April 29, 2019 Pionline.com CRAIN

Pensions&Investments

THE INTERNATIONAL NEWSPAPER OF MONEY MANAGEMENT

NO END IN SIGHT: Royce Kosoff thinks the economic landscape is good for defined benefit risk transfer activity, and he doesn't see it slowing anytime soon.

SPECIAL REPORT: CORPORATE BALANCE SHEET

Defined benefit funding rises even as returns turn negative

Rise in the discount rate offsets late-year market plunge for corporate plans

By TRILBE WYNNE

MORE ON PENSION FUNDING

- Higher rates trim liabilities, could hurt expenses: **Page 12.**
- For more corporate balance sheet data with charts and graphs, go to **pionline.com/balance2019**

A higher average discount rate lowered liabilities for the 100 largest U.S. corporate defined benefit plans in 2018, but that funding advantage was mostly offset by negative returns for plans with a reporting date of Dec. 31, *Pensions & Investments*' annual analysis of Securities and Exchange Commission filings shows.

The average discount rate used by the plans in *P&I*'s universe rose to 4.25% in 2018, up 57 basis points from one year earlier, contributing to an aggregate $117.3 billion drop in pension liabilities.

However, only three of the 86 plans with a reporting date of Dec. 31 showed a positive return in 2018. The average return on plan assets for the 100 largest plans plummeted to -3.53% from 12.27% one year earlier, while the average return for plans with a reporting date of Dec. 31 was -4.6%. The aggregate fair value of assets dropped 6.5% to $1.164 trillion in 2018 from the previous year's $1.245 trillion.

In contrast, all 100 of the plans in *P&I*'s universe reported a positive return in 2017 and 87 plans had double-digit returns for the year. In 2016, 97 plans had positive returns and the average return on assets was 6.5%.

Overall, the average funding ratio for the 100 plans rose 90 basis points to 90.1% and the aggregate funding deficit fell $36.2 billion to $171.5 billion in 2018, achieving the highest funding ratio and lowest asset-liability deficit since 2013.

"We're in a period where we're going to see a broad spectrum of actions from plan sponsors," said Royce Kosoff, managing director, retirement, at Willis Towers Watson PLC in Philadelphia.

Mr. Kosoff said risk management strategies, particularly risk transfer transactions, were a continuing trend. "As the economics tend to work for both the plan sponsor and the insurance company, we expect pension risk transfer to be vibrant well into 2019," he said.

Mr. Kosoff pointed to Lockheed Martin's December buyout and buy-in as an innovative risk management transaction by a large plan sponsor.

To reduce risk in its U.S. plans, Lockheed Martin Corp., Bethesda, Md., in December purchased a $1.82 billion group annuity contract from Prudential Insurance Co. of America that transferred the obligations for about 32,000 U.S. retirees and beneficiaries, while also purchasing an $810 million group annuity buy-in contract from Athene Annuity and Life Co., which will reimburse Lockheed Martin for future benefit payments the plan will make to about 9,000 U.S. retirees and beneficiaries.

Lockheed Martin also contributed $5 billion to its qualified plans in 2018. Its funded status jumped 5.9 percentage points to 73.9% as assets fell to $32 billion from $33.1 billion and liabilities dropped to $43.3 billion from $48.7 billion.

Memphis, Tenn.-based FedEx Corp. made the largest risk transfer transaction in *P&I*'s 2018 universe, purchasing a group annuity contract from Metropolitan Life Insurance Co. in May that transferred about $6 billion in obligations for about 41,000 U.S. retirees and beneficiaries.

With a $2.55 billion contribution by FedEx to its U.S. plans, the funded status increased 7.9 percentage points to 97.4%, assets decreased $2.87 billion to $22.06 billion, and liabilities dropped $5.22 billion to $22.65 billion as of May 31, 2018.

In December, Bristol-Myers Squibb Co., New York, announced plans to fully terminate its $3.6 billion principal U.S. plan through a combination of lump-sum payments to eligible participants and a group annuity agreement with Athene. The transaction is expected to close in the third quarter, according to the company's 10-K.

Bristol-Myers Squibb's defined benefit plans were 102.7% funded as of Dec. 31, with $6.13 billion in assets and $5.97 billion in liabilities.

Fixed income grows

Mr. Kosoff said liability-driven investing is another important risk management trend, as plan sponsors continue to review asset allocation and may further commit to liability-matched fixed-income

glidepaths as a hedge against interest-rate driven funding volatility. The aggregate allocation to fixed income in 2018 increased 5 percentage points to 46.2%. From 2014 through 2017, the aggregate fixed-income allocation hovered just above 41%. Fifty-six plans in *P&I*'s universe allocated more than 40% of plan assets to fixed income in 2018, up from 36 companies in 2017.

As interest-rate volatility continues to impact liabilities, "the best plan is to stay true to the glidepath," said Michael Moran, a New York-based pension strategist at Goldman Sachs Asset Management.

"It was a tough year from a returns perspective" and underfunded plans need to generate returns by taking advantage of growth asset classes while also hedging their liabilities, he said.

Mr. Moran, who annually tracks the funded status of all of the U.S. plans in the S&P 500, said the plans' failure to shift asset allocation to a liability-matched fixed-income glidepath means many corporate defined benefit plan sponsors have missed opportunities to consolidate gains in funded status and hedge against the impact of future rate changes.

As an example, Mr. Moran said the S&P 500 plans he tracks were funded at an aggregate 108% at the end of 2007 and made contributions that exceeded new benefit accruals during the following decade, but the funded status at the end of 2017 dropped to an aggregate 86%.

"Some just aren't going to derisk, for whatever reason. Others want to but either aren't set up to do it when those opportunities arise, or aren't set up to move quickly when funded status has improved. And we certainly hear that from clients. 'We're just not set up to be quick, to be nimble.' But if we don't take advantage of the funded status, we pay for benefits twice," Mr. Moran said.

He said a mismatched asset-liability mix meant these sponsors made contributions of $474 billion during the decade between the end of fiscal year 2007 and 2017, although there were only $267 billion in new benefit accruals during the period.

Capturing opportunities

Mr. Moran said efficient glidepath strategies, such as automatic triggers based on the plan's investment policy statement or partnering with an outsourced chief investment officer, could help sponsors make asset allocation shifts and consolidate funded status gains more proactively when opportunities arise.

"Especially for plans that are closed and frozen, we often talk about this as a risk management exercise as opposed to an investment exercise," Mr. Moran said.

The Bloomberg Barclays U.S. Aggregate Bond index returned zero for the one-year period ended Dec. 31; the Bloomberg Barclays Global Aggregate ex-U.S. Bond index returned -1.2%; the Bloomberg Barclays U.S. Long-Government Bond index, -1.8%; and the Bloomberg Barclays U.S. Long-Duration Corporate Bond index had a one-year return of -7.2% in 2018.

The aggregate allocation to equities dropped to 30.2% from 33.3% in 2017. The equity allocation in *P&I*'s universe has trended downward since 2014, when the aggregate allocation was 35.8%.

The S&P 500 index had a one-year return of -4.4%, the Russell 3000 index returned -5.2%, and the MSCI World ex-U.S. index returned -14.1% in 2018.

The aggregate allocation to alternatives rose to 17.9% in 2018 from 16.5% one year earlier. In alternatives, the private equity allocation increased to 5.8% from 4.9%, hedge funds rose slightly to 3.9% from 3.8%, and real estate jumped to 4.4% in 2018 from 3.7%.

The allocation to cash fell to 3% from 4.2% in 2017, while 2.7% of assets were allocated to other investments in 2018.

The average long-term assumed rate of return on plan assets continued its steady decline in 2018. The average fell to 7% from 7.13% in 2017. The average expected return was 7.94% in 2011.

Positive return

Seattle-based Weyerhaeuser Co.'s 2.5% return on assets was the highest among plans with a reporting date of Dec. 31. Weyerhaeuser allocated 58.6% of its portfolio to alternatives, with 36.7% in hedge funds and 21.9% in private equity. The fixed-income allocation was 30%, 5.8% was in cash and 5.6% was allocated to other investments.

"As of the end of 2018, we have begun to shift pension plan assets to an allocation that will more closely match the pension plan liability profile going forward," Weyerhaeuser's 10-K said. The plan's hedge funds, private equity funds, derivative and other investments will be redeemed or liquidated before being reinvested according a revised investment strategy of 60% growth assets and 40% liability-hedging assets, according to the 10-K. "Growth assets include new investments in global equities, hedge funds, which are generally in redemption, and private equity assets, which are generally in run-off mode. Liability-hedging assets include corporate credit and government-issued fixed-income securities, Treasury futures and interest rate swaps selected to align with the plan liabilities," the 10-K said.

Weyerhaeuser contributed $345 million to its U.S. qualified plans in 2018, made lump-sum payments totaling $664 million in the fourth quarter to eligible terminated vested U.S. plan participants, and purchased a group annuity contract from Athene in January, which transfers about $1.5 billion of U.S. pension obligations. Weyerhaeuser's funding ratio surged 12.5 percentage points to 93.7% at the end of 2018, with $4.93 billion in plan assets and $5.26 billion in liabilities, down from $5.51 billion in assets and $6.79 billion in liabilities at the end of 2017.

AT&T rises

Dallas-based AT&T Inc.'s 16.5- percentage-point leap to a 93.2% funding ratio and its $9.3 billion contribution were the largest contribution and funded status increases in 2018. Plan assets rose $6.22 billion to $51.68 billion, while liabilities fell $3.85 billion to $55.44 billion.

AT&T acquired Time Warner Inc. in June, along with an asset-liability deficit from Time Warner's defined benefit plans.

AT&T was one of 11 plans that made contributions of $1 billion or more in 2018, down from 14 plans in 2017. Aggregate contributions by the plans in *P&I*'s universe decreased modestly to $51.2 billion from the previous year's aggregate $52.5 billion. (The aggregate figure includes global contributions when U.S.-only contributions were not available.) So far, the plans in *P&I*'s universe have announced expected contributions of $13.8 billion for 2019. United Parcel Service Inc. and Exxon Mobil Corp. each expect to make contributions of more than $1 billion, according to their annual filings.

A 7.1-percentage-point drop to 85.1% funding for The Allstate Corp., Northbrook, Ill., was the largest decrease in funded status last year. The plans had $5.3 billion in assets and $6.22 billion in liabilities at the end of 2018.

NextEra Energy Inc., Juno Beach, Fla., saw its funding ratio fall 4.1 percentage points to 150.9%, but it still had the highest funding ratio on *P&I*'s list for the 14th consecutive year. Assets decreased $214 million to $3.81 billion and liabilities decreased $71 million to $2.52 billion in 2018.

Irving, Texas-based Exxon Mobil's 61.3% funding ratio was the lowest on *P&I*'s list, with a $1.65 billion drop to $11.13 billion in assets and a $1.14 billion drop to $18.17 billion in liabilities. Exxon contributed $491 million in 2018 and announced expected contributions of $1.02 billion to its U.S. pension plans in 2019. Its pension plans returned -6.4% in 2018. ■

Pensions&Investments

The funded status of corporate pension funds

The largest corporate pension plans ranked by funding ratio — plan assets as a percentage of projected benefit obligation — as of Dec. 31, unless otherwise noted. Dollars are in millions.

Rank	Plan sponsor	Fair value of plan assets	Benefit obligation	Funded status	Funding ratio	Expected long-term rate of return
1	**NextEra Energy**	$3,806	$2,522	$1,284	**150.9%**	7.35%
2	**Bank of America**	$18,178	$14,144	$4,034	**128.5%**	6.00%
3	**BB&T**	$5,968	$4,697	$1,271	**127.1%**	7.00%
4	**BNY Mellon**	$5,040	$4,123	$917	**122.2%**	6.63%
5	**SunTrust Banks**	$2,885	$2,468	$417	**116.9%**	5.90%
6	**J.P. Morgan Chase**	$18,052	$15,512	$2,540	**116.4%**	5.50%
7	**PNC Financial Services Group**	$4,963	$4,355	$608	**114.0%**	6.00%
8	**Travelers Cos.**	$3,771	$3,444	$327	**109.5%**	7.00%
9	**Emerson Electric**[1]	$4,233	$3,957	$276	**107.0%**	7.50%
10	**Honeywell International**	$17,109	$16,141	$968	**106.0%**	7.75%
11	**Duke Energy**	$8,233	$7,869	$364	**104.6%**	6.50%
12	**Deere**[2]	$12,602	$12,108	$494	**104.1%**	5.70%
13	**WestRock**[1]	$3,921	$3,784	$138	**103.6%**	6.50%
14	**Bristol-Myers Squibb**	$6,129	$5,966	$163	**102.7%**	6.20%
15	**Eastman Kodak**	$3,445	$3,405	$40	**101.2%**	6.40%
16	**IBM**	$48,213	$47,812	$401	**100.8%**	5.25%
17	**Macy's**[3]	$3,018	$3,011	$7	**100.2%**	6.75%
18	**Target**[3]	$3,925	$3,928	-$3	**99.9%**	6.30%
19	**Conagra Brands**[4]	$3,355	$3,424	-$69	**98.0%**	7.50%
20	**American Electric Power**	$4,696	$4,810	-$114	**97.6%**	6.00%
21	**FedEx**[5]	$22,057	$22,653	-$596	**97.4%**	6.50%
22	**Prudential Financial**	$12,807	$13,185	-$378	**97.1%**	6.25%
23	**CVS Health**	$5,663	$5,841	-$178	**97.0%**	6.60%
24	**Charter Communications**	$2,943	$3,041	-$98	**96.8%**	5.75%
25	**General Mills**[6]	$6,177	$6,416	-$239	**96.3%**	7.88%
26	**Ford Motor**	$39,774	$42,269	-$2,495	**94.1%**	6.75%
27	**Abbott Laboratories**	$8,553	$9,093	-$540	**94.1%**	7.70%
28	**Goodyear Tire & Rubber**	$4,445	$4,734	-$289	**93.9%**	4.58%
29	**Weyerhaeuser**	$4,930	$5,263	-$333	**93.7%**	8.00%
30	**Wells Fargo**	$9,477	$10,129	-$652	**93.6%**	6.24%
31	**United Technologies**	$35,253	$37,795	-$2,542	**93.3%**	6.80%
32	**AT&T**	$51,681	$55,439	-$3,758	**93.2%**	7.00%
33	**Consolidated Edison Co. of New York**	$13,450	$14,449	-$999	**93.1%**	7.50%
34	**Union Pacific**	$3,887	$4,181	-$294	**93.0%**	7.00%
35	**3M**	$14,803	$15,948	-$1,145	**92.8%**	7.25%
36	**Coca-Cola**	$7,409	$8,004	-$595	**92.6%**	8.00%
37	**Altria Group**	$7,138	$7,726	-$588	**92.4%**	7.80%
38	**General Motors**	$56,102	$61,190	-$5,088	**91.7%**	6.61%
39	**Kellogg**	$4,677	$5,117	-$440	**91.4%**	7.40%
40	**Southern California Edison**	$3,124	$3,431	-$307	**91.1%**	6.50%
41	**Verizon Communications**	$17,816	$19,567	-$1,751	**91.1%**	7.00%
42	**Southern Co.**	$11,611	$12,763	-$1,152	**91.0%**	7.95%
43	**Rockwell Collins**[1]	$3,552	$3,908	-$356	**90.9%**	8.00%
44	**Merck**	$9,648	$10,620	-$972	**90.8%**	8.20%
45	**Citigroup**	$11,490	$12,655	-$1,165	**90.8%**	6.70%
46	**Sysco**[7]	$3,666	$4,043	-$377	**90.7%**	7.00%
47	**Textron**	$7,122	$7,901	-$779	**90.1%**	7.58%
48	**Chubb**	$2,784	$3,092	-$308	**90.0%**	7.00%
49	**HP**[8]	$10,018	$11,167	-$1,149	**89.7%**	6.90%
50	**U.S. Bancorp**	$4,936	$5,507	-$571	**89.6%**	7.25%
51	**PepsiCo**	$12,258	$13,807	-$1,549	**88.8%**	7.20%
52	**Harris**[9]	$5,098	$5,774	-$676	**88.3%**	7.66%
53	**United States Steel**	$4,960	$5,626	-$666	**88.2%**	6.85%
54	**PG&E**	$15,312	$17,407	-$2,095	**88.0%**	6.00%
55	**Huntington Ingalls Industries**	$5,726	$6,519	-$793	**87.8%**	7.25%
56	**Walt Disney**[10]	$12,728	$14,500	-$1,772	**87.8%**	7.50%
57	**Schlumberger**	$3,748	$4,278	-$530	**87.6%**	7.25%
58	**Cigna**	$4,151	$4,741	-$590	**87.6%**	7.00%
59	**Ameren**	$3,899	$4,459	-$560	**87.4%**	7.00%
60	**United Parcel Service**	$39,554	$45,333	-$5,779	**87.3%**	7.75%
61	**CenturyLink**	$10,033	$11,594	-$1,561	**86.5%**	6.50%
62	**Public Service Enterprise Grp.**	$5,120	$5,921	-$801	**86.5%**	7.80%
63	**Pfizer**	$13,051	$15,141	-$2,090	**86.2%**	7.50%
64	**Pinnacle West Capital**	$2,733	$3,191	-$457	**85.7%**	6.05%
65	**Allstate**	$5,299	$6,224	-$925	**85.1%**	7.32%
66	**Baxter International**	$4,769	$5,623	-$854	**84.8%**	6.25%
67	**Johnson & Johnson**	$26,818	$31,670	-$4,852	**84.7%**	8.46%
68	**Dominion Energy**	$7,197	$8,500	-$1,303	**84.7%**	8.75%
69	**MetLife**	$8,948	$10,591	-$1,643	**84.5%**	5.75%
70	**Eaton**	$3,068	$3,633	-$565	**84.4%**	7.52%
71	**American International Group**	$3,840	$4,553	-$713	**84.3%**	6.75%
72	**Northrop Grumman**	$27,150	$32,231	-$5,081	**84.2%**	8.00%
73	**Hartford Financial Services Group**	$3,344	$4,000	-$656	**83.6%**	6.60%
74	**International Paper**	$8,735	$10,467	-$1,732	**83.5%**	7.50%
75	**DTE Energy**	$4,273	$5,124	-$851	**83.4%**	7.50%
76	**Medtronic**[11]	$2,661	$3,202	-$541	**83.1%**	7.90%
77	**Eversource Energy**	$4,574	$5,520	-$946	**82.9%**	8.25%
78	**Eli Lilly**	$11,064	$13,662	-$2,598	**81.0%**	7.30%
79	**Exelon**	$16,678	$20,692	-$4,014	**80.6%**	7.00%
80	**PPL**	$3,109	$3,883	-$774	**80.1%**	7.25%
81	**Caterpillar**	$12,697	$15,953	-$3,256	**79.6%**	6.30%
82	**Xcel Energy**	$2,742	$3,477	-$735	**78.9%**	6.87%
83	**Boeing**	$56,102	$71,424	-$15,322	**78.5%**	6.80%
84	**DowDuPont**	$41,462	$53,014	-$11,552	**78.2%**	7.08%
85	**Alcoa**	$4,610	$5,997	-$1,387	**76.9%**	6.89%
86	**Raytheon**	$19,321	$25,456	-$6,135	**75.9%**	7.38%
87	**Motorola Solutions**	$3,673	$4,864	-$1,191	**75.5%**	6.95%
88	**Entergy**	$5,497	$7,405	-$1,908	**74.2%**	7.50%
89	**Lockheed Martin**	$32,002	$43,305	-$11,303	**73.9%**	7.00%
90	**FirstEnergy**	$6,984	$9,462	-$2,478	**73.8%**	7.50%
91	**Marsh & McLennan**	$4,062	$5,529	-$1,467	**73.5%**	5.83%
92	**General Dynamics**	$11,532	$15,720	-$4,188	**73.4%**	7.45%
93	**General Electric**	$50,009	$68,500	-$18,491	**73.0%**	6.75%
94	**Chevron**	$8,532	$11,726	-$3,194	**72.8%**	6.80%
95	**United Continental Holdings**	$3,827	$5,396	-$1,569	**70.9%**	7.31%
96	**Unisys**	$3,113	$4,558	-$1,445	**68.3%**	6.80%
97	**Delta Air Lines**	$13,459	$19,809	-$6,350	**67.9%**	8.97%
98	**Arconic**	$4,334	$6,476	-$2,142	**66.9%**	7.00%
99	**American Airlines Group**	$10,053	$16,378	-$6,325	**61.4%**	8.00%
100	**Exxon Mobil**	$11,134	$18,174	-$7,040	**61.3%**	6.00%
	Totals/averages	**$1,163,580**	**$1,335,095**	**-$171,515**	**87.2%**	**7.00%**

Notes: **1** As of Sept. 30, 2018; **2** As of Oct. 28, 2018; **3** As of Feb. 2, 2019; **4** As of July 27, 2018; As of May 31, 2018; **6** As of May 27, 2018; **7** As of June 30, 2018; **8** As of Oct. 31, 2018; **9** As of June 29, 2018; **10** As of Sept. 29, 2018; **11** As of April 27, 2018.

Source: Company reports

Reprinted with permission from *Pensions & Investments*. © 2019 Crain Communications Inc. All Rights reserved.
Further duplication without permission is prohibited. Visit www.pionline.com. PI5999