

AFP 2017

SAN DIEGO | OCTOBER 15-18



Aligning Fiduciary Duties with Pension Risk Management

October 16, 2017

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Agenda

- **Aligning Fiduciary Duties with Pension Objectives**
- **Working with Independent Fiduciaries and Other Intermediaries to Manage Plan Risk**
- **Solutions to Manage Pension Risk**
- **Solutions to Help Defined Contribution Participants Manage Longevity Risk**

Fiduciary Duties for Qualified Plans

ERISA Fiduciary Duties – What You Need to Know

- **ERISA's fiduciary standards of prudence, exclusive benefit and diversification**
- **Requirement to follow written plan documents**
- **ERISA's conflict of interest and self-dealing prohibited transaction rules**
- **Key words: Procedural prudence, 95-1, fiduciary delegation, risk management and documentation**

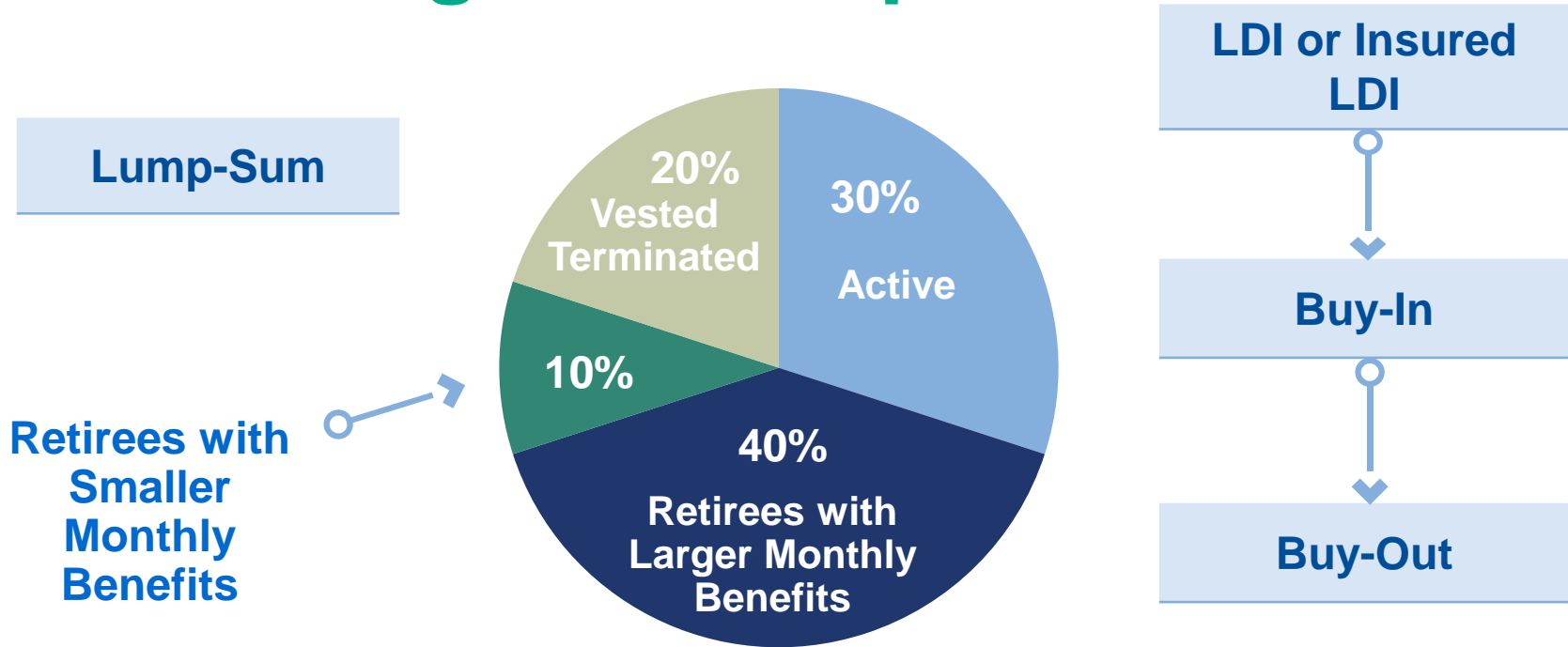
Working with Independent Fiduciaries and Other Intermediaries to Manage Plan Risk

Fiduciary Risk Management: Use of Independent Fiduciaries, Advisors and Other Intermediaries

- **What does it mean to “outsource” fiduciary duties?**
 - Key words: OCIOs, outsourced named fiduciaries, 3(38) vs. 3(21) advisors
- **What responsibilities remain?**
 - Selection and monitoring
 - Other responsibilities are based on specifics – contract terms are important
- **What we’re seeing...**

Managing Pension Risk

De-Risking Road Map



PRT Selection Process

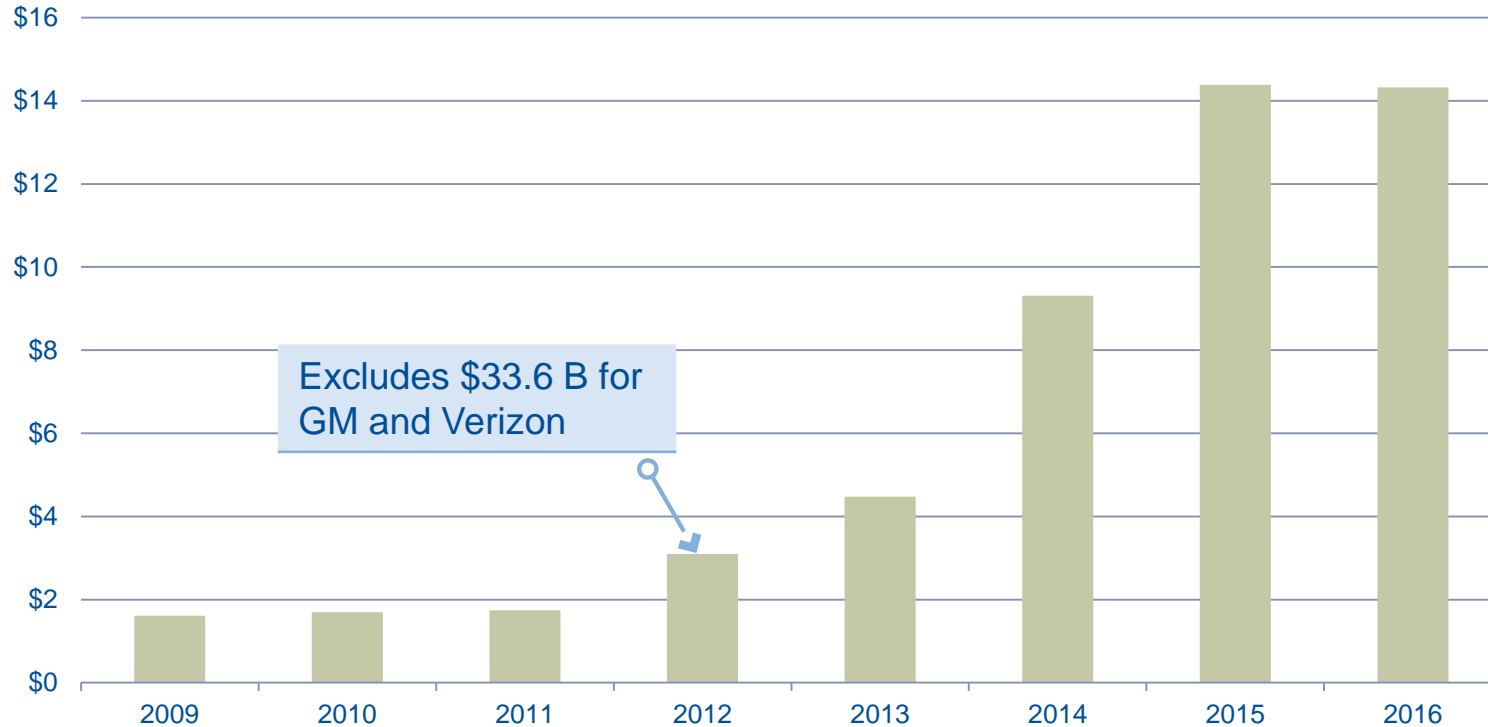
- Selection of intermediaries
- Review of insurance companies (95-1)
- Final bid day
- Selection of insurance company or companies
- Transfer of participant data

PRT – Increased Activity

Historical Sales

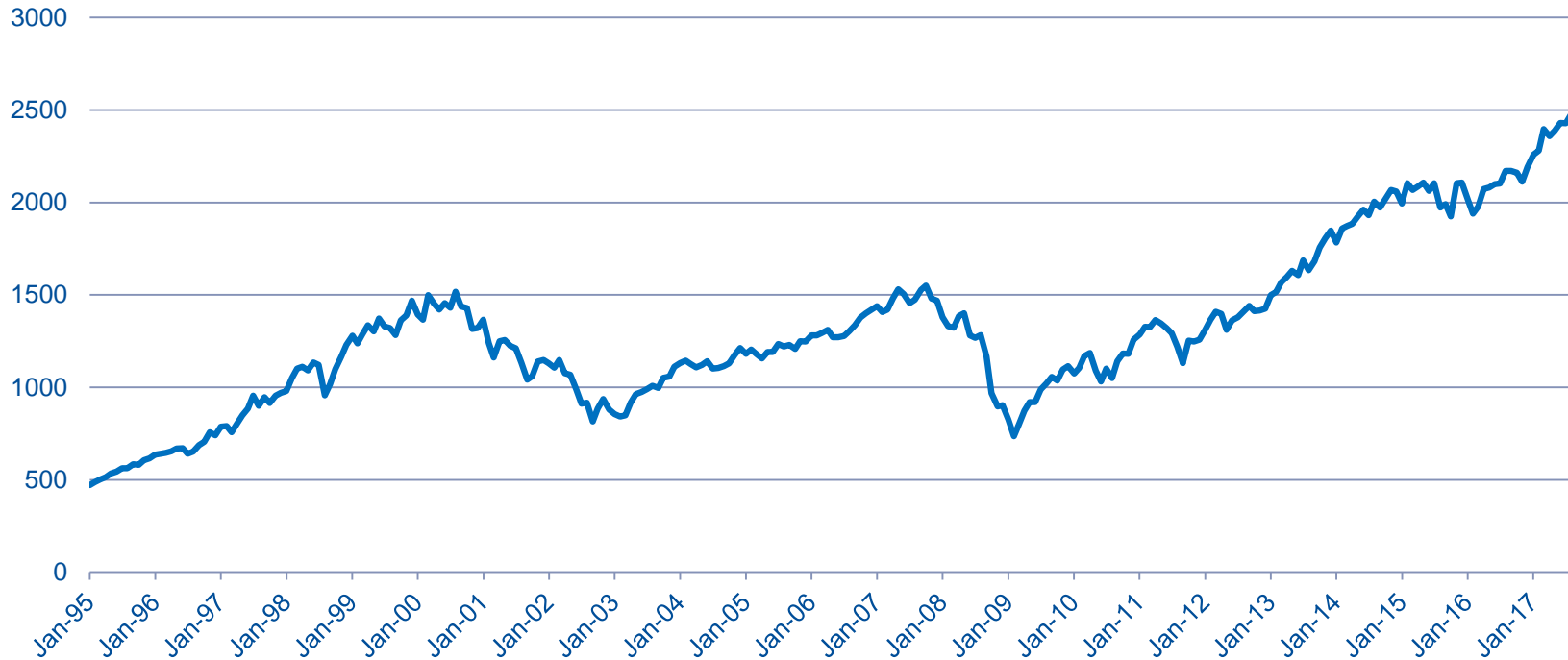
\$Billions

Terminal Funding and Buy-Outs (\$B)



Volatile Equity Market Environment

S&P 500® Index - Jan 1995 to July 2017¹

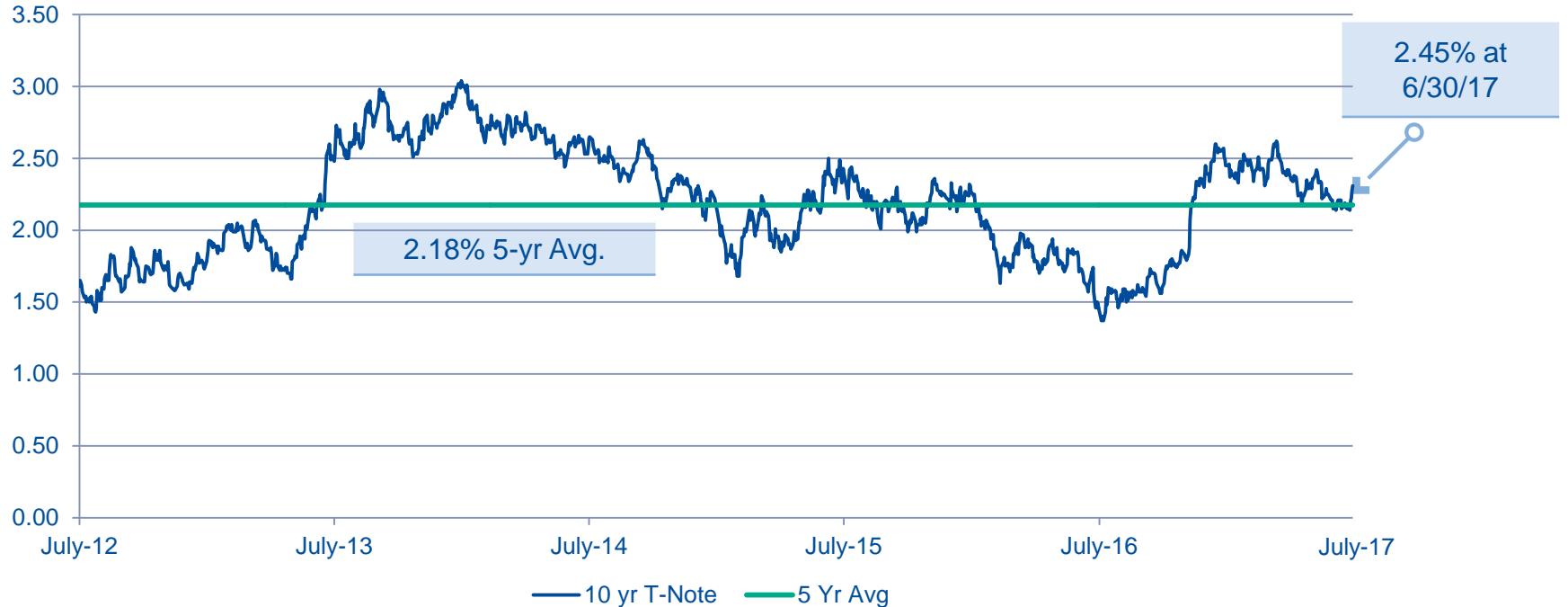


¹S&P 500® is a registered trademark of Standard & Poor's Financial Services LLC. Index value at beginning of month.



Interest Rate Volatility – 10YR T-Note

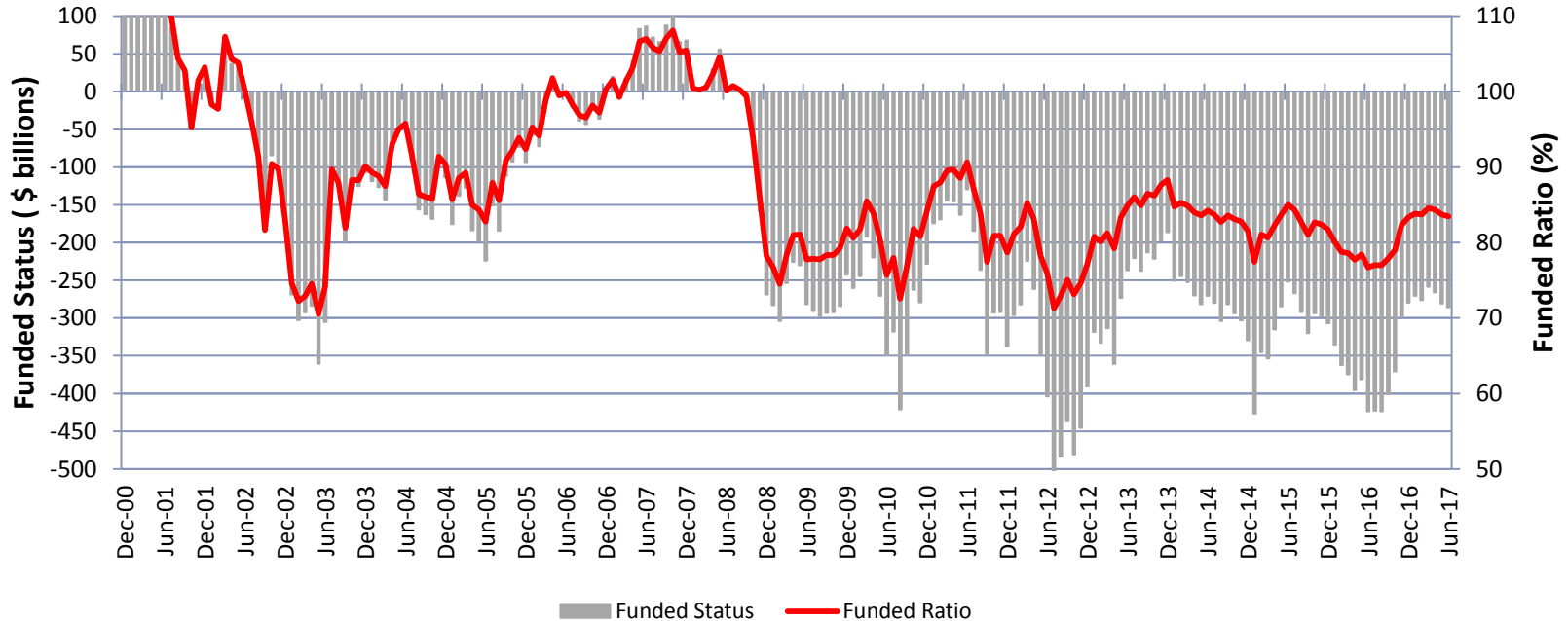
10 yr T-Note - 5 Year History



Source: US Department of Treasury, June 30, 2017

Pension Risk Market Environment

Milliman 100 Pension Funding Index Pension Surplus/Deficit and Pension Funded Ratio

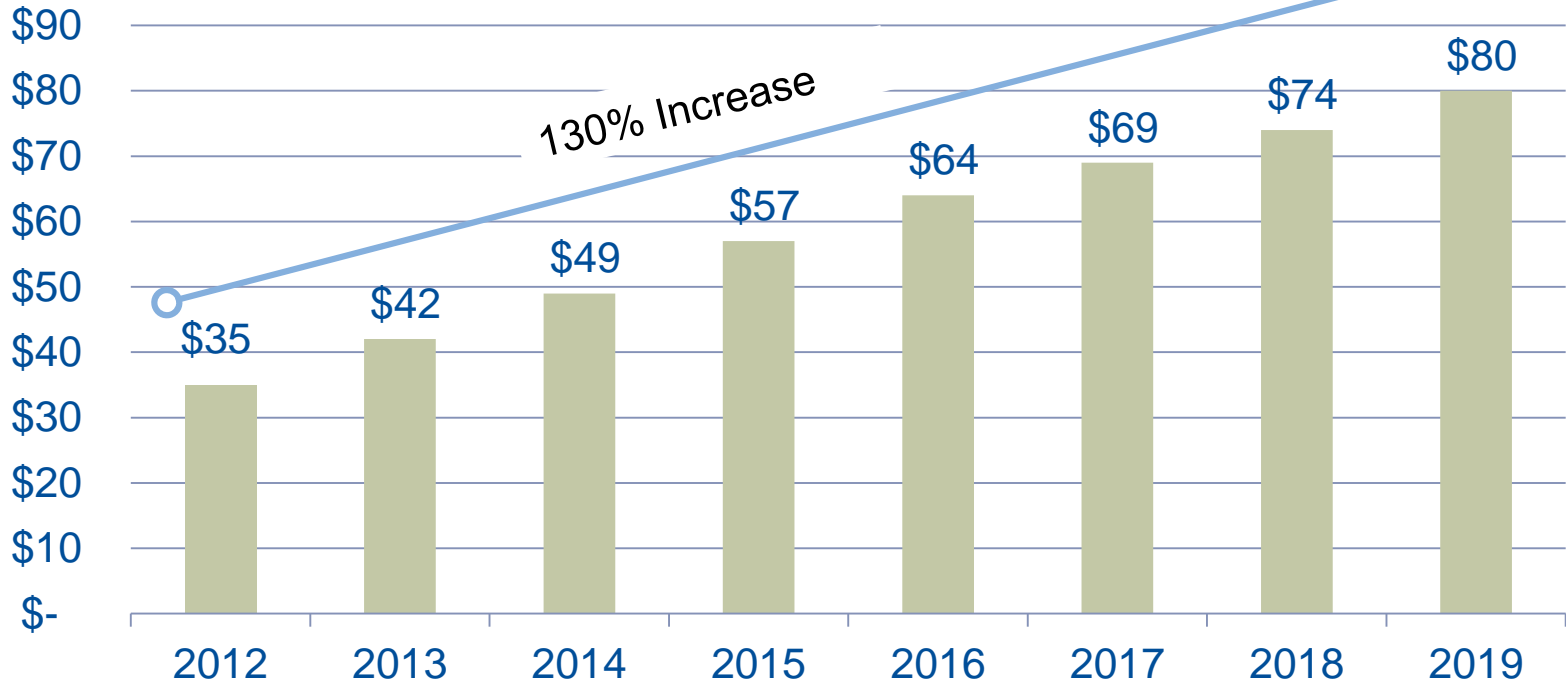


Source: Milliman 100 Pension Funding Index, July 2017.



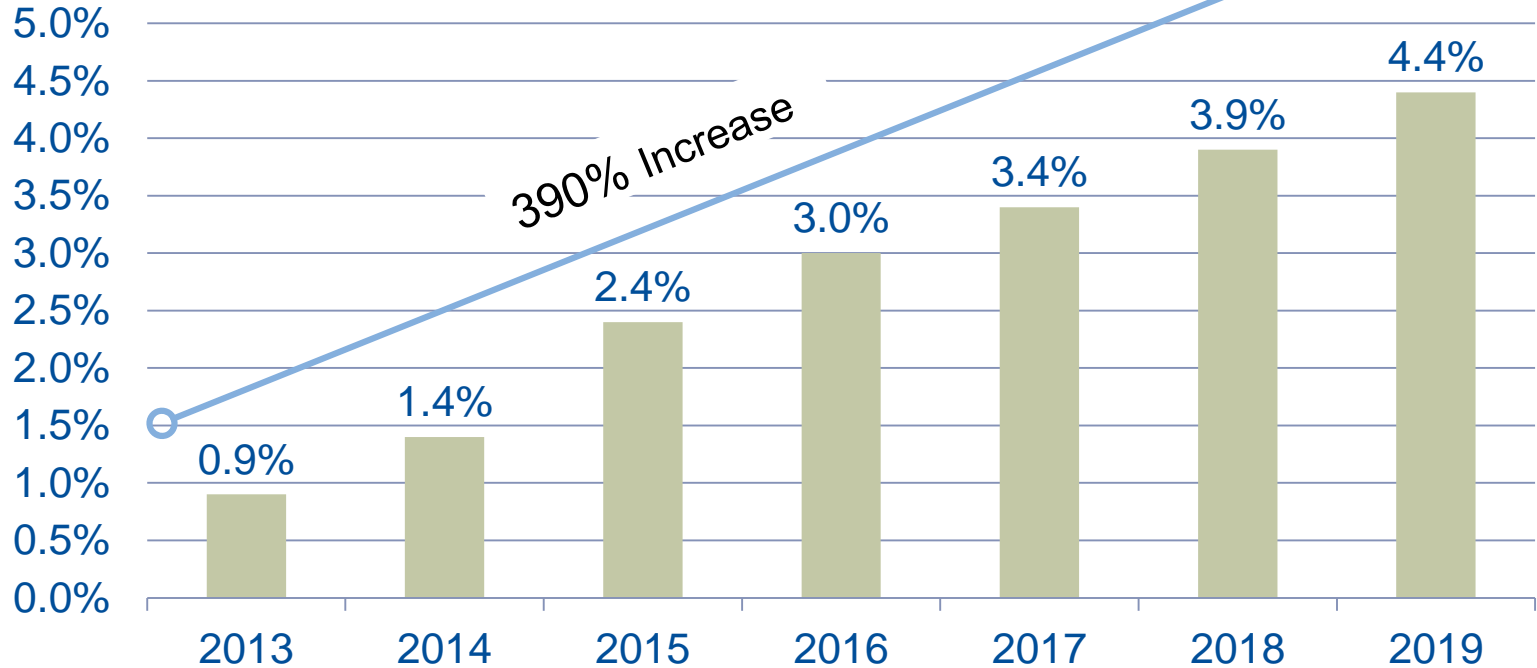
PBGC Premium Increases

Flat Rate Premium (Per Participant)



PBGC Premium Increases

Variable Rate Premium (Unfunded Liability)



Premium rates, Pension Benefit Guaranty Corporation website. December, 2016
Assumes 3% annual increase in National Average Wages

Buy-Out

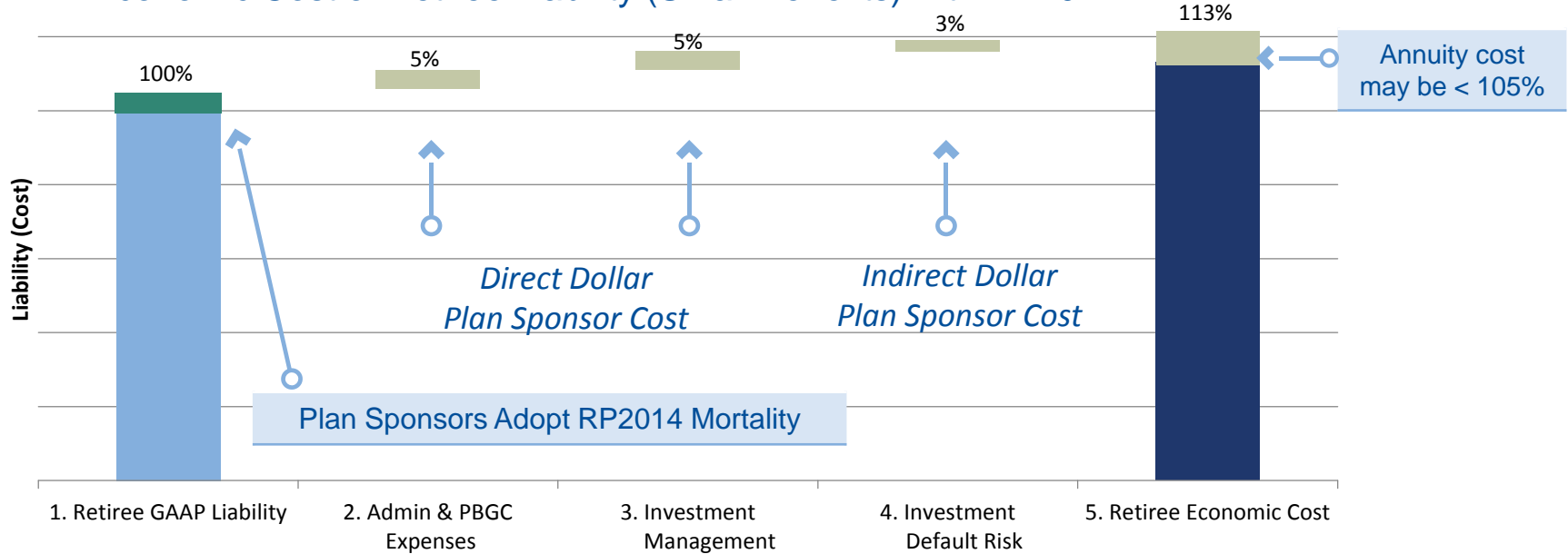
Buy-Out: Key Features

- **Can cover part or all of the plan participants**
- **For Covered Participant Group:**
 - Transfers all pension obligations and risks to insurer
 - Removes the pension liability from plan sponsor's balance sheet
 - Plan sponsor no longer subject to PBGC premiums and other expenses
 - Insurer provides all annuitant servicing

Case Study: Reducing Expense With a Buy-Out

For illustrative purposes only.

Economic Cost of Retiree Liability (Small Benefits) with RP2014



1. Liability for accounting based on current market discount rate for retiree liability
2. Estimated administrative expenses including actuarial fees and PBGC fixed-rate premium of \$80 per person
3. Estimated investment management fees (assumes 50 bps per year)
4. Estimated cost of defaults on high-quality bond portfolio (assumes 30 bps per year)
5. This is the true economic cost if the plan sponsor retained the liability

Buy-In

Buy-In vs. Buy-Out: What is the Difference?

- **Buy-In is similar to Buy-Out except:**
 - Settlement accounting?
 - Contract value remains an asset of the plan/trust
 - Change in plan's funded status?
 - No communication required to participants
 - Revocable?
- **May be converted to Buy-Out**

When Does a Buy-In Make Sense?

- **Qualified Plans**
 - Underfunded plan
 - Unrecognized losses
 - Not ready to terminate
- **Nonqualified Plans**
 - Defined benefit SERP

Buy-In Case Study #1:

Delay Recognition of Settlement Loss

- **Buy-In purchased in August 2015**
- **Buy-In contract covered current retirees**
- **Converted to buy-out in April 2016**
- **Settlement accounting triggered in 2016 at conversion**
- **Loss recognized in 2016 instead of 2015**
- **Plan terminated in 2016**

Managing DC Plan Longevity Risk

How Long Will You Live?

50% Probability of living to future age from 65

Male

22 Years

Age 87

Female

25 Years

Age 90

How Long Will You Live?

50% Probability of living to future age from 65

Male

22 Years

Age 87

Female

25 Years

Age 90

Last survivor of a couple

29 Years

Age 94

How Long Will You Live?

50% Probability of living to future age from 65

Male

22 Years

Age 87

Female

25 Years

Age 90

Last survivor of a couple

29 Years

Age 94

20% Probability of living to age 100 from 65

Last survivor of a couple – 20% chance of living > 35 Years

Age 100

Guaranteed¹ Lifetime Income Options for DC plan

- **Few DC plans provide access to an annuity**
 - In Plan
 - Out of Plan
- **Rollover to IRA - Often only option**
 - May rollover entire account even though only portion used for annuity
 - Retail annuities typically cost more than institutional annuities

¹Guarantees are subject to the claims-paying ability and financial strength of the issuing insurance company.



Should More Money Stay in DC plan?

- **New DOL fiduciary rule may reduce IRA rollovers by 50%**
 - According to The Cerulli Report – “US Evolution of the Retirement Investor 2016”
- **Best interest of participant?**
- **IRAs have higher average expense ratio**
 - 0.71% IRA vs 0.54% 401(k) (Investment Company Institute)
- **Good for DC plan**
 - More assets = lower average expense through economies of scale

Advantages of Guaranteed Lifetime Income Options in DC plan

- **Plan can negotiate lower or no commissions**
- **Receive wholesale pricing**
- **Retain non-annuitized assets in plan**
 - lower average expense for participants

Fiduciary Duties of Guaranteed Lifetime Income Options in DC plan

- **Communication**
- **Safety of Insurance company**
- **Offer more than one company?**
- **Administration/Coordination of quotes**
- **Recent Treasury and DOL guidance**
- **Role of outsourcing**
- **Portability**

Questions?

Appendix

Biographies

Mark Simons

Mark is of counsel in the top-ranked benefits practice of Morgan, Lewis & Bockius LLP, with 27 years of experience in advising clients on matters related to qualified and non-qualified retirement plans. In particular, Mark advises plan sponsors on matters related to fiduciary governance and regulatory compliance under Titles I and II of ERISA, and has assisted a wide variety of corporate plan sponsors and related fiduciaries in de-risking their tax-qualified defined benefit plans.

Russ Proctor, FSA, CFA, EA, MAAA

Russ joined Pacific Life in 2011 as a director in the Retirement Solutions Division. He is responsible for consulting with companies to reduce and remove financial risk inherent in their pension plans through the Pacific Life buy-out, buy-in, and insured LDI solutions. Russ also works with companies who have defined contribution plans, such as a 401(k) or 403(b) plan, to provide guaranteed lifetime income options for plan participants.

Prior to joining Pacific Life, Russ was a retirement consultant with more than 24 years of experience, most recently as a principal with Mercer Human Resource Consulting. He provided strategic retirement consulting on all aspects of pension, 401(k), and executive retirement plans. He also conducted asset-liability modeling studies for clients and co-authored several articles including one on Liability Driven Investing.

Russ holds a Bachelor of Science degree in actuarial science from Drake University. He is a Fellow of the Society of Actuaries (FSA), a Fellow of the Conference of Consulting Actuaries (FCA), an Enrolled Actuary (EA) and a Member of the American Academy of Actuaries (MAAA). He is also Chartered Financial Analyst Charterholder (CFA).

Biographies

Marty Menin

Marty joined Pacific Life in 2012 as a director in the Retirement Solutions Division. He is responsible for consulting with companies to customize solutions that solve the financial risk inherent in their pension plans through the Pacific Life suite of pension-risk products. Marty also works with companies who have defined contribution plans, such as 401(k) or 403(b) plans, to provide guaranteed lifetime income options for plan participants.

Prior to joining Pacific Life, Marty held a variety of positions in the insurance and employee benefits industry for firms such as Prudential, Mullin/TBG, Marsh & McLennan, Merrill Lynch, and MetLife.

Marty holds a Bachelor of Science degree in mathematics and economics from University of California, Los Angeles.

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