

\$20 BILLION CLUB STRATEGY



PENSION PLAN STRATEGY THROUGH
INVESTMENT, BENEFITS, AND FUNDING POLICIES



RUSSELL INVESTMENTS RESEARCH

Contents

| | |
|--|----|
| Introduction | 2 |
| Part I: Investment policy | 3 |
| Part II: Benefits policy | 6 |
| Part III: Funding policy | 9 |
| Conclusion | 11 |
| A note on \$20 billion club membership | 12 |

\$20 billion club strategy

Pension plan strategy through investment, benefits, and funding policies

Adam Field, FSA, EA, Senior Asset Allocation Strategist

Introduction

The \$20 billion club is a group of pension plans near \$20 billion and more in global pension liability. We have been reporting on this group since 2011, pointing out how and why the funded status has changed, and we have been reporting on how these sponsors' strategies for managing risk have evolved over time.

When it comes to defined benefit (DB) plans, there are several major levers available to the plan sponsor to help successfully manage the costs, benefits, and risk of their plans. At the broadest level, we split these into three policies: investment, benefits, and funding policies. These levers are often closely intertwined and pulling one lever can lead to adjusting another. What each of these policies aims to achieve is:

- 1. Investment policy** - This lays out how the assets and contributions go to work for the sponsor
- 2. Benefits policy** - This directly impacts plan participants' benefit accruals
- 3. Funding policy** - This determines the contributions made by the sponsor to pay for those benefits

The intertwined nature of pension management can lead to wide ranges in how each of these policies is set and adapted.

The interaction of the three policies and plan specific considerations can create a broad array of reasonable outcomes. This often will leave plan sponsors looking to their peers on how their own policies have been set and viewing the trends of the \$20 billion club members is a great place to start.

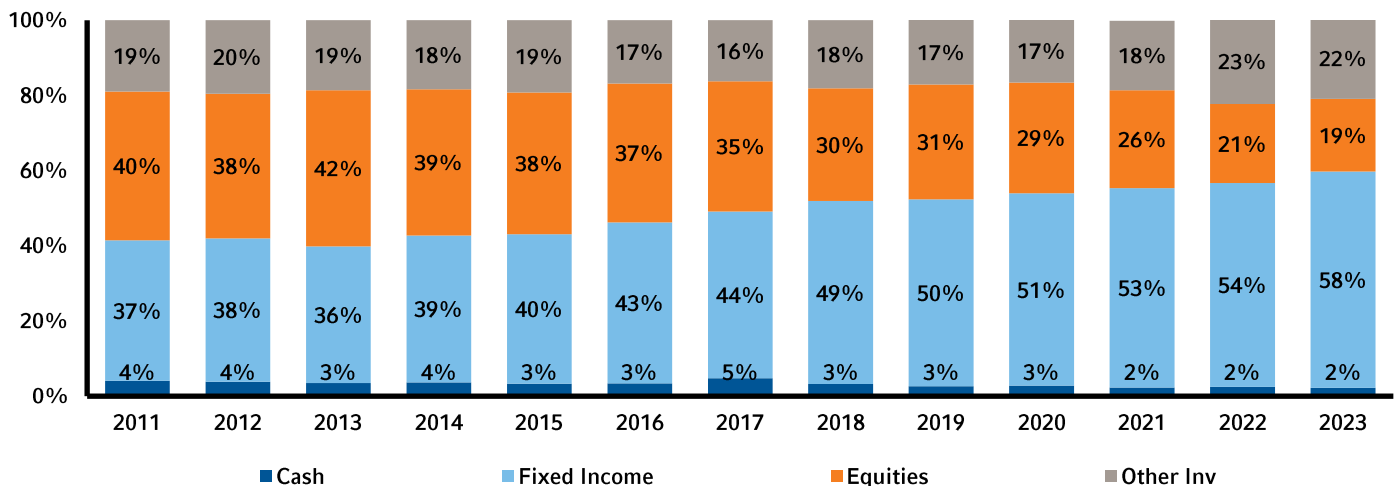
The members of the \$20 billion club represent the largest corporate DB plan sponsors in the United States—and this leaves them uniquely poised to establish trends that the rest of the industry will follow, as we have seen time and time again out of this group. These plan sponsors have access to the most sophisticated service providers and latest innovation in the space. They also tend to have large, experienced staff that focus solely on their DB plans. Therefore, gathering and reviewing what these jumbo-sized plans have been implementing and adjusting in the three major policies helps us observe the current trends and also provide insight to where the industry may be heading.

 *The members of the \$20 billion club represent the largest corporate DB plan sponsors in the United States...*

Part I: Investment policy

This section delves into the plan investment policy within the \$20 billion club and what has transpired in recent history. The investment policy is used to instruct how the plan sponsor wants its plan assets allocated and what objectives and constraints guide this decision. Since we began tracking this data in 2011, there has been an overall shift in asset allocation in the pension industry. Plan sponsors used to largely invest with a traditional asset-only focus, which has slowly evolved into an asset-liability focus. There are several important advantages for plan sponsors to invest the pension assets in this liability-centric way, not the least of which is a decreased volatility in the plan surplus (the difference between assets and liabilities). In the past we have discussed how this trend has worked its way through the \$20 billion club, and this year we have crossed an interesting milestone. In illustration of the evolution from asset-only to asset-liability investing, the mix of return-seeking versus fixed income assets has flipped from roughly 60/40 (return-seeking/fixed income) to now be 40/60. **Exhibit 1** illustrates how the average asset allocation of the club for the period 2011 to 2023 has evolved during that period.

Exhibit 1: Average actual asset allocation 2011-2023



Source: 10-k filings. Annual averages are based on the \$20 billion club membership in the given year.

Over the past decade, the average amount of fixed income assets has slowly been on the rise and equities have been on the decline. For many plans, this type of asset allocation move is the result of an increase in funded status and is pre-planned through a [glidepath](#)¹. Due to how DB plan liabilities are measured, they behave in a very similar manner to fixed income assets. By increasing the amount of fixed income held by the plan, the assets will begin to behave more like liabilities. The more the assets behave like the liabilities, the less the surplus will fluctuate. Since 2011, the average amount of fixed income assets has increased by 17%. Moving from an asset allocation of 60/40 to 45/55 is not an insignificant move and illustrates a deliberate move toward assets that behave more like the liabilities.

In 2023, the de-risking trend continued, with target asset allocations decreasing equity allocations by about 2% on average, fixed income increasing by about 1%, and other assets by about 1%. It is important to distinguish the difference in these targets from the actual allocations shown in **Exhibit 1**. Actual allocations are subject

By increasing the amount of fixed income held by the plan, the assets will begin to behave more like liabilities.

to market movement and these jumbo plans can fall victim to their size in how quickly actual allocations move toward targets, especially with private asset illiquidity. The target allocations give a good idea of the intended strategic asset allocation and tend to be stickier than actual allocations. A few notable moves in 2023 can be seen in **Exhibit 2**.

Exhibit 2: Notable target asset allocation activity in 2023

| ORGANIZATION | NOTABLE ACTIVITY |
|------------------------------|---|
| 3M | Fixed income allocation increased by 3% |
| AT&T | Fixed income allocation increased by 2% and other investments by 3% |
| Dow | Fixed income allocation increased by 10% |
| General Motors | Fixed income allocation decreased by 9% and other investments increased by 6% |
| Johnson & Johnson | Fixed income allocation increased by 4% |
| Pfizer | Fixed income allocation increased by 3% and other investments by 8% |
| Northrop Grumman | Fixed income allocation increased by 4% |
| Raytheon | Fixed income allocation increased by 7% |

Source: 10-k filings.

From **Exhibit 2**, one sponsor that appears to buck the trend of the rest of the \$20 billion club members is General Motors and its reduction in its fixed income target allocation. However, this seems to be in an effort to increase the “other assets” category, which does align with the general trend we are seeing. This also does still keep General Motors’ fixed income target allocation above the actual average allocation of the group. Importantly, this will be something to keep an eye on as we continue to track these sponsors.

An interesting outcome over the past decade is the use of “other assets” in the asset allocation. These assets are often viewed as diversifiers and range from real estate and real assets to hedge funds and private markets. Since we have been gathering information on these plans, the amount that is allocated to these assets has stayed relatively consistent, hovering just under 20% of total plan assets. However, when considered within the greater context of the move from equity to fixed income, a greater percentage of the return-seeking assets are coming from these “other” investments, now making up over half of return-seeking assets. Time will tell if this is a persistent effect, or the result of illiquidity issues introduced in the 2022 downturn.

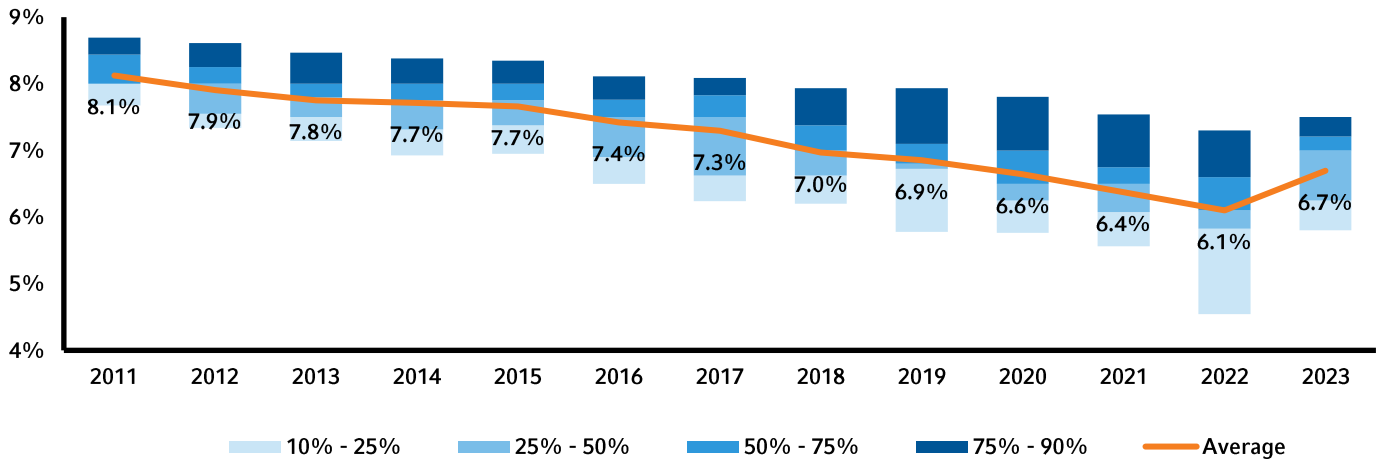
A key metric that is tied to the asset allocation and the investment policy is the expected long-term return on assets (ELTRA). In broad terms, the ELTRA assumption is useful only in the calculation of pension expense, which may be more or less important for a given company. Over the past decade, every member of the \$20 billion club has reduced its ELTRA and very few have increased it year-to-year during that period. However, that changed dramatically in 2023, with 63% of members increasing their ELTRA and only three decreasing (all of which had increases in their fixed income target allocations of at least 4%). This is the first time the average ELTRA for the \$20 billion club has increased since we began monitoring this group. However, in the context of the large rise in fixed income

“ Over the past decade, every member of the \$20 billion club has reduced its ELTRA and very few have increased it year-to-year during that period.

yields in 2022, this is not completely unexpected. **Exhibit 3** illustrates this downward trend on the assumption over time.

In 2023, 12 companies increased their ELTRA assumptions. Interestingly, the plan sponsors that increased their ELTRA assumptions didn't do so on the margins, but averaged a nearly 95 basis points (bps) increase to their assumption. The top end of the increases came from Caterpillar at 180 bps, followed by 3M at 150 bps.

Exhibit 3: ELTRA assumptions since 2011



Source: 10-k filings. Based on the \$20 billion club membership in the given year.

What does this all mean for your DB plan?

As mentioned, the different levers available to plan sponsors are often interconnected, but for the investment policy, the trend continues to be one toward de-risking plan assets. This is in the face of funding regulations like the [American Rescue Plan Act](#)² and the Infrastructure Investment and Jobs Act, which have provided plan sponsors the ability to take contribution holidays and potentially incentivize increasing risky assets in the plan.

Outside of exceptional client circumstances and goals, at Russell Investments, we have a strong belief in a similar approach that the members of the \$20 billion club have taken for closed and frozen plans. This is one of the reasons we advocate for implementing a glidepath in the investment policy statement. As a plan approaches full funding, we view it as a good idea to lock in your wins by moving from growth-oriented to liability-hedging assets, which will ultimately reduce the plan's surplus volatility. When starting this transition, it can be even more impactful to use [longer duration fixed income assets](#)³ like treasury STRIPs, or even synthetic rate exposure through Treasury futures. Perhaps there's been no greater time to de-risk pension plan assets than given the level of interest rates and the boost in ELTRA assumptions.

“ This is one of the reasons we advocate for implementing a glidepath in the investment policy statement.

Part II: Benefits policy

This section reviews the benefits policy of the \$20 billion club and what we might observe from the recent history of these mega-plans. The benefits policy is one of the key levers a plan sponsor can pull to impact the plan outlook. This can range from minor tweaks to the plan's benefit formula to major adjustments that close the plan to new hires or freeze the plan's accrual for existing participants.

During the past decade or so, there has been a broad trend in the industry toward closing and freezing DB plans. The reasoning behind this approach is myriad, complex, and non-linear. Regulations, funding hurdles, and workers' preference toward benefits can be cited, but there is no single item that is the root cause. When the Pension Protection Act of 2006 (PPA) was passed, the DB landscape changed dramatically. While the resulting changes significantly increased protections for participants, the same changes increased the cost, governance, and burden on pension plan sponsors.

Since then, large DB plans have been on the decline, both in plan count and participant count. Total participant count is down more than 34% from 2006 to 2022, according to the Pension Benefit Guaranty Corporation (PBGC) data tables.⁴ This takes place through closing, freezing, and the subsequent natural attrition as participants leave the plan through cash-out or pass away, and can be accelerated by executing [pension risk transfers](#)⁵. This is no different for the \$20 billion club plans that have altered plan design by closing plans to new entrants and, in many cases, freezing benefit accruals altogether, followed by small to large pension risk transfers.

Like many of the trends we are bringing to light here, this has come up in the \$20 billion club before and it is no surprise that it has continued in the past few years. Closing and/or freezing a DB plan will inherently reduce the risk that the plan poses to the plan sponsor due to the reduction in future uncertainty associated with benefit accruals for active participants. This, in turn, has an impact on the investment policy, which we detailed in the previous section. **Exhibit 4** lists some notable activity in this space in 2023.

Exhibit 4: Notable activity 2023

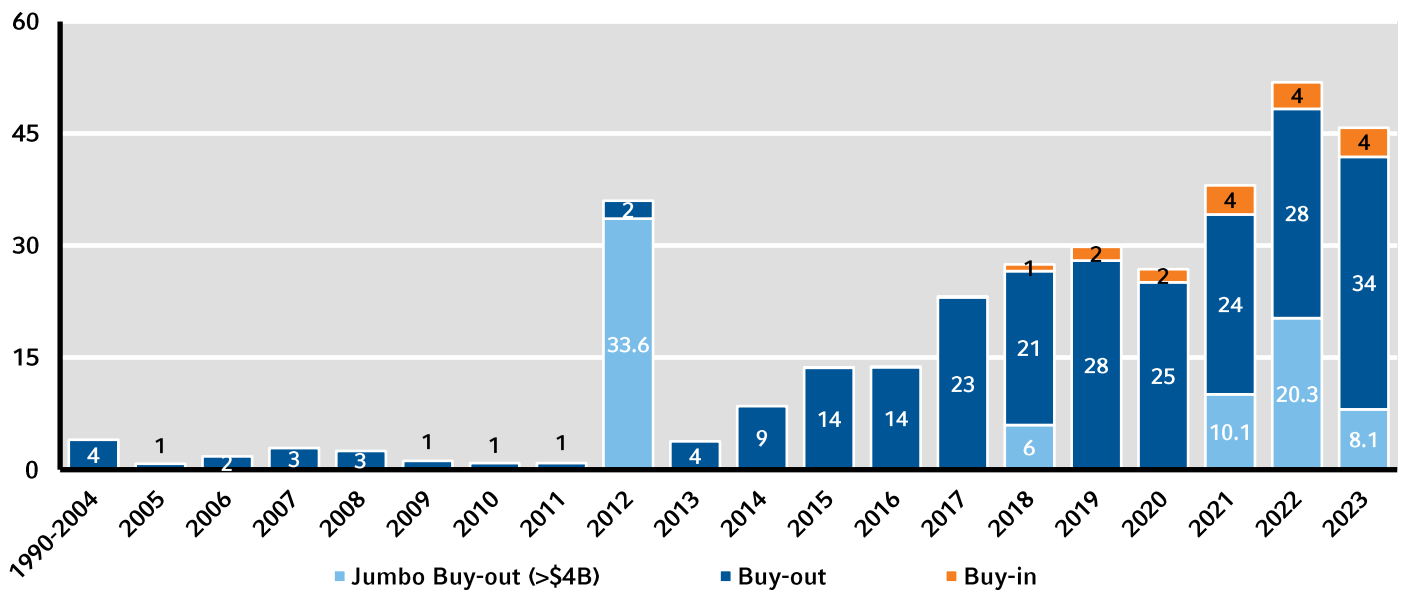
| ORGANIZATION | NOTABLE ACTIVITY |
|-------------------|---|
| UPS | Full freeze of 70,000 non-union participants became effective in 2023, as announced in 2017 |
| AT&T | \$8.1B group annuity contract purchase |
| Dow | \$1.7B group annuity contract purchase |
| Johnson & Johnson | \$800M group annuity contract purchase |
| Lockheed Martin | \$400M lump sum window |
| IBM | Reopened DB plan to replace 401(k) employer contributions ⁶ |

2023 was another very strong year in the pension risk transfer market with over \$45 billion in annuity purchases, the second most only to 2022 at over \$50 billion, as seen in **Exhibit 5**. However, the number of transactions was the highest seen to date, which means that the risk transfer trend we've observed in the \$20 billion club has truly made its way down to the smaller plan size.

While the resulting changes significantly increased protections for participants, the same changes increased the cost, governance, and burden on pension plan sponsors.

In 2022, IBM took part in this trend by de-risking its pension plan with a \$16 billion annuity purchase risk transfer. This was the second largest pension risk transfer, topped only by General Motors' 2012 \$25 billion annuity purchase, which arguably kicked off the high pace of annuity purchase risk transfers we see in the industry today. However, IBM made waves at the end of 2023 by reopening its DB plan to current active participants and new entrants. This unleashed a [flurry of discussion](#)⁷ on the future of DB plans and how much of a trend this would become. We will need to wait a little longer to see how this all plays out, but it's something we'll be tracking closely.

Exhibit 5: Annuity purchase history



Source: LIMRA Secure Retirement Institute.

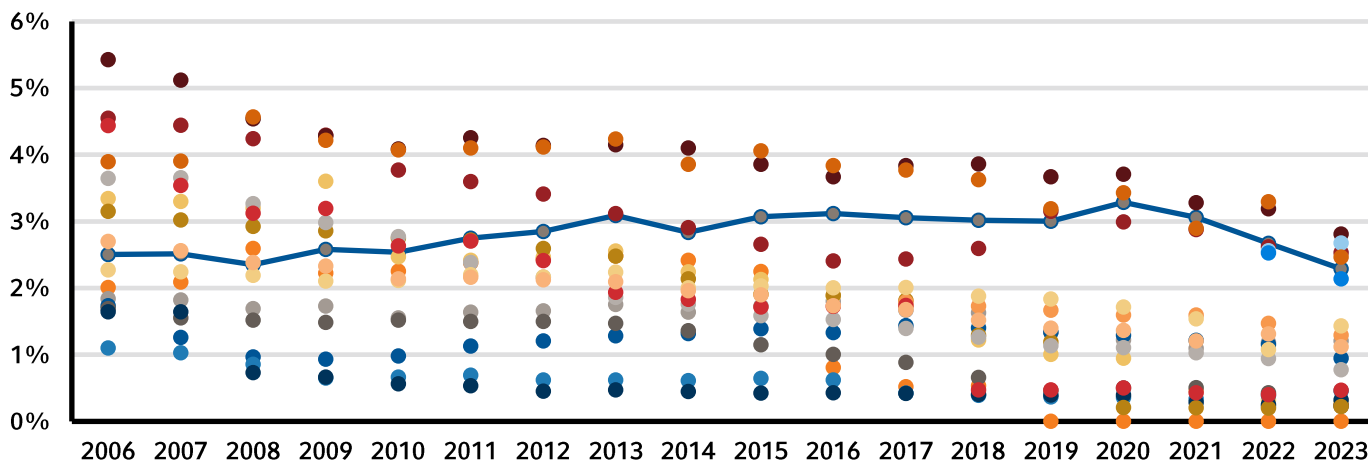
While the UPS freeze was announced several years ago, it's worth noting that of the \$20 billion club members, UPS had the highest service cost relative to PBO in 2022—a key metric when comparing open and closed plans. UPS was one of only two plans where this ratio was above 3% in 2022, with Johnson & Johnson being the other. The freeze to its non-union participants has since decreased this ratio for UPS, with the company no longer having the highest service-cost-to-PBO ratio among members in 2023. With UPS in mind, let's look more broadly at this key metric.

To further illustrate the trend of pension plans closing and freezing, we can look at the size of service cost relative to PBO across the \$20 billion club. The service cost for a pension plan represents the annual cost associated with new benefit accruals for active participants. For an established and open plan, the service cost relative to the PBO will be consistent as active participants accrue benefits and inactive participants exit the plan through mortality (or otherwise). This ratio of service cost to PBO is generally between 3% and 5% for an open plan.

However, there has been a broad trend of plans closing to new entrants (soft freeze) and freezing benefit accruals altogether (hard freeze) for several years. For a soft-frozen plan, this ratio will decrease over time and will be 0% for a hard-frozen plan.

Exhibit 6 illustrates the move of closing and freezing plans since the PPA was passed in 2006 through the decline of the service-cost-to-PBO ratio. In 2006, the service cost ratio among these companies ranged between 1.1% and 5.4%. In 2023, the range dropped to between 0% and 2.7%, with an average decrease of about 1.6% since 2006.

Exhibit 6: Service cost relative to PBO since 2006



Source: SEC Form 10-K filings.

With the uptick in pension risk transfers, which focus on non-accruing participants (i.e., they have no service cost), it would be reasonable to expect that the service cost relative to PBO would increase as the PBO shrinks (e.g. AT&T’s ratio increased by 0.4% from 2022 to 2023, presumably in part due to its large risk transfer). However, even as plans have executed lump sum offers and annuity purchases, the ratio of service cost to PBO has continued to drop over the past few years, further emphasizing the impact of closing and freezing.

It should be noted that we have begun to see diverging paths within the \$20 billion club membership with respect to this metric as seen in **Exhibit 6**. The plans with higher service cost relative to PBO have been relatively flatter, or at least have a slower decline, than those plans now at the bottom of this exhibit that continue their steady trend toward zero. Similar to UPS, many of these freezes were implemented years ago and are continuing to come to fruition or have over the past few years. Other plans were closed many years ago and the plan’s service cost continues to tick down as active participants leave the plan. This is something we will continue to track.

What does this all mean for your DB plan?

As we’ve mentioned, the different levers available to plan sponsors are often intertwined, but the industry trend on benefits policy has leaned into closing and freezing plans and executing [risk transfers](#)⁸. This reduces the overall risk of the plan through a shorter in-plan duration and the ability to [lock things in](#)⁹ when fully funded through [hibernation](#)¹⁰ as well as [other concepts](#)¹¹. However, there are considerations on how and when to do this. Choosing the right populations to annuitize with an insurer is already an important decision, but we believe it’s also critical to consider the implications on other levers, such as investment policy and

Exhibit 6 illustrates the move of closing and freezing plans since the PPA was passed in 2006 through the decline of the service-cost-to-PBO ratio.

corresponding asset allocation. Off-loading certain participant cohorts can look appealing at first blush, but the leftover plan can sometimes unintuitively lead to higher average contribution requirements. Or perhaps IBM is on the cutting edge and more DB plans will follow suit in reopening their own plans.


At Russell Investments, we are agnostic on whether your plan is open, closed, or frozen. However, each plan status inherently has different needs, objectives, and goals. Open plans will have a higher return hurdle rate to keep up with the service cost for actively accruing participants. Frozen plans have a finite timeline as participants leave service through termination, retirement, and ultimately, mortality. This means that plan sponsors may want to consider end-game planning and how to approach those specific concerns. Closed but unfrozen plans land somewhere in the middle with unique considerations and timelines. Add a layer of funded status to the mix and things can get complicated fast. We're here to help with those complications and work through those details, whether it be picking the right return-seeking and liability-hedging mix, selecting the equity mix, or helping implement a completion mandate to reduce interest rate risk.

Part III: Funding policy

In this final section, we will review the funding policy of the \$20 billion club and what we might gather from the recent history of these jumbo-plans. Many plan sponsors have official policies to “contribute at least the amount required under the law” but under the hood, there is often much more going on than meets the eye.

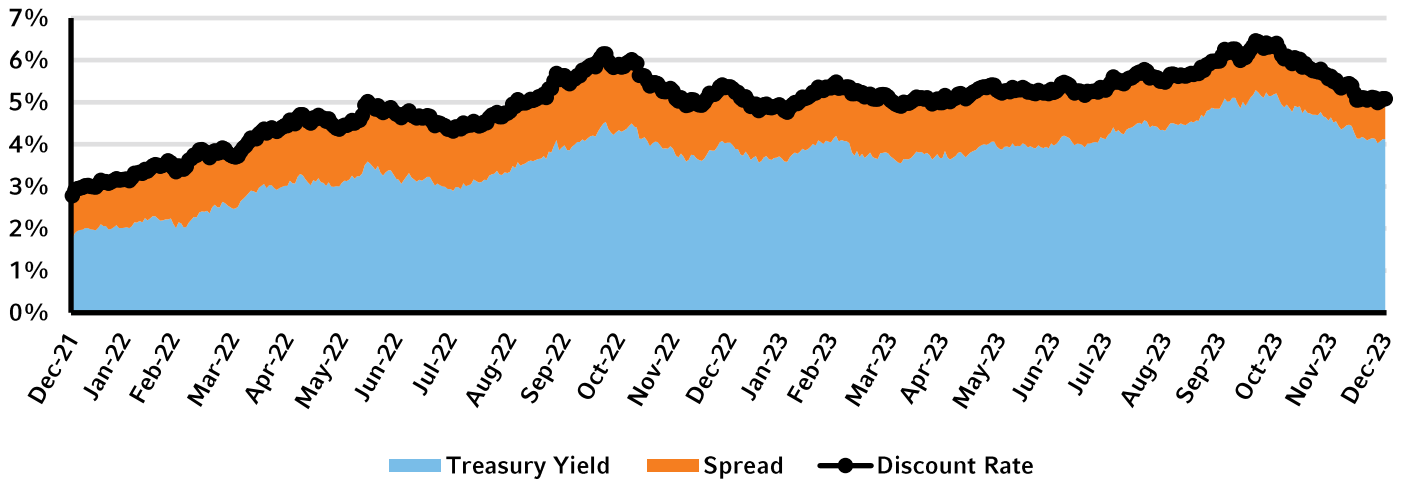
Like the other policies we've discussed over the course of this series, the funding policy is connected with the other policies but, perhaps even more so than the others, it is a function of the funded status of the plan. Of course, there are regulatory contribution requirements under the Pension Protection Act (PPA), based primarily on funded status, but it goes further than that. Depending on the goals of the plan sponsor, funding can continue up to and beyond the plan being fully funded. Before we dive into some more contribution specifics, let's take a step back and review the funded status of the plans in the \$20 billion club.

Last year we discussed how extraordinary 2022 was with respect to the large increase in interest rates we saw over the year. While 2023 didn't see another large increase, we did see a peak that even surpassed 2022 during October 2023. In broad terms, interest rates have been declining over the past 40 years, but 2022 and 2023 have really flipped the impact of shifting interest rates on its head. In the past, falling rates created a headwind to funded status by increasing liabilities as rates declined. However, in the current higher interest rate environment, even though liabilities are now at decades-long lows, the discount-rate impact persists in the form of a significantly higher interest cost component. This is creating a much larger headwind than just two years ago, as liabilities are now accruing at over 5% instead of 3%. This difference must be made up either through investment gains or contributions in order for plans to remain at the same funded level.



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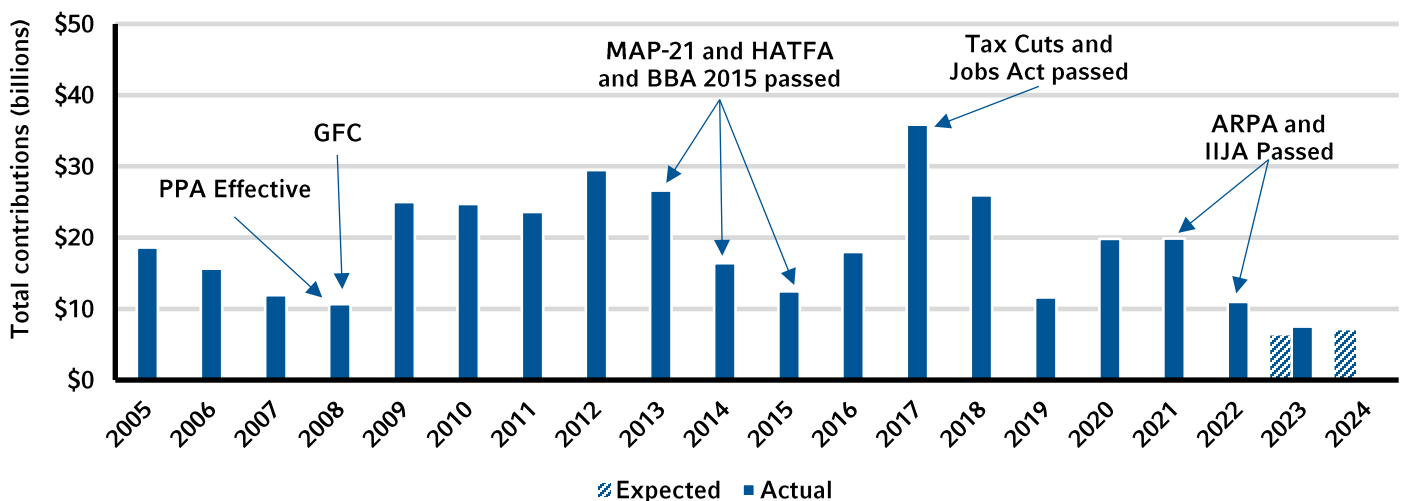
Exhibit 7: Discount rates during 2022 and 2023 for a 12-year duration liability; discount rate based on ICE BofA A-AAA corporate yield curve.



Source: Russell Investments. Discount rate based on Merrill Lynch A-AAA yield curve.

As mentioned, for better or worse, many plan sponsors’ funding policies are linked to minimum required contributions under the PPA. While the PPA does provide a path to full funding in large part due to the shortfall amortization, regulations over the past decade have enabled plan sponsors to reduce or delay contributing to their plans, as seen in **Exhibit 8**. With the exception of the Tax Cuts and Jobs Act (TCJA), each noted piece of legislation with pension-funding-relief-related measures has led to a reduction in contributions in the following years. The Tax Cuts and Jobs Act led to a large increase in contributions in 2017 and 2018 due to the tax benefits of contributing to pension plans. While funding relief sometimes provides much needed cash flow flexibility for plan sponsors, plan funded status has not always benefitted from it.

Exhibit 8: \$20 billion club members contribution history in the context of legislation




We also see in **Exhibit 8** that contributions for the \$20 billion club members were at their lowest point since the PPA became effective, and that if the expected contributions in 2024 hold, they will be the lowest we've seen while monitoring the \$20 billion club.

What does this all mean for your DB plan?

As previously mentioned, while the different levers available to plan sponsors are often intertwined, the industry trend on funding policy has geared itself to taking advantage of the funding relief and opportunities offered up by regulatory changes over the past decade. Plans have also benefited from an increase in funded status due to the large rises in interest rates from 2022-23.

Since the introduction of [MAP-21](#) (Moving Ahead for Progress in the 21st Century Act)¹² legislation and subsequent pension funding relief legislation, discount rates for contributions have been disconnected from discount rates for accounting disclosures. Because of the large increase in rates the past few years, however, today's market interest rates are near or above the interest rates used to determine regulatory contributions for the first time since MAP-21 was passed. This can lead to interesting decisions, which we discussed [last year](#)¹³, that have direct impact on the regulatory contributions and therefore many plan sponsors' funding policy.

Leading up to the plan being fully funded, we would generally advocate for greater funding for the plan if the sponsor has the capacity to do so. In our [2023 prudent pension funding report](#)¹⁴, we discussed what it might look like to fund a plan in the context of cash flow from operations. Once the plan is fully funded, managing the plan can then be simplified through [hibernation](#)¹⁵, and costs of the plan decrease in a meaningful way. In most cases, this will allow plan sponsors to forgo making annual contributions and also largely reduce the risk of significant downside contribution events.



Because of the large increase in rates the past few years, however, today's market interest rates are near or above the interest rates used to determine regulatory contributions for the first time since MAP-21 was passed.

Conclusion

One of the main goals of the \$20 billion club has always been to help plan sponsors understand how industry trends have been developing.

As we've highlighted over the course of this paper, the investment, benefits, and funding policies for the \$20 billion club members are always changing and adapting to fit the characteristics, goals, and objectives of each member's plan. Like all plan sponsors, each member is looking at how to best handle the assets and liabilities under their purview—and together, their approaches form a comprehensive volume of insights that we can glean from. We've touched on some important topics here, including how these jumbo plan sponsors have approached today's biggest problems and how these issues may impact your own plan. Importantly, however, every plan is different, with its own unique circumstances, preferences, and goals. At Russell Investments, this recognition is central to our client-first service philosophy. We stand ready to assist plans of all sizes and levels of maturity.

A note on \$20 billion club membership

Over the past several years, inclusion in this group of mega-plans could have increased a few times due to falling interest rates, which caused liabilities to soar. However, we have kept this group stable in the past to maintain a certain level of consistency. While the last couple of years have been exceptional in many ways, the impacts have arguably been reflected more keenly in the DB plan space than in many other areas due to the dramatic decline in liabilities.

We have used this as an opportunity to refresh the membership of our \$20 billion club. The most recent list of 21 companies—many of which have long been members of the club—can be found in our [2024 update](#)¹⁶. We expect this list to continue to evolve over time.

¹ Owens, J. (2023). "Pension de-risking glide paths: Defining a plan for pension plan end games". *Russell Investments Research*. Available here: <https://russellinvestments.com/-/media/files/us/insights/institutions/defined-benefit/pension-de-risking-glide-paths.pdf>

² Field, A. (2021, March 11). "How the American Rescue Plan impacts funding relief for pension plans". *Russell Research*. Available here: <https://russellinvestments.com/us/blog/american-rescue-plan-and-funding-relief>

³ Owens, J. (2022, November 16.) "Is now the time to elevate your hedge ratio?". *Russell Research*. Available here: <https://russellinvestments.com/us/blog/elevate-hedge-ratio>

⁴ Source: Table S-30: PBGC-Insured Plan Participants (1980-2022). *Pension Benefit Guaranty Corporation*. Available here: <https://www.pbgc.gov/prac/data-books> Accessed: October 2, 2024.

⁵ Owens, J. (2022, September 28). "Risk transfer potholes: How to avoid them or brace for impact". *Russell Research*. Available here: <https://russellinvestments.com/us/blog/risk-transfer-considerations>

⁶ Owens, J. (2023, November 7). "How IBM reopened its DB plan to replace 401(k) contributions". *Russell Research*. Available at: <https://russellinvestments.com/us/blog/ibm-db-plan>

⁷ Owens, J. (2024, January 8). "How I would redesign a shared DB/DC retirement program". *Russell Research*. Available here: <https://russellinvestments.com/us/blog/db-dc-retirement-program-design>

⁸ Owens, J. (2023). "Pension risk transfer options and considerations". *Russell Investments Research*. Available at: <https://russellinvestments.com/-/media/files/us/insights/institutions/defined-benefit/pension-risk-transfer-options-and-considerations.pdf>

⁹ Owens, J. (2023). "A guide to pension plan hibernation". *Russell Investments Research*. Available at: <https://russellinvestments.com/-/media/files/us/insights/institutions/defined-benefit/a-guide-to-pension-plan-hibernation.pdf>

¹⁰ Owens, J. (2021, February 23). "DB plan hibernation: Does it really work?". *Russell Research*. Available here: <https://russellinvestments.com/us/blog/db-plan-hibernation>

¹¹ Frick, B. (2023, March 14). "PPA yield curve elections: A potential for change". *Russell Research*. Available here: <https://russellinvestments.com/us/blog/ppa-yield-curve-elections>

¹² "Moving Ahead for Progress in the 21st Century." MAP-21 | *Federal Highway Administration*, www.fhwa.dot.gov/map21/. Accessed: October 1, 2024.

¹³ See endnote 11.

¹⁴ Hall, M. (2023, November 28). "2023 Prudent Pension Funding Report: A story of positive trends and persistent outliers". *Russell Research*. Available here: <https://russellinvestments.com/us/blog/2023-prudent-pension-funding-report>

¹⁵ See endnote 9.

¹⁶ Owens, J. (2024, March 5). "\$20 billion club: Higher rates means...higher return assumptions?" *Russell Research*. Available here: <https://russellinvestments.com/us/blog/2024-20bn-club-update>

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