$20 billion club

Liabilities and assets peak in 2019 as funded status continues to stagnate

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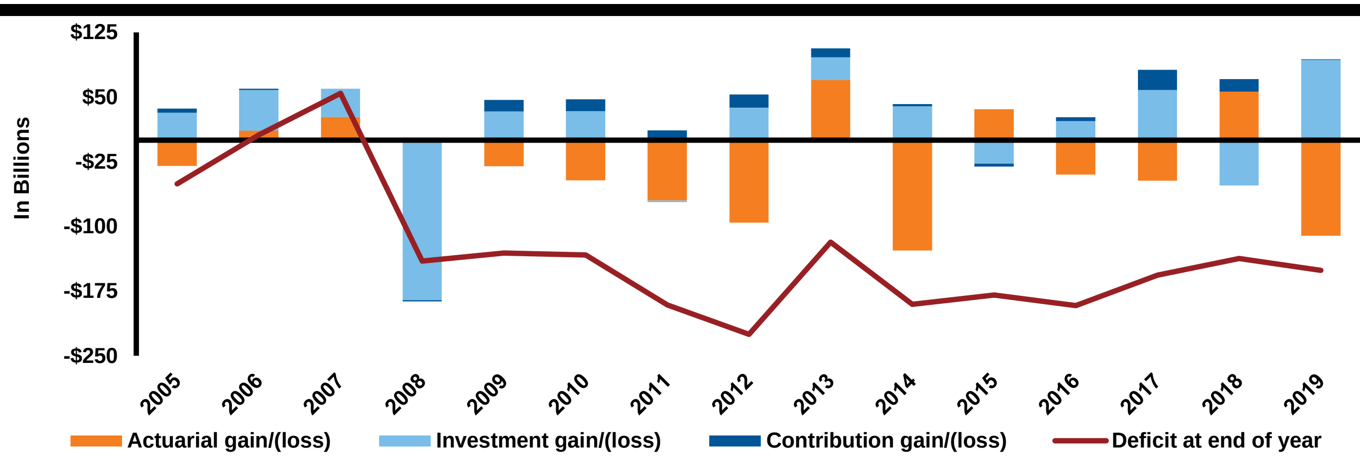
Under more normal circumstances, the historic performance of equities in 2019 would have given DB sponsors a much-needed funded status boost, which in turn would have helped accelerate progress down de-risking glidepaths. Instead, the largest 20 US-listed corporate DB sponsors experienced an equally historic rise in liabilities stemming from a crushing drop in discount rates. Global equities returned 27% in 2019 while discount rates fell around 100 bps, leading to a slight decrease of average funded ratio in this group from 85.3% to 84.9%. The funding deficit in dollar terms increased from $137 billion to $151 billion.

We follow this select group of listed companies since they offer a current snapshot of the DB industry, and they help set the stage for the future. Their tendencies toward de-risking via glidepaths, risk transfer and contribution policy reliably signal forthcoming industry trends. They tend to have the scale and resources to trailblaze their own path, which many other DB sponsors eventually follow.

Exhibit 1 below illustrates funded status experience for this group since 2005. The red line shows the dollar surplus or deficit, with the bars indicating the key change drivers in each year. You will notice the reverse images of 2018 and 2019. While actuarial gains reduced the deficit in 2018, the opposite occurred in 2019. The converse was true for investment gains and losses, with 2018 returns weak and 2019 returns strong. Last year was like 2017 in this way, but without the significant contributions. In fact, contributions in 2019 were the lowest we have observed since 2008, as many sponsors pre-paid contributions for a higher tax benefit in 2017 or 2018 on the heels of tax reform. The outlook for 2020 contributions is only slightly higher.

We also observe that the offsetting pattern of discount rates and investment returns continues. With the exception of 2013, DB sponsors have not experienced the benefit of actuarial gains (usually through rising rates) and positive net investment returns in the same year since 2007.

Exhibit 1: Combined surplus/(deficit) of the $20 billion club, 2005-2019[1]



Investment gains offset the actuarial losses, which were driven by a ~100 bps decrease in discount rates

The average change in funded ratio among these sponsors was -0.4%. A few notable outliers included FedEx losing 9% in funded ratio due to poor timing of asset returns and discount rate reductions with their May 31 fiscal year (the previous year they gained from this timing relative to the other companies). Honeywell performed best and still maintains the only global funded ratio above 100% in this group.

Exhibit 2 below shows how liabilities and assets performed during 2019.

Exhibit 2: 2019 global pension assets and liabilities development

LIABILITIES	(IN $BILLIONS)
Liability (Projected Benefit Obligation) at Start of Year	896.6
Accrual of new benefits (Service Cost)	11.3
Benefits paid	-54.9
Interest payable on liability (Interest Cost)	32.0
Impact of change in interest rates and in actuarial assumptions (Actuarial loss)	110.9
Miscellaneous other	-14.9
Liability (Projected Benefit Obligation) at End of Year	981.0

ASSETS	(IN $BILLIONS)
Assets (Fair Value) at Start of Year	759.5
Employer contributions	11.9
Benefits paid	-54.2
Investment return on plan assets	125.2
Miscellaneous other	-12.2
Assets (Fair Value) at End of Year	830.2

SURPLUS / (DEFICIT)	(IN $BILLIONS)
Excess (Shortfall) of assets below liabilities at Start of Year	-137.1
Excess of employer contributions over service cost	0.7
Actuarial gain (loss)	-110.9
Investment return less interest cost	93.2
Miscellaneous other	3.3
Excess (Shortfall) of assets below liabilities at End of Year	150.8

Source: Corporate 10-K Filings, Russell Investments

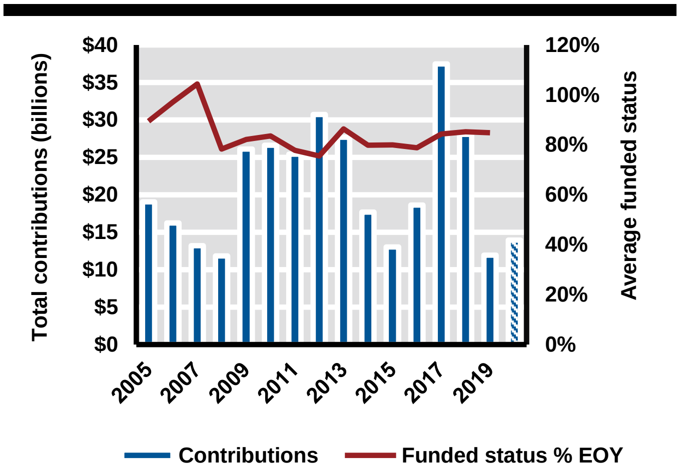
Contributions in 2019 were weak, but 2020 could be slightly up due to GE

After two years of elevated levels – mostly due to tax advantages – contributions in 2019 took a nosedive. Not only were the $11.9 billion in contributions the lowest since 2008, they also represent a year-over-year decline of over 55%. With pension funding stabilization still in place, few sponsors have significant required contributions in their US plans. Coupled with strong recent asset returns, sponsors saw little need to make discretionary contributions, despite historically high PBGC premiums that penalize the sponsors of underfunded plans.

In 2020, most of these sponsors have only committed to paying the minimum required in their U.S. and international plans, with a notable exception being GE.

Exhibit 3 shows the pattern for contributions since 2005, including an estimated value for 2020.[2]

Exhibit 3: Contributions 2005-2020



General Electric takes aggressive action and Lockheed Martin continues to transfer risk

After years of floundering funded status with minimal contributions, GE announced three major actions affecting their U.S. DB plans. With funds from recent spin-offs, they committed to paying an additional $4-5 billion into their plan in 2020, on top of $6 billion already paid in 2018. In addition, they plan to freeze benefits for 20,000 salaried employees, curbing future costs directly related to the plan.

The last action included a lump sum offer to about 100,000 former employees made in the fall of 2019. They recently announced that about $2.65 billion was transferred from the plan via lump sum due to this offer, making it one of the largest lump sum offers in recent memory.

While none of these actions are new, they are noteworthy for GE – a company that has resisted them for years.

For the second year in a row, Lockheed Martin transferred nearly $2 billion of their liabilities out of the plan, employing both buy-in and buy-out annuity purchases to supplement lump sum offers from several years ago as they try to reduce the size of their U.S. pension plans.

[1] Source: Russell Investments, Corporate 10-k filings

Membership of the $20 billion club

The $20 billion club consists of the following 20 corporations, generally included due to their global pension liabilities exceeding $20 billion:

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

These are no longer the only US-listed corporations with over $20 billion in liabilities. Others – including Exelon, Caterpillar, Citigroup and Merck – have also grown to over $20 billion. But observations and comparisons are more straightforward when the group is consistent from year-to-year.

While future adjustments are possible, for the time being the only change we have made is to replace DuPont with Corteva, which inherited the vast majority of the DuPont pension liabilities after the DOW DuPont merger/split.

[2] This is the sum of all the individual companies' expected 2020 contributions.

Related reading

Owens, J (2019). "$20 billion club: Equity downturn in Q4 nearly overshadows higher discount rates and strong contributions in 2018", *Russell Investments*

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

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

Field, A (2019). "$20 billion club strategy", *Russell Investments*, March 2019

Owens, J. (2018). "Tax Reform has been signed – what could this mean for DB plan sponsors?", *Russell Investments Blog*, January 3

Owens, J. (2018). "Record-breaking contributions and returns for $20 billion club", *Russell Investments Blog*, February 28

Owens, J. (2018). "20 billion club posts record contributions in 2017 as funded status jumps", *Russell Investments*

Owens, J. (2018). "FedEx delivers the largest DB annuity purchase since 2012", *Russell Investments Blog*, May 9

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