COMPARING
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Group annuity contracts play a vital role in protecting pension benefits. The following is a comparison of the benefits and features of group annuity contracts to those of traditional defined benefit (DB) pension plans.
GROUP ANNUITY CONTRACT

A contract sold by an insurance company, providing a guaranteed stream of income for members of a specified group at stated intervals, at least annually. Payments are typically made for each recipient’s lifetime, and, if applicable, the lifetime of a joint annuitant thereafter. In some instances, payments are made for a specified period. Group annuity contracts make it possible to provide more workers with guaranteed retirement income less expensively than if each worker had to be individually insured.

DEFINED BENEFIT PENSION PLAN

An employer-sponsored retirement plan whereunder the employer commits to paying employees a specific benefit for life beginning at retirement. The benefit amount is established in advance and is typically based on age, earnings and years of service. The plan sponsor is required to make contributions to the plan for the purpose of funding retirement benefits and in accordance with statutory funding obligations.

A Brief History

1875
First U.S. pension plan established

1921
Group annuity contracts are among the first arrangements pension plan sponsors use to fund retirement plans

1985
90% of Fortune 100 companies offered traditional DB pension plans

Past decade, participants in single-employer DB pension plans declined by approximately 2.7 million

2013
The number stands at 30%

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1 History of Pension Plans, Employee Benefit Research Institute, March 1998.
GROUP ANNUITY CONTRACTS

Ability to Provide Guaranteed Income

- Benefits provided under the annuity contracts are guaranteed for the entire amount
- Funding requirements are carefully calculated subject to state regulation and monitoring
- Insurers selected by plan fiduciary under DOL fiduciary standards (DOL IB 95-1) typically must carry capital above the required minimum

Approaches to Risk Management

- Separate Account assets invested primarily in high-grade, fixed-income securities
- Insurers are legally required to hold ample benefit reserves, ensuring fulfillment of all obligations
- Insurers hold explicit capital to account for possible losses
- Adequacy of assets to provide for promised benefits tested each year
- State regulatory supervision continues throughout the life of the promises made

Additional Layers of Protection

- Insulated Separate Account assets used exclusively for annuitant benefits covered by group annuity contract
  - If Separate Account assets are exhausted, full faith and credit of insurer stands behind commitments it has made
  - Insurer will pay any remaining obligations to annuitants using its General Account assets

DEFINED BENEFIT PENSION PLANS

Ability to Provide Guaranteed Income

- Guaranteed income is provided by the pension plan
- Plan sponsors establish a pension fund to generate stable, long-term growth, to provide pensions for employees when they retire

Approaches to Risk Management

- Typical pension plan invests over 60% in risky investments like common stocks, private equity and hedge funds
- Typical plan sponsor does not hold additional reserves to cushion possible losses the pension plan may incur
- No explicit capital required to account for possible losses
- Assets are subject to market volatility—fluctuating significantly both up and down
- Investment risk assumed by the plan sponsor, indirectly
- Federal regulation of plan and sponsor

Additional Layers of Protection

- If a DB plan fails, the Employee Retirement Income Security Act (ERISA) requires guaranteed payment of benefits through the Pension Benefit Guaranty Corporation (PBGC)
  - The goal of the PBGC is to encourage the continuation and maintenance of private-sector pension plans; provide timely and uninterrupted pension benefit payments for workers affected by failed pension plans; and keep insurance premiums to a minimum
Supervisory Safeguards

State Guaranty Associations (SGAs)
- Each state (including Puerto Rico and the District of Columbia) has an SGA operating under individual state laws
- In the unlikely event of an insurance company failure, state insurance regulators provide annuitant protection through their SGA
- Regulators place policyholders and annuitants first in priority for claims on a failed insurance carrier’s assets

Since 1987, average recovery by annuitants from liquidated insurance companies exceeds 94%.

Pension Benefit Guaranty Corporation (PBGC)
- Only guarantees payments up to specified limits and is not supported by a separate reserve fund
- For those annuitants whose benefits are paid by the PBGC, 16% had their benefits reduced (the percentage is higher for multi-employer plans).
  - Those benefits were reduced by an average of 28%
- Permitted to operate with a long-term deficit—currently $36 billion

Since ERISA was enacted in 1974, the PBGC has taken on over 1.5 million people from 4,600 failed DB plans, making annual payments of $5.5 billion.

Twice in the past 13 years, the 100 largest U.S. corporate pension plans lost more than 30% of plan funded status to market declines.

5 Source: PBGC’s Guarantee Limits—an Update. A PBGC study describing the effects of the statutory and regulatory limitations on PBGC guarantees.
6 Insurance Oversight and Legislative Proposals, National Organization of Life and Health Insurance Guaranty Associations, November 2011.
7 As of fiscal year 2013.
8 Source: Milliman Pension Funding Index, as of May 31, 2014.
Prudential's buy-out is a group annuity contract issued by The Prudential Insurance Company of America (PICA), Newark, NJ 07102. Amounts contributed to the contract are deposited in a separate account established by PICA. Payment obligations specified in the group annuity contract are insurance claims supported by the assets in the separate account and, if such assets are not sufficient, by the full faith and credit of PICA. All guarantees are dependent on the claims-paying ability of the insurance company and are subject to certain limits, terms and conditions.

Prudential Financial and The Prudential Insurance Company of America are each solely responsible for their own contractual obligations and financial condition.

Products not available in all states.

Group annuity contracts are issued by The Prudential Insurance Company of America (PICA), Newark, NJ, a Prudential Financial company.

The Milliman 100 Pension Funding Index projects the funded status for pension plans included in the annual Milliman study of the 100 largest defined benefit plans sponsored by U.S. public companies, reflecting the impact of market returns and interest rate changes on pension funded status, utilizing the actual reported asset values, liabilities, and asset allocations of the companies’ pension plans.

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