

The PRT Opportunity: Finally, A “Free Lunch” for DB Plan Sponsors

By Joe Anzalone

For over a decade, transferring a portion of retiree obligations to insurance carriers (known as “Pension Risk Transfer,” or “PRT”) has been a popular strategy for Defined Benefit (DB) pension plan sponsors. By transferring the responsibility of paying retirees to insurance carriers in exchange for an asset transfer (or “premium”), sponsors have reduced risk and operational costs. Historically, this came at a price, as premiums were slightly higher than balance sheet liabilities, and pension expense sometimes increased due to reduced expected asset returns.

Now, the PRT landscape has shifted dramatically as a result of increased competition. Premiums have dropped significantly, often below balance sheet liabilities. Sponsors can now eliminate the cost and risk of retiree obligations while improving their balance sheets and potentially reducing pension expense, making PRT a win-win solution. This is especially true if the amount of retiree obligation is less than the amount of hedging assets in the pension portfolio.

For many corporate plan sponsors, the DB plan liabilities will ultimately be transferred to an insurance company. The premium for this type of transaction is as low as it has ever been, but there is no guarantee it will stay that way. Plan sponsors should consider a PRT transaction today.

Why PRT Makes Sense Now, especially for plans using LDI

For plans using fixed income or Liability-Driven Investing (LDI) to hedge retiree obligations, the current environment presents a unique arbitrage opportunity. While LDI is a strong hedging tool, it has limitations:

- **Investment Risk:** LDI is subject to tracking errors, downgrades, and defaults.
- **Longevity Risk:** Retirees living longer than expected increases liabilities.
- **Additional Costs:** Plans still face administrative expenses, PBGC premiums, and operational costs.

PRT eliminates these risks and costs entirely, offering a level of security that no hedging program can match. Sponsors can now achieve this with fewer assets than hedging requires, further improving their financial position.

LDI vs. PRT Side-by-Side		
Category	Hedging with LDI	Pension Risk Transfer
Investment Risk	Tracking Error, Downgrades, and Defaults	None
PBGC Premiums	\$111 - \$862 per person per year	None
Administrative Costs	Present	None
Assets required to cover \$50M of PBO	\$50 million	\$47 - \$49 million ¹

PRT not only eliminates risks but also reduces the assets required to manage retiree obligations. For sponsors relying on LDI, this is a significant opportunity to optimize their pension plans.

¹ Illustrative range. Subject to market pricing. Actual cost could be lower or higher than this range.

Why Every Pension Sponsor Should Consider PRT

Every pension sponsor using fixed income assets to support their retiree obligations should strongly consider trading in a portion of those assets for a PRT transaction. The benefits include:

1. **Risk Elimination:** PRT removes financial, demographic, and operational risks.
2. **Cost Savings:** Premiums are now often below balance sheet liabilities.
3. **Potential for Improved Pension Expense:** Reduced interest cost and plan expenses could outweigh reduced expected asset returns if paying the premium with LDI assets.
4. **Operational Efficiency:** PRT eliminates administrative burdens and other operational costs related to the participants covered by the transaction.

Conclusion: Act Now

With premiums at historic lows, the PRT market offers DB plan sponsors an unprecedented opportunity to reduce costs, eliminate risks, and improve balance sheets. For sponsors relying on LDI, the case for PRT is even stronger; this is your chance to achieve better outcomes while using less of your pension assets.

At Gallagher, we help organizations navigate pension challenges and seize opportunities like PRT. Contact us today to learn how we can help you secure a brighter future for your pension plan.

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