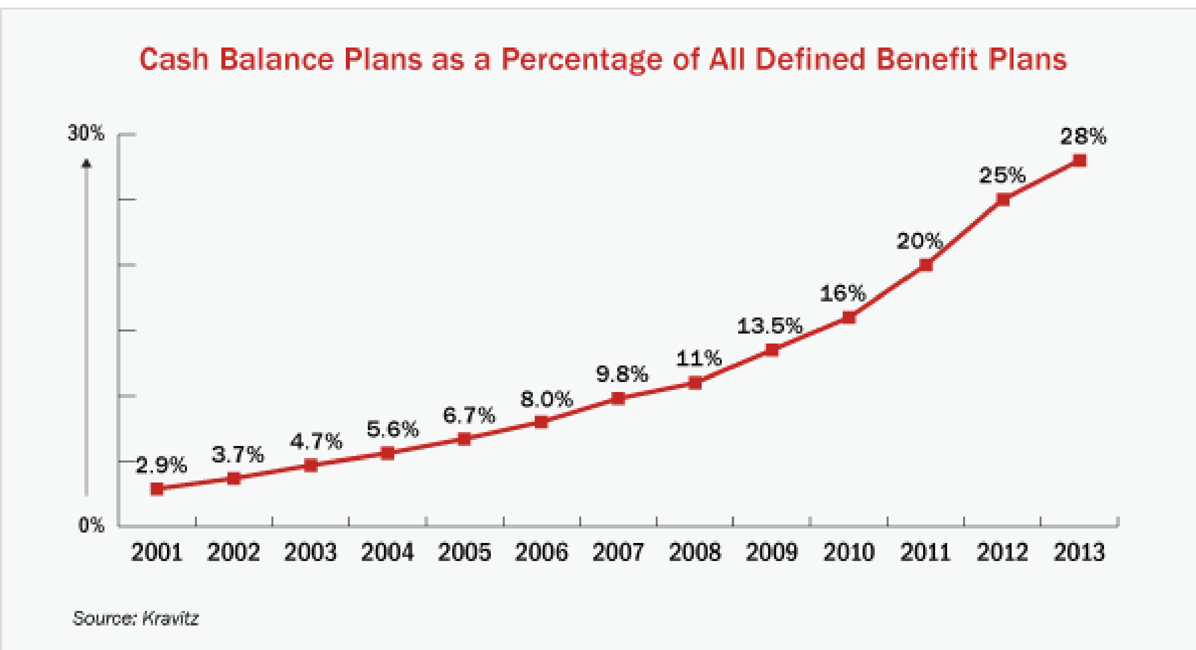
# New DB Plan Growth Offers Managers Hope in Fading Sector

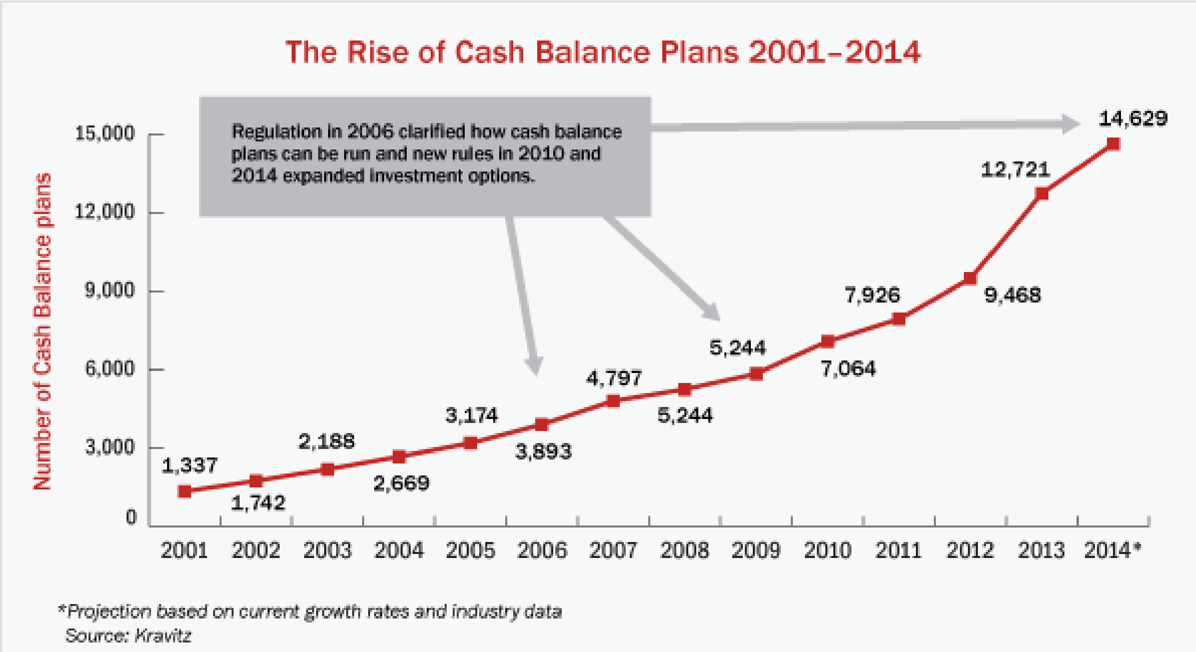
By Jake Safane December 10, 2015

One type of defined benefit plan that can sit within defined contribution offerings provides significant opportunity for separate account asset managers to thrive, experts say.

Cash balance plans are DB plans that resemble DC plans by providing employees with a total dollar value of the account rather than defined monthly payout. They are typically used in combination with DC plans, focus on conservative asset classes like fixed income and low volatility, and are gaining popularity.

These plans measured nearly $1 trillion in aggregate across the U.S. at the end of 2013 and accounted for 28% of all DB plans in 2013, up from just 2.9% in 2001, according to retirement plan administrator **Kravitz**.






For asset managers facing a structural move away from DB plans, cash balance plans could become a critical feature of the separate account industry.

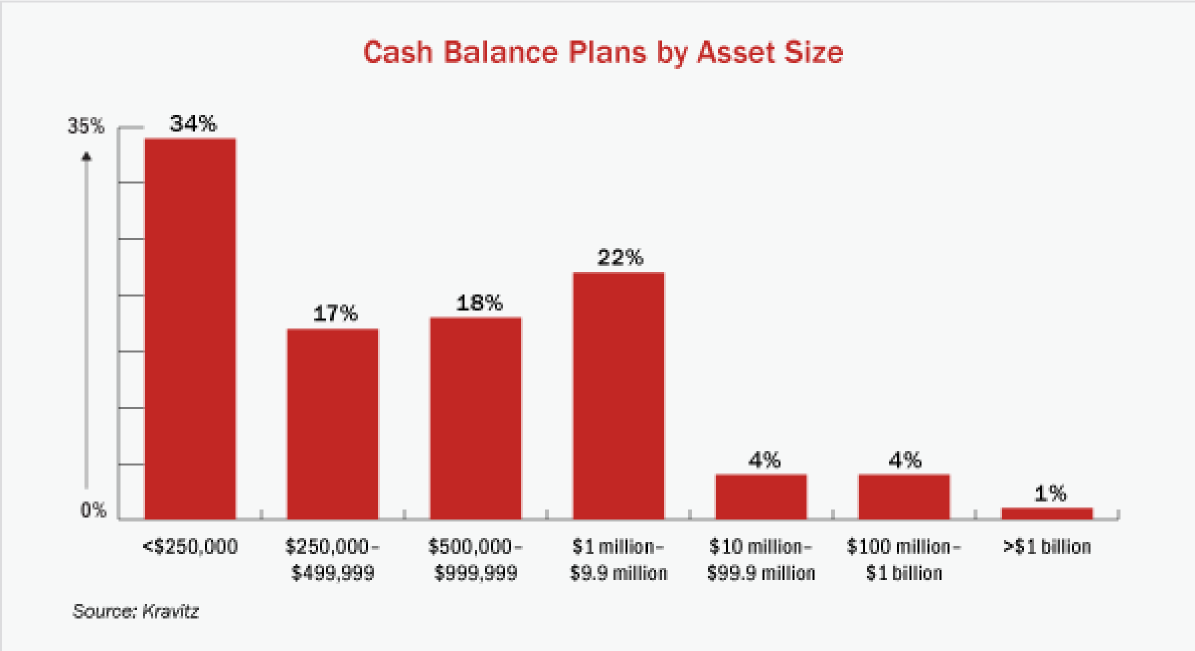
The combination of corporations shunning DB plans for DC options and the fact that a few large mutual fund complexes dominate the DC market will mean a bulk of separate account asset managers will be fighting for fewer assets, says **Russ Kamp**, managing partner at Kamp Consulting Solutions.

"If DB plans go away and only a handful of asset managers dominate the DC space, what happens to all the other asset managers?" says Kamp. "I've been wondering where the outcry [from separate account managers] has been in terms of defined benefit plans."

Although technically DB plans, cash balance plans straddle the line between the DC and DB sectors, according to Kravitz, so not all asset managers will benefit from the proliferation of these plans.

For new cash balance plans, "the investment choice is going to be somewhat limited… it might not be unusual to start with mutual funds," says **Dick Botelli**, principal and actuary at Milliman.

But managers looking to offer separate accounts to cash balance plans still have a significant amount of assets to target, especially as traditional DB plans convert to this structure. Corporations like **AT&T** and **IBM** were early adopters, converting their traditional DB plans to cash balance plans in 1997 and 1999, respectively, and both winning against employee lawsuits related to the conversion. Now, each has over $50 billion in assets in these plans. Healthcare organizations are also a popular segment for cash balance plans, with several hospitals having over $1 billion in assets.

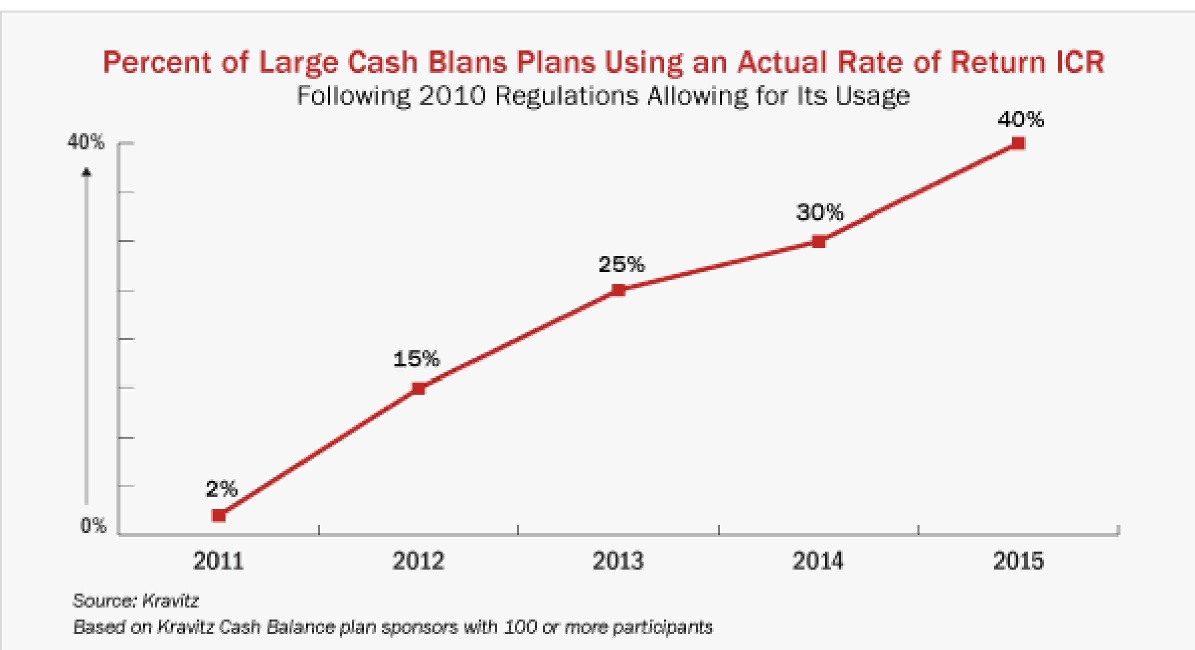



The asset manager's role in overseeing these plans depends on how they are set up, as the employer is responsible for a fixed contribution to the account as well as what's termed an interest crediting rate (ICR), which is an additional contribution linked to investment returns. Like a traditional DB plan, the employer is responsible for the crediting rate regardless of the actual returns.

The ICR varies based on the plan, but in many cases it's tied to a relatively modest return benchmark such as the 30-year Treasury rate. New regulations cap the maximum ICR at 6%, though employers can still choose a lesser rate.

However, new regulations also allow plan sponsors to choose an actual rate of return as the ICR, as long as the investments meet certain diversification requirements. This allows employers to have different return objectives for different employee segments, such as a more aggressive strategy for younger workers.

"For a brand new cash balance plan, [the ICR] is typically going to be the actual investment return. For existing cash balance plans it's all over the place," explains Milliman's Botelli.



Still, because plan sponsors are responsible for paying out the principal contribution and some plans are primarily aiming for the tax benefits of reducing participants' gross income, cash balance plans tend to be less aggressive than other investors, including some types of public pensions. Thus, fixed income and low-volatility managers could benefit the most, similar to what's playing out in the liability-driven investing (LDI) space.

One manager targeting institutions that have established cash balance plans is Sage Advisory Services.

The firm is creating ICR-sensitive strategies and teaming up with administrators and actuaries to fight for cash balance assets and educate other institutions about the benefits of these plans.

Larger asset managers will likely enter the space later once cash balances grow, similar to how the LDI space grew, says **Bob Smith**, president and CIO at Sage. "I don't know if there's enough meat on the hoof yet, but it's building," he adds. "I would argue that over the next 10, 20, 30 years that this is the new paradigm in terms of how do we create an accretion in benefits."

For now, the majority of the cash balance plan growth is coming from smaller companies starting new plans, but there may be more conversions of large traditional DB plans over the next few years, according to Kravitz, as an alternative to terminating a troubled plan.

In addition, the administrator's president, **Dan Kravitz**, says more public pension plans are also considering a conversion to cash balance plans. And rather than being reactive, the broader investment management industry can potentially nudge these plans' growth. "There's an opportunity for the investment community to add value by helping participants understand how they work," he says.