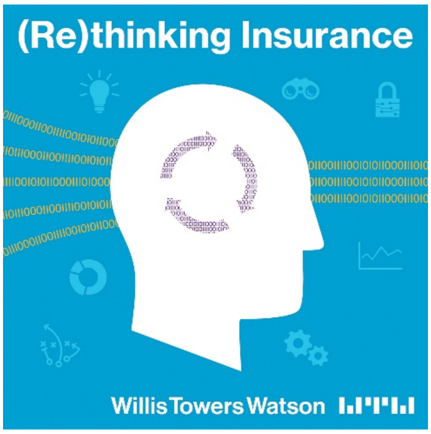

Episode 10: Navigating the pension risk transfer landscape

KAREN GROTE: If we drill down over the past few years, not only has the overall market grown, but we're seeing larger-sized cases are gaining popularity.

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SPEAKER: You're listening to Rethinking Insurance, a podcast series from Willis Towers Watson where we discuss the issues facing P&C, life, and composite insurers around the globe, as well as exploring the latest tools, techniques, and innovations that will help you to rethink insurance.

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CARRIE KELLEY: Hello, and welcome to Rethinking Insurance. I'm your host Carrie Kelley. Today, I'm delighted to be joined by my guest Karen Grote, director from our Philadelphia office. Good morning, Karen.

KAREN GROTE: Good morning, Carrie. Thanks for having me.

CARRIE KELLEY: All right. So in today's episode, we're going to be discussing the pension risk transfer market and what it is and why we've been seeing an increasing number of deals in the market recently.

But before we get into the topic, we like to start with learning a little bit more about our guests.

And what we do on Rethinking Insurance, Karen, we ask if you Google yourself, what does your search come back with? And what would you really like it to come back with? So I did Google you. The first, it is actually Karen Grote at Willis Towers Watson. I don't know if that is your life goal, if you're happy with that, or are there other things you want to aspire to?

KAREN GROTE: Yeah, it's funny. I actually googled myself, too. And I thought, oh, gosh, how professional. I am that the first hit is my LinkedIn profile. Yeah, it's an interesting question. So I do love to paint, although I get very little time to do so. But I was thinking, how cool would it be if you googled my name and all these beautiful images of artwork came up instead of the very professional LinkedIn profile?

CARRIE KELLEY: Nice. All right. So we are going to talk about pension risk transfer. And maybe just to start out, you can tell us just about the PRT market and what it is, how it came about.

KAREN GROTE: Yeah, sure. So the pension risk transfer or PRT market, it really kicked off in 2012. There was two very large deals that made a splash. But the market's been growing ever since then. So I guess I'll start with the why, and then I'll go into the how.

So the why is that-- so we have companies or plan sponsors as we call them who offer defined benefit plans to their employers. And because of that, they're dealing with all of the risks that come with offering that plan so things like longevity risk, investment and interest rate risk, and asset liability management risk. And if those sound familiar, of course these are risks that insurance companies are used to dealing with all the time on their other lines of business. So it just makes sense that insurance companies would be well placed to take on this business.

So by transferring the plan to an insurance company through the purchase of a group annuity, the plan sponsor gets to transfer all those risks, and then, of course, they also remove the effort and costs to actually administer that plan. So that's the why. But how this looks is a transaction starts with the plan sponsor hiring an advisor.

And Carrie, interestingly, so we're in the insurance consulting and technology division of Willis Towers Watson. But outside of our group in the retirement section, there is the annuity placement group. And they are actually the largest provider of those advisory services.

So it's pretty interesting for Willis Towers Watson to be on both sides of the transaction. And as you can imagine, we have to be very careful to keep up a wall. And we don't regularly interact with the annuity placement group.

But in any case, so the advisor helps the plan sponsor package their data so data about the plan, about the participants in the plan, as well as any experience that the plan has had, and then also develop a request for proposal. Once that's all done, it goes out into the market. Insurance companies are then able to bid on the business.

Those bids often occur in multiple rounds. And I can assure you through our work, I think we've done something like over a hundred deals. I've lost count after a hundred assisting the insurance companies. I can tell you they often come with very tight deadlines. Not always, but sometimes we're scrambling to meet those deadlines, but we do. And then the advisor then helps the plan sponsor select the winner. And the business is awarded to that winner.

CARRIE KELLEY: So are insurance companies in this market typically then bidding on multiple deals at a time?

KAREN GROTE: Yes, they are. And as you can imagine, it gets a bit hectic, which is why a lot of our clients like to rely on us to help them deal with all these bids. So a lot of times, we're actually doing the projections for them and giving them that output to make their lives easier and allow them to bid on more than one deal.

CARRIE KELLEY: So you touched on it a little bit. But kind of circling back, what are the key risks for some of these transactions? And what are the key sources of earnings as people are looking at these deals and trying to price them?

KAREN GROTE: So getting the mortality assumption right is a key area of risk. And deals can vary significantly in terms of the demographics. So it's really important to have a solid view of the base mortality and how the mortality of one deal will look different from another. And this is a bit of a departure from more normal or standard insurance products in that the, like I said, the demographics from one deal to another can be so very different. If you think about a plan sponsor that is manufacturing maybe a bit dangerous work, maybe lower benefits versus let's say a finance company where everyone is just sitting behind desks.

And actually, this variation was a key area. A few years ago, Willis Towers Watson completed what we call the pension mortality analysis. And this was one, as I said, key area that we looked into. How does that mortality differ across the deals? And actually, a lot of insurers are relying on those mortality rates that we produce as part of that analysis.

And as you know, Carrie, you produce our mortality improvement guidance for the firm. And we find that very helpful. Thank you. We use that internally when we're setting our mortality improvement assumption. And quite a few insurers are using it as well. So earnings can emerge if mortality is greater than expected, of course but also, of course, if the main source of earnings is on the assets supporting the liabilities.

CARRIE KELLEY: Right. So then what, I guess, what is the impetus for insurers entering this market? We've talked previously about how more and more insurers are getting into the market, maybe a little bit about that, what kind of numbers you're seeing in the market, and why insurers are entering the market.

KAREN GROTE: Not surprisingly, as the market grows and grows, the number of players in the market has grown as well. I think we're up to 18 players now with a handful of new ones over the past 12 months, I would say. And as I said earlier, insurance companies are very well positioned, given the risk and benefit profile of this business. It is similar to that of an annuity.

So essentially, if a company feels they can be competitive, if the business profile fits in with their company's goals, and they have enough capital to do so, this would certainly give insurers the opportunity to gain a large amount of business and assets in one transaction.

CARRIE KELLEY: And so is it difficult to enter the market if you're considering and kind of what kind of tools or expertise does someone need if they think this sounds interesting and want to explore more?

KAREN GROTE: Yeah. And that's a question that we get a lot from our clients. That's often the very first question that we hear from insurance companies who are thinking about entering the market. It can take some time to gain traction as a new player. But as I said, we have seen multiple companies successfully do so.

One of the key items is that the Department of Labor requires the plan sponsor to select what they call the safest available option. So that means the insurer really has to demonstrate creditworthiness and that they can both administer the policies and pay the benefits out to the policyholders, of course. That's important.

We've seen that in practice translate to a credit rating of A or better. That's kind of one area where it's pretty black and white. You really have to have that solid rating. But of course, it also means having the right level of capital. It means having the right staff with the proper expertise and then also the administrative system capabilities.

And then as you might imagine, once you've established your company on a few deals, that will certainly go a long way of helping. And of course, price competitiveness, that's a high priority too for plan sponsors. I'm not on that side of the deal. But I'm sure they're weighing that heavily. It's a balance of aggressiveness and safety.

CARRIE KELLEY: So then, what do you think has been driving the strong year-over-year growth in the PRT market?

KAREN GROTE: I touched on earlier the costs of the plans. Those costs are not fixed. They are going up for the plan sponsors. In fact, those costs have been going up I think every year for just about the last decade.

There's also a lot of volatility for plan sponsors. So they have to make sure their plan is funded correctly. So depending on how their assets are performing, that funding status can go up or down quite a bit quarter to quarter or year over year. And the nice thing for the players in the marketplace is just the sheer amount of US-defined benefit liabilities is just very high.

So there's really no shortage of the business. And the success builds upon itself. So I mentioned those two large plans in 2012 making a splash. And what I really meant there is I think it made a lot of other plan sponsors take notice and start thinking about, is this something that might work for us? So when plan sponsors see others successfully transferring their DB plans, that piques their interest.

We often also see a plan sponsor test the waters. So they'll try a smaller transaction, maybe cut out small benefits, and do a transaction with that part of the business first. And if that all goes well, and they're happy with the results and then the prices they get, they'll often move on to transferring a larger part or maybe all of the plan.

And I guess parallel to that too, I've been talking a lot about the plan sponsor view, which is funny because I'm working with the insurance companies. But we also see more insurers entering the market. And even those that are there, we see them willing to take on larger cases and more complicated cases. And in fact, if we drilled down over the past few years, not only has the overall market grown, but we're seeing larger-sized cases are gaining popularity.

CARRIE KELLEY: All right. So how has COVID-19 if at all impacted the market? And do you expect any long-term impact from COVID-19?

KAREN GROTE: Yeah. So like anything, COVID-19 introduced uncertainty and volatility. We're dealing with that everywhere, insurance and in business. And in Q2, a lot of plan sponsors pulled back. They got scared. They didn't feel confident they could get the right price.

But what was interesting about that time is that the insurance companies never were deterred. They remained very, very aggressive. Some even mentioned that their prices would be even better in the market, which I think surprised everyone. So once the plan sponsors regained their comfort, which really happened over Q3, we saw a flurry of new deals.

And Carrie, you asked about are insurance companies bidding on more than one deal? Yes. And in Q3 and Q4, I think that's never been truer than it was then. So that meant everyone, including us, got really, really busy, everyone trying to catch up. And the insurance companies were very happy, very happy to have more supply for their demand. So yeah, everyone's taking a step back now and trying to wrap everything up from all that work.

But as far as the actual mortality impacts, that was one of the first questions we started asking. Theoretically or I guess not theoretically, these are typically older-attained age blocks. These are typically participants. In some cases, they're all retirees. So this is people who are generally over 65. And the average age is somewhere in the low 70s so very much the block of people that are most impacted by COVID-19 mortality rates going up.

But we didn't really see insurance companies making a lot of adjustments for that. They cited there would be some offsetting mortality impacts. So short term, I haven't really seen a lot of impacts other than that pulling back in Q2 and then rushing in Q3 and Q4. And going forward, I am feeling pretty confident that the marketplace is going to continue to grow over the next few years.

CARRIE KELLEY: So I guess, what would the key takeaways you want someone to have from listening to this discussion?

KAREN GROTE: Yeah. So the PRT marketplace does remain a growing market with new entries every year. And that makes it exciting. It's exciting to be a part of. It's exciting to watch. We find it very enjoyable to assist insurers at all stages of the process, whether they're looking to get into the market, increase their competitiveness, win more deals.

So I would encourage everyone in the insurance field, whether you're involved in PRT or not, to keep an eye on the market. As I said, it's interesting. It's growing. And reach out to us if you want to know more. I'm clearly very happy to chat about it.

CARRIE KELLEY: All right, great. Thank you, Karen, for joining us today. Your insights on the PRT market have been very interesting.

KAREN GROTE: Thanks, Carrie, for having me. As always, a pleasure to talk to you.

CARRIE KELLEY: And thank you, everyone, for listening to Rethinking Insurance.

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