De-risking at home and abroad

Alyssa Manning examines how the US is now following the UK's lead in pension risk transfer

With over $3 trillion of defined benefit pension liabilities, the US has the largest concentration of defined benefit pension risk in the world and the US pension market is now beginning to follow the UK's lead in pension de-risking. In the UK, more than £105 billion in defined benefit pension risk has been transferred from corporate balance sheets to insurance companies through buyouts, buy-ins and longevity insurance. The very same trends that have made the UK the world leader in pension de-risking are taking hold in the US. Companies and plans are increasingly looking to take advantage of the growing global market in pension de-risking to achieve security for their members and stability for shareholders.

Three crucial factors drove the establishment of the UK pension risk transfer market, which have now emerged in the US.

Accounting rules

Firstly, US corporates have begun to take greater notice of their pension plans due to changes in accounting rules in the US, namely FAS 158. Like IAS 19 in the UK, FAS 158 has brought the financial position of corporate pension plans to the forefront of public attention. Shareholders have accordingly taken notice of pension plans, noting many companies have pension liabilities greater than the market capitalisation of the company itself. As in the UK, US companies have started to identify ways to address the balance sheet volatility caused by pension deficits.

Longevity extensions

Secondly, increased risk awareness has spurred pension plan trustees and corporates on both sides of the Atlantic to address their pension risks and provide greater certainty to plan members. Just as the many updates to mortality tables over the early 2000s highlighted the impact of longevity risk to UK pension trustees, the recent US Society of Actuaries' release of its RP-2014 mortality tables emphasised this risk to US pension and corporates. The 2014 mortality table update was the first update in the Retirement Plan (RP) tables since 2000 and resulted in a 5-10 per cent increase in US pension liabilities, encouraging corporates to offer their members the security of the insurance regime and remove this liability from their balance sheets.

Rising costs

Thirdly, the rising cost associated with running pension plans has increased the relative value of transferring the risk to an insurance company. The trend of rising costs in the US began with the Pension Protection Act of 2006 setting stricter funding requirements for pensions by targeting a 100 per cent funding level and increasing the Pension Benefit Guaranty Corporation (PBCG) premiums for underfunded plans. In 2015 PBGC fixed premiums were further increased by roughly 22 per cent over the following three-year period.

Global de-risking

These trends have created a need for global pension solutions. Several pension plans have already engaged in global pension de-risking initiatives, most notably TRW in 2014 and Philips in 2015. By undertaking a global pension de-risking initiative, corporates can ensure consistent treatment and messaging across pension plans while looking at their pension situation in a holistic way at the balance sheet level. Global pension de-risking can benefit from working with global players. By working with a single insurer on a multi-front de-risking project, companies and pensions trustees can benefit from governance efficiencies at the insurance company, ensure a coordinated message to pension members, and provide a unified message to shareholders.

The alignment of accounting rules, longevity extensions, and rising pension costs across the UK and US have created a similar set of circumstances for pension plans on both sides of the Atlantic. Companies with pension plans in the UK and US can work with organisations with global pension risk transfer capabilities to present a coordinated response and to find the best solutions worldwide to benefit their members and shareholders.

For more information on how Legal & General can help companies manage their global pension exposures please contact Alyssa Manning on 0203 124 2029 or email derisking@landg.com

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