Pension Plan Fix-It Handbook

Employee Benefits Series | THOMPSON | February 2013 | Vol. 20, No. 5

Pension Funding, Plans' Financial Impact, Fee Disclosures Concern Sponsors in Surveys

By Mary B. Andersen, CEBS, ERPA

Mary B. Andersen is president and founder of ERISAdiagnostics Inc., an employee benefits consulting firm that provides services related to Forms 5500, plan documents, summary plan descriptions and compliance/operational reviews. Andersen has more than 25 years of benefits consulting and administration experience. She is a CEBS fellow and member of the charter class. She also has achieved the enrolled retirement plan agent designation. Andersen is the contributing editor of the Pension Plan Fix-It Handbook.

Employers and plan administrators often find surveys useful when gauging the trends and temperament of the retirement plan industry. Early in the new year, we review three surveys that captured opinions for 2012 — two regarding defined benefits and one on defined contribution plans. Employers may find the results instructive.

The DB surveys, the MetLife U.S. Pension Risk Behavior Index and the Vanguard Survey of Defined Benefit Plan Sponsors, 2012, presented differing respondents and questions, but both reports revealed similar findings:

- the impact of pension plans on company finances concerns employers;
- managing pension risk is garnering more attention as overall return becomes less important as a measure of success;
- "derisking" strategies that reduce pension risks and obligations through asset allocation changes or by transferring distribution responsibilities to third parties either have been addressed or will be; and
- plan sponsors have, or are considering, freezing their DB plans.

On the DC front, the Oppenheimer Funds survey, "Regulatory Serendipity: Fee Disclosure Generates Optimism and Opportunity," was conducted in September 2012, shortly after the initial wave of service provider and participant fee disclosures was released. The results reveal that plan sponsors have a positive view of these disclosures, both for themselves and their participants. Yet many plan sponsors admitted that they are not sure what to do with the information received.

MetLife U.S. Pension Risk Behavior Index

In MetLife's latest U.S. Pension Risk Behavior Index, plan sponsors were asked to provide a self-assessment of risk management success in 18 areas and to indicate those areas receiving the most attention at their firms. The majority of the 156 respondents had plan assets of $500 million or more. It was the fourth annual study by MetLife of risk management attitudes and aptitude among DB plan sponsors.

The MetLife study calculates an index value based on areas of importance as ranked by the respondents, success in dealing with the risk areas and the consistency between the two rankings. The 2012 index level is 85 (out of 100), up from 81 in 2011. The authors say they believe this significant increase represents sustained plan sponsor engagement with pension risk management.

Investment risks presented in the MetLife survey were:

- ability to measure risk;
- inappropriate trading;
- asset allocation;
- investment management style; and
- meeting return goals.

Liability risks comprised:

- asset and liability mismatch;
- underfunding of liabilities;
- mortality risk;
- longevity risk;

See *Sponsors' Concerns*, p. 2

Sponsors' Concerns (continued from p. 1)

- early retirement risk; and
- quality of participant data.

Business risks the survey addressed were:

- plan governance;
- adviser risk;
- accounting impact;
- fiduciary risk and litigation exposure;
- investment valuation;
- liability measurement; and
- decision process quality.

Key Findings

The top four risk factors the MetLife DB survey identified in 2012 remained the same as in 2011: underfunding of liabilities, asset and liability mismatch, asset allocation and meeting return goals.

Both years' studies revealed that plan sponsors are more focused on the liability side of pension plan management, with asset decisions made while keeping liabilities in mind. Underfunding of liabilities and asset and liability mismatch topped the respondents' importance list, with asset and liability mismatch jumping 5 percentage points.

Plan sponsors have shifted their risk management to an approach that takes into account both assets and liabilities from one that focuses on assets and returns.

Plan sponsors are concentrating on easing the strain that the plans place on corporate finances. Many have determined that market volatility will demand reducing risk to the plan through asset allocation. Approximately one-eighth of plan sponsors surveyed expect to freeze their plans and stop accepting new participants within the next three years.

Many plan sponsors indicated that they plan to address risk management through formal asset-liability studies, liability-driven investing or dynamic asset allocation and by hiring new investment advisers.

The majority of plan sponsors MetLife surveyed said they believe that a plan's funding status is a key success measurement. The economic downturn has been a major contributor to this focus on liability-related risks. Pension plan assets are being carefully monitored to ensure that the plan's funding level will support benefit payments to participants over the long term. A majority of plan sponsors surveyed agreed that low interest rates affect funding ratios and require significant contributions over a longer period of time to achieve full funding.

The self-assessment aspect of the report indicated that plan sponsors consider themselves successful in the area of liability measurement. The survey's index value indicates that there is growing consistency between the rankings of the importance of the risk factors and the plan sponsors' self-assessment in addressing them.

Ideally, there should be a correlation between what plan sponsors consider important and their perceived success in managing that particular risk.

Interestingly, the study showed respondents' rating of their success in managing the two risk areas they ranked as most important in 2012, underfunding and asset and liability mismatch, was fairly low, perhaps due to factors beyond their control such as the current interest rate environment. (See p. 10 chart for more on success ratings.)

Plan governance moved up in the self-assessed success ratings but both the importance and success of decision process quality ranked low. Quite a few plan sponsors found it difficult to distinguish between the two risk factors.

Vanguard's Survey of Defined Benefit Plan Sponsors, 2012

Vanguard conducted the second in an expected series of surveys to evaluate how plan sponsors are managing their DB plans, given the regulatory and market environment. The latest survey was completed in May 2012; responses were received from 169 plan sponsors. The sponsors appear to be making progress in managing risk, and were increasingly aware of derisking strategies. A majority of those surveyed indicated they are using at least one liability-driven strategy to manage risk.

Major plan sponsor concerns that came to light:

- impact of DB plan management on financials; and
- interest rate risks and market volatility.

Answers to questions on asset allocation showed that:

- domestic bonds and equities top the list of asset classes most used for investment; and
- equity allocations were comparable to the 2010 survey, although bondholdings increased.

Fifty-seven percent of respondents had closed or frozen their plans; this percentage was almost twice that reported in Vanguard's prior survey, in 2010.

See *Sponsors' Concerns*, p. 3

Sponsors' Concerns (continued from p. 2)

Although the plans are underfunded, funding levels increased. The survey notes that while the funding level of Vanguard's survey population increased, funding levels across a broader population of DB plans have declined since 2009. Low interest rates were the No. 1 pension risk identified in this survey, rising from their 2010 ranking.

Derisking strategies moved from something respondents were aware of in 2010 to being actual strategies in place in 2012.

A footnote in the Vanguard report says that MAP-21 — the Moving Ahead for Progress in the 21st Century Act — was signed into law after the survey was conducted and indicates that it could have changed the way respondents answered about funding requirements. (See December 2012 newsletter story, "Funding Stabilization May De-emphasize Risk," for more information.)

Oppenheimer Funds' Regulatory Serendipity: Fee Disclosure Generates Optimism and Opportunity

Oppenheimer Funds' survey of 200 randomly selected DC plan sponsors was conducted in September 2012, just after the initial wave of service provider and participant fee disclosures was released.

Many plan sponsors responding to this survey said they believe that benefits of increased fee disclosure will outweigh the drawbacks by helping them meet their fiduciary obligations, improving transparency and helping sponsors better understand fees for services provided. The disclosures also aid participants by offering more information about their retirement plans, which enables better understanding of fee structures. Other added benefits mentioned included participants gaining familiarity with their plans and increased trust in plan sponsors.

However, as part of fee disclosure plan sponsors must assess the value of the services provided, and many said they are not confident they know what to do with the information. This finding affirms a Government Accountability Office study that concluded that plan sponsors don't understand fees (see August 2012 newsletter column and ¶526 of the *Handbook* for discussions on evaluating covered service provider disclosures.)

In addition, plan sponsors are concerned with the time that must be allocated to the disclosures and the potential for increased questions from participants regarding the sponsor's investment choices. And plan sponsors are concerned that participants will not take the time to understand the information provided, choosing to select the lowest-cost investments without an overall strategy.

Other key findings of the Oppenheimer DC survey:

- fees are an important consideration in selecting a service provider;
- advisers play a key role in investment selection;
- fees are an important consideration in selecting an investment adviser, although not so dominant as when selecting a recordkeeper; and

See *Sponsors' Concerns,* p. 4

MetLife Study: Avg Sponsor Success Self-Ratings

Risk Item	Change from 2011 to 2012	2012	2011	2010	2009
Liability Measurement	0.09	4.86	4.77	4.72	4.51
Plan Governance	0.16	4.70	4.54	4.58	4.58
Inappropriate Trading	0.07	4.69	4.62	4.56	4.22
Asset Allocation	0.04	4.59	4.55	4.36	4.60
Investment Valuation	0.07	4.56	4.48	4.45	4.28
Advisor Risk	0.01	4.54	4.54	4.57	4.44
Meeting Return Goals	0.11	4.51	4.39	4.44	4.35
Accounting Impact	0.16	4.50	4.34	4.25	4.25
Quality of Participant Data	0.21	4.49	4.28	4.29	4.26
Investment Management Style	0.01	4.37	4.36	4.39	4.04
Underfunding of Liabilities	0.33	4.32	3.99	3.89	4.17
Asset & Liability Mismatch	0.20	4.19	3.99	4.06	3.69
Ability to Measure Risk	0.14	4.13	3.99	4.06	3.76
Mortality Risk	0.06	4.01	3.95	3.98	3.93
Fiduciary Risk & Litigation Exposure	0.11	3.98	3.87	4.00	3.98
Decision Process Quality	0.25	3.92	3.66	3.74	3.50
Early Retirement Risk	0.06	3.57	3.51	3.57	3.30
Longevity Risk	0.06	3.26	3.20	3.48	3.37

Note: All figures shown, including the calculation of changes from 2011 to 2012, were rounded to two decimal points.

Sponsors' Concerns (continued from p. 3)

- while fees are important, plan sponsors are willing to pay a premium for active investment management and superior recordkeeping services. Larger plans (500+ participants) are more willing to pay the premium for active investment management services.

Plan sponsor responses in the Oppenheimer report indicated a need for better understanding of the fee disclosure requirements, with 58 percent reporting they know the rules somewhat well; 27 percent saying they do not know them well; and only 16 percent responding that they are confident they know the requirements well.

The survey recommends that plan sponsors take advantage of heightened participant awareness by communicating the importance of retirement savings and investments to them.

What Can Plan Sponsors Glean from the Surveys?

In their quest to understand pension plan liabilities and the associated risk, company management will be asking the benefits staff for information. You may want to consider increasing communications to keep your management team apprised of factors affecting your plan. As noted in the MetLife survey, make sure your pension plan data is clean and comprehensive, as it will affect actuarial valuation results.Given the need for pension plan information and the lack of clarity regarding what to do next with DC fee disclosures, consider a fiduciary education training program for senior management as well as the plan's fiduciaries.

Finding out More

To view the complete surveys, use these links:

MetLife: https://www.metlife.com/assets/institutional/services/cbf/retirement/MetLife-2012-Pension-Risk-Behavior-Index-exp0213.pdf.

Vanguard: https://institutional.vanguard.com/iam/pdf/ICRSDB.pdf?cbdForceDomain=true.

Oppenheimer Funds: https://www.oppenheimerfunds.com/digitalAssets/Inside-the-Minds-of-Plan-Sponsors-2d73c5a5-f115-44a5-b0a7-c53a623ce85a.pdf.