Q&A with RGA

Developments in Longevity Risk Management for PRT Transactions

RGA

Reinsurance Group of America, Incorporated

Headquarters	St Louis, Missouri
Year Founded	1973
Life Reinsurance In Force	$3.5 trillion*
Consolidated Assets	$84.7 billion*
Market Capitalization	$7.9 billion*
Website	rgare.com

** As of December 31, 2020*

David Lipovics FIA

Vice President, US Pension Risk Solutions

Global Financial Solutions, North America

David is responsible for leading RGA's activities in the US longevity space with an emphasis on reinsurance support to the US Pension Risk Transfer (PRT) market. Previously, David was Business Development Director in RGA's UK unit, where he led the origination and execution of transactions in the UK pension/annuity market.

In 2019, BCG advised on the first-ever longevity reinsurance transaction in the United States. Under the agreement, a PRT insurer transferred to RGA all longevity risk pertaining to a portion of its in-force PRT liabilities.

BCG: *Tell us a little bit about RGA as an organization and what makes the PRT market attractive to the company.*

Lipovics: RGA is unique in that we are the only global reinsurance company to focus primarily on life and health-related reinsurance solutions. We have approximately $3.5 trillion of life reinsurance in force, so longevity risk is a good complement for our overall risk profile. Completing our first longevity transaction in 2008, we have developed significant expertise in the management of longevity risk, which we bring to the benefit of the growing US market.

BCG: *When pricing PRT annuities, most PRT insurers tend to focus much of their attention on investment returns, while mortality assumption setting is secondary. Do you see any problems with this approach?*

Lipovics: Investment performance is undoubtedly the most visible driver of profitability in PRT transactions. However, the importance of getting mortality assumptions right is often underappreciated. As an illustration, using generic tables for mortality assumptions instead of portfolio-specific assumptions can easily have a present value impact of 3-5% in either direction. That is comparable to gaining or losing 30-40 bps in annual asset returns, and can make the difference between winning or losing a deal as well as whether a case is profitable or not.

BCG: *What are some of the recent key developments in the assessment of longevity risk and how do you expect these developments to impact US PRT transactions?*

Lipovics: There is a trend towards deeper analysis with the use of more sophisticated models. The traditional set of mortality rating factors (such as age and gender) is rapidly expanding to include more detailed 'risk predictors', for instance, geographical location. This should lead to more informed pricing, and improved risk assessment and management. I expect similar developments in the way the industry starts to recognize differences between general population and pensioner mortality improvements, with the latter generally being higher.

BCG: *Speaking of mortality improvements, given the COVID-19 pandemic and its impact on longevity, are you seeing any fundamental changes in future views on mortality?*

Lipovics: I think it is fair to say that currently the only area of industry consensus is that the impact of the pandemic on future mortality rates is uncertain – both in terms of quantum and direction. Different dynamics could be at work in the short versus long term – it is simply too early to tell. Interestingly, however, the rate of global longevity risk transfer related to pension plans has not slowed one bit.

BCG: *You mentioned that RGA is active in PRT markets outside the US, such as the UK, that see significant longevity reinsurance activity. Why do you think US longevity risk transfer has yet to take off? Can you also comment on what transaction structures are most common in the UK and whether similar structures are available in the US?*

Lipovics: In Europe, longevity reinsurance can have very clear regulatory capital benefits. However, this is not the only reason that hundreds of billions of longevity risk has been reinsured to date; risk management, economic capital budgets, and capacity considerations are equally valid motivations. With growing volumes of this risk on US insurers' books, demand for reinsurance is likely to increase. With regards to pension plans, this is a market of its own in the UK, with over $150 billion of longevity risk transferred from pension plans to the reinsurance market. It took considerable product innovation and early movers to get to the transaction volumes we see today, but I anticipate the US will evolve similarly as the understanding of longevity risk and its management options develop. UK pension plans have been accessing the reinsurance market through intermediary or fronting insurance carriers – I think this could be a viable route in the US, too. By contrast, a 'self-intermediation' structure, which has been employed in the UK, has significant regulatory hurdles in the US.

BCG: *A recent article that we published highlighted currently exceptional PRT annuity pricing; for example our 2020 retiree annuity placements averaged 94% of plan accounting PBO values. With pricing like this, why should a pension plan sponsor consider a longevity only risk transfer transaction?*

Lipovics: I see longevity risk transfer as a de-risking tool that complements other solutions. There are pension plans for whom full termination will be the right answer and they should capitalize on the attractive pricing we see today. On the other hand, there are plans that can't afford a complete de-risking right now – for them, offloading longevity risk could be a step towards the end goal, requiring less upfront cost. Plan sponsors that remain comfortable with investment risk and the potential upside of retaining this risk, plans at or near their end-state, and plans that are just not ready to fully de-risk for other reasons could also find value in longevity risk transfer. I agree, though, that pricing needs to be compelling whatever a plan's objectives.

BCG: *In closing, can you comment on whether longevity only risk transfer is available for both deferred participants and retirees, or is capacity currently only available for retiree lives? Also, how large does a retiree liability or number of lives need to be to attract reinsurer interest?*

Lipovics: Most reinsurers still have a strong preference for retirees, and this is true globally. However, there is a conscious and gradual move towards accepting younger lives, subject to appropriate guardrails, to respond to growing demand in certain markets. It is worth noting though that the cost of transferring risk for these long liabilities tends to be higher due to the increased longevity risk profile. In terms of size criteria for longevity risk transfer, a minimum of roughly $500 million present value of retiree benefits, or a few thousand lives is preferred. Smaller retiree groups are not out of the question, but assumption development becomes more challenging.

David Lipovics can be contacted at 636-736-3459, or dlipovics@rgare.com

About BCG Pension Risk Consultants | BCG Penbridge ("BCG")

BCG specializes in assisting defined benefit plan sponsors with managing the costs and risks associated with their pension plans. Since 1983, BCG has successfully helped over 2,000 organizations achieve their pension de-risking goals.

Please visit our website bcgpension.com to learn more.