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CORPORATE PENSIONS

Shifting to a mindset of surplus

BlackRock.

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A long trip before a new journey

Following the passage of the Employee Retirement Income Security Act (ERISA) in 1974, defined benefit (DB) corporate pensions have been on a long journey to meet the promises made to employees. Corporations have had to navigate significant market complexity – the Dot Com Bubble, Global Financial Crisis, COVID Pandemic, and decades of persistently low interest rates and increasing costs (e.g., Pension Benefit Guaranty Corporation (PBGC) premia) – which progressively made DB plans less attractive.

Sponsors have been closing and freezing their DB plans (reducing or eliminating benefit accruals) at a steady rate over the past 20 years, and many struggled to reach "full funding" where they have enough assets to meet obligations.[1]

From deficits to surpluses

Circumstances for DB plans changed in 2022 as rising rates, contributions, and asset performance drove the average US corporate DB pension plan to reach a funded level of above 100%.[2] This improvement continued in 2023, and PBO funded ratios are now at their highest level in 15 years.[3] As we discussed in our 2024 Corporate Pension Themes, this is spurring corporations to revisit their future aspirations for their DB plans in light of new market conditions, labor force preferences, and their own unique needs.

Our provocative title *"Re-open the plan"* coincided with IBM's recent decision to unfreeze the company's $25.1bn[4] overfunded DB plan and leverage its $3.6bn surplus to replace a 401(k) benefit with a defined benefit. **This is only one way to potentially use a surplus.**

Ways to use a pension surplus

The following table briefly summarizes the different ways sponsors may use a pension surplus and the potential benefit and investment implications of each:

	Benefit design and regulatory considerations	Investment implications
Reopen plan to new participants **Enhance benefits for existing participants**	• Consider benefits holistically across full range of offerings (defined contribution, healthcare, other post-retirement, etc.)	• Return hurdle to maintain strong funded ratio likely to be higher • Potential need to 're-risk' asset allocation • Consider role of private markets • Revisit Liability-Driven Investment (LDI) program and consider capital efficiency for hedging
Fund additional benefits (e.g., post-retiree medical)	• Consider benefits holistically across full range of offerings (defined contribution, healthcare, other post-retirement, etc.)	• Consider healthcare inflation trends • Reconsider portfolio and underlying investment structure • Assess contribution strategy against discount rates for the future
Pension Risk Transfer	• Determine future state goal of plan and benefits • Structure cohorts accordingly	• Reconsider portfolio pre-transfer • Strong tilt toward liquid investment grade fixed income and detailed liability risk management to help reduce transaction costs
Put surplus to work for approved corporate activities	• Assess ERISA rules on plan mergers • Identify business-relevant activities and stakeholders • Consider timeline for implementation	• Reevaluate the overall portfolio structure to prepare for future state while deliver promised benefits in line with objectives • Potential reallocation or consolidation of plan assets
Bring surplus back to the organization	• Plan needs to be partially or fully terminated • Considerations on IRS and ERISA rules regarding surplus reversion	• Liquidity considerations for reversion amount • Plan sponsors may be subject to a 50% excise tax as well as corporate taxes which can reduce the potential amount to be reverted to the plan sponsor.

[1] Milliman Insights, 10 May 2022: https://www.milliman.com/en/insight/the-way-forward-decision-starting-point
[2] BlackRock Corporate Pension Peer Risk Study, 2022:: https://www.blackrock.com/institutions/en-us/insights/investment-actions/corporate-pensions-funding-ratios
[3] Milliman 2023 Corporate Pension Funding Study (milliman.com)
[4] IBM 2022 10-K; 2024 IBM U.S. Benefits Guide

A better hedge is likely relevant on any route

These are only a handful of ways that corporate DB sponsors can consider the transition from a deficit environment to one characterized by surplus. Each decision will reflect the unique needs of a plan sponsor, but every decision merits revisiting the liability hedge. Rising funded statuses, structurally higher rates, and an inverted/flat yield curve are catalysts for most plans to reevaluate their hedge programs, preserve funded status, and we seek to introduce better risk control regardless of the path they choose.

Consider this an opportunity

A new backdrop – the highest funding levels since the Global Financial Crisis, with many plans at or approaching "fully funded" alongside structurally higher interest rates – means corporate defined benefit plan sponsors face new options to address their goals, and even consider new objectives. From improvements in liability management to benefit design and optimization, we continue to hear new questions every day, all as large corporate sponsors continue to make headlines. Working with a strategic partner can help plan sponsors understand the full implications of a pension surplus and take action, and BlackRock's deep team of professionals is here to share our insights.

Authors

Martin Jaugietis
Co-Head of Americas Pensions,
Multi-Asset Strategies & Solutions

Matthew Nili
Head of U.S. and Canada
Liability Driven Investing (LDI)

Calvin Yu
Head of the
Client Insight Unit (CIU)

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