

**Pension 'Buy-In' Deal Could Impact Managers**
By Paul Menchaca
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**Prudential** announced last week that it had closed on the nation’s first “pension buy-in transaction,” a move that experts say is an important first step in helping the beleaguered pension industry unload some of its risk while assuring that its participants continue receiving their benefits. Though this $75 million deal with a North Carolina-based corporate pension is relatively small, the implications are potentially significant for asset managers, which could be competing for fewer mandates going forward.

The transaction with Hickory Springs Manufacturing Co. is being done through **Prudential’s** Portfolio Protected Buy-in, which is a contract Hickory Springs signs with **Prudential** that guarantees the insurer will cover liability payments to retirees in exchange for a single premium payment by Hickory. The insurance contract is essentially an asset within the pension plan.

Steve Ellis, CFO of Hickory Springs, says that the contract with **Prudential** will cover about 1,000 retirees, representing roughly half of the plan’s $150 million in obligations. He says the company’s plan has been “soft frozen” and closed to new participants since Jan. 1, 2009.

The deal with **Prudential** “eliminates interest-rate risk, mortality risk and liquidity risk, as well,” Ellis says. “It’s about making the best investment decisions for the pension and the retirees, and this is the only investment that exactly matches the liability. It made a whole lot of sense.”

Although it is not known how the $75 million from Hickory Springs was invested previously, Dylan Tyson, v.p. and head of **Prudential’s** pension risk transfer business team, says the assets “are expected to be predominately investment-grade fixed income securities.” Furthermore, Tyson says, this will be the investment strategy used for all future buy-in strategies from **Prudential**.

Bradley Belt, senior managing director of the Milken Institute, a nonpartisan Washington, D.C.-based economic think tank and the former executive director of the Pension Benefit Guaranty Corp., says the potential proliferation of pension buy-ins could have a significant impact on asset managers, as they could lose out on mandates when the management of the assets is taken over by an insurance company or other financial services company. For instance, equity or alternative managers would be impacted if a decision is made, like with **Prudential**, to only invest in fixed income securities.

While **Prudential’s** deal with Hickory Springs is for only a portion of the company’s pension liabilities, other plans could eventually look to transfer all of their liabilities.

“If the trend is accelerated and became pervasive, it would have an impact, especially on the traditional, asset-only side of the equation,” Belt says. “Obviously we are a long way from there, because this is a $75 million transaction in $2 trillion industry.”

But Belt, who led the PBGC under President George W. Bush, says that it is his “hope that [**Prudential’s** buy-in deal] is an important risk management development” that will lead to others of its kind.

“Hopefully this represents a breaking of ice so that other sponsors will take notice of the options that the private market can provide to better hedge some of the risks they are exposed to as being sponsors of a defined benefit plan,” Belt says.

Glenn O’Brien, managing director of **Prudential Retirement’**s pension and structured solutions business, says the company has been exploring the pension de-risking market for about five years and has been working on its Portfolio Protected Buy-in solution for two years. **Prudential** has “engaged a hundred clients over the past two years about various iterations de-risking the plans,” and there are currently “two or three dozen” in talks about transferring some of their liability risk, he adds.

O’Brien says it is difficult to know whether there could be further buy-in transactions this year. “I’m an optimist and I would like to be able to do that, but everyone has their timeframe with different fiduciary situations,” he says. “It’s a highly regulated business.”

Although a pension buy-in contract is intended for underfunded pensions, O’Brien notes that it likely makes more sense for pensions that are between 80% and 90% funded. Plans in this range would be interested in moving principal risk, while plans that are less than 80% funded are more likely to be motivated to take on more risk.

“Plans that are in that 80% to 90% funded range like to move principal risk and need an anchor to match a big portion of liability, which is retiree liability,” O’Brien says. “This is a structured opportunity to do that.”