

## Commentary

# Sustained Demand for Pension Risk Transfer Deals Despite Member Concerns and Regulatory Scrutiny

Morningstar DBRS

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### Key Highlights

- With life expectancy trending higher across the globe, retiree populations are growing, driving increasing demand for retirement security solutions. Plan sponsors eager to reduce longevity risk exposures associated with defined benefit pension plans are entering PRT deals to reduce their balance sheet risk.
- A key driver for the continued PRT demand in 2024 was higher interest rates, which improved defined benefit pension plan funded ratios. The favorable interest rates also drove bond yields higher, improving insurers' fixed income investment returns and enabling insurers to offer more attractive pricing on PRT deals.
- The demand for PRT deals is attracting regulatory scrutiny especially in the U.S. and the UK, where a significant number of global PRT deals are done.

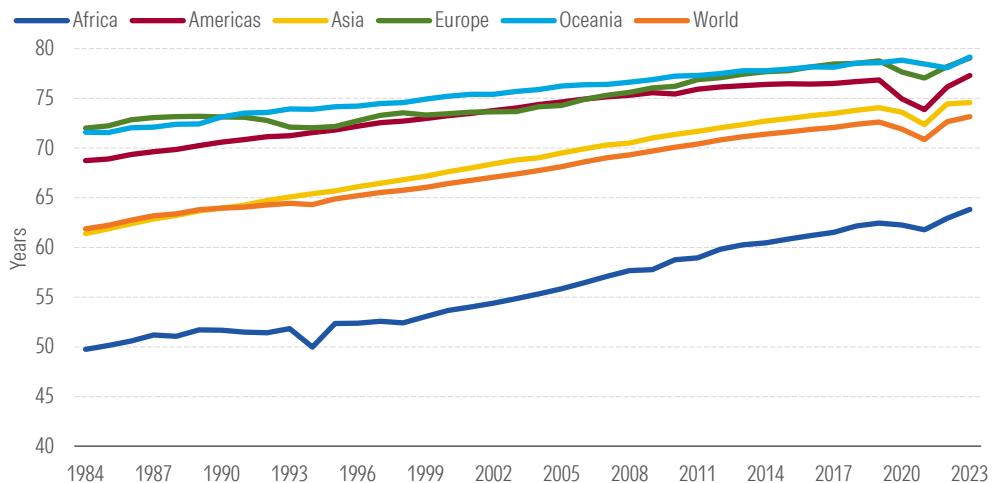
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### Overview

As retiree populations grow and life expectancy is trending higher across the globe (Exhibit 1), the demand for retirement security solutions is also on the rise. In line with this shifting demographic trend, pension risk transfer (PRT) deals have experienced steady demand from plan sponsors seeking to transfer their pension obligations to a third party, often a life insurance company. A PRT transaction is primarily associated with defined-benefit pension plans wherein the provider seeks to transfer some or all its obligations to pay out guaranteed retirement income to plan members. However, such transactions have been met with skepticism from plan members in the U.S., with some resulting in lawsuits being filed against their employers. The demand for these deals is also attracting regulatory attention in the U.S. and the UK. Notwithstanding these developments, we believe that the demand for PRT transactions will remain steady, with some variability according to the prevailing interest rate environment.

**Exhibit 1** Global Life Expectancy by Region 1984 to 2023



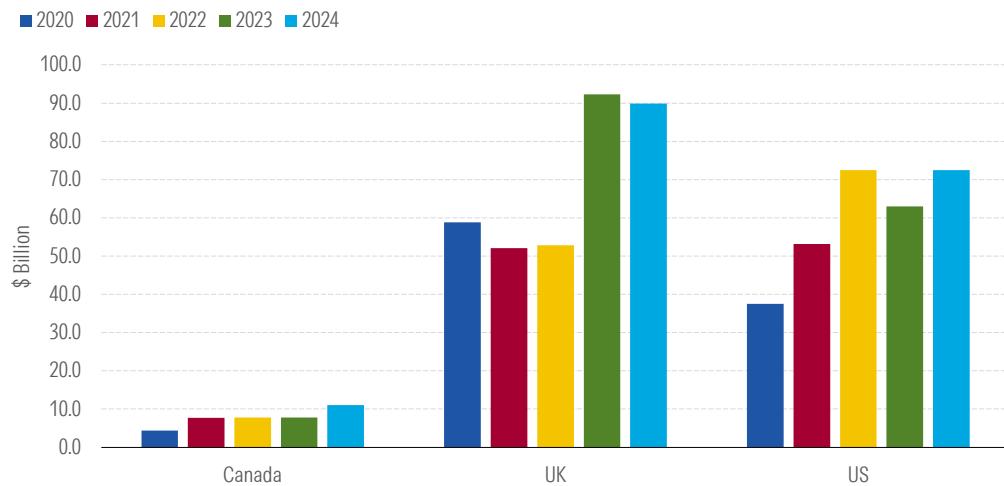
Sources: UN WPP (2024); HMD (2024); Zijdeman et al. (2015); Riley (2005) OurWorldinData.org/life-expectancy.

### Sustained Demand for PRT Transactions in the U.S., UK, and Canada

Over the past five years, there has been relatively steady demand for PRT deals. Specifically, the U.S. PRT volumes reached USD 51.8 billion, a 14% increase from 2023, though broadly aligned with 2022 levels. Meanwhile, the UK market remained largely stable, ending the year at GBP 47.6 billion. Lastly, Canadian market PRT market volumes stood at \$11 billion in 2024, a 42% jump over a comparatively smaller base

in 2023 (Exhibit 2). These PRT deal volumes were driven by higher interest rates that strengthened the funded ratio of pension plans and increased the demand for de-risking strategies.

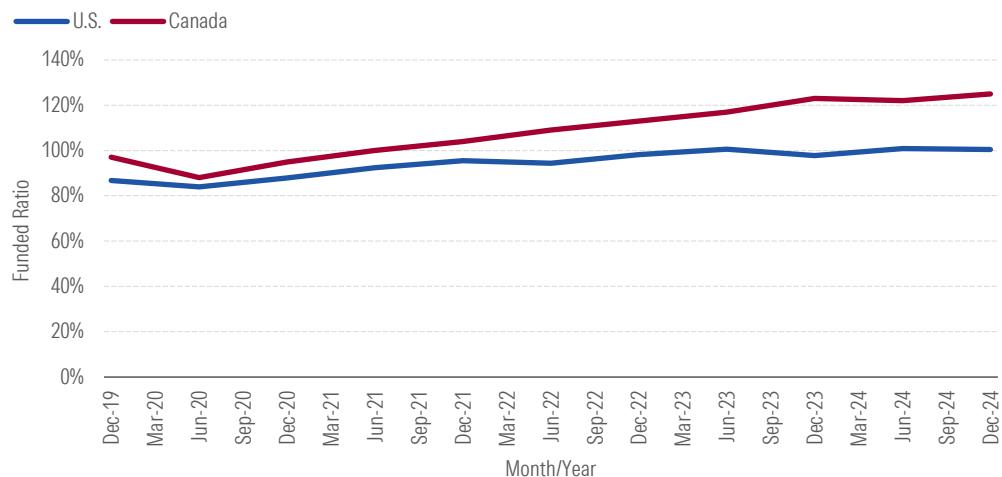
**Exhibit 2** PRT Market Volumes: U.S., UK, and Canada (2020–24)



Sources: Aon, Limra, Lane Clark & Peacock and Morningstar DBRS.

Reflecting the constructive interest rate environment, defined benefit pension plan funded ratios improved. Indeed, according to Aon, the median funded ratio in the U.S. was 100.4%, an increase from 88% in 2020. Similarly, according to Mercer, the median funded ratio in Canada reached 125% from 95% in 2020<sup>1</sup> (Exhibit 3). Higher interest rates made PRTs more attractive as sponsors sought to lock in gains and reduce volatility that could emerge from future rate cuts. The favourable interest rates also improved insurers' fixed income investment returns, enabling insurers to offer more attractive pricing on PRT deals. In the UK, Rethesay, Legal & General, Aviva, and Pension Insurance Corporation remain top PRT providers. Across the Atlantic, MetLife, Athene, and Prudential lead the U.S. market. Meanwhile, in Canada, Sun Life and Blumont Annuity Company (formerly Brookfield Annuity Company) continue to dominate the market with other players like iA Financial, BMO Insurance, and RBC Insurance participating as well.

1. The Mercer database contains information for approximately 450 pension plans in every industry across Canada, including private, not-for-profit, and public sectors.

**Exhibit 3** Pension Plan Funded Ratio—U.S. S&P 500 Pension Funds vs. Canadian Pension Funds


Sources: Aon, Mercer and Morningstar DBRS.

**U.S. Plan Members Concerned About Pension Security**

While pension sponsors continue to actively engage in PRT deals, there has been some pushback in the U.S. from plan members concerned about the security of future benefit payments by insurers. In the U.S., lawsuits by participants of Lockheed Martin, Alco, and Bristol Myers Squibb over the transfer of pension obligations to Athene highlight worries about the security of guaranteed retirement benefits. However, major insurers (including Athene) maintain that all covered participants will continue receiving the promised pensions. In addition, according to Aon, there have also been several class action lawsuits filed against plan sponsors and plan fiduciaries related to PRT transactions. These lawsuits claim a breach of fiduciary duties with respect to the selection of an insurer to whom the pension risks are being transferred. To fulfill the obligations to plan members, sponsors must ensure that the chosen insurer is financially strong and passes rigorous fiduciary reviews.

**Regulatory Spotlight and Outlook**

In the U.S., the Employee Retirement Income Security Act (ERISA) of 1974 is the foremost federal law that governs employee benefit plans such as pensions. Enforcement of ERISA's rules is the responsibility of the Department of Labor (DOL). On June 24, 2024, the DOL issued a report to Congress related to its guidance regarding fiduciary considerations in the selection of annuity providers with regard to PRT deals. In the UK, the Prudential Regulation Authority requires robust solvency levels and stress tests to ensure PRT providers are well capitalized and can withstand adverse developments such as sudden severe shocks to equity markets. We anticipate that the PRT market will continue to grow in the short to medium term, driven primarily by cost savings and risk reduction strategies of plan sponsors. However, interest rates are starting to decline across the globe, which will likely make this business less attractive to insurance companies, and pricing will likely become more expensive, reducing demand from plan sponsors.

**Related Research**

- *Canadian Pension Funds' Debt Issuances Continue Steady Growth in 2024, Outlook Remains Largely Stable*, February 6, 2025.
- *Infrastructure Assets Remain Key to Canadian Pension Funds' Investments Strategies Despite Thames Water Losses*, October 3, 2024.
- *Weakness in Real Estate Assets Persists as Canadian Pension Funds Deliver Weak Returns in H1 2024*, August 27, 2024.
- *The Coffers Are Running Dry: What's Next for Thames Water?*, April 4, 2024.
- *Potential Implications of an Alberta Pension Plan for CPP Investments*, September 26, 2023.
- *Resilience of Large Canadian Public Pension Funds in the Wake of Thames Water Turmoil*, July 5, 2023.

All figures are in Canadian dollars unless otherwise noted.

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