De-Risking:
Plan Sponsor & Participant Perspectives & Actions

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In keeping with Brookings independence, these are my own opinions and do not represent the views of Brookings, its trustees, management, employees, or its other scholars.
Why do sponsors de-risk?

- **Pension Management**
  - Reduce volatility
    - Funding Requirements
    - Financial Statements

- **Pension Exit**
  - Reduce retirement expense
  - Improve creditworthiness?
  - Evidence of new corporate strategy
De-risking in ongoing plans is part of overall risk management

- Portfolio Diversification, Alternatives
- Conversion to Hybrid DB Plans (Variable Benefits)
- Liability-Driven Investing
- Buy-Ins
- Longevity Swaps
Primary form of de-risking since ERISA is abandoning traditional pensions

Est. % of Private Sector Workers with DB Pension Plans

ERISA (1974)
401k Regs (1981)

FAS 158 (2006)
PPA (2008)

Source: SSA, BLS, EBRI, PBGC staff estimates
Most employer-provided plans are already *DC plans without employer longevity or investment risk.*
Pension buyouts, freezes, terminations over-predicted

- In US, expected a wave of US freezes & buyouts after 2006 due to PPA & accounting changes.

- In practice, has been much less than was expected: US transactions 2007-15 total $71B, ~2% of assets.

- Reasons:
  - Valued benefit for existing employees
  - Union opposition
  - Expect plan investments to outearn annuities

- Exception: lump sum offers
Private plan sponsors are closing DB plan eligibility continually but slowly

"Freezing" of Large US Corporate DB Plans

- Hard Frozen
- Closed to New Entrants
- Open

Source: CEIBA survey of large private DB plans
Plan termination rate has accelerated only modestly

% of plans terminating / year (5-year avg)

Source: PBGC
Lump Sums: De-Risking at a Discount

- 1980’s: “right” to lump sums “protected”

- Under current regulations, lump sums are offered at a discount to market value.

- US regulators encouraged the arbitrage by failing to change methodology (until 2018) & declining to require disclosure that lump sums are discounted.

- As a result US risk transfers were dominated by lump sum offers. 65% of all risk transfer activity tracked by PBGC 2009-13 involved lump sums.

- Employers expanding lump sum options.
Summary of Sponsor Perspectives / Actions

- Sponsors have been de-risking ever since ERISA.
- Many will abandon DB pensions via annuity purchase & (unfortunately) lump sums.
- Nonetheless, DB pensions will continue to cover tens of millions.
  - Continue to manage risk largely through investment strategies, but with limited role for buyouts.
  - Lump sum payouts will likely continue to expand.
Participant Perspectives

John Tenniel illustration for Alice’s Adventures Underground
More people are worried about retirement than other economic concerns

Retirement worries have topped list of US economic concerns since 2000

*Sources: 2015 Gallup Poll*
Most private sector workers have no employer-provided retirement plan.
In 1974, 73% of retirement savings were annuities or pensions that paid annuities.

Today, 75% of retirement savings are DC & IRAs. IRAs are becoming dominant.

Source: ICI
Participant Responses

Individual Responses
- Passivity
- Inadequate saving in expensive vehicles
- Acceptance of reduced lump sums

Organized Responses
- Decline to negotiate lump sums
- Oppose buyouts (Verizon litigation)
- Public policy proposals
Retirement Security in the Post-ERISA Era

- Increased saving: facilitated or mandated
- More lifetime income: facilitated or mandated
- Employers ≠ fiduciaries
  - ➔ payroll distribution systems
- Shift from regulating company sponsors to regulating financial service providers
- Financial education, not just disclosure
- Greater need for product oversight
- Shift from procedural regulation to substantive regulation

N.B.: Author’s Views