

Defined Benefit Plan Trends and Issues in Current Economic Environment

WP&BC – LA Chapter
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Convergence of Events

↳ Move to marked to market for defined benefit plans

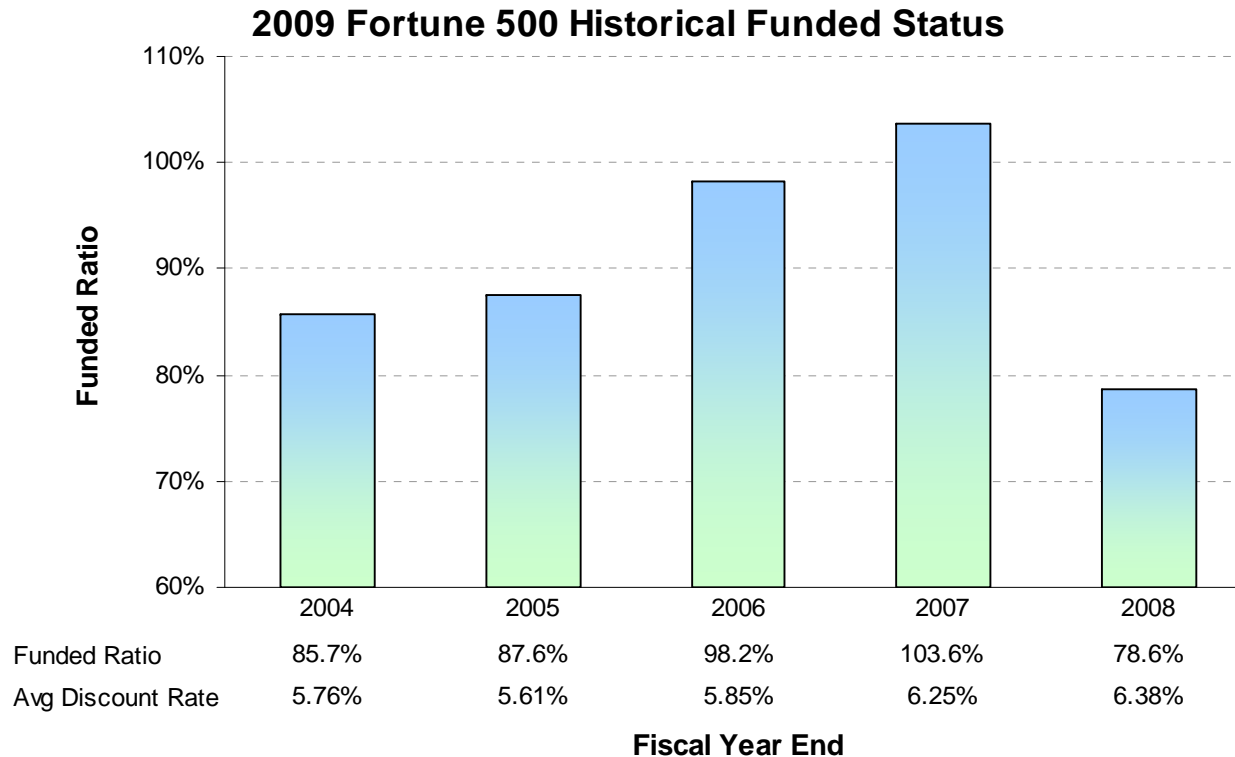
- Pension Protection Act of 2006
- Accounting rules changes
 - Immediate balance sheet recognition
 - Convergence with international accounting standards

↳ Economic crisis

- Global recession
- Dramatic losses in equity markets resulting in significant losses in funding position for most sponsors
- Difficulty in borrowing cash at reasonable rates

↳ Combine to highlight financial risks inherent in sponsoring a defined benefit plan

Historical Funded Status



➔ Changes in funded ratio driven by assets and liabilities performance, not by net contributions in excess of benefit accruals

- Favorable outcomes during FY2006 and FY2007
- Catastrophic outcome during FY2008

Short Term Help

- Last week, the IRS released final regulations on minimum funding requirements and benefit restrictions
 - Provides short term relief when combined with WREERA and other informal guidance
- Flexibility in method selection (asset valuation and discount rates) for 2008 and 2009 plan years
 - Allows use of most favorable discount rate at measurement date
 - Allows deferral of some of the asset losses to future years
 - Results in improved funded position and lower required cash contribution
 - Automatic approval to change to long term methods in 2010

In most cases, net effect is to defer funding spikes or benefit restrictions to 2010/2011

Considerations in Managing Defined Benefit Plan

Levers	Short Term / Tactical	Long Term / Strategic
Design	<ul style="list-style-type: none"> ▪ Immediate cost reduction through benefit suspensions ▪ No significant impact on overall risk level 	<ul style="list-style-type: none"> ▪ Reviewed in terms of long term workforce management objectives ▪ Can lower costs if employees actively engage in achieving long term financial wellness ▪ Competitive considerations
Contribution	<ul style="list-style-type: none"> ▪ Availability of cash ▪ Impact of possible benefit restrictions 	<ul style="list-style-type: none"> ▪ Closing the gap ▪ Managing contribution volatility ▪ Coordinate with investment strategy
Investment	<ul style="list-style-type: none"> ▪ Market opportunities ▪ Window nearly closed to take advantage of dislocations in credit markets 	<ul style="list-style-type: none"> ▪ Align with defined cost and risk budgets ▪ Review to optimize financial risk ▪ Dynamic policy that reflects changes in funded status and liability structure
Methods	<ul style="list-style-type: none"> ▪ 2008/2009 opportunities to pick most favorable methods without long term “lock-in” 	<ul style="list-style-type: none"> ▪ Align with contribution and investment policies to achieve risk targets

What are sponsors doing?

Plan Design

- ➔ Aon Consulting 2009 Benefits and Talent Survey* results
 - 45% of respondents sponsor a defined benefit (DB) plan
 - Of those, very few have committed to making significant changes to their plans
 - Possible reasons for this:
 - Many employers have already closed / frozen their DB plans
 - During downturn, measures such as pay and bonus freezes may have offered immediate savings and less burdensome implementation
 - Critical business issues took management's focus away from those programs
 - Plan freezes tracked by the Pension Rights Center may indicate that the number of sponsors announcing plan freezes may be higher in 2009 than in recent years

* More than 1,300 individual responses collected during March 2009

What are sponsors doing?

Investments

- Aon Consulting 2009 Benefits and Talent Survey* results
 - Only 34% of respondents sponsoring a defined benefit (DB) plan have either implemented or are considering changes to their pension investments
 - Of those who made or are contemplating a change
 - 72% are looking at increasing fixed income allocations
 - 53% are looking at increasing bond duration (to better match liabilities)
 - 18% are looking at annuitizing or cashing out liabilities

* More than 1,300 individual responses collected during March 2009

What's next?

- ↳ Employers should actively manage the risks of their retirement programs through:
 - Defining cost (affordability) and risk (financial volatility) budgets
 - Prudent and coordinated funding and investment policies to fund the deficit as the economy recovers
 - Dynamic investment policy that accounts for changes in funded status and changes in liability structure
 - Plan management best practices to manage fiduciary, compliance, and operational risks
- ↳ Employers have an opportunity to redefine the employment contract as the economy recovers:
 - The cost of benefit programs can be lower if employees actively engage in achieving financial security
 - Optimizing total rewards by balancing employee values and cost can improve outcomes for the company and employees