Reserving for PRT Contracts

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Justin Bevan

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Agenda

1. Pension Risk Transfer Background
2. Reserving for PRT – Current Regulations
3. Reserving for PRT – New VM-22 Regulations

Pension Risk Transfer Background

Pension Risk Transfer (PRT) 101

- **PRT** is the process of transferring the financial risk associated with a defined benefit (DB) pension plan from the plan sponsor to an insurer
- **Defined benefit plans** are offered by employers to their employees and specify a pension payment (or lump sum) upon retirement

Terminology		
	Plan sponsor	Employer which maintains the pension plan
	In-pays/retirees	Plan participants currently receiving monthly payments
	Deferred lives	Plan participants who have not yet begun receiving monthly payments • **Actives** – still employed with the plan sponsor • **Terminated vested** – former employee who became vested (i.e., eligible to receive pension payments) before employment terminated with the plan sponsor

- **There are two primary methods for PRT transactions:**
  - Buy-in: the insurer assumes a portion of the plan's liabilities
  - Buy-out: the insurer assumes all of the plan's liabilities
- **Associated risks:**
  - Longevity
  - Investment
  - Interest rate
  - Asset/liability
  - Other Demographic

PRT Contract Product Features

Pension risk transfer deals are structured as a group annuity contract covering the specified plan participants. While there are no individual policyholders, the two main groups of participants share characteristics with other retail annuity products.

Inpay Lives

- Essentially a Single Premium Immediate Annuity (SPIA)
  - Either single or joint life contingent payments.
  - No options to cash out.

Deferred Lives

- Similar to a Deferred Income Annuity (DIA) with additional optionality but no investment growth during the "accumulation phase."
  - Elective Benefits:
    - Participants retain the option to "commence" their pension after eligibility is met under terms of the pension plan.
    - Benefit amount reduced/increased if commenced at age other than "normal retirement date."
    - Typically, several annuity options (single life, joint life, certain and life) and sometimes a lump sum.
  - Non-Elective Benefits
    - Pre-commencement death benefits

Reserving for PRT – Current Regulations

Statutory Valuation Law

Items Clearly Defined for PRT Liabilities

- PRT is not subject to VM-21.
- Minimum reserve requirements point to VM-A and VM-C, i.e. NAIC model laws and actuarial guidelines.
- Noted exception of maximum valuation interest rates which are defined in current VM-22:
  - Set of four rates published quarterly (non-jumbo) or daily (jumbo), varies by reference period and, if life contingent, initial age.
  - Group annuity contracts are specifically called out in text:
    - Rates determined for each participant
    - Not reestablished at commencement for deferred lives
    - Reference period defined by normal form
- Reserve mortality: GAR 94 with generational mortality improvement using scale AA
- This clearly defines reserve method for inpay lives.
- Deferred lives are more complicated…

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Relevant Sources:

Valuation Manual, Section II, Subsection 2: Annuity Products, Paragraph C

Current VM-22

NAIC Model Rule 821, Section 6, Paragraph C

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Statutory Valuation Law

Not as Cleary Defined – Interpretations Vary

Because of the optionality of deferred lives there are more considerations when calculating reserves. Industry interpretations of how to handle necessary assumptions fall into either CARVM or PBR with PAD.

Arguments for CARVM:

- NAIC Model Rule 820 (SVL), Section 5a – assigns commissioners annuity reserve method for benefits under annuity contracts.
- Deferred lives have enough optionality, especially in plans that allow lump sums, that a “greatest present value” approach to elective benefits is prudent.

WTW’s 2024 PRT Survey found that over 60% of direct writers of pension risk transfer business have not consulted on SVL reserve levels with state regulators.

Arguments for Principals Based Reserve with PAD:

- NAIC Model Rule 820 (SVL), Section 5, Paragraph C, Subparagraph (2) – calls out that group annuity contracts could be subject to CRVM
  - Given there are no future premiums this essentially becomes a present value of future benefits valuation.
- AG 9B: provides guidance on reserves for SPIA and deferred income and calls out a present value of benefits method.
- Most pension plan participants do not optimize – plan sponsors set best estimate assumptions based on plan experience.

Reserving for PRT – New VM-22 Regulations

VM-22

High Level Summary

- Effective 1/1/2026 (optional transition to 1/1/2029):
- Aligns non-variable annuity reserving to the Principle-Based Reserve (PBR) methods used for Variable Annuities (VM-21) and Life products (VM-20)
  - Real World (GOES scenarios) ALM projection for products within scope.
  - **Aggregate Reserve** equals:
    - **Stochastic Reserve** (SR) equal to CTE 70 of Greatest Present Value of Accumulated Deficiencies (GPVAD) metric, plus
    - **Deterministic Reserve** (DR) for contracts satisfying the Single Scenario Test, less
    - Any pre-tax interest maintenance reserve (PIMR) for contracts not valued under VM-A and VM-C, plus
    - Reserve for contracts valued under VM-A, VM-C, and VM-V for contracts satisfying the Stochastic Exclusion Test (SET)
    - Aggregation may occur across reserve categories (noted in table to right), provided that the assets are risks are managed consistently.
- In-scope business now subject to VM-31 reporting, disclosure, and certification requirements as well as VM-G corporate governance guidance.

Products in Scope	
Deferred Annuities	**Payout Annuities**
Fixed indexed annuities (FIAs)	Single premium immediate annuities (SPIAs)
Single and flexible premium fixed deferred annuities (FDAs)	Pension risk transfer (PRT)
Multi-year guarantee annuities (MYGAs)	Deferred income annuities (DIAs)
	Structured settlement contracts (SSCs)

VM-22

Considerations for PRT

- Prudent estimate mortality utilizing actual experience data if available (Section 11)
  - Expected to be beneficial to reserves, 80% of WTW's PRT Survey responded that GAR was a conservative estimate.
- Current VM-22 (future VM-V) Interest rates not used unless stochastic exclusion test is passed and insurer elects to value under VM-A and VM-C.
- Prudent estimates for policy holder behavior (Section 10)
  - Pension ASOP's may be helpful.
- Pension plans without lump sums may pass both the single scenario test and the stochastic exclusion test but it may still be advantageous to elect stochastic reserves:
  - If assets are well matched to liabilities.
  - Allows for prudent estimate mortality
  - Insurer may need to calculate SR if aggregation desired.
- Pension plans with lump sums could require special attention:
  - Interest rates used for conversion are market related but can not be directly hedged.
  - Consider dynamic election formula as relative value of lump sum can influence plan participant behavior.

VM-22

Field Testing

Results show change from CARVM to VM-22 reserve[1]

- PRT showed a small decrease to reserves in both the model office and in the average participant testing.
- Some participants in the testing saw an increase in reserves.

Reserving Category	Product	Model Office Impact	Participant Results				
			Number of Companies	Mean	Median	Standard Deviation	Range
Payout Annuity	SPIA	-3.4%	8	-3.3%	-0.9%	13.8%	44.8%
	PRT	-3.5%	6	-0.4%	-1.0%	4.7%	13.2%
	SSC	-5.7%	5	20.9%	9.7%	30.1%	83.1%
Accumulatio n	FDA (no WB)	0.3%	11	2.6%	1.6%	4.6%	17.7%
	FIA (no WB)	4.6%	12	6.3%	3.9%	7.9%	27.9%
	FIA (WB)	-16.7%	12	-4.5%	-5.0%	8.4%	26.5%

[1] SR + SPA – PIMR (when provided). Since field testing results, SPA has ben removed as an additional reserve.

Source: https://content.naic.org/sites/default/files/call_materials/20250407F%20FT%20Participant%20Results%20for%20VM-22%20Subgroup%20%281%29.pdf