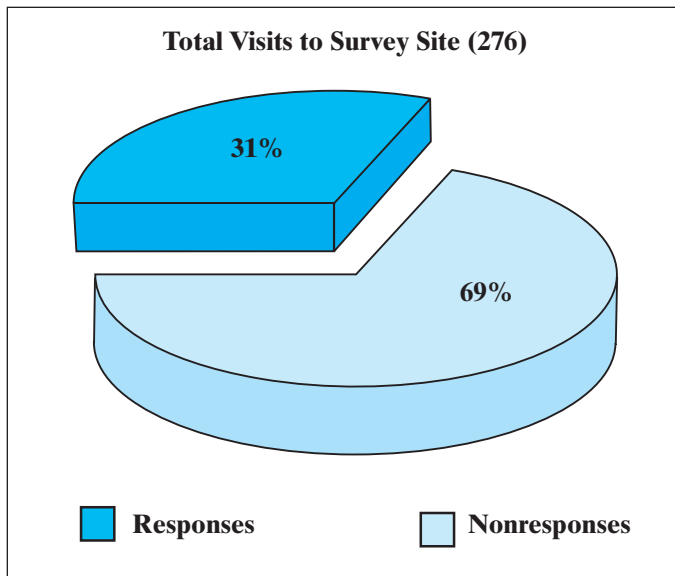


# What's Happening With Defined Benefit Plans?

by Dawn Bizzell, CEBS

The International Society was interested in knowing how employers may have changed or are considering changing their defined benefit (DB) plans in today's economic and regulatory environment. A 2004 survey by Deloitte Consulting LLP found that 25% of DB plan sponsors were considering changing their plan design (up from 21% in 2003).<sup>1</sup>

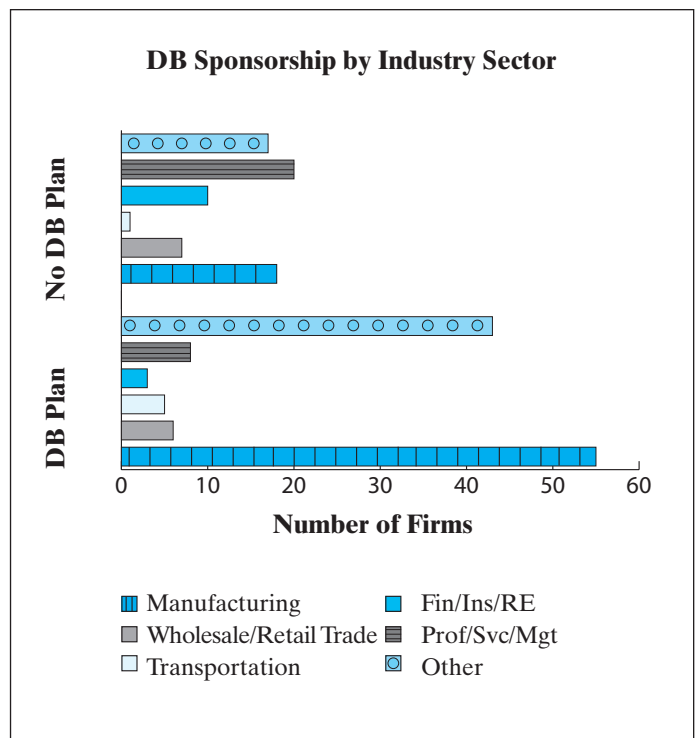
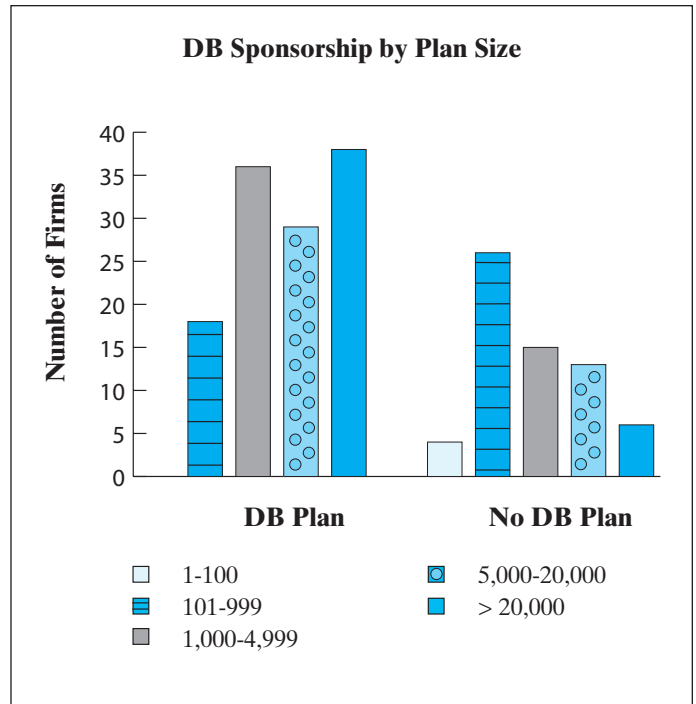
In June, e-mail surveys were sent to 805 Society members identified as plan sponsors; the site had 276 visits and 188 surveys were completed (24% of those invited to participate).<sup>2</sup>



From the responses, 121 represent firms that sponsor defined benefit plans. Overall, the results indicate that current Society member firms that sponsor DB plans have more than 5,000 employees and are primarily found in the manufacturing sector. Of those members that indicated they *previously* sponsored a DB plan (10), the majority were midsize firms (101-4,999 employees) with more than half coming from the services sector and *all* having terminated their plans more than two years ago.

This is consistent with other data on the DB universe that reports the prevalence of DB plans in the mature, larger-employer manufacturing sector and the decline of DB plans in the small and midsize employer firms found in the services sector.<sup>3</sup>

The Society survey asked two sets of questions with regard to changes in plan design—specifically whether the plan had converted to a “cash balance” plan formula and whether the plan had been “frozen.”



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## Defined Benefit Plans

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### Cash Balance Conversions

In this survey, 20% of the plan sponsors indicated that their plans had been converted to a cash balance design (24/121). The Employee Benefit Research Institute (EBRI) reported that in 2003, 23% of DB plans were “hybrid” plans (defined as those offering *only* a lump-sum distribution).<sup>4</sup>

More than half (15) of the firms indicated that the conversion took place more than two years ago. Demographically, almost three-quarters of the conversions occurred in the larger-employer size (+5,000 employees) and half were in the manufacturing sector.

In addition to converting their plans, eight of these firms had also frozen their plans. Two-thirds of these firms (6) indicated that the freeze took place during the same time period as indicated for the benefit formula conversion. This pattern is typically for firms that are “completely” switching to the cash balance formula for future benefit accruals.

Of the remaining two respondents, both indicated that the plan conversion occurred more than two years ago while the plan freeze occurred within the last 12 months. This pattern could indicate the gradual decline of the firm and or the DB plan—or, perhaps the cash savings anticipated from the conversion were not actually realized. For these two plan sponsors, one indicated that the freeze was the result of deteriorating business conditions and the other as an alternative to plan termination.

One respondent is currently working on a plan formula conversion. It is a large manufacturing firm that also froze its plan within the last two years. The reason given for the freeze was that it was necessary to remain competitive.

### Plan Freezes

Twenty-one percent of current plan sponsors indicated that their plans had been frozen (25/121). A 2002 Aon Consulting survey found that since January 2001, 15% of DB plan sponsors had frozen their plans (either for new entrants only or for all future accruals).<sup>5</sup> The Deloitte Consulting LLP survey found that 8% of DB plan sponsors had frozen benefit accruals (down from 12% in 2003).<sup>6</sup>

Almost half (11) of the firms indicated that the freeze took place within the last 12 months. Similar to plan conversions, demographically almost two-thirds of the freezes occurred in the larger-employer size (+5,000 employees) and half were in the manufacturing sector. The two primary reasons given for plan freeze were necessity to remain competitive (44%), and alternative to plan termination (33%).

In addition to these firms, eight respondents indicated they were considering plan freezes within the next 24 months. One is currently working on them (necessity to remain competitive), one is very likely to consider them (alternative to plan termination) and six are likely to consider them (three as a necessity to remain competitive, two due to changing workforce and one as a result of deteriorating business conditions).

## Plan Asset Allocation and Portfolio Management

On another topic, the Society survey asked questions regarding the asset allocation and portfolio management of the pension plan.

On average, firms in the survey allocated 58% to equities, 33% to fixed income and 14% to other types of assets, with a majority of these assets held in domestic investment vehicles.<sup>7</sup> A 2004 *Pensions & Investments* survey found that, on average, the top 1,000 corporate DB funds held 68% in equities, 28% in fixed income and 3% in other types of assets, with 72% in domestic instruments.<sup>8</sup> (The table below gives the minimum, maximum and median values from the ISCEBS survey.)

### ASSET ALLOCATION

	Equities	Fixed Income	Other	Domestic	Foreign
<b>ISCEBS Survey</b>					
Average	58%	33%	14%	86%	16%
<b>P&amp;I Survey</b>					
Average	68%	28%	3%	72%	28%
<b>ISCEBS Survey</b>					
Minimum	20%	10%	10%	50%	10%
Maximum	90%	70%	60%	100%	50%
Median	60%	30%	10%	90%	10%

Of the respondents, more than half indicated that the plan’s investment policy was set by the board of directors or senior management, and 65% of the plan sponsors indicated that the policy was reviewed at least annually (23% semi-annually and 42% annually).

### Final Thoughts

It is difficult, from a purely statistical context, to draw significant conclusions from this survey. However, the trends observed in other larger surveys provide some “validation” for the results reported. Given the prevalence of DB plans in the mature larger-employer manufacturing sector, it is not surprising that a majority of the reported cash balance conversions and the plan freezes occurred in this sector. So, it is safe to say that Society members who sponsor DB plans are representative of the broader DB plan sponsor universe.

If I had a crystal ball, what results would I expect from a similar survey in 2005? 2010? Plans sponsors will continue to “tweak” their benefit packages—including their pension plans. You’re likely to see a steady increase in plan formula conversions—this may take the form of a cash bal-

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## Defined Benefit Plans

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ance design or some other hybrid-type design. If the economy sustains itself, plan freezes would be expected to fall off; however, this could be offset by other cyclical or industry-specific factors.

In the area of asset allocation and portfolio management, it is interesting to note the span of responses from the survey. For example, from 98 plans, equity holdings ranged from 20% to 90% (the minimum and maximum values). In the future, this area may receive more attention as plan sponsors look for ways to reduce costs through either maximizing returns (given the current pension accounting rules under FASB) or duration matching of assets and liabilities—even if on a limited basis. As the DB population ages, assets under this scenario would shift from equities to fixed income vehicles. It remains to be seen whether equity returns revert to their double-digit level of the 1990s, whether FASB comes out with new pension accounting rules, or whether board of directors and senior-level executives became as familiar with pension liabilities as they are with pension assets.

What will Congress do? Will 2005 be the year of pension reform? Well, there's a crystal ball I'd love to have!

**Note:** Complete survey results are on the Society Web site at [www.iscebs.org](http://www.iscebs.org).

## Endnotes

1. Deloitte Consulting LLP, "Pension Crisis Survey 2004" *Human Capital I.Q.*, Volume 50 April 2004.
2. Reported survey results do not include inconsistent response(s). Where significant, the unused responses will be noted.
3. Department of Labor, Employee Benefit Security Administration, Form 5500 Tabulations (2004); Pension Benefit Guaranty Corporation, Pension Insurance Data Book (2004).
4. Employee Benefit Research Institute (2004).
5. Aon Consulting (2002).
6. Deloitte Consulting LLP (2004).
7. 19% of the responses were not included (23) because they were blank or did not total 100% for the allocation of assets (26% of the responses were not included for the domestic/foreign component).
8. "The P&I 1,000," *Pensions & Investments*, January 26, 2004. ■



Dawn Bizzell, CEBS

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*Author's note: The views expressed in this paper are my own and do not necessarily represent the views of the PBGC or the administration.*

# Survey Questions

- 1. Does your company offer a Defined Benefit Plan?**  
(If your company offers more than one Defined Benefit Plan,  
please answer the questions based on the largest plan.)

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Yes	64%
No	36%
<b>Total</b>	<b>100%</b>

- 2. Have you converted this plan to a Cash Balance design?**

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Yes	20%
No	80%
<b>Total</b>	<b>100%</b>

- 3. When did you convert this plan?**

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Within the last 12 months	24%
Within the last 2 years	12%
More than 2 years ago	64%
<b>Total</b>	<b>100%</b>

- 4. How likely are you to convert to a Cash Balance Plan within the next 24 months?**

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Working on it now	1%
Very likely	0%
Likely	0%
Not very likely	41%
Not being considered	58%
<b>Total</b>	<b>100%</b>

- 5. Did you “freeze” this Defined Benefit Plan?**  
(i.e., no new entrants, no future accruals)

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Yes	22%
No	78%
<b>Total</b>	<b>100%</b>

- 6. When did you freeze this plan?**

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Within the last 12 months	41%
Within the last 2 years	19%
More than 2 years ago	41%
<b>Total</b>	<b>100%</b>

- 7. How likely are you to freeze this Defined Benefit Plan within the next 24 months?**

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Working on it now	1%
Very likely	1%
Likely	6%
Not very likely	47%
Not being considered	45%
<b>Total</b>	<b>100%</b>

**8. What was the PRIMARY reason for considering (or implementing) a plan freeze?**

Deteriorating business conditions	12%
Necessity to remain competitive	44%
Changing workforce	18%
Alternative to plan termination	26%
<b>Total</b>	<b>100%</b>

**9. Asset Allocation (Equities, Bonds and Other Holdings)**

Equities in Percentage	Responses in Percent	Bonds in Percentage	Responses in Percent	Other Holdings in Percentage	Responses in Percent
10%	0%	10%	3%	10%	70%
20%	2%	20%	24%	20%	22%
30%	7%	30%	30%	30%	3%
40%	9%	40%	32%	40%	4%
50%	12%	50%	8%	50%	0%
60%	42%	60%	2%	60%	1%
70%	21%	70%	1%	70%	0%
80%	6%	80%	0%	80%	0%
90%	2%	90%	0%	90%	0%
100%	0%	100%	0%	100%	0%
<b>Total</b>	<b>100%</b>	<b>Total</b>	<b>100%</b>	<b>Total</b>	<b>100%</b>

**10. Asset Allocation (Domestic and Foreign)**

Domestic in Percentage	Responses in Percent	Foreign in Percentage	Responses in Percent
10%	1%	10%	61%
20%	0%	20%	21%
30%	0%	30%	15%
40%	0%	40%	1%
50%	4%	50%	1%
60%	1%	60%	0%
70%	13%	70%	0%
80%	19%	80%	0%
90%	47%	90%	0%
100%	16%	100%	0%
<b>Total</b>	<b>100%</b>	<b>Total</b>	<b>100%</b>

**11. Who sets the Investment Policy for the pension fund?**

Board of directors	21%
Senior management	36%
HR department staff	1%
Other	42%
<b>Total</b>	<b>100%</b>

**12. How often is the Investment Policy reviewed?**

Semiannual	23%
Annual	42%
Every 2 to 3 years	12%
As needed	23%
Never	0%
<b>Total</b>	<b>100%</b>

**13. Did your company previously offer a Defined Benefit Plan?**

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Yes	20%
No	80%
<b>Total</b>	<b>100%</b>

**14. When was the plan terminated?**

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Within the last 12 months	0%
Within the last 2 years	0%
More than 2 years ago	100%
<b>Total</b>	<b>100%</b>

**Demographics**

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**15. Employer Size**

One to 100 employees	2%
101 to 999 employees	23%
1,000 to 4,999 employees	29%
5,000 to 20,000 employees	22%
Over 20,000 employees	23%
<b>Total</b>	<b>100%</b>

**16. How many years have you been in the employee benefits industry?**

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Less than 5 years	1%
6-10 years	10%
11-20 years	46%
More than 20 years	44%
<b>Total</b>	<b>100%</b>

**17. In what type of industry does your employer primarily operate?**

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Manufacturing	39%
Wholesale/retail trade	7%
Transportation	3%
Finance/insurance/real estate	6%
Professional/management/services	13%
Other	31%
<b>Total</b>	<b>100%</b>