Falling discount rates hurt DB pensions at insurers: AM Best

By Kerry Pechter *Thu, Apr 8, 2021*

Only 184 insurance companies rated by AM Best had defined benefit plans at year-end 2019, compared with 257 in 2016, according to a new report. Aggregated insurance company unfunded pension benefits have dropped to $13.9 billion in 2019 from $19.4 billion five years ago.

Defined benefit plans at insurance companies have been declining for more than four decades, a long-term trend that has been reinforced in recent years, according to a new AM Best Special Report, "Low Interest Rates Leading To Sharp Decline in Insurer Defined Benefit Plans."

Only 184 companies rated by AM Best had defined benefit plans at year-end 2019, compared with 257 in 2016, according to the report. "In most cases, the decline can be attributed to companies terminating their plan, though in some instances, the benefit obligations were moved off the insurance entity balance sheet and are at the holding company level," said AM Best in a release this week.

In 2013, new statutory accounting rules began requiring all insurers with defined benefit plans to recognize unfunded benefits on the balance sheet. Companies could either recognize the unfunded benefit obligations up front, or amortize them for a period no longer than 10 years.

Unfunded obligations can vary significantly each year, as economic conditions change and dictate new assumptions, which measure obligations and impact asset performance. Aggregated insurance company unfunded pension benefits have dropped to $13.9 billion in 2019 from $19.4 billion five years ago.

Pension obligations and assets have exhibited more volatility over this period, while other post-retirement benefit obligations and assets have been stable at around $16.5 billion. Few assets are held for post-retirement obligations, as they tend to vest much closer to retirement age.

An initial review of year-end 2020 statement filings indicates that benefit obligations will rise sharply as the Federal Reserve kept rates very low to stem the effects of the COVID-19 pandemic, the release said.

While interest rates started to rise late in 2020, the baseline discount rate to determine plan obligations will average between 2.50% and 2.60%, a drop of 80 to 90 basis points from 2019 levels. This is partially offset by strong returns on the equity assets backing the obligations.

The number of defined benefit plans on insurers' balance sheets will continue to decline, AM Best predicts, either through plan termination or movement of the exposure elsewhere in the organization. As the accounting transition from 2013 winds down, these unfunded obligations will be fully recognized on statutory balance sheets.

To access the full copy of this special report, please visit http://www3.ambest.com/bestweek/purchase.asp?record_code=307416.