$20 BILLION CLUB: 2024 UPDATE

FUNDED STATUS GAINS STALL AS ASSET RETURNS CAN'T OVERCOME LIABILITY INCREASES

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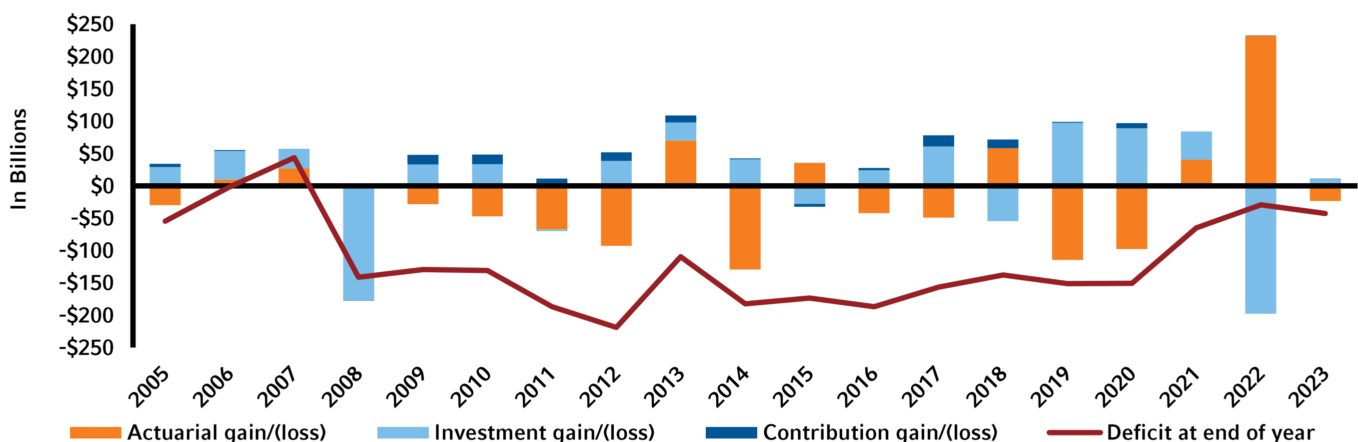
What a difference a year makes. The year 2022 was characterized by dramatic declines in both assets and liabilities as discount rates jumped 250 bps and equities markets faltered. In stark contrast, in 2023 we saw much more subtle changes. Discount rates decreased by about 25 bps. Pension assets had a decent year (average return of about 7%) but are still far below the highs of late 2021. Despite the ongoing effects of risk transfer, plan closures and plan freezes, total liabilities were still up, due to the decline in discount rates and higher interest cost in comparison to prior years. For the 21 US-listed companies with the largest global DB liabilities, the average net effect was a decline in funded ratio, with assets inching down while liabilities were up. **This brought average funded ratio down after two years of gains, from 96.9% to 95.0%**. The funding deficit in dollar terms increased from $30 billion to $43 billion.

We track these large corporate pension sponsors since they are the bellwether for the corporate DB industry. From them, we see new trends emerging and find perspective with the plans we manage. Understanding trends among this group will help all DB sponsors in their fiduciary roles. While many in the industry report estimates of how funded status *could* have changed in the year, this is the first paper published each year (since 2011) that shares actual disclosed data from 10-k filings. We sometimes find industry estimates vary, and a fact check can be helpful in resetting reality.

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: Combined surplus/(deficit) of the $20 billion club, 2005-2023



Source: Russell Investments, Corporate 10-k filings

Exhibit 1 illustrates the funded status experience and attribution 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. The year 2023 shows the severe contrast to 2022, in that 2022 was the year of extremes while 2023 changes were much more subtle. The effect of actuarial gains were as small as we have seen since 2008. While investment gains were positive, they were offset by relatively high interest cost. The net change is shown in the exhibit. This all led to a small drop in the funded ratio, after two years of increases

Employer contributions were historically low in 2023, the lowest we have seen in 19 years of data tracking for this group and less than 25% of the high in 2017. The year 2024 looks similar, based on each company's disclosed expectations. We see very little appetite to contribute beyond government requirements.

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The average decrease in funded ratio among these sponsors was 1.4%, with only a handful seeing an increase in the year. The two companies with the largest funded ratio gains were **FedEx** (up 3.3%, mainly due to its June 30 fiscal year) and **Pfizer** (up 3.1%, keeping their discount rate flat).

Overall pension assets remained quite low compared to values before 2022, falling to about $665 billion, with good investment returns but offsetting benefit payments and risk transfers.

Exhibit 2 shows how liabilities, assets and surplus performed during 2023.

Overall pension assets remained quite low…

Exhibit 2: 2023 global pension assets and liabilities development

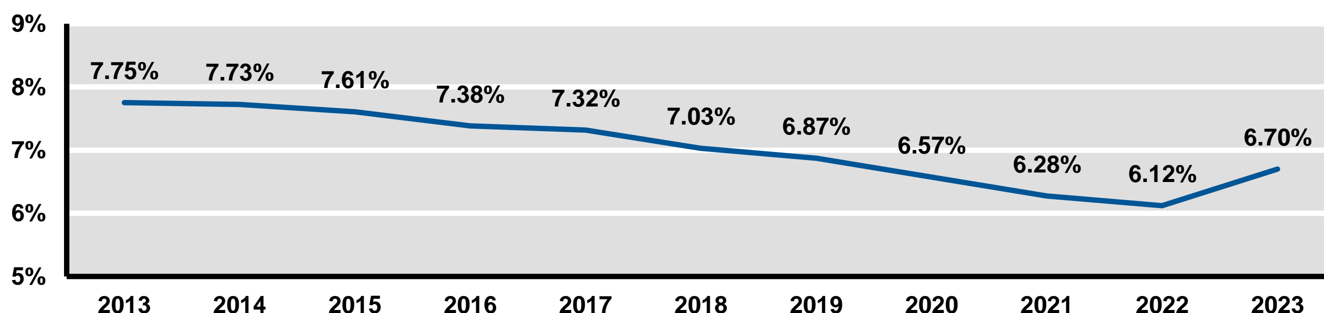
LIABILITIES	(IN $BILLIONS)
Liability (Projected Benefit Obligation) at Start of Year	701.6
Accrual of new benefits (Service Cost)	7.3
Benefits paid	(50.8)
Interest payable on liability (Interest Cost)	34.5
Impact of change in interest rates and in actuarial assumptions (Actuarial Loss)	23.1
Miscellaneous other	(7.2)
Liability (Projected Benefit Obligation) at End of Year	708.5

ASSETS	(IN $BILLIONS)
Assets (Fair Value) at Start of Year	672.0
Employer contributions	7.5
Benefits paid	(50.2)
Investment return on plan assets	45.1
Miscellaneous other	(8.8)
Assets (Fair Value) at End of Year	665.6

SURPLUS / (DEFICIT)	(IN $BILLIONS)
Excess of assets above (below) liabilities at Start of Year	(29.6)
Excess of employer contributions over service cost	0.2
Actuarial gain (loss)	(23.1)
Investment returns less interest cost	10.6
Miscellaneous other	(1.0)
Excess of assets above (below) liabilities at End of Year	(42.9)

Source: Corporate 10-K Filings, Russell Investments calculations

Exhibit 3: Average EROA assumption since 2013



Source: 10-k filings

Expected return on assets (EROA) is up

Over the last ten years, expected return on asset (EROA) assumptions used for income statement purposes in the US have only gone in one direction – down. This is due to two factors.

First, an increase in liability-hedging fixed income in DB portfolios as closed or frozen plans implement glidepath strategies naturally reduces return expectations.

Second, and sometimes less noticed, as rates declined, expected returns on fixed income also decreased.

The second factor changed after 2022. While we don't expect dramatic reductions in fixed income, expected returns on fixed income are much higher than they have been. Most of these companies (13 out of 21) chose to increase expected return assumptions for accounting purposes, some quite dramatically.

For these companies, a higher EROA assumption would lead to lower pension expense (or higher pension income) disclosed on the corporate income statement.

IBM unlocks surplus potential

As previously covered at length by Russell Investments and others, IBM made a dramatic change to retirement benefits package by eliminating the employer match in the 401(k) plan while introducing a new cash balance benefit in the previously frozen US DB plan.

This change is important for two reasons.

First, it puts attention on potential uses for pension surplus, which IBM's US DB plan has in abundance (about $4.5 billion with 123% funded ratio). This change is likely to save them billions of dollars in cash over the next several years by offering benefits within the overfunded DB plan structure.

Second, this enlivens a discussion on the best way to offer retirement benefits to participants. Does the shared DB and DC model offer the best combination of shared risk, responsibility, and lifetime income? The discussion is just getting started.

Contributions stay low

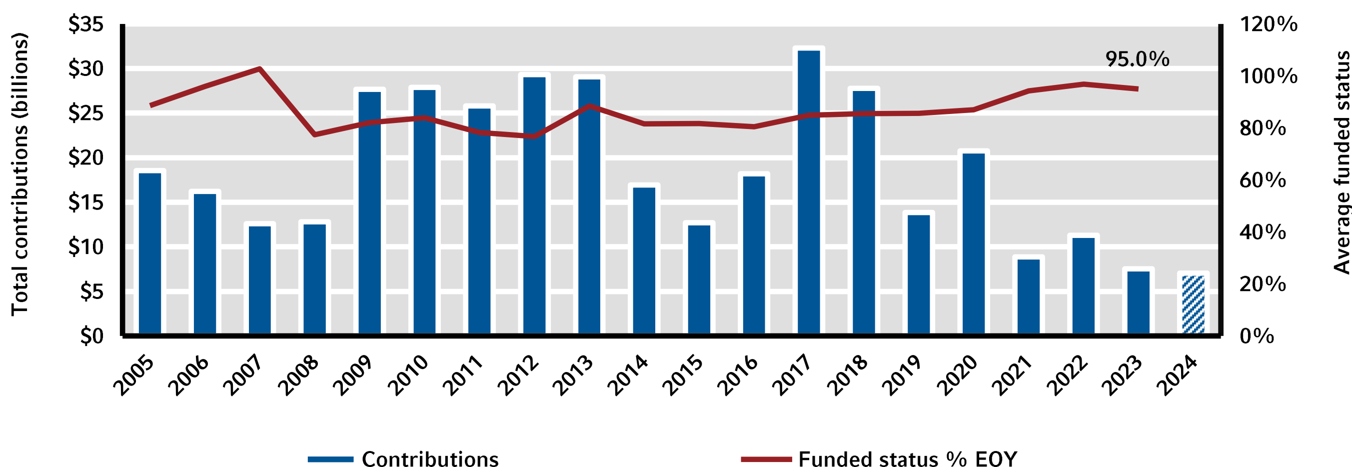
As expected, employer contributions in 2023 reached historic lows. The combination of improved funded status and ongoing lenient funding requirements has led to only minimal new contributions to these plans.

This is unlikely to change soon. Expectations for 2024 are close to 2023 levels, and there is very little appetite to contribute to these plans when not required, particularly when they can deploy cash for other corporate initiatives where they find more value. Likewise, we have seen little appetite to overfund plans in preparation for a plan termination. While risk transfer is nearly ubiquitous, plan termination among the largest plan sponsors with over $1 billion in assets is still quite unusual.

Exhibit 4 shows the pattern for contributions since 2005, including an estimated value for 2024 as disclosed in financial reporting.

> *Expectations for 2024 are close to 2023 levels, and there is very little appetite to contribute to these plans when not required…*

Exhibit 4: Contributions 2005-2023



Source: 10-k filings. The 2024 column is the sum of all the individual companies' expected 2024 contributions.

Other activity

AT&T had the largest risk transfer of the year by a wide margin, with $8 billion transferred to an insurer. While this amount is large, it only represents about 20% of global plan liabilities.

Johnson & Johnson joined the risk transfer trend by transferring $800 million to insurers for its US Salaried Pension Plan.

Lockheed Martin continued its annual tradition of pension risk transfer. While typically participating in an annuity purchase (in each of the last five years), this year they offered lump sums to former participants to the amount of about $400 million.

3M announced plans to freeze benefit accruals for non-union employees effective December 31, 2028.

We now track 21 corporations, generally included for having global pension liabilities exceeding $20 billion.

Membership of the $20 billion club

While we do our best to keep this group of companies consistent, this year we again needed to make a new addition. As previously announced, GE is splitting its company into three entities. The first new company – GE Healthcare (GEHC) – is large enough to be included on its own. This may also be the case with GE Vernova when its spinoff is finalized this year.

We now track 21 corporations, generally included for having global pension liabilities exceeding $20 billion:

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

While we try to keep this group consistent, other changes could impact which companies we measure in the future. Besides the GE changes, 3M has announced a spinoff of their health care business (to be named Solventum) in 2024. This is most likely to lead to them being excluded next year.

Related reading

Owens, J. (2023, October). "A guide to pension plan hibernation". *Russell Investments Research Viewpoint*.

Field, A. (2023, September). "$20 billion club: Policy strategies". *Russell Investments Research*.

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

Owens, J. (2023, February). “20 billion club: 2023 update”, *Russell Investments*.

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

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