Adopting Hybrid Pension Plans

Effects of Economic Crisis and Regulatory Reform

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History of Hybrid Plans

- The first hybrid plan was adopted by Bank of America in 1985
- Through the 1990s, there was a surge of hybrid plan adoptions
- Motivations for adopting hybrid plans
  - Changing accounting rules
  - Increasing preferences for more mobile pensions
  - Shifts in compensation packages that reduced dollars allocated to retirement plans
  - Overfunded status of some traditional plans

New Millennium Brought Shift in How Employers Viewed Hybrid Pensions

- Law suits began to emerge around the turn of the century
  - Transition methods used by some conversions called "wear-away" were accused of violating age discrimination laws and policy
- The uncertainty of the legal status of these plans resulted in a sharp decline in plan conversions between 2004 and 2006.
  - Recently, in the courts and the legislature, most charges have been dismissed or resolved
- Passing of the Pension Protection Act of 2006
  - New law provided an age discrimination safe harbor for hybrid plans encompassing essentially all existing designs
  - Essentially legalized all hybrid plans

Then Came the 2007 Economic Recession

- The sharp decline in the value of pension assets due to the recession became the primary disincentive for sponsoring pensions
- However, there were a number of hybrid plan adoptions, albeit smaller than in the 1990s, by plan sponsors who still wanted to offer a “DB+DC” retirement plan design
  - Offering hybrid plans allows plan sponsors to continue offering a benefit that did not fluctuate like benefits from DC plans
  - The investment risk of offering a hybrid plan versus a traditional DB plan is lower for the plan sponsor

Adopting Hybrid Plans from 2000-2009

- Due to the legal battles, regulatory reform, and the 2007 economic recession, growth of hybrid plans in the last decade has fluctuated
- To identify the determinants for converting to a hybrid plan in the last decade we perform analyses using two data sources
  - Form 5500 data files for years 2000-2007
  - Towers Watson's Fortune 1000 pension finance data for fiscal years 2000-2009

Form 5500 Non-Frozen Pensions Sponsored by Fortune 1000 Companies

Plan Year	Number of Hybrid Plans	Hybrid Plans as a Percentage of DB Plans	Active Participants in Hybrid Plans as Percentage of Active Participants in DB Plans	Assets in Hybrid Plans as Percentage of Assets in DB Plans
2000	134	13%	27%	31%
2001	126	13%	25%	30%
2002	163	17%	29%	34%
2003	192	19%	36%	37%
2004	189	20%	39%	39%
2005	207	23%	42%	40%
2006	185	23%	40%	39%
2007	195	25%	46%	44%

Note: We identified Form 5500 pensions using Employer Identification Numbers and Name identification. We found over 80% of Fortune 1000 companies in the Form 5500 data

Pension Plan Conversions by Year for Fortune 1000 Companies

Year	Continuing Sponsoring Traditional DB Plan (Active or Closed DB Plan)	Converted to Hybrid Plan	Total
2000 to 2001	433	18	451
2001 to 2002	414	12	426
2002 to 2003	395	11	406
2003 to 2004	347	1	348
2004 to 2005	313	1	314
2005 to 2006	308	1	309
2006 to 2007	288	5	293
2007 to 2008	232	8	240
2008 to 2009	219	2	221
Total	2949	59	3008

Note: We identified a conversion for a Fortune 1000 company when at least one of their plans converted to a hybrid plan

Logit Regression Results for Fortune 1000 Companies including Plan Information from Form 5500, 2000-2007

	First Regression		Second Regression		Third Regression	
	Coefficient	Std. error	Coefficient	Std. error	Coefficient	Std. error
Intercept	-4.367*	2.411*	-8.033***	2.738***	-9.424***	3.055***
Weighted average funding level	-0.667	0.727	0.341	0.685	0.520	0.633
Weighted average actives/retirees	-0.0006	0.004	-0.0003	0.003	-0.00007	0.003
At least one plan is collectively bargained indicator	0.557***	0.1561***	0.549***	0.161***	0.554***	0.169***
Weighted average total participants per plan	0.000004	0.000002	-0.000004*	0.000002*	-0.000005**	0.000002**
Logarithm of average of plan assets	0.197	0.136	0.272*	0.140*	0.280*	0.147*
Offer 3 plans or more indicator	0.238	0.270	2.872*	0.276*	0.223	0.279
PBO/market value	2.129***	0.408***	1.867***	0.428***	1.985***	0.440***
(Total pension assets-PBO)/market value	3.790***	1.420***	2.872*	1.486*	3.076*	1.514*
EPS	0.00003	0.0002	-0.00005	0.0002	-0.00005	0.0002
Logarithm of market value	-0.222*	0.123*	-0.255**	0.123**	-0.209	0.130
Year dummy variables	No		Yes		Yes	
Industry dummy variables	No		No		Yes	
-2 Log L	588.706		558.984		546.701	

N=1,327

Conclusions

- Large company conversions do not appear to be driven by the funded status of the individual plans they sponsor
- Rather, the overall financial health of the company and the overall size and overall health of all of the plans they sponsor appear to be motivating companies to convert to a hybrid plan
  - It seems that companies that have a smaller market capitalization and large pension benefit obligations and pension assets relative to their market capitalization were more likely to convert
  - It seems that when companies were not doing well relative to their peers, changing their pension plan design was more likely, perhaps in an effort to reduce costs

Policy Implications

- Implications of the current regulatory process
- What we expect to see in the next 5-10 years