



SURVIVE AND ADVANCE: THE CURRENT STATE OF CORPORATE DB PLANS

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With March Madness in full swing, college basketball programs are looking to survive and advance in the NCAA tournament. Last year, U.S. corporate defined benefit (DB) plans did their best to survive and advance in a challenging market environment.

Thanks to rising discount rates, plans not only survived, but also many increased their funded ratios year-over-year. While there was significant dispersion across individual plans, the aggregate funded ratio for our corporate DB plan peer group reached 99% at the end of 2022, up 2% for the year.

Each year publicly-traded companies are required to disclose information on their defined benefit plans as part of their 10-K reports filed with the Securities and Exchange Commission. The key measures disclosed in these filings include plan assets, liabilities, funded status, expected return on asset assumptions, discount rates, and plan allocations. The following observations are based on a review of filings from nearly 250 plan sponsors.

FULL FUNDING ON THE HORIZON

For much of the last decade, the aggregate funded ratio for our corporate DB plan peer group was well below 100%. The combination of strong returns from equities in 2021 and rising discount rates in 2022 pushed the aggregate funded ratio to 99% as of December 31, 2022, up from 97.4% as of December 2021, and 89.2% as of December 2020. The increase in funded ratio in 2022 was driven largely by higher discount rates as plan assets declined 25% while liabilities were down 27%¹.

YOUR MILEAGE MAY VARY

While the aggregate funded ratio was up in 2022, there was significant dispersion at the sector and at the individual plan levels. Among our database of 241 companies, 32 plans, or 13%, had a decline in funded ratio of more than 5% while 57 plans, or 24%, had an increase in funded ratio of more than 5%. The remaining 152 plans, or 63%, had a change in funded ratio between -5% and 5% in 2022. Looking at individual sectors within our universe, financials had the highest average funded ratio of 111%, while the energy sector had the lowest average funded ratio of 89%.

DE-RISKING CONTINUED

The multi-year trend of de-risking continued in 2022 driven by the combination of improved funded

¹ Asset and liability changes inclusive of market impact, benefit payments, risk transfer activity.

status and higher discount rates. Within our database of companies, the average allocation to fixed income was 53% at year end, up from 51% a year earlier, and 47% as of the end of 2018. We expect this trend to continue, particularly if funded ratio levels and discount rates remain elevated.

THE END OF LOW-RETURN EXPECTATIONS IS NOW

Given the significant rise in interest rates last year, along with declining equities, we expected plan sponsors, on average, would increase their assumptions for expected return on assets (EROA). Within our peer group, that outcome failed to materialize as we saw yet another year of declining EROA assumptions. The average EROA assumption declined 20 basis points last year and fell 100 basis points over the last five years. Similar to funded ratio outcomes, there was a wide dispersion at the plan level. Of the plans in our database, 21% increased their EROA assumption last year, while 44% lowered their EROA assumption (the remaining 35% of plans left their EROA assumption unchanged year-over-year). We expect EROA assumptions to increase in 2023, driven primarily by higher starting interest rates. In some filings, plan sponsors have already noted their intention to increase their EROA assumption this year.

LOOKING AHEAD

With many plans approaching or above full funding, we recommend clients increase interest rate hedge ratios to protect funded levels. Additionally, we suggest that clients review exposures across the yield curve for both liabilities and hedging portfolios, evaluate their contribution policies, and review their overall risk tolerance.

We welcome the opportunity to discuss these topics in greater detail. We are also happy to provide you with a custom Corporate Pension Peer Report, which shows your plan's metrics relative to sector peers and our broader peer database. To learn more, please contact your NEPC consultant.

IMPORTANT DISCLOSURES

Past performance is no guarantee of future results.

All investments carry some level of risk. Diversification and other asset allocation techniques do not ensure profit or protect against losses.

This memo should not be considered customized investment advice. Please contact NEPC for advice specific to your investment program.

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