Aon

Global Pension Risk Survey 2023 – U.S. Findings

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Introduction

For at least 30 years, people have predicted that U.S. private sector pension plans would disappear, yet they are still around. It is true that private sector pensions are not growing, but the U.S. results of our Global Pension Risk Survey—as well as anecdotal evidence from our consulting work—show that most plan sponsors expect their plans to stay around for many years to come.

That is,

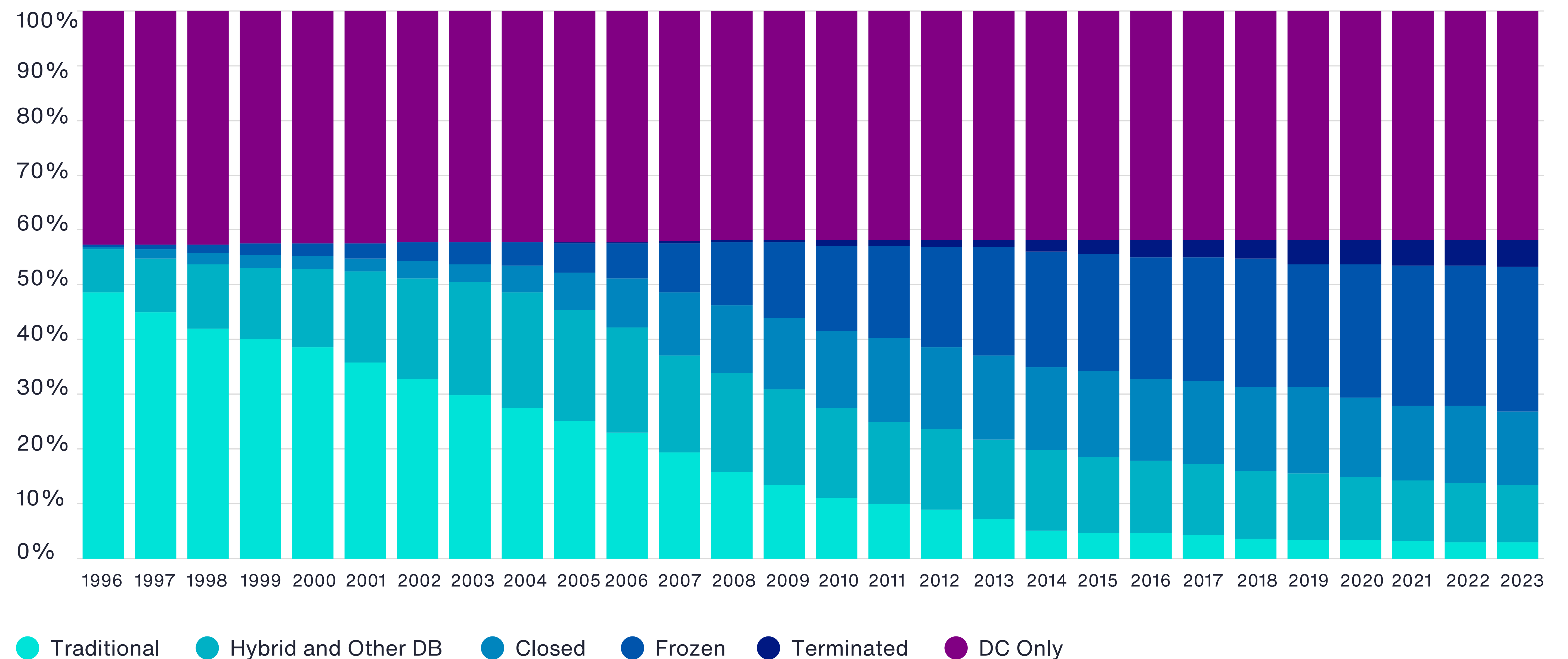
78%

of respondents said that their long-term objective is something other than plan termination.

This is particularly notable because plans are now better funded than they've been in years. For the U.S. results of this Global Pension Risk Survey—our 9th update since 2008—we're splitting the report into two mini-reports: one for the sponsors reporting an objective to terminate their plans and another for those continuing to support their plans.

For plan sponsors intending to maintain their plans over the long-term, most intend to continue de-risking the assets and/or shrinking the liabilities through lump sums or partial annuity settlements. Our previous survey report noted a dynamic that continues in this report: the pension funding relief legislation enacted in 2021 will likely create a greater bifurcation between plan sponsors seeking to maintain their plans at a low-

Retirement Plan Sponsorship in Fortune Ranked Companies



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Introduction

to-moderate level of risk (hibernate) and those seeking to completely transfer the liabilities (terminate). That is, even though many plans are fully funded based on their Projected Benefit Obligation ("PBO," the measure used in the US GAAP balance sheets), the new, relaxed contribution rules facilitate some plans delaying reaching full funding on a plan termination basis for many years.

We also note that US corporations have made great strides in shrinking the size of their pension obligations over the past decade via lump sum and annuity settlements. At year-end 2012, the average large plan sponsor had a global PBO of about 28% of their market cap and a deficit of 11% of market cap. By year-end 2022, those percentages had dropped to 13% and 2% respectively.[1] For many corporate sponsors, pensions are not the existential threat they might have been after the Global Financial Crisis.

Even for respondents reporting an objective to terminate their plans, only

12%

expect this to happen in two years or less, and over half expect it to happen in six years or longer.

So even most "terminating" plans don't appear to be rushing to the exit.

While we see U.S. private sector pensions maturing, they are not going away. Most are moving toward lower risk positions to reduce their impact on the plan sponsor. As plans shrink and de-risk, many plan sponsors are also looking to outsource the management of this non-core business to other parties better positioned to run the plans. Outsourced Chief Investment Officer (OCIO) mandates can do this for the investment functions. Aon's (OCIO) business, as well as the OCIO market as a whole, has seen tremendous growth over the last decade, as many plan sponsors find this to be an appealing solution for risk management with greater ability to undertake more customized and complex investment strategies, for hibernating plans as well as for those on a path to termination. If you haven't reviewed such solutions in the past three years, now is a good time to take a closer look.

We hope this survey report provides a constructive backdrop of data and insights. Aon is in the business of helping our clients be better informed and better advised to make better decisions, and your Aon consultant would be happy to help you assess the right solutions for your situation.

Jennifer Brasher
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Wealth Solutions

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Head of Investments,
North America
Wealth Solutions

1. Source: S&P Market Intelligence and Aon calculations.

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Executive Summary

After fifteen years, this is the first time we've run this survey when the average U.S. pension plan is over 100% funded on a PBO basis. While 22% of respondents reported a long-term objective to terminate their plan, the other 78% reported other objectives – typically de-risking the plan in one or more ways and maintaining it on an ongoing basis. Because plan sponsors are choosing a path – maintenance vs. termination – their risk management strategies will be more clearly delineated with that path. We divided this report into two mini-reports for plan sponsors with each objective.

For plan sponsors seeking to manage and maintain their plans, key themes we found include:

1. Most ongoing plans are still on a path to de-risk.
2. Many plan sponsors intend to shrink their plans through lump sum windows and retiree annuity lift-outs.
3. Many plans will likely be run as chronically slightly underfunded.
4. Investment changes continue the trajectory to more liability-hedging assets, greater customization of liability-hedging assets, and less equity exposure.
5. Many plan sponsors appear to be unaware of how the benefits of OCIO often increase as plans reduce investment risk.
6. Many plan sponsors have not yet changed their investment policies in light of today's much higher interest rates.
7. There has been considerable progress on cyber risk assessments.
8. There's much greater awareness about fiduciary liability insurance than a year ago.
9. Environmental, Social, and Governance (ESG) policies that require portfolio changes remain rare for U.S. pensions in the private sector.

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Executive Summary

For plan sponsors with the objective of terminating their plans, we found:

1. Plan termination will continue to appeal to a specific subset of plan sponsors.
2. Favorable insurer pricing will continue for plan terminations.
3. Customized liability-driven investment strategies will become more common.
4. There is potential for increased use of derivatives as part of investment strategy.
5. OCIO mandates will continue to grow, as plan sponsors increasingly find the benefits and costs of this approach attractive.
6. More plan sponsors will move their current DC plans to Pooled Employer Plans.

Respondents

We received

118 responses

from the U.S. for this survey, with 22% reporting a long-term objective to terminate their plan, and the other 78% reporting different variations of maintaining the plan over the long-term.

To create the 2023 U.S. report for the Global Pension Risk Survey, Aon relied on a survey of Aon's contacts with U.S. single employer pension plans, conducted from April through June 2023.

Responses from the survey were analyzed and aggregated to create summary results. Respondents received no incentive for taking part in the survey.

Long-Term Objective

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Report for Ongoing Plans

i.e., Those not Stating a Long-term Goal of Termination

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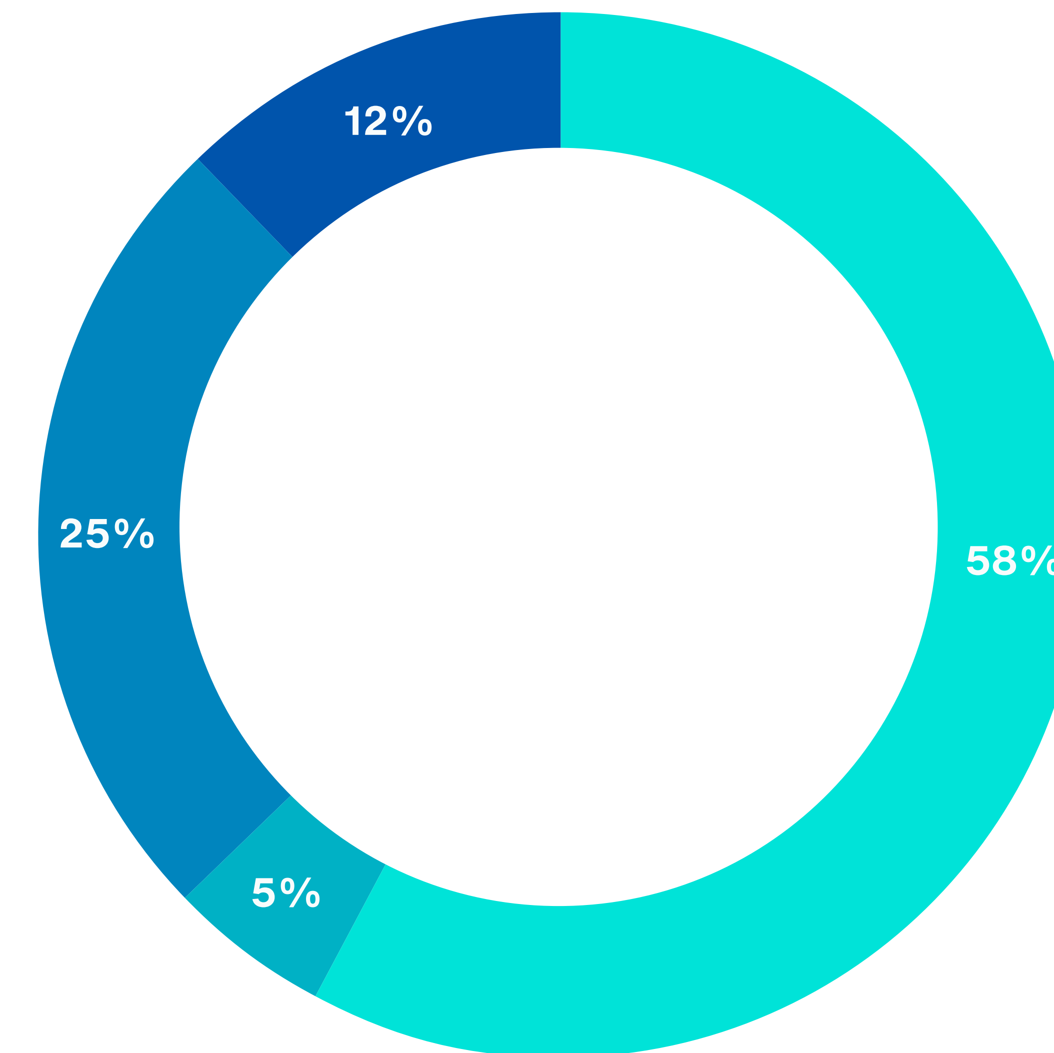
Most Ongoing Plans are Still on a Path to De-risk

Only 12 %

of ongoing plans are expected to maintain a material amount of investment risk over the long term.

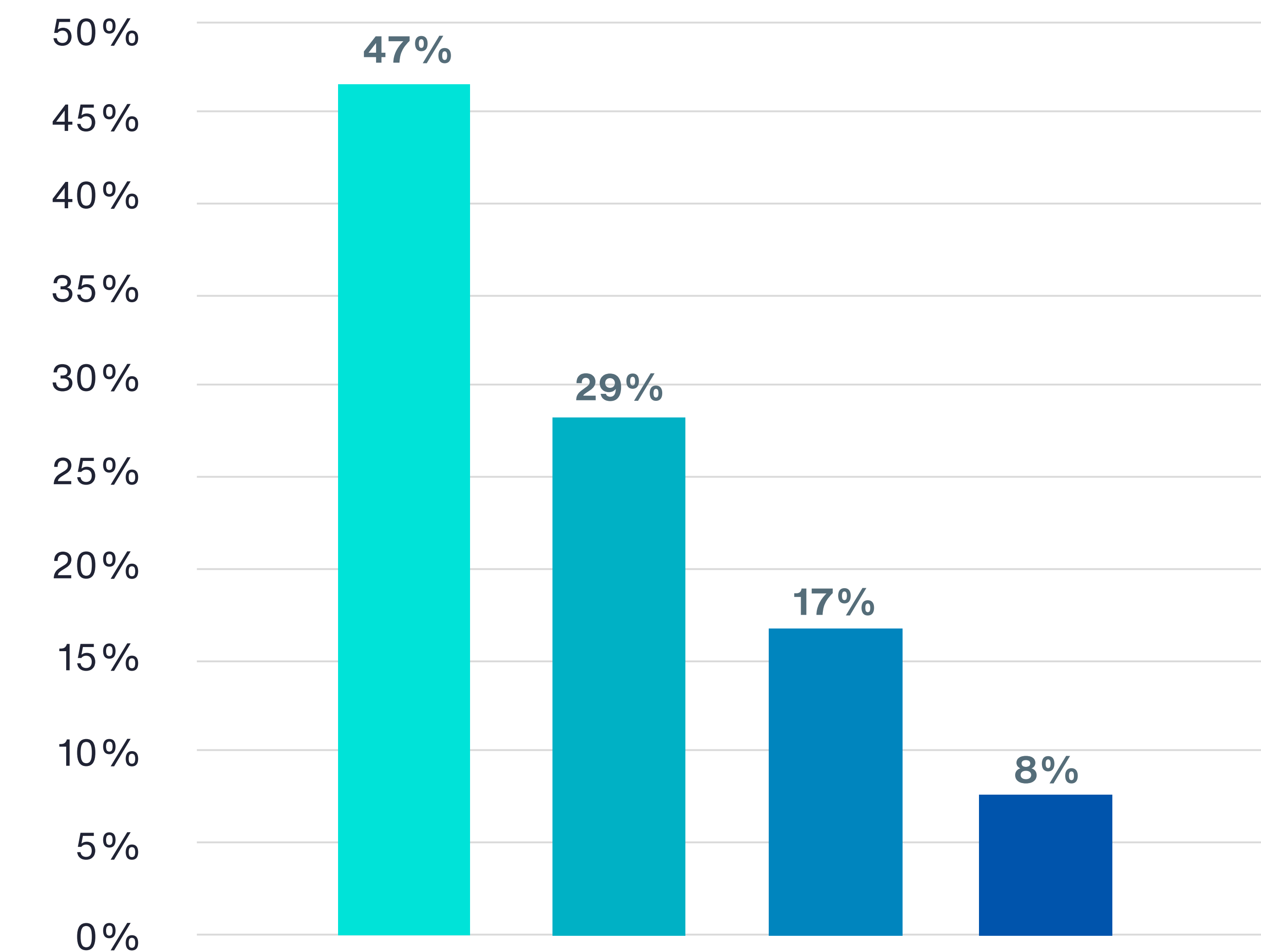
De-risking in some form is the dominant intention for ongoing plans, with 58% expecting to maintain the liabilities and run the plan in a low-risk way, and 25% expecting to de-risk while shrinking their plans with significant partial settlements. Further, most intend to get to their end states, via strategies such as glide paths and hedge paths.

Most Plans are De-Risking



- Maintain plan liabilities and run in a low risk way 58%
- No long-term objective yet 5%
- Significant partial settlement and run ongoing plan in a low risk way 25%
- Maintain material investment risk over the long-term 12%

How Would You Describe Your Plan to Reach Your Long-term Objective?



- Robust plan (e.g., documented plan, execution in process) 47%
- Basic plan (e.g., documented intent, plans being finalised) 29%
- Aspirational plan only (e.g., documented intent, plan not started) 17%
- No plan 8%

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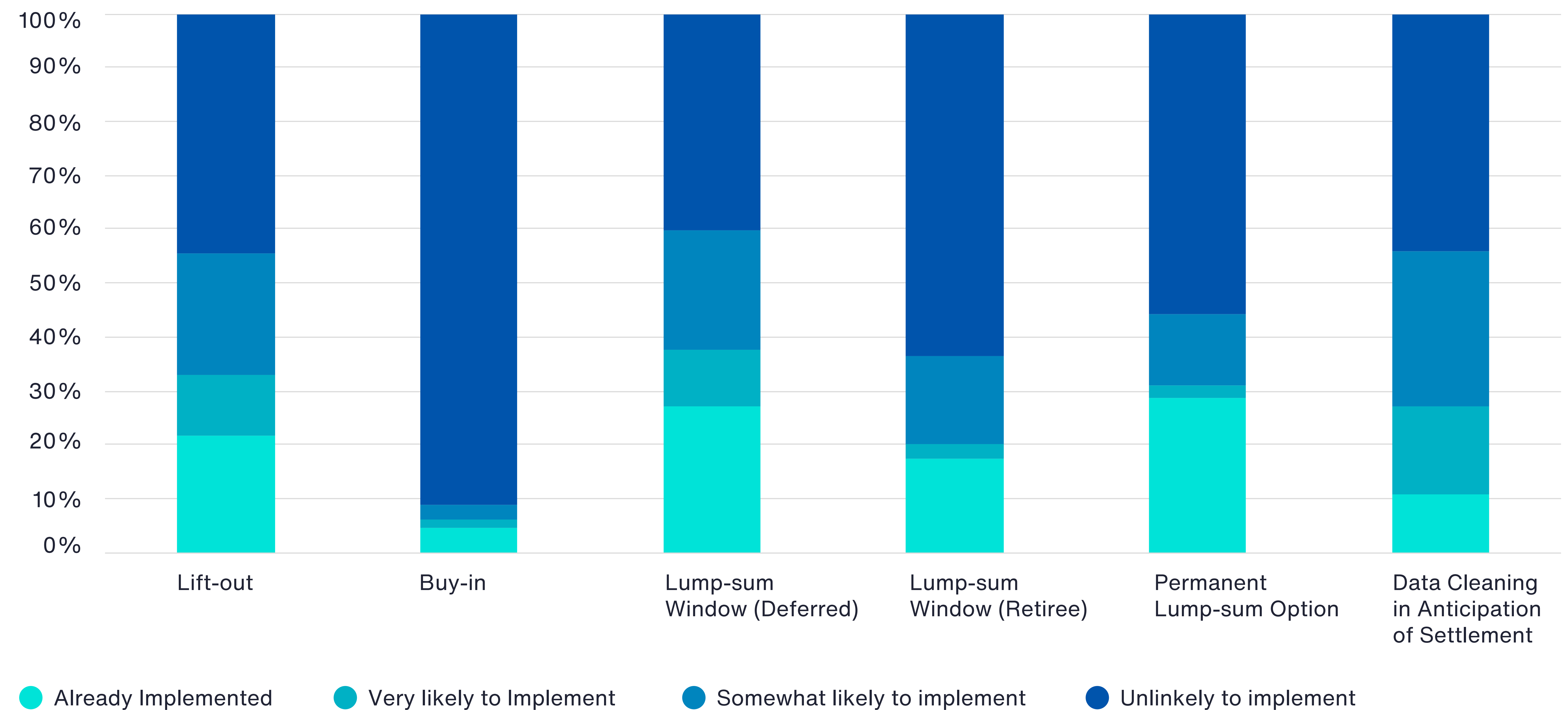
Many Plan Sponsors Intend to Shrink Their Plans Through Lump Sum Windows and Retiree Annuity Lift-outs

Lump sum windows and annuity lift-outs can shrink the size of the plan, and most plan sponsors either have performed one or believe it is likely that they will. While there is interest in most types of these actions, lump sums seem to be the preferred option for deferred participants (former employees not yet collecting retirement payments) and annuity lift-outs tend to be of greater prevalence for retirees. Retiree lift-out pricing has become increasingly competitive as a growing number of insurance companies find their "asset-intensive" risk profile attractive, while lump sum pricing is more attractive for deferred participants because of insurer aversion to the administrative complexity of deferred lives and the potential mortality anti-selection for retirees.[2]

Combining all the possible actions to shrink the liabilities, only 18% of respondents are unlikely to do any of them. We find that particularly interesting when compared to the fact that 44% of respondents report that they are unlikely to do any data cleanup, which is a key step for any form of liability settlement. We would expect this 44% figure to shrink as plan sponsors move forward with liability settlement initiatives and realize the importance of having clean data.

Actions to Shrink the Liabilities (Ongoing Plans)

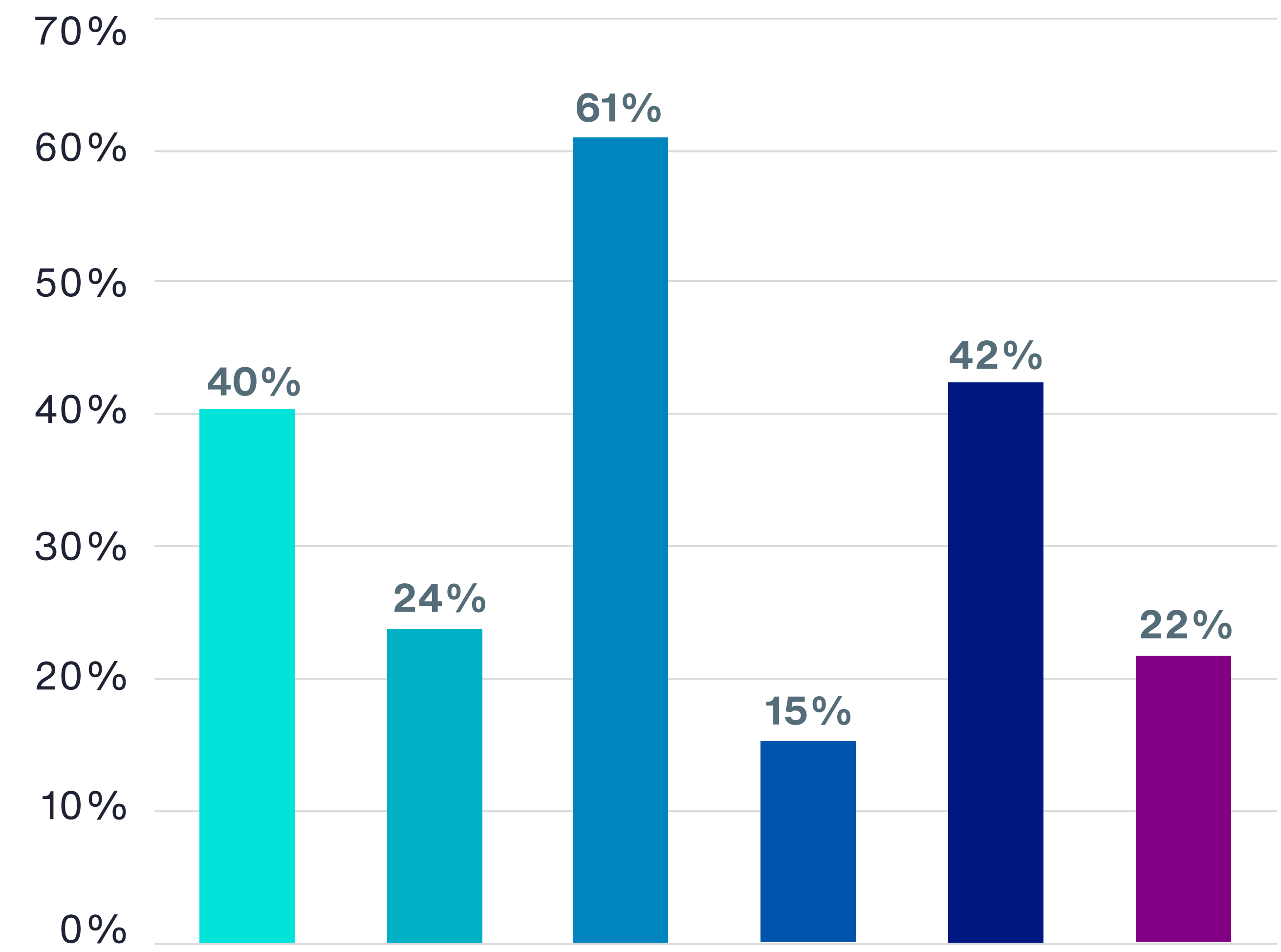


2. Source: Mortality anti-selection is when the least healthy participants tend to choose lump sum options. While it can happen at every age, the impact on costs tends to be higher at older ages.

3 Many Plans Will Likely be Run as Chronically Slightly Underfunded

Most have little intention to contribute above the minimum required amount. The current funding rules set in 2021 make it less likely that sponsors will be forced to write checks to achieve full funding. While many respondents expect their investment performance will help them achieve their long-term objectives, performance can only go so far since they are also de-risking their assets as they approach full funding. While hedge paths and similar strategies have been successful in bridging this gap, there appears to be a general understanding that it will take time to reach their long-term target. This has been reinforced by the multiple rounds of funding relief the federal government has passed over the years.

How Do You Expect to Reach the Level of Funding Consistent With Your Long-term Target?



Make only the minimum required contributions	40%
Additional contributions beyond the minimum required	24%
Investment performance	61%
Rising interest rates	15%
Liability management e.g., lump sums, annuity purchase	42%
Long-term target already achieved	22%

Time Frame – Ongoing Plans

2 years or less	19%
3-5 years	18%
6-10 years	30%
11-20 years	18%
More than 20 years	14%

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4 Investment Changes Continue the Trajectory to More Liability-hedging Assets, Greater Customization and Less Equity Exposure

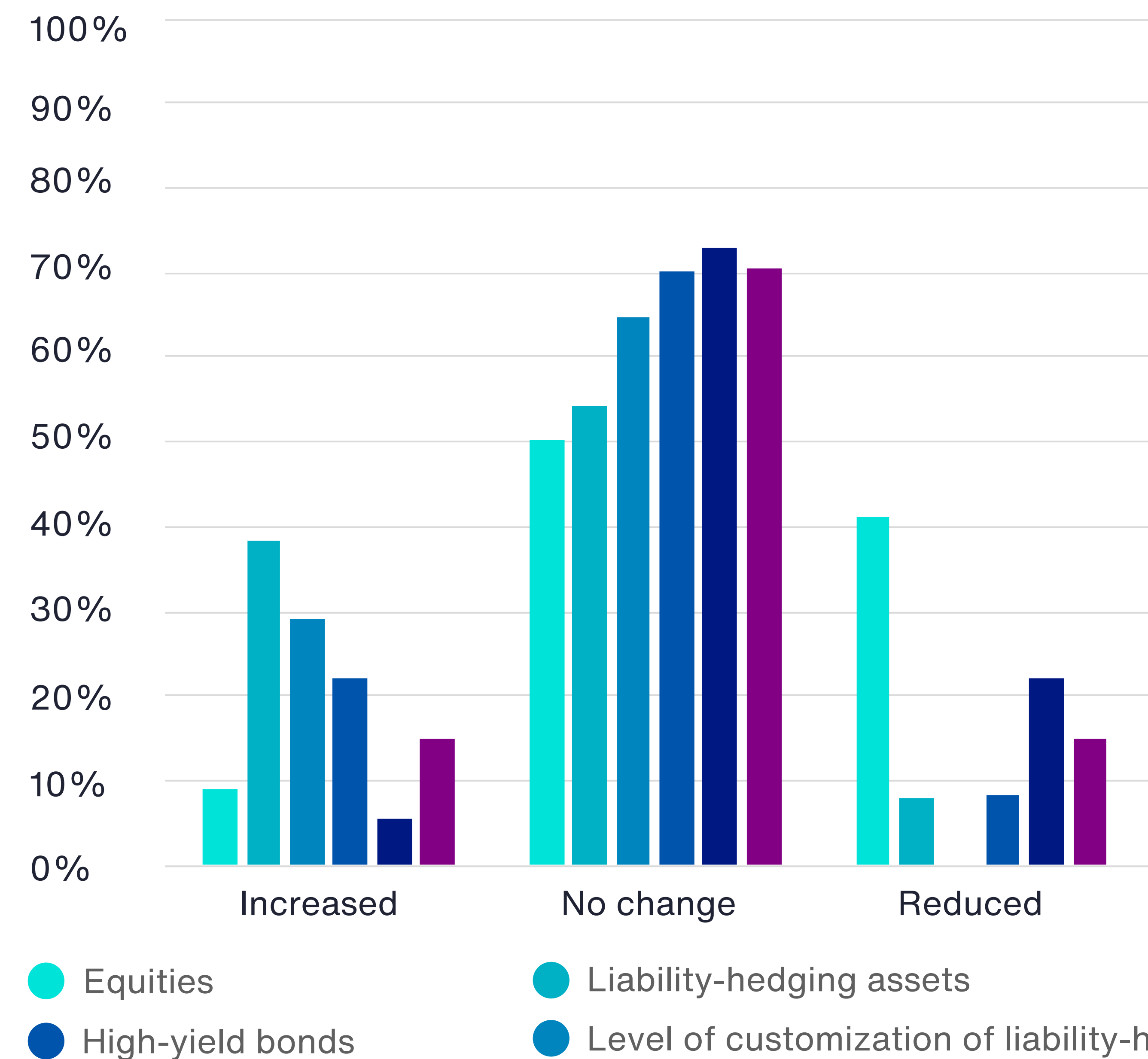
We note that the bars on the left, showing changes in the past 12 months, are almost identical to those on the right, showing prospective likely changes. These all point toward de-risking by reducing equity, increasing liability-hedging assets, and increasing the customization of the liability-hedging assets. Further, we asked about derivative use, and only 17% of respondents indicated that they would not consider using derivatives. The most common reason cited for using derivatives was to achieve improved hedging compared to using only physical bonds by better matching the term structure of the liabilities.

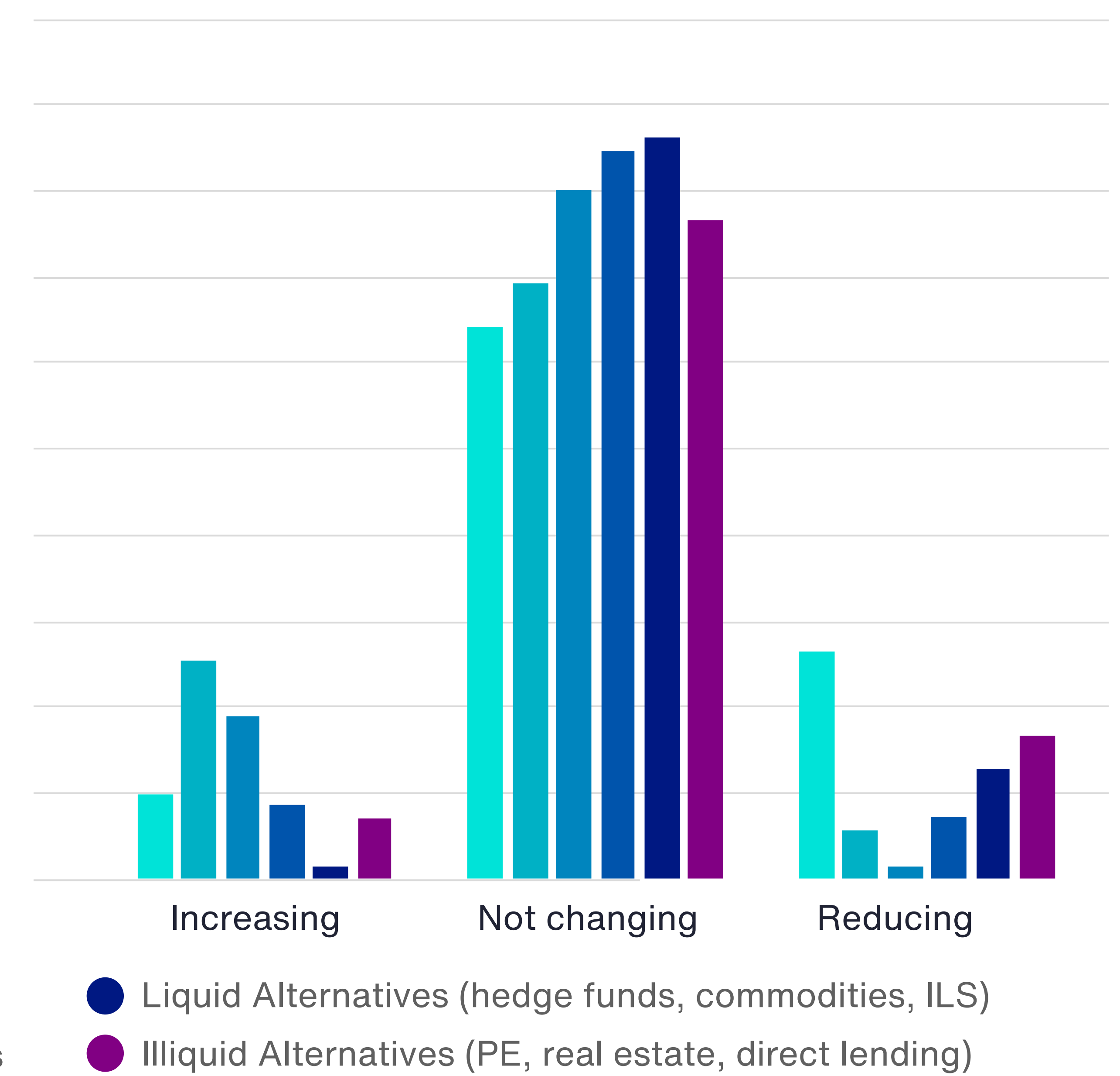
Only

17%

of respondents indicated that they would **not** consider using derivatives.

Looking Back and Looking Ahead – Changes in Asset Allocation





- Equities
- High-yield bonds
- Liability-hedging assets
- Level of customization of liability-hedging assets
- Liquid Alternatives (hedge funds, commodities, ILS)
- Illiquid Alternatives (PE, real estate, direct lending)

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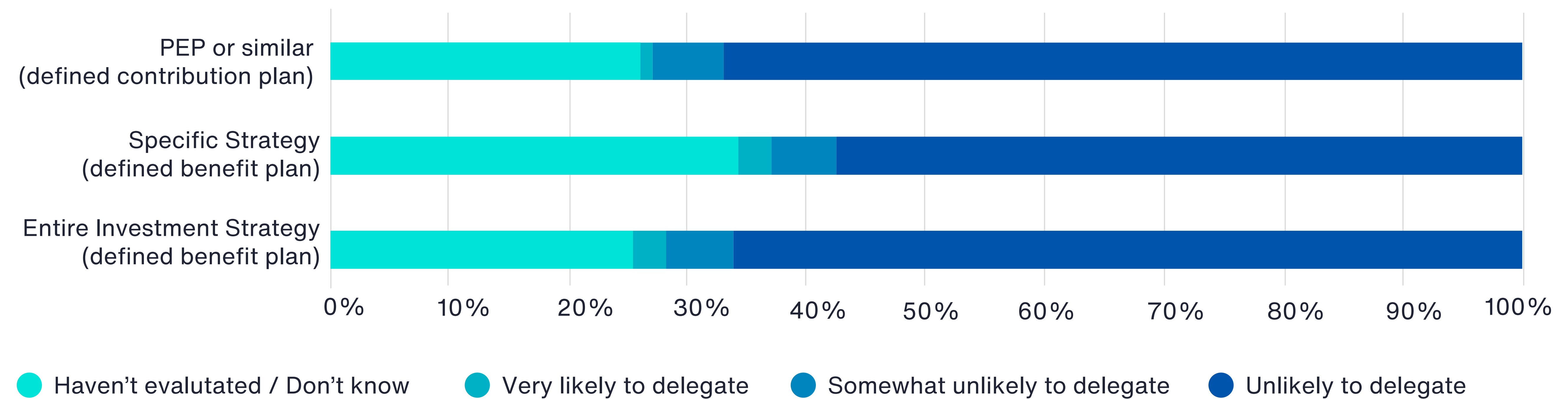
5 Many Plan Sponsors Appear to be Unaware of How the Benefits of OCIO Often Increase as Plans Reduce Investment Risk

34% of the respondents already had already delegated responsibilities to an OCIO. Among those who didn't, the proportion of plan sponsors unlikely to delegate was about the same as it was for our 2022 survey. This was surprising to us because for many plan sponsors, the benefits of OCIO increase as plans de-risk. The primary reasons plan sponsors use an OCIO are to:

- **Improve governance:** Many committees have difficulty accomplishing their stated objectives with their existing resources. OCIO arrangements allow fiduciaries to focus on strategic issues with the biggest impact on outcomes, including asset allocation, investment structure, and risk management. The remaining areas are outsourced.
- **Manage complexity:** The markets have become more complex and volatile, so committees partially outsource the complex aspects, such as glide paths, hedge paths, and the use of alternative or other illiquid investments.
- **Drive savings:** The large OCIO providers have the scale to reduce investment management fees and pass those savings to clients.

Although this survey was primarily about defined benefit plans, we also asked about defined contribution plans in the question about OCIO and found general openness to OCIO solutions for these plans. We believe many plan sponsors should examine newly emerging OCIO solutions in the defined contribution space, such as Pooled Employer Plans (PEPs). PEPs offer a multitude of benefits to the plan sponsor, such as less cost, less risk, and less work for the employer's HR staff.



34%

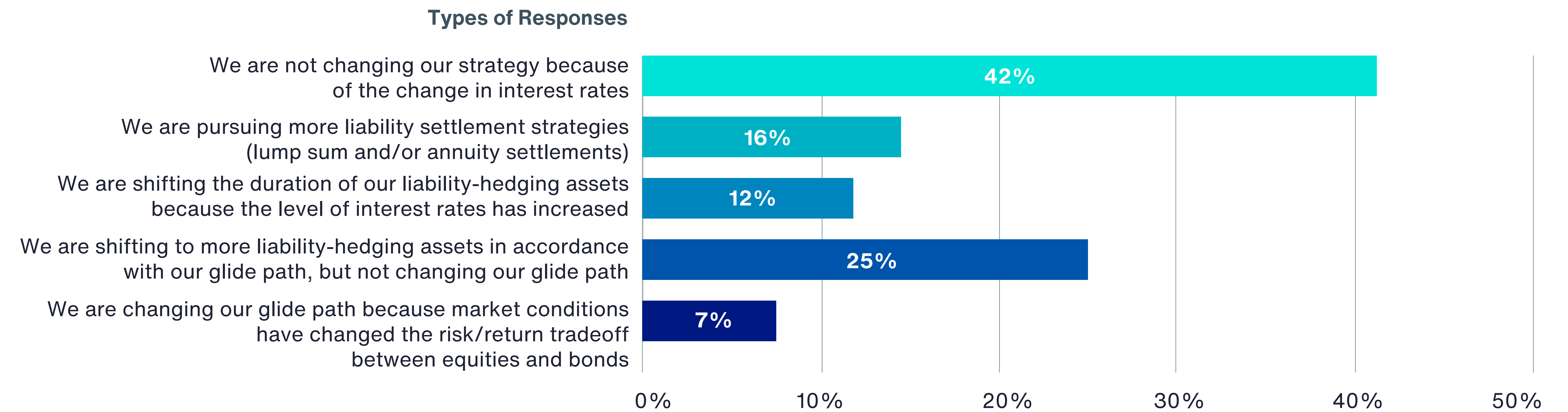
of the respondents already had already delegated responsibilities to an OCIO.

6 Many Plan Sponsors Have not yet Changed Their Investment Policies in Light of Today's Much Higher Interest Rates

Since year-end 2021, high quality corporate bond yields have increased by close to 300 basis points and the long-term expected return on corporate bonds is getting closer to the long-term expected return on equities. With the expected return premium for equities over bonds shrinking so much, lower risk can be achieved without sacrificing much expected return. Long-term bonds possess cash flow characteristics similar to liabilities and can serve as natural hedge against interest rate risk.

Based on the survey responses, most plan sponsors haven't yet identified this opportunity, and should revisit their investment policy. Further, allocating part of the fixed income portfolio to private debt (greater yields at similar risk to public bonds) should be a consideration for plan sponsors looking to hedge more without sacrificing returns, and alternative assets may be good diversifiers if the return-seeking assets are dominated by public equities.

Interest Rates Have Risen to Levels Not Seen in Many Years. How is this Impacting Your Strategy?



	12/31/2021	9/30/2023
Yield on Long Credit	3.16%	6.13%
Aon's Expected Return on Long Credit	2.7%	6.4%
Aon's Expected Return on Global Equity	6.4%	6.9%
Aon's Expected Return Premium for Global Equity Over Long Credit	3.7%	0.5%

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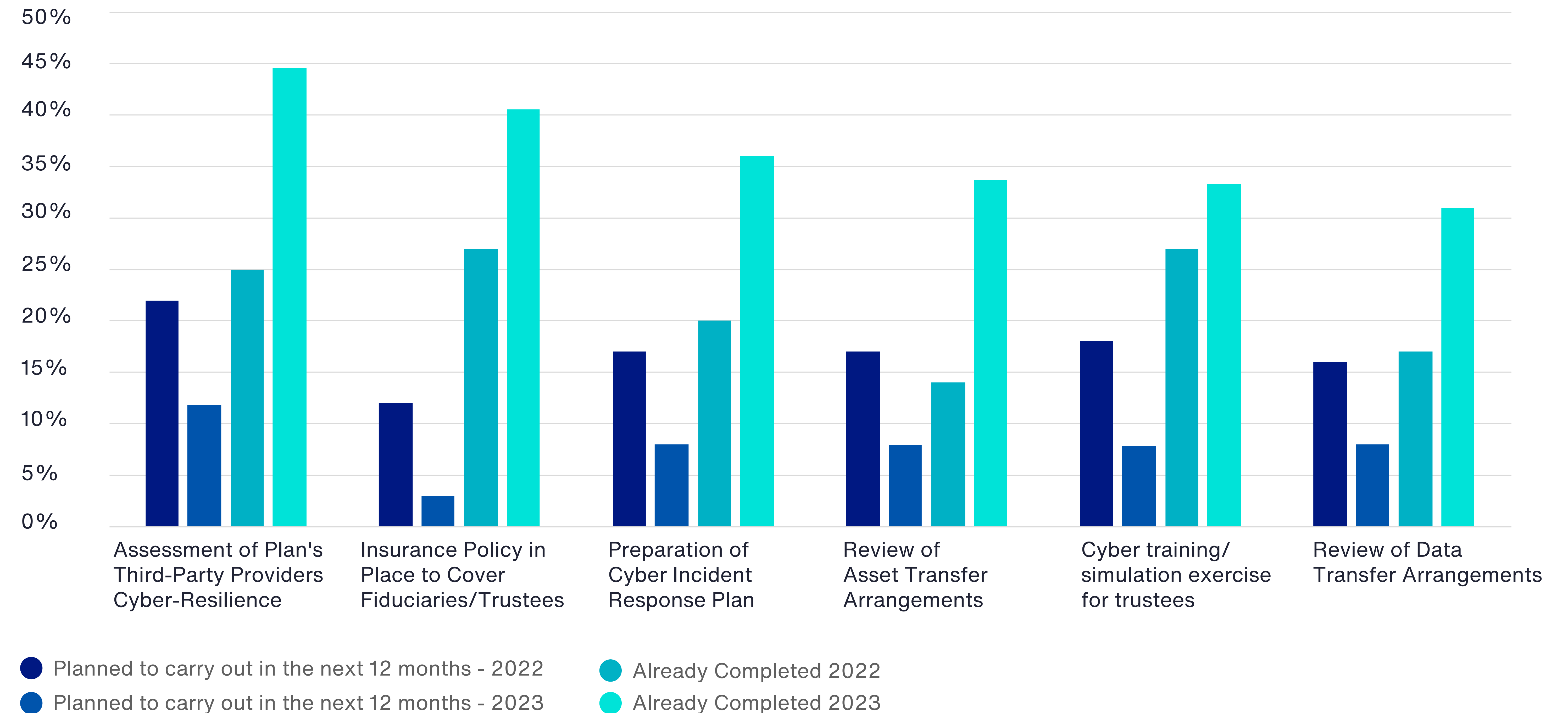
There has Been Considerable Progress on Cyber Risk Assessments

Compared with our 2022 pension risk survey, plan sponsors in 2023 have taken more action to address cyber risk. It is not surprising that we see an uptick in action on cyber risk, because on April 14, 2021, the U.S. Department of Labor issued guidance addressing the cybersecurity practices of retirement plan sponsors, their service providers, and plan participants. Prior to this guidance, this topic was relatively low on the radar for most plan sponsors, so it is noteworthy to see how things changed. Our 2023 survey again asked about six different actions plan sponsors could take to address cyber risk. For all six, we found that more respondents in our 2023 survey indicated that they had already taken action, and fewer respondents indicated that they were planning to take action in the next 12 months. A logical inference might be that many plan sponsors took action in this area shortly after the DOL guidance, and those who didn't do it then are not inclined to do it later.

However, if the Department of Labor is as serious about cyber risk as it appears to be, we expect the trend to be toward more universal action across all plan sponsors. The top actions appear to be assessment of a plan's third-party providers' cyber-resilience, getting insurance in place to cover fiduciaries/trustees, and preparing a cyber incident response plan. Aon has dedicated teams that specialize in this area and are available to help plan sponsors.

Cybersecurity Actions



8 There's Much Greater Awareness About Fiduciary Liability Insurance Than a Year Ago

The 2023 survey again asked if respondents have fiduciary liability insurance. Fully 81% of respondents have this coverage, compared with only 48% in the prior survey. While we would like to believe that our last survey resulted in a surge of new policies, the real reason for the jump is probably more pedestrian. In our prior survey, we noted that an alarming 48% of respondents didn't know whether they had this insurance. In the ensuing year, we expect that many respondents, perhaps chastened by our last report, found that indeed they had this coverage. The percentage responding with a definite "No" remains consistent, at 4% compared to 3% last year. Since there is still a great deal of confusion and misinformation about fiduciary liability insurance, here is some basic information about this type of coverage.

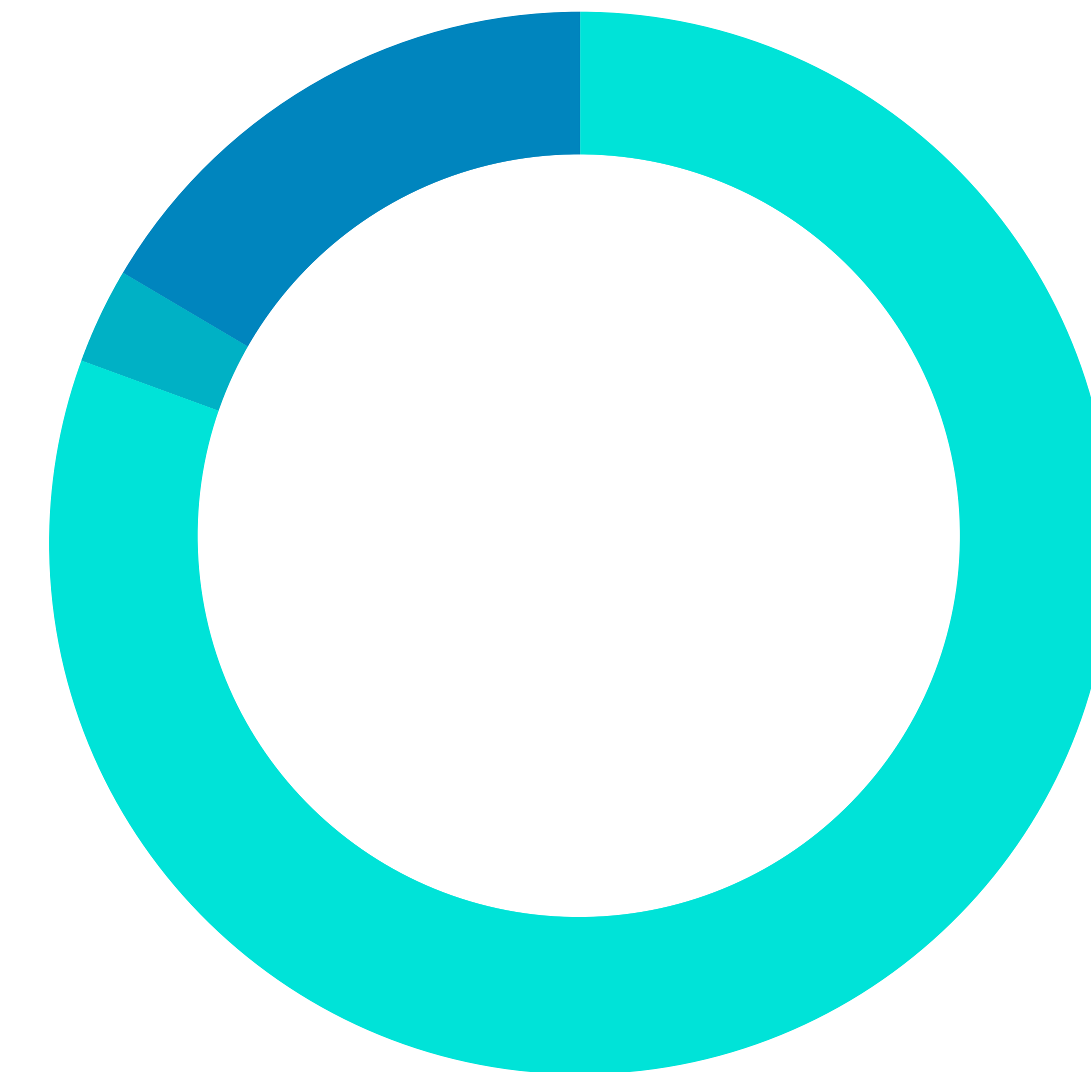
Fiduciary liability insurance is designed to provide coverage for breaches of fiduciary duty and administrative errors. Though it is not required, many organizations purchase it for their fiduciaries, who are personally liable for fiduciary failures, meaning that their personal assets could be at risk. Fiduciary liability insurance is different from—though sometimes confused with—an ERISA bond. Under ERISA, plan fiduciaries and those who handle plan funds or assets must be bonded to protect the plan from losses caused by dishonest or fraudulent actions. But the ERISA fidelity bonds that they are legally required to purchase will not protect from losses arising from breaches of fiduciary duty (such as the failure to prudently invest plan assets) or plan administrative errors. These exposures require fiduciary liability insurance.

Aon's Financial Services Group ("FSG") is a team of executive liability brokerage professionals with extensive experience representing buyers of complex insurance products including fiduciary liability, directors' and officers' liability, employment practices liability, fidelity, and professional liability insurance. FSG's global platform assists clients in addressing their executive liability exposures across their worldwide operations. Aon's claims team has handled over 500 fiduciary liability claims in the last five years, including those involving excessive fees, employer stock drop, and improper employee stock ownership plan valuation allegations.

81%

of respondents have this coverage, compared with only **48%** in the prior survey.

Does the Plan Sponsor Purchase Fiduciary Liability Insurance to Protect the Investment Committee?



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9 Environmental, Social, and Governance (ESG) Policies That Require Portfolio Changes Remain Rare for U.S. Pensions in the Private Sector

ESG has been a hot topic across investment industry conferences and the press, so we wanted to understand how U.S. pension plan sponsors were acting on this. Only 5% of respondents said that they have an ESG policy in place and have made changes to their investments as a result of it. This apparent disconnect could be for a few reasons:

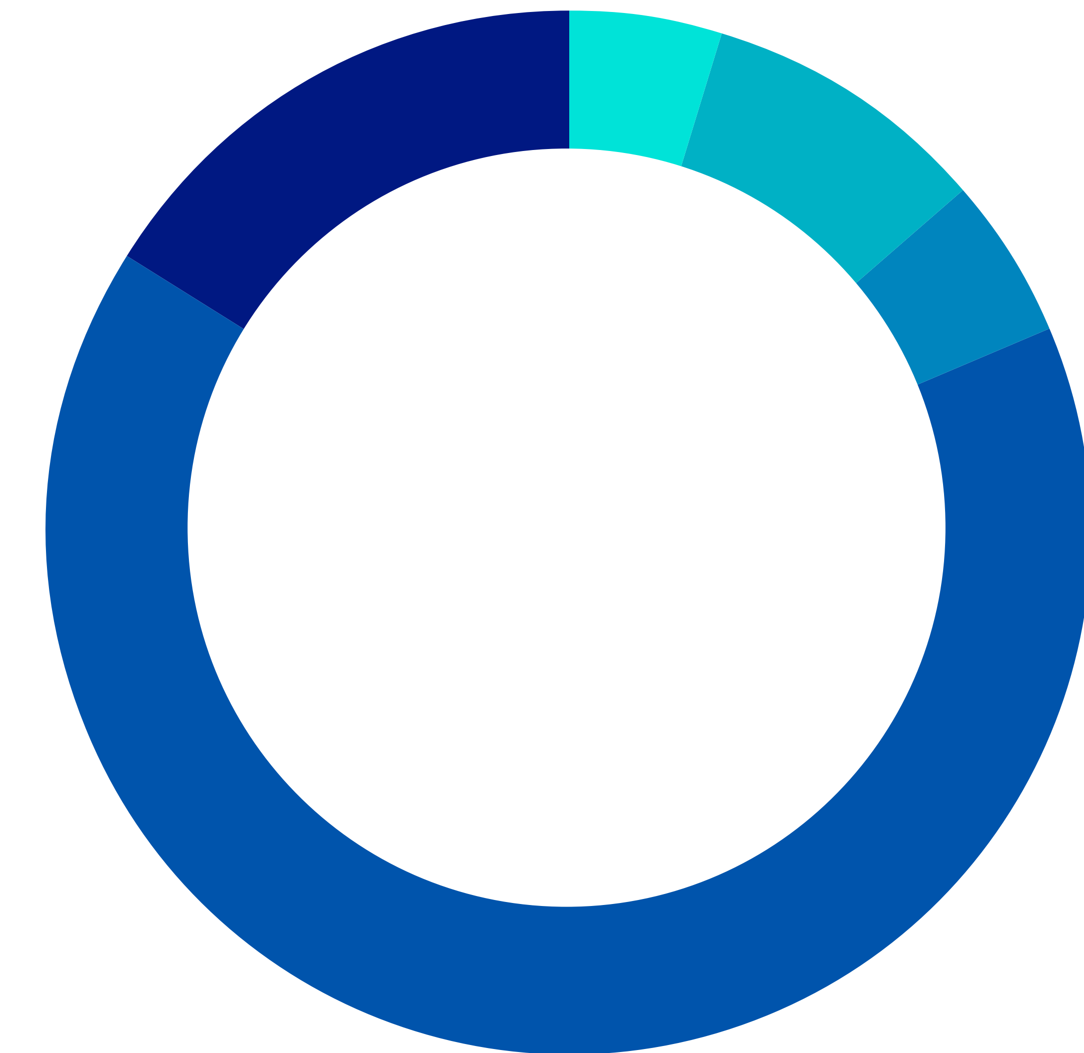
- Other types of institutional investors, such as public funds, endowments, and foundations, may be leading the way on ESG.
- While ESG is an interesting topic for discussion, plans subject to ERISA could be waiting for more favorable, definitive regulatory guidance before putting it in their policies.
- Plan sponsors believe they don't need an ESG policy to implement it in the way they want. For example, their active managers may already be considering ESG factors in security selection to improve the portfolio's risk/return characteristics.

Aon continues to consider ESG capabilities in our process for rating investment managers to assess how they incorporate all factors material to portfolio risks and returns into their decisions.[3]

5%

Of respondents said that they have an ESG policy in place and have made changes to their investments as a result of it.

Do you have a Responsible Investing or ESG Policy?



Response	%
We have a policy and we have made changes to our investments as a resullt	5%
We have a policy but it has not yet led to changes in our investments	9%
We are in the process of putting a policy in place	5%
We do not currently have a policy in place	66%
Don't know	16%

3. Source: A summary of Aon's approach is at https://insights-north-america.aon.com/responsible-investing/esg-manager-ratings.

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Aon's Predictions for Ongoing Plans

While we hope this survey data is enlightening, we want to share further insights and predictions based on other sources—our understanding of the environment for pension plans through our work with plan sponsors.

1. **Increased bifurcation of pension plan sponsors.** The tendency of plan sponsors to fall into one of two camps—those looking to settle most/all of the liabilities (terminate) and those looking to manage and maintain their plans (hibernate)—will become more stark as time goes on.
2. **Slowing pace of plan freeze or closure.** Most of the plan sponsors that wanted to freeze or close their plans have already done it, and the recent changes to contribution rules made a better environment for ongoing plans.
3. **De-risking will continue, but at a slower pace.** With funded statuses higher, more plans are near their end-state funded status. That means there's less capacity for further de-risking, and the plans remaining are less affected by market trends for return-seeking assets.
4. **Liability-hedging assets will become more customized.** With more liability-hedging assets for plans across the board, it is natural for sponsors to put more thought into what resides in those portfolios. We expect greater efforts to customize the term structure of the liability-hedging assets as well as use Enhanced Liability Driven Investments (eLDI) to diversify exposures beyond vanilla government and credit securities. This will include some migration to private debt from public corporate bonds within the overall fixed income portfolio, as well as derivative overlay strategies.
5. **Return-seeking assets will become more diversified.** With the expected lower return outlook for US and global equities, plan sponsors seeking higher returns will diversify their return-seeking portfolio by investing in private equity, hedge funds, and other liquid and illiquid alternative asset classes. The lower correlation between the alternative asset classes with equities will broaden their appeal.
6. **Plan sponsors will have increasing awareness of cyber risk and fiduciary liability insurance, taking actions accordingly.** These are both areas that many plan sponsors were unaware of until recently, but the environment has changed, and we don't expect to reverse course. Going forward, many fiduciaries will build cyber risk evaluations into their ongoing governance processes.
7. **OCIO mandates will continue to grow.** This will happen as plan sponsors increasingly find the benefits and costs of this approach attractive. Further, the OCIO mandates will grow for both defined benefit and defined contribution plans, the latter of which will grow through PEPs.

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Report for Plans with the Long-Term Objective of Termination

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A Limited Number of Plan Sponsors are Explicitly Targeting a Full Plan Termination

As originally conceived, the Pension Protection Act of 2006's contribution rules forced plan sponsors to fund their pension plans towards a level where plan termination could be achieved. In response, some sponsors made the short mental leap to adopting plan termination as their long-term objective. Ever since 2012's Moving Ahead for Progress in the 21st Century Act (MAP-21) legislation kicked off several rounds of funding relief, many plan sponsors have extended their time horizon to get to full funding, and in many cases, termination has ceased to be a primary objective.

Below are the survey results for plan sponsors who have indicated plan termination as a long-term objective.

- The percentage of respondents with a long-term objective of terminating their pension plan remained stable, 22% in the current survey compared to 23% in the prior survey.
- Still, most of these termination-focused respondents are several years away from implementing the plan termination objective. Just 12% of respondents indicated plan termination implementation within the next two years. However, a total 43% of respondents plan to terminate within the next five years, and another 50% intend to terminate in 6-10 years.
- Of course, a significant number of plans have terminated over the past few years, and their sponsors are no longer responding to the survey.

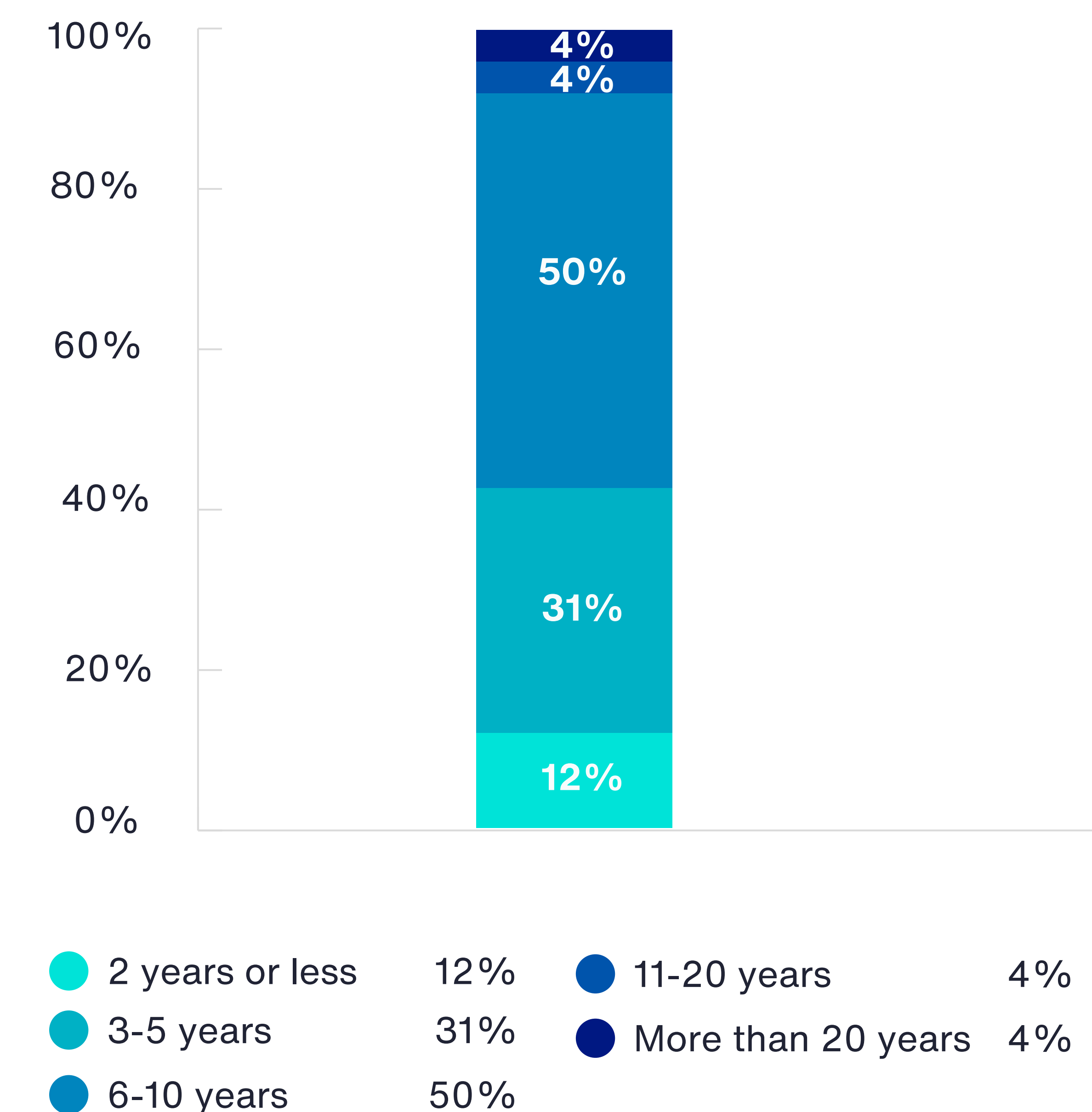
We expect these trends to persist as more plan sponsors take time to fully assess the impact of the new funding rules.

The percentage of respondents with a long-term objective of terminating their pension plan remained stable,

22%

in the current survey compared to 23% in the prior survey.

Time Frame – Terminating Plans



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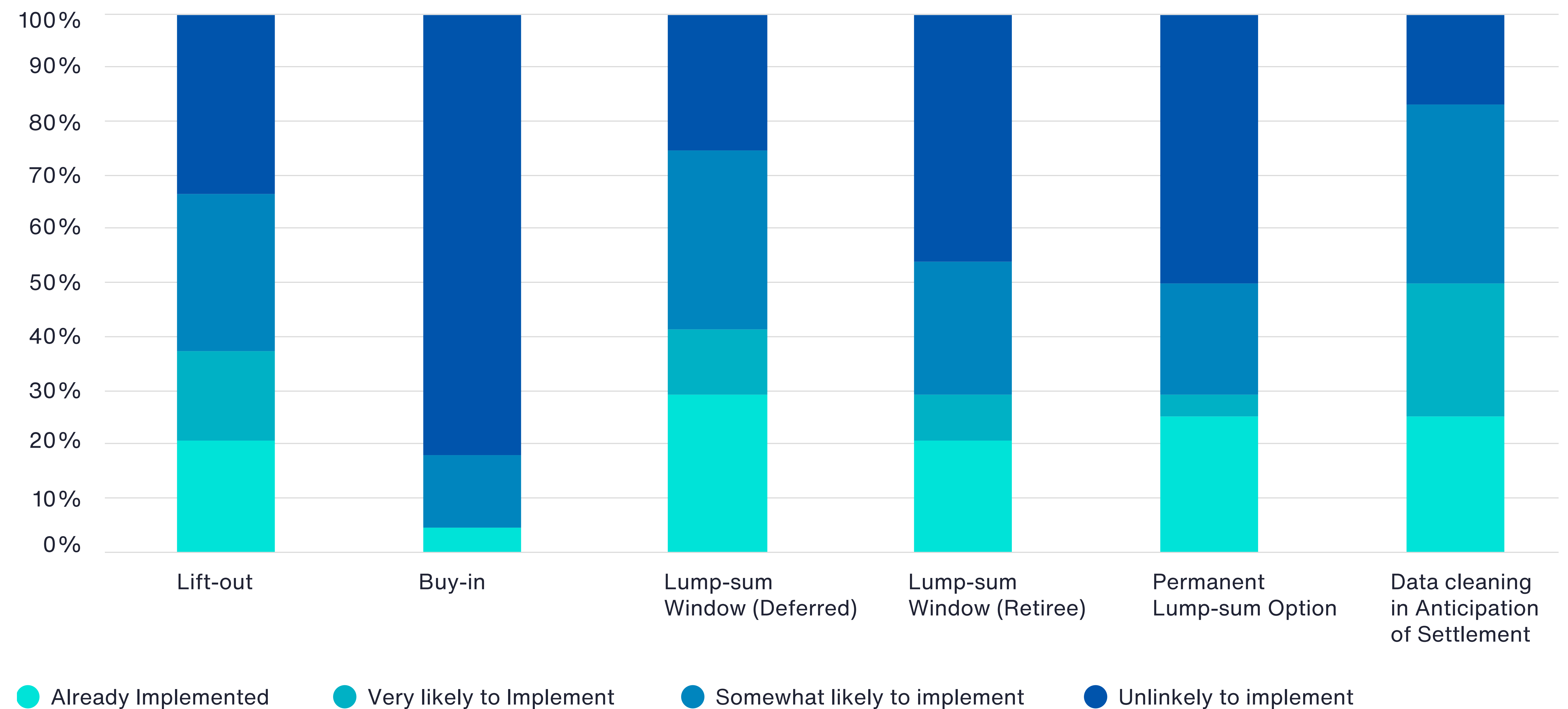
Liability Management Strategies for Plan Sponsors Considering Plan Termination

Below are some common liability management strategies that plan sponsors adopt to be better positioned for execution of the plan termination.

- **Retiree Annuity Lift-Out:** This is an effective strategy for plan sponsors to reduce the size of their pension obligations and lower PBGC premiums, recently made more attractive by favorable interest rates and competitive insurer pricing. Lift-outs can be executed for all the retirees of a plan or targeted to subsets of retirees with small annuity benefits. 38% of the respondents in our survey who indicated a long-term objective of terminating their pension plan are likely to implement this strategy in next two years.

Actions to Shrink the Liabilities (Terminating Plans)



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Liability Management Strategies for Plan Sponsors Considering Plan Termination

50%

of the terminating respondents in our survey are likely to implement data clean-up in next two years.

- **Terminated Vested Lump Sum Window:** This is another good strategy for plan sponsors to reduce the size of their pension obligations and lower PBGC premiums, especially for plans without a permanent lump sum option. 42% of the terminating respondents in our survey are likely to implement this strategy in the next two years.
- **Data Clean-Up:** This is a critical step to execute in anticipation of a lump sum window, data transfer to an insurance company for an annuity purchase, and post-termination PBGC audit. This can also help in lowering liabilities ahead of plan termination by identifying and removing deceased participants and beneficiaries. 50% of the terminating respondents in our survey are likely to implement data clean-up in next two years. It is also noteworthy that 17% of respondents said that they are unlikely to do a data cleanup; we believe that number will go down as these plan sponsors move toward termination.

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Key Steps for Successful Plan Termination Investment Strategy

When a plan termination is over two years away – which is the case for 88% of the respondents to our survey indicating plan termination is their goal – we see four main areas they should focus on for their investment strategies:

1. Plan sponsor education and strategy review, including an asset/liability study to develop a glide path, hedge path, and other aspects of a plan for the end-goal.
2. Hedge the liabilities with less equity and more liability-hedging assets.
3. Structure the portfolio to increase liquidity.
4. Customize the liability-hedging strategy.

In next few pages, we'll look at survey responses to see how plan sponsors are addressing points 2, 3, and 4 above.

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Hedge the Liabilities with Less Equity and More Liability-hedging Assets

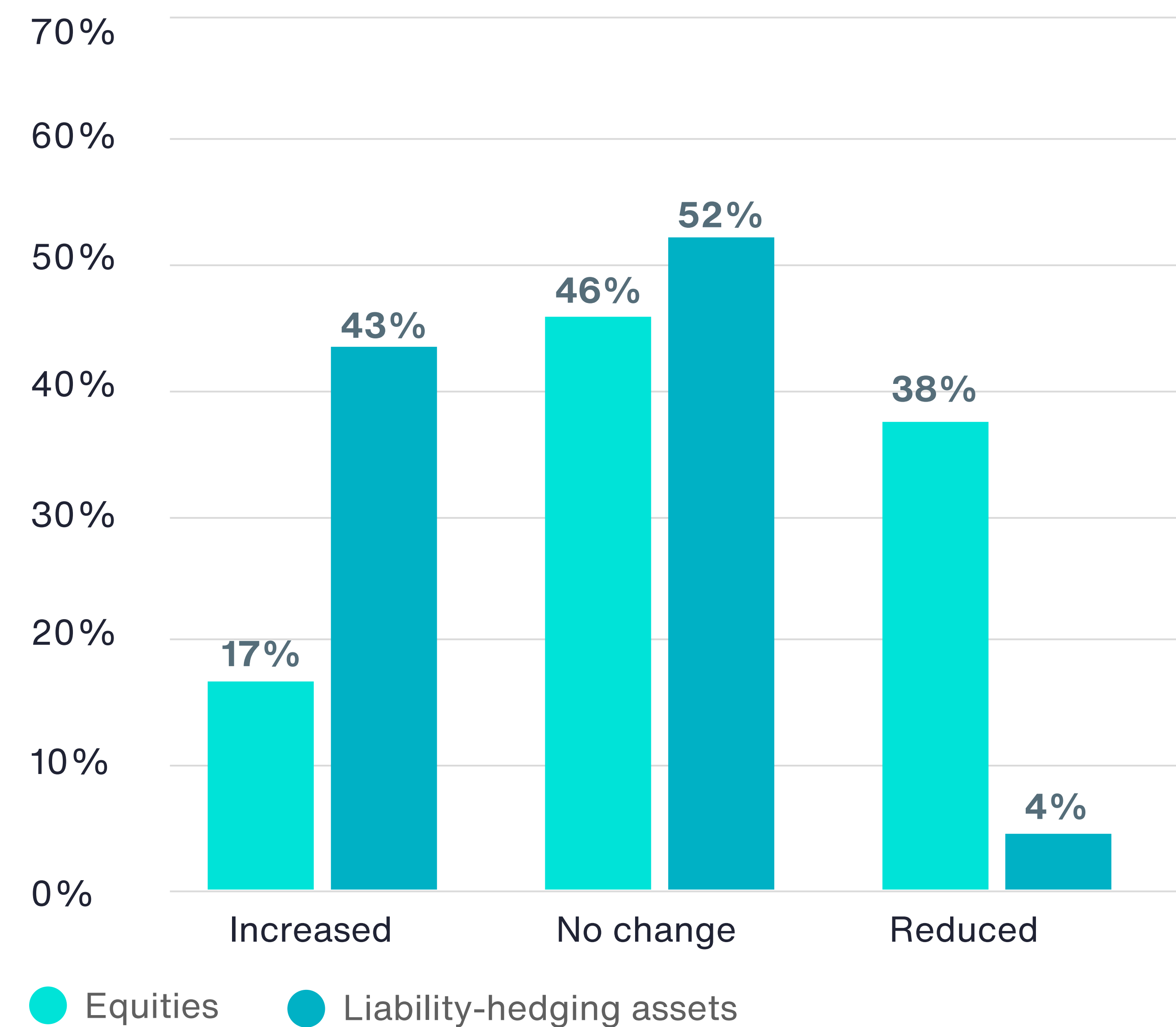
38%

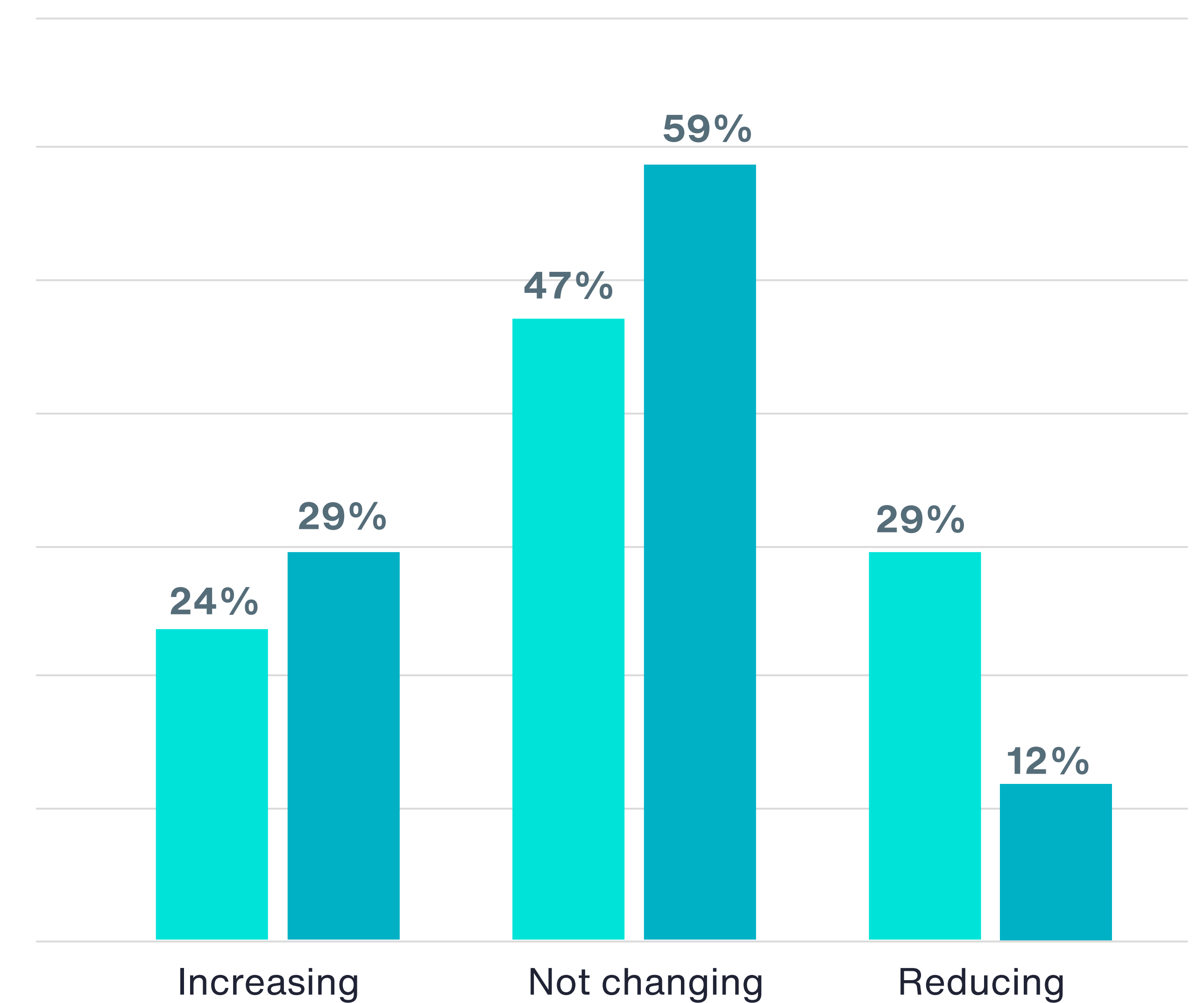
of terminating respondents reduced their equity allocation in the last 12 months

And 29% plan to reduce their allocation to equities in the next 12 months. These plan sponsors are moving their asset allocation towards a de-risked end-state, which usually precedes termination.

Sponsors of terminating plans should focus on better matching of assets and liabilities, by higher allocation to liability-hedging assets, to "lock in" the funded ratio of the plan and avoid volatility in final contributions and expense. 43% of terminating respondents increased their allocation to liability-hedging assets in the last 12 months and 29% plan to increase their allocation to liability-hedging assets in the next 12 months.

Changes in Asset Allocation – Terminating Plans





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Structure the Portfolio to Increase Liquidity

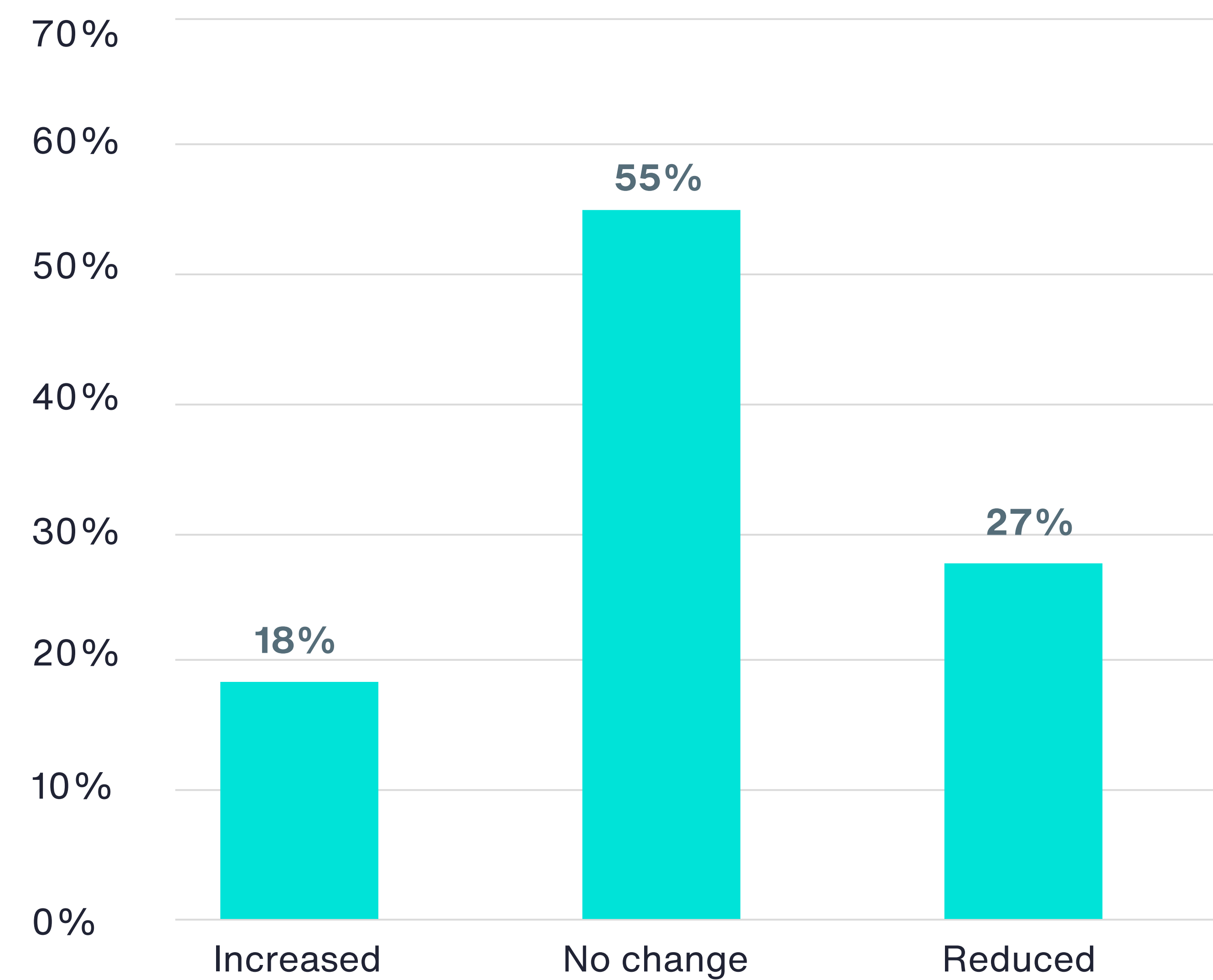
27%

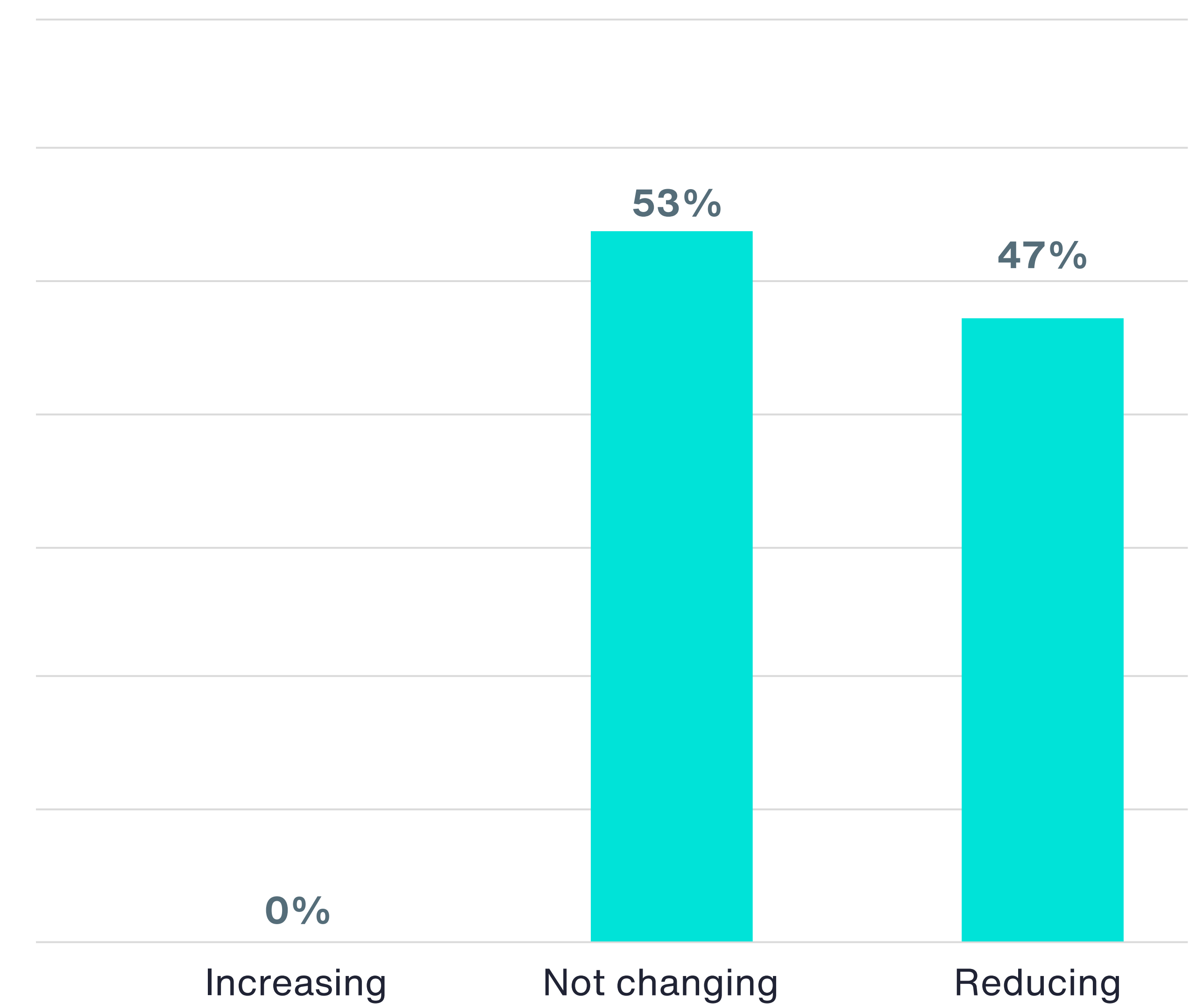
of terminating respondents reduced their allocation to illiquid assets in the last 12 months

While all terminating plans will need to do this eventually, the timing of this is important. Illiquid assets can provide compelling returns and diversification, so many plans seeking to terminate in several years may want to delay eliminating their illiquid assets. In our survey, 58% of respondents with the goal of plan termination don't expect to do that for at least 6 years.

While 27% of terminating respondents reduced their allocation to illiquid assets in the last 12 months and 47% plan to reduce their allocation to illiquid assets in the next 12 months, it may be reasonable that so many appear to be holding onto their illiquid assets.

Changes in Asset Allocation – Terminating Plans





Illiquid Alternatives (Private equity, real estate, direct lending)

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Customize the Liability-hedging Strategy

35%

of terminating respondents indicated increasing the customization in their liability-hedging assets in the last 12 months

33%

plan to further increase customization of their liability-hedging assets in the next 12 months.

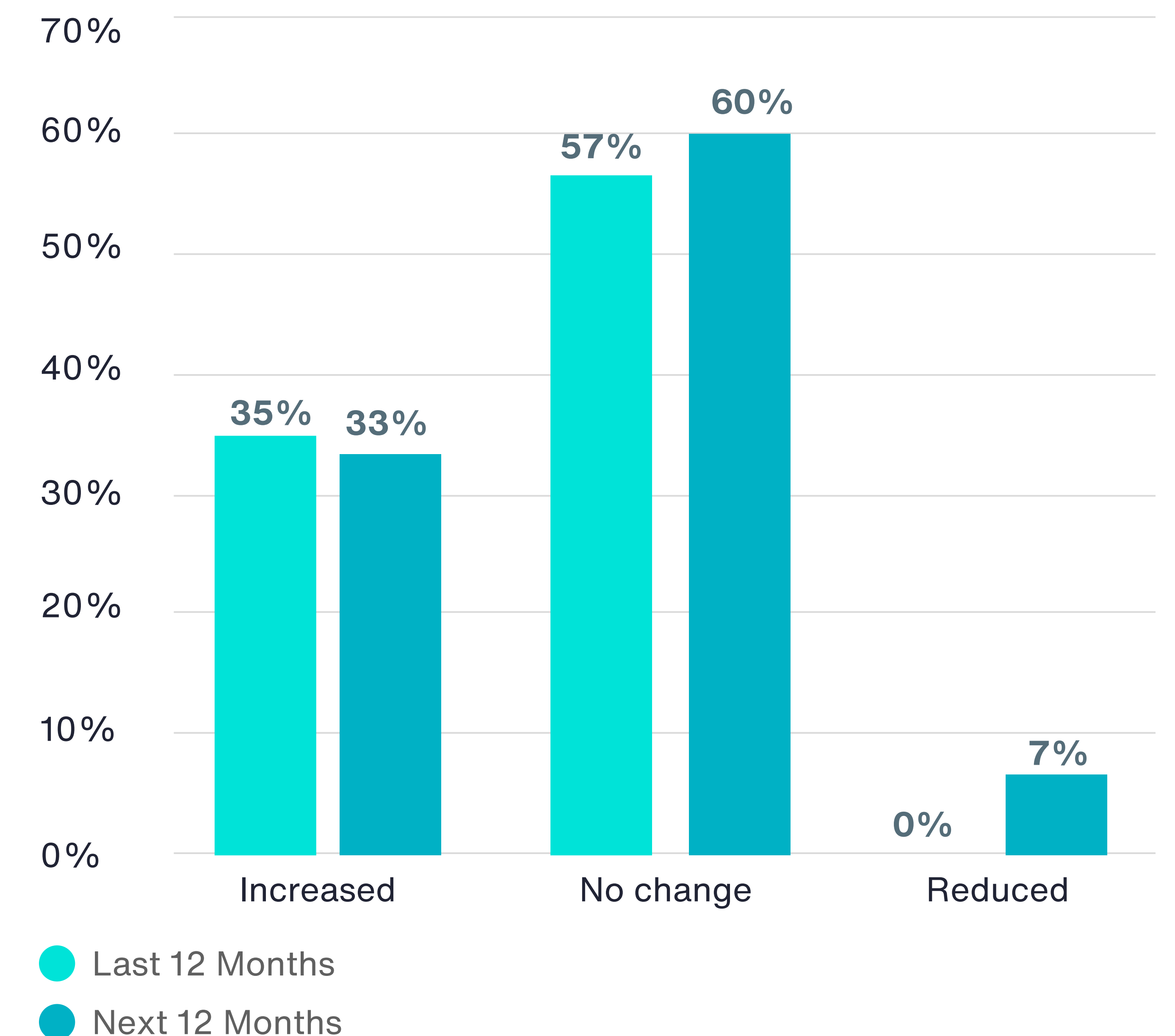
Custom liability-driven strategies are designed to dynamically align asset and liability exposures by evolving over the remaining time to plan termination to limit exposures to interest rate, credit spread, and yield curve risks.

Examples of a customized strategy include:

- Aligning the credit quality in the bond portfolio with the metric used to value the liabilities and insurance company preferences for asset-in-kind transfers.
- Tighten the duration match by using key-rate duration to minimize the exposure to yield curve twists.
- Lower duration once lump sum window interest rates are set, since lump sums no longer remain interest rate-sensitive and cash becomes the best hedge for these liabilities.
- Adjust the assets to maintain the hedge as estimated lump sum take rates change.

In our survey, 35% of terminating respondents indicated increasing the customization in their liability-hedging assets in the last 12 months and 33% plan to further increase customization of their liability-hedging assets in the next 12 months. We see this as a key area that many plan sponsors can benefit from. It may be particularly compelling in today's environment of an inverted yield curve, as plan sponsors may want to protect themselves from the yield curve reverting to a more normal shape.

Changes in Asset Allocation – Terminating Plans



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'Last Mile' Delivery in the Final Two Years Before Termination Requires Different Tools and Methods

When a plan termination is within two years—which we call the "last mile"— this period is often the most complicated and impactful. No one wants to tell their Board the plan can be wound down for a specific contribution amount, and then a few months later the "final payoff amount" number turns out to be twice that or more. Successful completion requires three things:

1. **A strong understanding of complexities of the underlying liabilities.** Terminations are often preceded by lump sum windows, in which the duration of the liabilities can change quickly when the interest rate for lump sums is locked in, and the portfolio should be managed to avoid unintended interest rate exposures.
2. **Insight into managing the funded status with a myriad of investment tools and techniques.** This includes overlay tools to make sure the plan is not exposed to changes to the shape of the yield curve. In addition to customizing the yield curve exposures, sponsors may want to consider tactical views considering over- and underpriced areas of the fixed income market. In addition, plan sponsors need to have a thoughtful plan for when and how to exit illiquid asset positions.
3. **Experience with the review of annuity providers and the annuity provider bid process.** There's a wide range of annuity pricing plan sponsors receive, and successful Last Mile delivery requires experience with the review of annuity providers and the annuity provider bid process. Key factors influencing pricing include timing, deal size, the simplicity or complexity of the deal (including factors such as New York residents, forms of payment, and lift-out vs. termination), and mortality/demographics. Further, plan sponsors may want to consider whether to pursue an in-kind asset transition to the insurer or liquidate in cash, and the associated investment implications.

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OCIO Mandates Can Help Terminating Plan Sponsors

The report for ongoing plans outlines the growing popularity of OCIO mandates for all defined benefit plan sponsors. The value proposition for OCIO (delegation of the entire investment management strategy) is especially suitable for terminating plans, because of the multitude of strategic investment actions they need to undertake within the short period of time leading up to the plan termination.

Among survey respondents,

nearly 50%

have already delegated responsibility for their entire investment strategy.

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Aon's Predictions for Terminating Plans

While we hope this survey data is enlightening, we want to share further insights and predictions based on other sources—our understanding of the environment for plan terminations through our work with plan sponsors.

1. **Plan Termination will continue to appeal to a specific set of plan sponsors.** Many plan sponsors who have frozen or closed their pension plans will look to terminate in the next several years, to have the HR staff focus on replacement DC plans. Fewer HR and finance employees available in the marketplace with knowledge of defined benefit plans will contribute to this trend.
2. **Favorable insurer pricing will continue for plan terminations.** As high interest rates persist, and as more insurers get into the crowded pension risk transfer business, we expect to see continued favorable annuity purchase pricing for plan terminations.
3. **Customized liability-driven investment strategies will become more common**. As plan sponsors focus on minimizing risk, more will adopt some level of customization in their liability-hedging strategies.
4. **Potential for increased use of derivatives as part of investment strategy.** As plan sponsors adopt more refined and flexible investment strategies for plan termination, they will use a combination of physical bonds and derivatives such as futures and swaps to optimize their portfolio structure.
5. **OCIO mandates will continue to grow.** It will happen as plan sponsors increasingly find the benefits and costs of this approach attractive. OCIO mandates will allow for more tailored investment strategies and more favorable financial outcomes for terminating plan sponsors.
6. **More terminating plan sponsors will move their current DC plans to a Pooled Employer Plan (PEP).** After elimination of the defined benefit plan, plan sponsors will have less in-house investment expertise to rely upon. As a result, more plans will outsource their defined contribution program to a PEP.

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