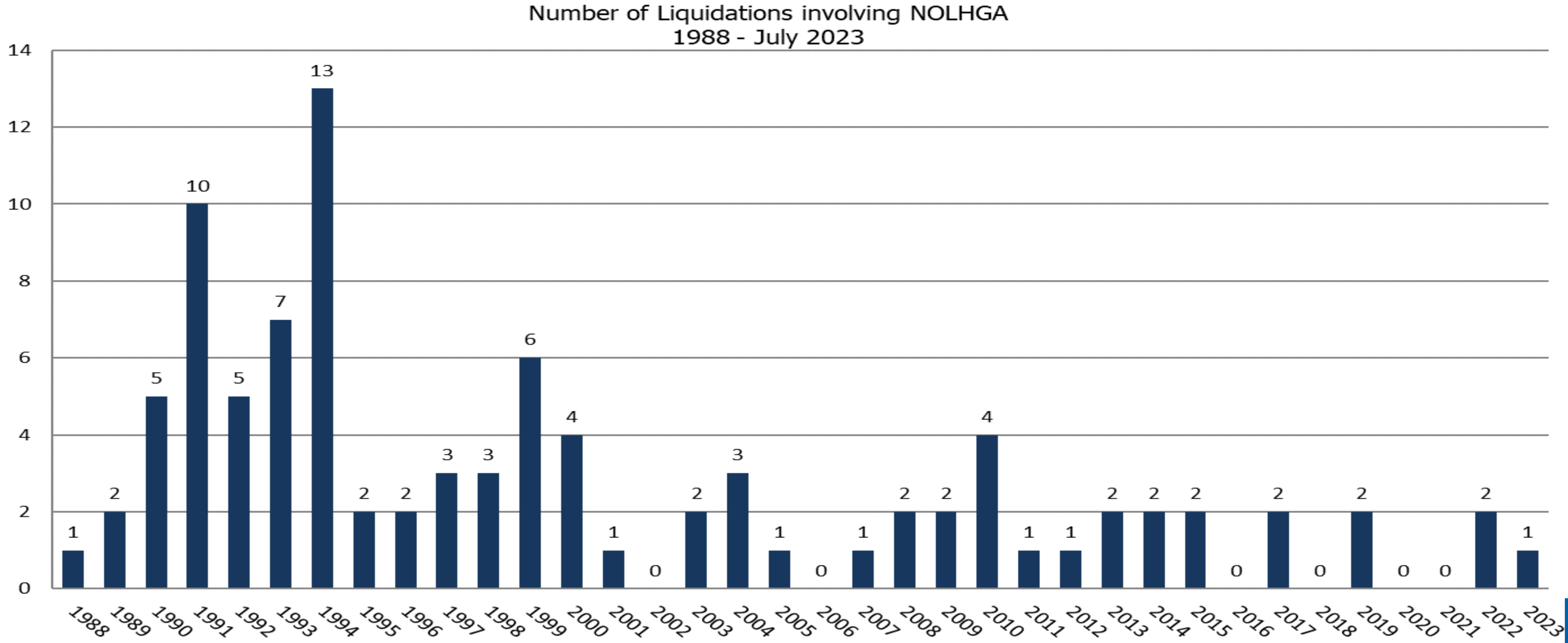
Example: $350k Present Value Individual Annuity

Guaranty Funding Mechanics



Insurance company failure experience



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Summary

Protection of annuity payees against the risk of default by the annuity issuer due to its insolvency is delivered through:

- **Inherent Financial & Operational Conservatism**
- **State Insurance Solvency Regulation**
- **Well-Designed & Effective Life Insurer Receivership Process**
- **Proven Insurance Guaranty System Financial Safety Net**

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Questions and Answers

Please enter your question(s) in the “Ask Question” box on your screen.

The presenters will answer as many questions as time allows.

Thank You

For more information, please contact

Philip Maguire, Policy Analyst, Pension maguire@actuary.org
Amanda Barry-Moilanen, Policy Analyst, Life barrymoilanen@actuary.org

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