COMPARING
GROUP ANNUITY CONTRACTS
AND DEFINED BENEFIT
PENSION PLANS
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.
An employer-sponsored retirement plan under which 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 contract sold by an insurance company that provides a guaranteed stream of income for members of a specific group at stated intervals (no less than 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.

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
From 2003-2013, participants in single-employer DB pension plans declined by approximately 2.7 million
2013  The number stands at 30%

1 History of Pension Plans, Employee Benefit Research Institute, March 1998.
# Defined Benefit Pension Plans

- Retirement income is provided by the assets in the pension fund
- Actuaries regularly review plan contributions when assessing the plan’s assets and liabilities to ensure that the pension fund will be able to meet future payment obligations
- The funded status of the 100 largest corporate pension plans has fluctuated between 77.5% and 82.7% from January to December 2015 (Source: Milliman 100 Pension Funding Index, December 31, 2015)

## Approaches to Risk Management

- Typical pension plans invest over 60% in risky investments like common stocks, private equity and hedge funds
- Typical plan sponsors do not hold additional reserves to cushion possible losses the pension plan may experience
- No precise amount of capital is required to account for possible losses
- Assets are exposed to market volatility—fluctuating significantly both up and down
- Investment risk is assumed by the plan sponsor, indirectly

## Layers of Protection

- Three layers of protection support the benefit promises of defined benefit plans:
  - Current assets and investment results
  - Contributions that employers are required to make to keep plans funded
  - Guarantees provided by the Pension Benefit Guaranty Corporation (PBGC) in case these plans are not able to meet obligations

# Group Annuity Contracts

- Benefits provided under group annuity contracts are guaranteed for the entire amount and are legally binding obligations between the insurer and the retiree
- Funding requirements are carefully calculated and are subject to state regulation and monitoring
- Under Department of Labor standards (DOL IB 95-1), plan fiduciaries must conduct an objective, thorough and analytical search for an annuity provider, evaluating a number of factors relating to the claims paying ability and creditworthiness
- Group annuity contracts are 100% funded at inception

## Approaches to Risk Management

- Assets are invested primarily in high-grade, fixed-income securities
- Insurers are legally required to hold ample benefit reserves, ensuring fulfillment of all obligations
- Insurers hold precise amounts of capital to account for possible losses
- Assets are tested each year to ensure sufficient amounts exist to fulfill the promised benefits
- State regulatory supervision continues throughout the life of the promises made

## Layers of Protection

- Insulated Separate Account assets are used exclusively for those annuitant benefits covered by the group annuity contract and related expenses, under a plan of operations approved by a state insurance regulator
- These assets are invested primarily in high-grade, fixed-income bonds, with cash flows that are intended to match the insurers’ liabilities
  - If Separate Account assets are exhausted, the full faith and credit of the insurer stands behind the commitment it has made
  - Insurer will pay any remaining obligations to annuitants using its General Account assets
Pension Benefit Guaranty Corporation (PBGC)

PBGC’s goal is to encourage the continuation of pension benefit payments for workers affected by failed pension plans
- Only guarantees payments up to specified limits and is not supported by separate reserve fund
- For those annuitants whose benefits are paid by the PBGC, 16% had their benefits reduced (percentage is higher for multi-employer plans)5
  - Those benefits were reduced by an average of 28%6
- PBGC is permitted to operate with a long-term deficit ($61.7 billion as of fiscal year 2014)6

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

Between 1991–2009, average recovery by annuitants from liquidated insurance companies exceeds 94%7

Since ERISA was enacted in 1974, the PBGC has taken on over 1.5 million people from 4,700 (2014 PBGC Annual Report) failed DB plans, making annual payments of $5.6 billion6

Twice since 2000, the 100 largest U.S. corporate pension plans lost more than 30% of plan funded status to market declines.8

5 Source: PBGC’s Guarantee Limits—an Update. A PBGC study describing the effects of the statutory and regulatory limitations on PBGC guarantees.
7 Insurance Oversight and Legislative Proposals, National Organization of Life and Health Insurance Guaranty Associations, November 2011.
8 Source: Milliman Pension Funding Index, as of December 31, 2015.
FUNDED STATUS
The comparison of a plan’s assets to its liabilities; the amount by which a pension plan’s assets exceed its projected future benefit payments.

EMPLOYEE RETIREMENT INCOME SECURITY ACT
A Federal law that sets standards of protection for individuals in most private-sector retirement plans.

PENSION BENEFIT GUARANTY CORPORATION
An independent agency of the U.S. government and created by ERISA. The PBGC is subject to limitations, paying pension benefits up to the maximum guaranteed benefit set by law to participants who retire at age 65 ($60,136 a year in 2015).9

STATE GUARANTY ASSOCIATIONS
State guaranty associations act as a form of insurance for customers of insurance companies. State guaranty associations supplement the state regulatory process and provide additional benefits coverage. Current coverage information can be found at nolhga.com.
