SNL Financial

Reprinted from SNL Financial

# New advisory firm targeting pension risk transfer for corporate plans

*February 05, 2013*
*By Joel Poelhuis*

Pension risk transfer deals reached a fever pitch in 2012, with massive transactions between Prudential Financial Inc. and corporate plan sponsors Verizon Communications Inc. and General Motors Corp. Steve Keating, former head of the pension solutions group at Lazard Ltd, is seeking to occupy a new niche in pension risk advisory with the launch of Penbridge Advisors LLC. Keating, who co-founded Penbridge with Robert Goldbloom, former head of the U.S. pensions business and chief pricing actuary for defined benefit buyouts at American International Group Inc., recently spoke with SNL about the new firm and how the market has developed in the low interest rate environment.

The following is an edited version of that interview.

**SNL Financial: What opportunity did you see that led you to found Penbridge Advisors?**

Steve Keating: I've been a pension consultant for my entire career — I spent a lot of time at Hewitt Associates. I spent a couple years in the U.K. with them, focusing on the U.K. buyout market. I'd been watching the shift from [defined benefit] to [defined contribution]. Corporate plan sponsors have found the expense of keeping a plan to be pretty substantial. In the low interest rate environment, plans have become more expensive to fund, and there's a lot of volatility around those costs. Big-name companies have been freezing their pension plans. The [Pension Benefit Guaranty Corp.] website publishes industry figures on hard-frozen pension plans. Back in about 1975 there were about 250,000 DB plans in the U.S. Today, there are only about 28,000 left, and of those about 10,000 are hard-frozen, meaning they are no longer accruing any new benefits — it's no longer used as an HR retention tool. And under the Department of Labor, under [the Employee Retirement Income Security Act], the only means for a plan sponsor to transfer the risk in the DB plan off its balance sheet is to purchase a group annuity contract via an insurance company.

I became familiar with a gap in the marketplace. That gap is twofold. We're bridging the information gap. Information around pension risk transfer is not getting to the plan sponsor. Their existing suite of advisers — the actuary, the asset manager — is tasked with doing very specific things, but they aren't necessarily designed to address the potential for a risk transfer. And insurance companies only get involved once a company has made the decision to terminate.

We saw this information gap, and we saw this financial gap, in that companies typically understand their accounting GAAP valuation, and from their actuaries they get their funding valuation. But then if [they] want to terminate the plan in the future, there's a premium charged by the insurance company — what we refer to as a plan termination valuation. Penbridge specializes in valuing the plan on the plan termination basis. We're looking to partner with advisory firms, but we also are expecting to build business with those 10,000 plans that have now frozen their plans.

**The market has seen some large deals lately, with Prudential's transactions with Verizon and GM. Do you see more deals along these lines or the potential for more smaller deals?**

The market's been around a long time. You're hearing about it now because a couple jumbo plans have transferred their risk to the insurance companies recently. The flow of business each year has typically been between $1 billion and $3 billion in size. In 2012, that was $35 billion, because between Verizon and GM that was $32.5 billion. But besides GM and Verizon, there was an additional $2.5 billion transacted, and that was between 75 and 100 deals.

On our website, we have a link that shows the number of plan sponsors using the database, which indicates some potential interest. As of Jan. 1, we have 128 plan sponsors using the database, of which 36 of them are over $1 billion. Around 50 to 60 of them are around $50 million and below.

**What characteristics make a corporate plan sponsor particularly interested in transferring pension risk? Is it unfunded liabilities? Is it the overall financial health of the company?**

It really boils down to two things. It's the size of the plan as it relates to the size of their business, either by market cap or the size of their operating business.

Over the last 10 years, we've had a lot of volatility in the markets, with the dotcom bubble and then the financial crisis. Plans are up against extraordinary pressure in this low interest rate environment. Under the [Pension Protection Act], which went into effect in 2006, plans are required to put more money in their plans than ever before.

The cost associated with that plan is directly linked to interest rates, and interest rates are at all-time lows. The burden of funding these plans has become quite intense for plan sponsors.

**When a company has made the decision to shop around for an insurer to take on those liabilities, what are their main concerns or their preferences in an insurance company? Is it size? Is it the history of the company? How big is the universe of insurers looking to take on these liabilities?**

On the insurance side, there are only nine insurance companies in the U.S. that are involved in this business. To the extent that this market continues to grow there could be new entrants, because there are capacity constraints. Each of those nine insurance companies has their own appetite for risk and their own parameters. Our database features all that information.

A DB plan is made up of active employees, terminated vested employees and retirees. Some insurance companies are agnostic to what the plan looks like. They'll take a full buyout of the entire plan, including actives, terminated vesteds and retirees, whereas other insurance companies will do only carve-outs of the retirees. That risk appetite is very dynamic among insurance companies. Our database is the only source of that information in the U.S. market. We have contracts with the insurance companies to ensure that their data is up to date.

**Have you seen any willingness for cooperation between insurers to carve up a plan, in the case that one company has more risk appetite and is willing to take on liabilities that another is not?**

This is a growing market. There's not only product innovation, but there could be risk-sharing in the future. As this market continues to grow, there's going to be innovation on the product side, but also on the capacity side.

Prudential and MetLife Inc., for example, essentially will work with plans of all sizes. Other insurance companies on the database tend to be in the micro market. [Mutual of Omaha Insurance Co. unit] United of Omaha Life Insurance Co., for example, only deals with plans up to $10 million in size. Those nine insurance companies have their own guidelines that they follow. As those guidelines change, our database is a good place to learn about the marketplace.

**I wanted to talk a little about the challenges involved in completing these deals. There have been some legal challenges from employees. What is the biggest challenge in completing these deals, and do you expect more legal action in the future to clarify this?**

The whole process is quite extensive. It typically takes 18 to 24 months to terminate a defined benefit plan in the U.S. There are a number of filings that are required with the PBGC and with the IRS. There's typically an array of stakeholders involved. The company has to wear two hats. Deciding to terminate the plan is not a fiduciary decision, but once they've decided to terminate the plan, they have to act in the best interests of participants and create a sound fiduciary structure for selecting the annuity provider. They normally hire an annuity adviser, they hire an ERISA attorney, and there may be other corporate advisers involved.

**There aren't a lot of corporations getting into defined benefit plans. What's the timetable for this opportunity, given the existing pipeline, and how long that will take to move to the insurers?**

I think it could be very dynamic in the next several years, especially as interest rates start to move up. In this low interest rate environment, it is expensive to terminate a plan. But because there are so many frozen DB plans and these big deals have been done, there are a lot of plans out there asking what pension risk transfer means for them. *i*


One SNL Plaza, P.O. Box 2124, Charlottesville, VA 22902 Phone: 434.977.1600 News fax: 434.293.0407 www.snl.com