# WHY RECOVERY IS MORE DIFFICULT FOR PENSION PLANS

**You may have noticed that most of your friends with 401(k) plans say their investments have bounced back from the 2008 economic crisis. This may lead you to wonder, why not our Pension Plan? The stock market crisis hit pension plans harder than the average 401(k) plan for several reasons.**

## Measuring Recovery

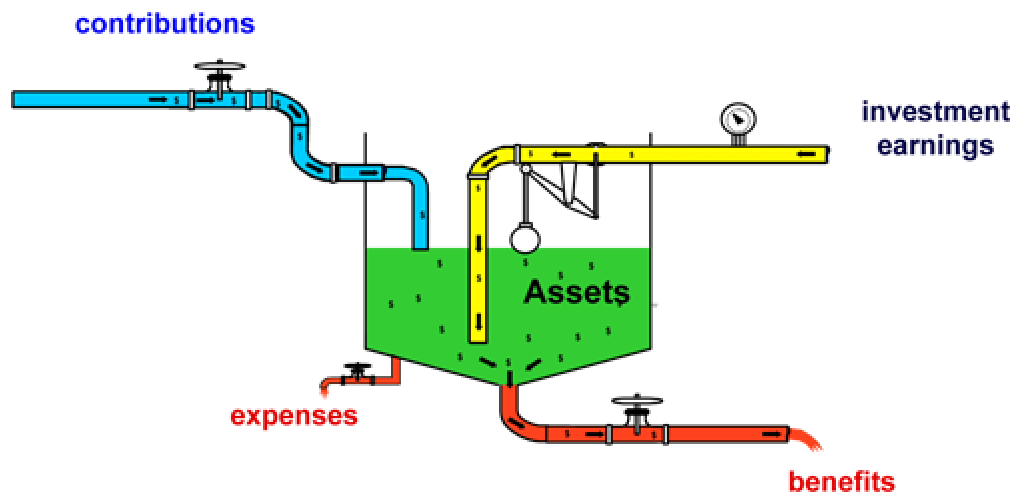
Many people considered their 401(k) plan “recovered” when their account balances returned to precrash levels. By this measure, a typical 401(k) participant who continued making contributions and stayed in a balanced portfolio would have likely “recovered” by 2010. But this measure of recovery only looks at reaching the previous high balance. It does not account for the fact that the person is now two years older and no closer to his retirement goals.

Pension plans measure recovery differently. A plan is generally considered recovered from the market downturn when the funded percentage of the plan returns to pre-crash levels. The funded percentage is the current assets divided by the liability. The liability is the value in today’s dollars of all the benefits promised by the plan. To do this calculation, the actuary makes an assumption for the long-term expected investment return of the plan’s assets.

Our Plan assumes investment returns of 7% per year. In a year when the assets earn 8%, the Plan gets 1% ahead; if the assets return 6%, it is 1% behind. In 2008, our Plan had a negative 33% return on investments – this didn’t put us 33% behind, it put us 40% behind: (-33% + -7% = -40%)! Looking at this example, it is easy to see that a 401(k) plan participant who makes no assumption regarding investment return, can “recover” faster than a pension plan with a 7.0% investment return assumption. In fact, if a 401(k) plan participant assumed 7% future returns, he would not have considered his 401(k) recovered until 2014.

## Plan Maturity and Negative Cash Flow

Two other related factors – plan maturity and negative cash flow – have made recovery even more difficult for our Plan. Before we explain, let’s look at a pension plan using a plumbing model. Contributions made on behalf of active employees (blue) and investment earnings (yellow) contribute to plan assets (green). The assets are then used to pay for retiree benefits as well as Plan expenses, such as administrative tasks (red).



Our Plan is experiencing a combination of plan maturity and negative cash flow:

- **Plan maturity** occurs when the pool of assets (green) is very large compared to the annual contributions (blue). In this Plan, annual contributions are about 1% of assets. The expected return each year of 7% of assets is much larger than the contributions. This means that the future funded status of the plan relies more on investment earnings than contributions. Contributions are still important, they just have smaller impact than they had when the size of the Plan was smaller.
- **Negative cash flow** occurs when benefit payments to retirees and expenses (both in red) are greater than the contributions (blue) to the Plan. During 2008, our plan lost a great deal of assets in the market and it lost some due to negative cash-flow. This made it more difficult to recover because pool of assets is being drawn down by benefit payments resulting in less assets to get the great returns in the years following 2008. This makes Plan assets and funded status slow to recover.

Working people with 401(k) plans do not experience plan maturity and they generally have positive cash flow (more money going in than coming out). So, contributions that came in during 2008 helped 401(k) plans recover, because more assets were available to get the good returns after 2008. This is the exact opposite of what happens for a pension plan.

# Looking Ahead

As we move forward, the biggest factors affecting recovery of our Plan will be a combination of market returns and contributions. To help recovery, in 2010 we implemented the Rehabilitation Plan which increased contributions, removed adjustable benefits, and reduced the accrual rate. These changes are understandably painful but necessary to help the Plan's funding recover. Overall, the Plan's investments have outperformed expectations due to a strong stock market since 2008. Over the six years following 2008, the Plan has averaged 11% per year returns, 4% higher than the 7% assumption. Because the funded percentage is only 90%, our Plan still has a ways to go before approaching the pre-crash high of 105% funded, but with the Rehabilitation Plan it is expected to recover over time.