

# \$20 BILLION CLUB: 2023 UPDATE



## LIABILITIES AND ASSETS BOTH PLUMMET AS FUNDED STATUS INCHES HIGHER

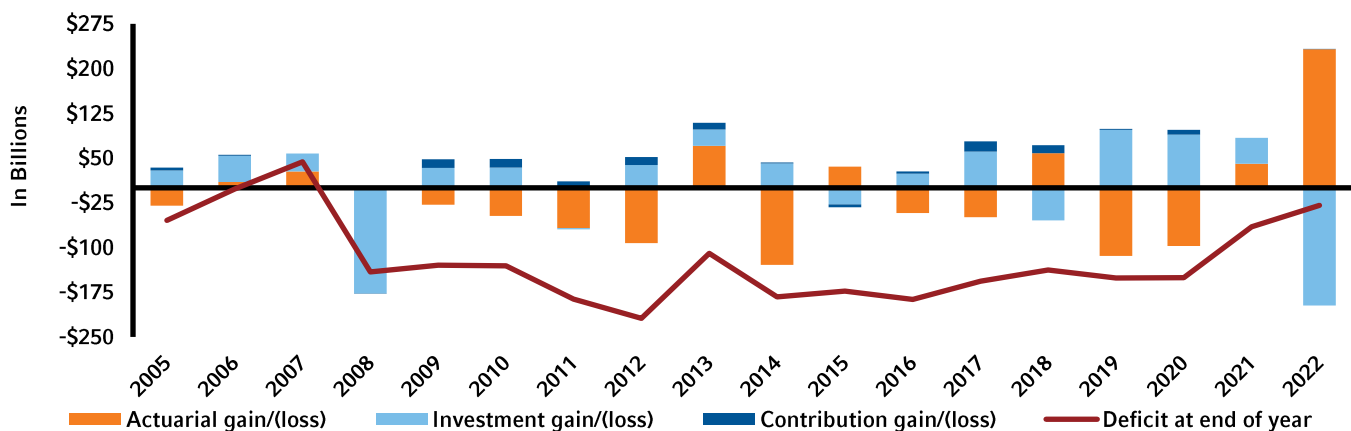
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For defined benefit (DB) plan sponsors, 2022 was one for the ages. In recent memory we have not seen discount rates increase by so much (about 250 bps) in one year. And, at the same time, plans suffered an asset loss (about 21%) even worse than the Global Financial Crisis (GFC)-driven 2008. In any year, either of these would be especially noteworthy and have a dramatic impact on funded levels. For the 20 US-listed companies with the largest global DB liabilities, the net effect was a slight improvement (about 2.6%) in funded ratio, with the drop in assets nearly offsetting the drop in liabilities. **This brought funded status to its highest level since 2007**, the year before the GFC. Funded ratios improved from an average 94.3% to 96.9%.<sup>1</sup> The funding deficit in dollar terms fell from \$65 billion to \$30 billion.

The majority of trends we see in the pension industry can be found in these 20 companies. While many industry reports post estimates of what funded status changes could have looked like in the year, this is the first published each year (since 2011) that shares actual disclosed data from 10-k filings. We sometimes find industry estimates vary widely, and a fact check can be helpful in resetting reality.

Understanding trends among this group will help all DB sponsors in their fiduciary duties. Looking at the latest corporate disclosures, released mere days or hours before this publication, provides all DB sponsors with perspective and broad-stroke trends in the corporate pension industry to help them fill their own fiduciary duties.

### Exhibit 1: Combined surplus/(deficit) of the \$20 billion club, 2005-2022



Source: Russell Investments, Corporate 10-k filings

<sup>1</sup> These values are slightly different from what was shown in last year's report due to a reconstitution of the sample group, as explained later in this report

Specifically, we are interested in how these companies have behaved in the current economic environment, and what strategies they have used to navigate their way toward achieving their goals.

**Exhibit 1** illustrates the funded status experience for this group since 2005. The red line shows the dollar surplus or deficit, with the bars indicating the key drivers of change (i.e., attribution) in each year. As mentioned, the year 2022 was unusual in an extreme way. The effect of actuarial gains (primarily discount rate changes) was larger than any other year. The investment loss was even larger than 2008. Despite this headwind, the actuarial gains slightly outpaced the investment losses to improve the funding deficit

The impact of employer contributions was minimal. In fact, 2022 contributions were near their lowest in all 18 years we have tracked this data. The year 2023 looks even lower, based on each company's disclosed expectations. Ongoing funding relief and improved funded status continue to drive contribution decisions.



*The year 2022 was unusual in an extreme way*

The average increase in funded ratio among these sponsors was 2.6%, and all but 3 sponsors saw some improvement in the year. The three companies with the largest funded ratio gains were **Exxon** (up 8.1%, largely due to a \$4 billion contribution), **Dow Chemical** (up 7.5%, after a 10.6% increase the year before), **Honeywell** (up 7.4%), and **Northrop Grumman** (up 6.3%).

Notably, Ford, a very well-hedged DB plan with a stated objective of minimizing funded status volatility, achieved this goal in 2022, with the funded status nearly identical to the year before.

Overall pension liabilities dropped to their lowest level since 2008, falling to about \$700 billion, as discount rates rose to their highest level since 2010. Combined assets were their lowest since 2010 at about \$670 billion.

**Exhibit 2** shows how liabilities and assets performed during 2022.

## Exhibit 2: 2022 global pension assets and liabilities development

LIABILITIES	(IN \$BILLIONS)
Liability (Projected Benefit Obligation) at Start of Year	998.1
Accrual of new benefits (Service Cost)	11.2
Benefits paid	(54.6)
Interest payable on liability (Interest Cost)	24.3
Impact of change in interest rates and in actuarial assumptions (Actuarial loss)	(232.2)
Miscellaneous other	(45.6)
Liability (Projected Benefit Obligation) at End of Year	701.2

ASSETS	(IN \$BILLIONS)
Assets (Fair Value) at Start of Year	932.9
Employer contributions	11.3
Benefits paid	(53.7)
Investment return on plan assets	(173.3)
Miscellaneous other	(45.5)
Assets (Fair Value) at End of Year	671.7

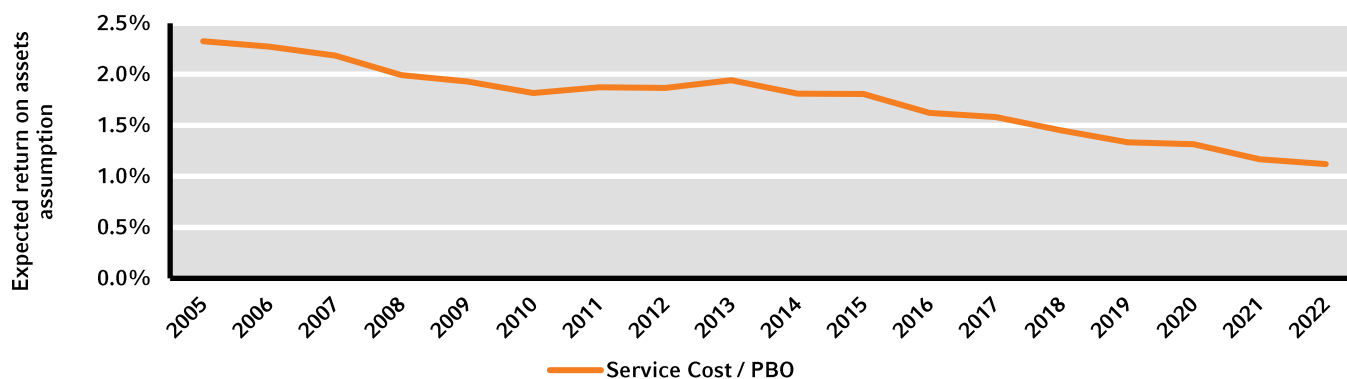
SURPLUS / (DEFICIT)	(IN \$BILLIONS)
Excess of assets above (below) liabilities at Start of Year	(65.2)
Excess of employer contributions over service cost	0.1
Actuarial gain (loss)	232.3
Investment returns less interest cost	(197.6)
Miscellaneous other	0.9
Excess of assets above (below) liabilities at End of Year	(29.5)

Source: Corporate 10-K Filings, Russell Investments calculations



*Overall pension liabilities dropped to their lowest level since 2008...*

### Exhibit 3: New benefits relative to liabilities since 2005



Source: 10-k filings

### Plans are maturing

We have a few ways to measure how “mature” plans are becoming. One of the most straightforward ways is to compare the value of new benefits earned each year (service cost) to the overall plan liabilities (PBO). This ratio naturally declines as more participants retire without new active participants taking their place, as in a plan closed to new entrants.

This ratio also declines as benefits are frozen. Many, but not all, of these sponsors have chosen to freeze at least a portion of their benefits, which reduces long term costs within the DB plan, but may increase them in other retirement programs (such as a DC plan).

The combined effect of participants aging, plans closing and benefits freezing has led to a nearly 50% reduction in the service cost to PBO ratio over the last 10 years.

**Exhibit 3** shows this trend since 2005, when most plans were still open and ongoing. As plans closed and froze, the ratio declined steadily. We expect this trend to continue.

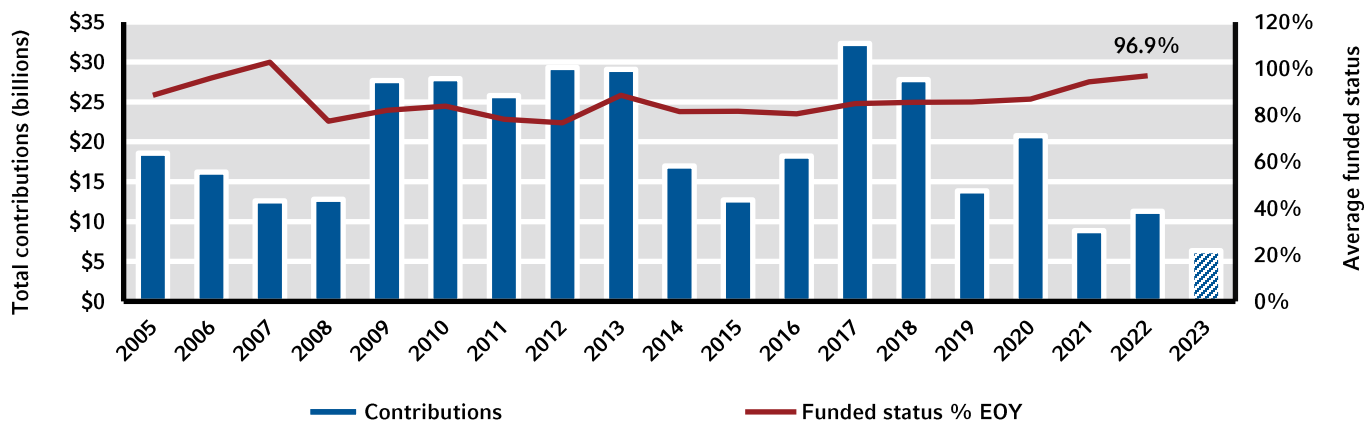
### Contributions continue to be low

Similar to 2021, contributions in 2022 were low at about \$11 billion, but not quite as low as 2021, primarily because of Exxon’s unexpected \$4 billion contribution. This is the second lowest total since 2005. Ongoing funding relief continues to influence this, as does improved funded status. Very few of these sponsors are choosing to make discretionary contributions of any kind into their US plan. As plans become fully funded and adopt hibernation strategies to stabilize that funded status, fewer contributions will be expected.

More commonly, the only contributions being made are those to unfunded, nonqualified DB plans, or to non-US plans with different funding requirements. Contributions made were in line with expectations from last year, with the exception of Exxon, and 2023 expected contributions look even lower than 2021.

**Exhibit 4** shows the pattern for contributions since 2005, including an estimated value for 2023 as disclosed in financial reporting.

### Exhibit 4: Contributions 2005-2022



Source: 10-k filings. 2023 is the sum of all the individual companies expected 2022 contributions.

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## Other activity

**IBM** participated in a \$16 billion annuity purchase, the largest risk transfer since 2012 when GM offloaded \$29 billion. This covered 100,000 retirees and beneficiaries and about 17% of their global pension liabilities.

**Lockheed Martin** participated in another large pension risk transfer of \$4.3 billion. This is now the fifth consecutive year they have purchased an annuity contract to reduce the size of their pension obligations. Despite this, their global pension liabilities still exceed \$38 billion.

**UPS's** freeze of benefit accruals for non-union employees, first announced in 2017, takes effect on January 1, 2023.

## Membership of the \$20 billion club

We have chosen to make several changes to the \$20 billion club membership this year. As companies merge/split, mature and pursue large risk transfers, their DB plan liabilities can dramatically diminish. Two companies in particular that we track (Corteva and Verizon) were falling far below our \$20 billion benchmark, and we have chosen to remove them.

In their place, we have added on three companies that have maintained global pension liabilities above \$20 billion the last few years (though 2022 was an exception for several companies).

We now have 20 corporations, generally included due to their global pension liabilities exceeding \$20 billion:

- |                     |                             |
|---------------------|-----------------------------|
| 1. 3M               | 11. Honeywell International |
| 2. AT&T             | 12. IBM                     |
| 3. Boeing           | 13. Johnson & Johnson       |
| 4. Caterpillar      | 14. Lockheed Martin         |
| 5. Dow Chemical     | 15. Merck                   |
| 6. Exxon Mobil      | 16. Northrop Grumman        |
| 7. FedEx            | 17. Pacific Gas & Electric  |
| 8. Ford Motor       | 18. Pfizer                  |
| 9. General Electric | 19. Raytheon Technologies   |
| 10. General Motors  | 20. United Parcel Service   |

While we try to keep this group consistent (comparisons are more straightforward that way), other changes could impact which companies we measure. GE is in the process of splitting into three plans, starting in early 2023 and extending into 2024. We will continue to follow GE and other companies their DB arrangements evolve.

## Related reading

Owens, J. (2022, September 30). "Defined benefit plan terminations: Funding and investment strategies", *Russell Investments Research*.

Owens, J. (2022, March 1). "20 billion club: 2022 update", *Russell Investments*.

Owens, J. (2021, March 1). "20 billion club report: Members slow to commit to 2021 contributions", *Russell Investments Blog*.

Field, A. (2021, March 11). "How the American Rescue Plan impacts funding relief for pension plans", *Russell Investments Blog*.

Owens, J. (2021, February 23). "DB plan hibernation: Does it really work?", *Russell Investments Blog*.

Owens, J. (2019, March 4). "DB contributions expected to plummet in 2019", *Russell Investments Blog*.

Owens, J. (2019, October 28). "Better late than never...GE pension risk in focus", *Russell Investments Blog*.

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