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Market Perspective
Capacity Constraints Impact Pension Risk Transfer Market - 2018
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Overview
The Pension Risk Transfer ("PRT") marketplace has grown significantly from 2012 when General Motors and Verizon combined for nearly $34bb in placements. In the 3Q of 2017 alone, sales of $6.4bb nearly eclipsed 4Q sales for each of the prior four years (See Appendix I).[1] This sea of change in the PRT industry comes with implications. For years, annuity placements were typically associated with defined benefit pension plan terminations. Now however, plan terminations are a smaller volume of the overall PRT market as more plan sponsors de-risk their plans as a way to right size risk or to prepare for a plan termination over time.

For many years, pension regulations flourished as returns on plan assets waned. Since 2012, higher interest in PRT has translated into marketplace volatility. Volatility increases as the sheer volume of easier retiree only PRT deals explodes and competes for limited resources that were designed to issue and administer plan termination transactions at a modest pace of activity. This shift in demand far outweighed the ability of new and seasoned providers to respond in a market that had been shrinking due to historically low interest rates.

Adding to demand was the increase in fixed and variable rate PBGC premiums when compared to insurer expense loads on retiree deals. The implementation of updated mortality meant that payments to retirees were expected to last longer as life expectancy improved due to medical advances and healthy lifestyles. Insurers' per life costs are also lower in small benefit retiree groups when compared to high PBGC expenses. The result has been disruption. Said another way, capacity constraints have changed. In economic terms, this simply means that supply cannot meet significantly increased demand at current prices when these factors are considered.

There are many reasons for this change which can be further highlighted as follows:

Provider Universe and Market Share
The number of changes in providers entering and exiting the market has increased dramatically. Offsetting added capacity for retiree only risk transfers is the inability of some new providers to administer provisions for deferred lives in DB plan termination annuities. Thus, new capacity has limitations and targeted volumes of retiree only risk transfer deals are much less complex to price and administer, making them more appealing.

New providers such as Athene, have sprung up to aggressively capture market share using the tax-free status of a captive reinsurer to leverage price opportunity against large old line

[1] Appendix I - "Group Annuity Risk Transfer Survey", 3rd Quarter 2017, LIMRA, November 2017

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companies such as MetLife, Prudential and MassMutual.[2] These competitive tax advantages cause more disruption in pricing models for old line companies who must then reevaluate how to effectively compete as management's attention is diverted from easier retiree only deals. Still other seasoned providers have reached new scale as Principal announced that it had written $2.8 billion on 60 deals in 2017.[3] The average size deal was $46.7 million and Principal indicated it had raised its minimums to $10-15 million per deal.

Rates and Pricing

The impact of low interest rates caused insurers to focus upon opportunistic retiree deals where mortality advantages are realized in less time and with greater accuracy than for deferred life blocks. Deferred pensions are normally sensitive to interest rates because of the precise nature of risk and expected time over which payments will be paid are known only when benefits commence at an actual retirement date sometime in the future. These variables are much trickier to price than a straightforward retiree benefit that is payable until the death of the annuitant.

Deal Size and Sole Bid Status

Jumbo transactions are generally defined as $1billion+ in size. Jumbo deals attract market attention and are typically risk transfer in nature as opposed to plan terminations. Even in these instances, capacity is limited and deals are sometimes split between two or more providers.[4] In the past, it was possible to obtain multiple bids to place a $500,000 deal. This has quickly moved to a point where only a single bidder may be available for a $1-10 million deal size. Deal size minimums now approach $25-50 million leaving a huge unfilled gap in capacity in the under $25 million market where few or no bids may be available. There have been numerous instances where providers have simply said "no" even when granted "sole" or "exclusive" bid status. If anything can be said, it is that the PRT market has matured in a way that could hardly be imagined a few years ago and which could be very detrimental for a large number of pension plan sponsors attempting to transact in the medium and small end of the market.

Timing and Seasonality

In the past, DB plan terminations and pension annuity contract placements normally occurred at the end of the year simply because 80% of DB plans operate on a calendar year end basis. As early as year end 2015, annuity placement activity and closings were impacted by volumes and capacity constraints pushing deals into the following year. This pattern continued through the end of 2017 only to find that deals cannot be placed in 2018. The number of deals that cannot be placed as "no bid" scenarios are increasing, causing a new phenomenon in the industry: backlog.

Administration, Installation and Support

Retiree only deals are easier to price, sell and install because payment systems are in place,

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[2] "Athene Enters Pension Risk Transfer Market with $320 million Deal"; *Reinsurance News*, 11th August 2017 - Author: Steve Evans

[3] "Principal Financial's 2017 Risk Transfer Sales Hit Record $2.8b", BNA, January 29, 2017

[4] "Prudential Splits Latest Mega-Buyout Deal with Competitor", Chief Investment Officer, February 24, 2015

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benefits are fixed and known and call center volumes are generally limited to very specific questions. Installing retiree only cases are systems intensive and such processes generally exist even with the newest market entrants. New capacity gravitates to low hanging fruit bolstering budgets and resources away from traditional pension group annuities with deferred plan provisions. Deferred benefit provisions have become more complex over time as numerous regulations must be followed to compute lump sums or grand fathered provisions in cash balance plan arrangements. The infrastructure required to price, sell, install and administer pension group annuities is entirely different from a block of retirees in a risk transfer deal.

Regulatory

In December 2017 MetLife announced that it had become the subject of an investigation by the Massachusetts and New York Departments of Insurance relating to non-payments to potential retirees under a number of pension annuity contracts.[5] This was followed by the announcement that the Securities and Exchange Commission was investigating the matter after MetLife disclosed that it would increase its reserves by $525-575 million due to the apparent lapses in controls.[6] This event could not have happened at a worse time as pension annuity deals are expected to once again approach $20 billion in 2018.[7] Furthermore, scrutiny of new and existing providers may result in delays in market development as others decide to take a "wait and see" attitude as these investigations unfold. Still others may decide to continue moving forward.

Conclusions

The ability to transfer risks through annuities will continue to be tempered by preferences for retiree risk transfers as jumbo first movers consume capacity. Plan termination deals with complex plan provisions for deferred lives less than $10 million will continue to become difficult to place as contract minimums are raised. Federal and state regulatory inquiries may bring more focus to the PRT market within an already complex set of rules and regulations. Momentum will require an influx of manpower resources and will absorb large quantities of capital very quickly. States such as New York maintain strict regulatory guidelines which are meant to protect policy holders. As a result, there are severe limitations on accessing adequate New York admitted providers for plans with less than $10 million or with deferred lives.

In difficult markets, strategy becomes more important as advantages or disadvantages change quickly from one provider to another. The process of shifting pension liabilities to annuities requires planning and coordination in a team approach. Providers lacking the adequate infrastructure to underwrite deferred deals will limit their appetite to the easier retiree deal flow until the market attains maturity. Providers will consider ways to partner on administrative capabilities to facilitate part of the solution.

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[5] "MetLife discloses it failed to pay benefits to some retirees from annuity buyouts", Pensions & Investments - Rob Kozlowski, December 18, 2017

[6] "SEC Stunts MetLife Q4 Earnings Report Due to Missing Pension Fallout", Chief Investment Officer, January 31, 2018

[7] "U.S. Single Premium Pension Buy-out Sales Post Record-Breaking Results for Second Consecutive Quarter", LIMRA, November 16, 2017

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Appendix I

The history of providers moving into and out of the PRT and plan termination annuity market shows volatility based upon market conditions and is driven by both macroeconomic factors and regulatory change.

Source: QAS Historical Group Pension Annuity and PRT Provider Universe

Provider	Status History
AXA Equitable Life	AXA offered individual annuity; no group annuity capacity; inactive
AIG	American General and United States Life (NY) labels; suspended new business in 2008; subsidiaries combined for non NY and NY contracts; focus on selective deferred cases
American United Life	Entered the PRT market in January 2014 and steadily wrote new business; volumes now in excess of $1 billion
Athene	Entered market in 2017 as Athene Annuity & Life Assurance; focus is jumbo retiree only
Banner Life	US platform offering group pension annuities for Legal & General (UK); offers similar products in UK; no deferred
Great American	Entered market in 2017; limited offerings to retiree only; small to mid market
Hartford Life	October 2009 withdrew from market; pension block sold to MassMutual
John Hancock USA/(NY)	December 2009 - John Hancock ceased new business; assets and liabilities combined to John Hancock Life USA/John Hancock NY; inactive
MassMutual Life	MassMutual is active and has a consistent presence; selective in underwriting
Metropolitan Life	MetLife's focus is larger plan market; raised minimums to $50mm
Minnesota Life	Minnesota Life/Securian NY operate as Securian Financial; entered market 2015
National Life VT	Intended to enter market during 2017; later withdrew
Nationwide Life	Ceased offering after re-entry in 2007; brief effort led to withdrawal
New York Life	Selective re-entry in 2015; retiree only deals; limited focus to retiree only cases
Pacific Life	Consistently active; prefers retirees; offers structured solutions to meet strategic customer needs
Principal Life	Consistently active; quoted large and small cases; minimums increased; becoming selective due to success in target market
Prudential Life	Offering general account/separate accounts; known for commitment to PRT market
Transamerica Life (NY)	US arm of AEGON, NV; suspended sales in 2012 indicated indefinite halt to sales
United of Omaha/Companion	Niche provider small cases; NY business offered through Companion Life
VOYA	2014 ING created and spun off Voya in US; entered the PRT market and exited in December 2016
Western-Southern	Entered the market in late 2013; expanded offerings to deferred in 2017; successfully issued and installed business

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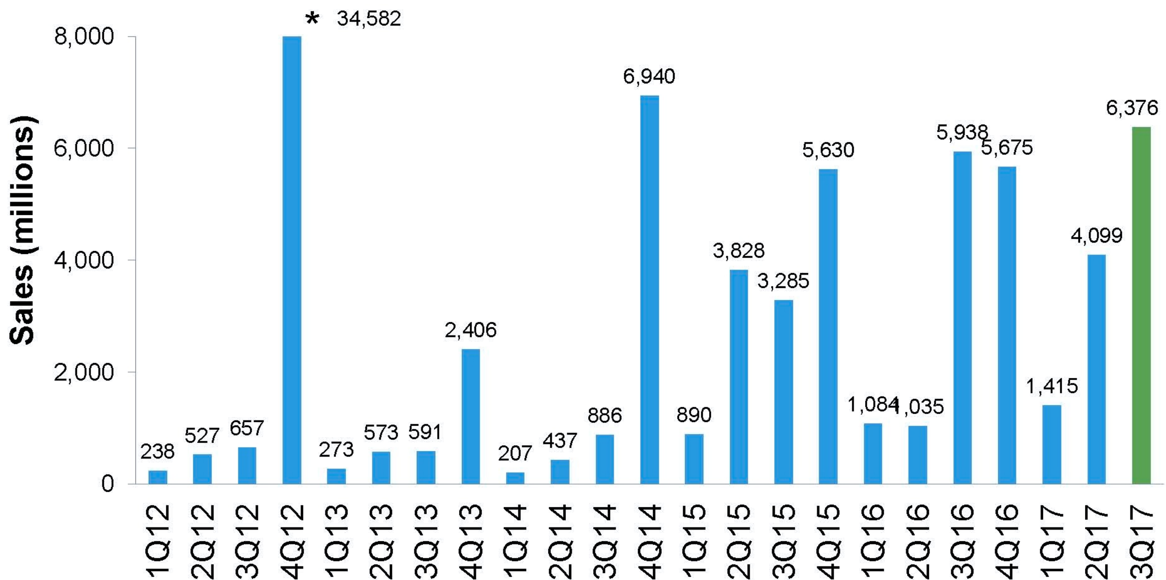
Appendix II

The seasonality of PRT deals is becoming less troublesome as deals are bid more often on the basis of available capacity. This is driving deals into the Q1 and Q3 avoiding to some extent the Q4 log jam.

Source: http://www.limra.com/Posts/PR/Data_Bank/_PDF/1Q-2012_3Q-2017-Buyouts-Quarter.aspx



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Research Source References

http://www.limra.com/Posts/PR/Data_Bank/_PDF/1Q-2012_3Q-2017-Buyouts-Quarter.aspx

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http://www.pionline.com/article/20171218/ONLINE/171219824/metlife-discloses-it-failed-to-pay-benefits-to-some-retirees-from-annuity-buyouts

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About QAS

Qualified Annuity Services, Inc. ("QAS") is a leading provider of pension risk transfer solutions serving the needs of pension plans since 1981. Pension Risk Transfer (PRT) and Terminal Funding Annuity contracts guarantee benefits for retired or deferred participants. Our proprietary Pension Risk Transfer 1000 Index allows us to dynamically monitor sensitivities of risk transfer solutions over time. Our leading PRT Index provides a discrete view to pension risk transfer costs. A properly executed Pension Risk Transfer strategy can reduce liabilities and costs.

QAS provides consulting services for clients that require services relating to plans which are subject to "The Employee Retirement Income Security Act of 1974" ("ERISA"). QAS provides Independent ERISA Fiduciary services to select an annuity provider pursuant to the requirements of Department of Labor Interpretive Bulletin 95-1 ("IB 95-1") or the "safest annuity standard". In addition, QAS fulfills the appropriate standards of ERISA for "procedural prudence" in selecting an annuity provider by adhering to standards as determined in Bussian v. RJR Nabisco, 223 rd F 3rd 286 (5th Cir. 2000), ("Bussian").

QAS has obtained an Opinion of Counsel that its process, when followed, meets both IB 95-1 and the procedural prudence standards of ERISA per Bussian. Clients who engage QAS meet their duties under ERISA for the annuity selection when they delegate that responsibility to QAS as Named Fiduciary. The Opinion is by Mr. Alfred A. Turco, Esq. of McElroy, Deutsch, Mulvaney & Carpenter, LLP, Hartford, CT. Mr. Turco's first Opinion was in June 2001 and second Opinion on December 16, 2014.

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