Aon Hewitt
Retirement and Investment

Introduction to Delegated Pension Manager

Overcoming Current Challenges Facing Defined Benefit Plans

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Investment advice and consulting services provided by Aon Hewitt Investment Consulting, Inc., an Aon Company.

The decline of the defined benefit plan as the primary source of employer-provided retirement income in the United States is well documented. As a result, a growing number of pension plan sponsors are strapped with a closed or frozen pension plan that provides no recruitment value; declining, if any, retention value; and ongoing financial stress on the organization. The majority of these plans face a funding deficit, which along with today's low interest rate environment, makes immediate plan termination an expensive and typically unrealistic proposition.

At the same time, the recent evolution of pension plan management has been dramatic. The traditional approach taken by plan sponsors—predicated upon a static investment policy, independent asset and liability strategies, and multiple vendors providing support—lacks the dynamic qualities required to efficiently manage a plan through the complexities of today's landscape. Success in the new era of pension plan management hinges on the ability to integrate investments with the liability profile, dynamically adjust asset allocations, settle liabilities opportunistically and coordinate strategies. All of this is required in addition to maintaining sound governance and ensuring benefit security for participants.

This scenario creates a quandary for plan sponsors. Efficient plan management requires more resources, more frequent attention and a more integrated strategy than ever before. Yet the role of the pension plan within the organization has diminished, which—all else aside—suggests that fewer resources should be devoted to managing the plan. As a result, Aon Hewitt has designed our turnkey Delegated Pension Manager approach to help plan sponsors overcome these obstacles.

Defining the Barriers

When it comes to managing closed and frozen pension plans, sponsors generally have one of the three following primary objectives:

- Eradicate any deficit efficiently and cost-effectively and then terminate the plan
- Sustain the plan for an indefinite period of time
- Terminate the plan immediately

Regardless of the objective, managing a pension plan is complex, and plan sponsors commonly cite a number of barriers that prevent them from effectively managing their plans:

- Volatility of pension costs
- Internal capacity restraints
- Increasing fees
- Execution of settlement strategies

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To add to the complexity, seeing a plan through to its ultimate termination involves many areas of plan management, including investments, actuarial, administration and end-game strategy. Within each, there are a number of important issues that must be addressed. Plan sponsors should consider the following questions:

Investment Policy	Actuarial
Do you have a dynamic investment policy in place that reduces risk exposure as the funded status improves?	What is the appropriate funding strategy going forward?
Do you have a partner that shares in the fiduciary responsibility associated with managing and executing your investment strategy?	What strategies should be considered to minimize the impact of the mortality table updates and large increases in PBGC premiums that will be seen over the coming years?
Administration	**End-Game Strategy**
Should you consider implementing a lump-sum window for terminated vested participants?	Should you consider opportunistic annuitization strategies (e.g., annuitizing the retiree liability)?
Who will manage any data clean-up that needs to be done, either now or in the future, before the plan is ready for termination?	How will you handle the fiduciary responsibility associated with the DOL requirements tied to identifying the safest available annuity provider?

Road Map for Successful Plan Management: A Three-Phase Approach

To overcome these barriers, a growing number of companies with the ultimate goal of plan termination have found success by implementing a three-phase approach to accomplish their objectives.

Phase 1: Strategy Development

As you're considering what to do with your closed or frozen pension plan, an important first step is to map out a guide for future plan management. This includes establishing an integrated investment strategy and formulating some initial thoughts regarding your time horizon.

Historically, the primary goal for managing pension plans has been to outperform asset benchmarks—and that may be what you have in mind. However, while investment manager outperformance is certainly desirable, asset-only benchmarks are inefficient due to a number of market, regulatory and plan-specific factors. A more efficient approach is to adopt a dynamic strategy for pension plan management, with the appropriate benchmark being funded status and the management of assets occurring in tandem with the liabilities.

This dynamic strategy should be documented in the plan's investment policy statement. Within the policy, you should consider incorporating both a custom glide path and a custom hedge path that will better match the plan's assets and liabilities over time. The glide path establishes a policy for systematically moving from return-seeking assets to liability-hedging assets as the plan funded status improves. A

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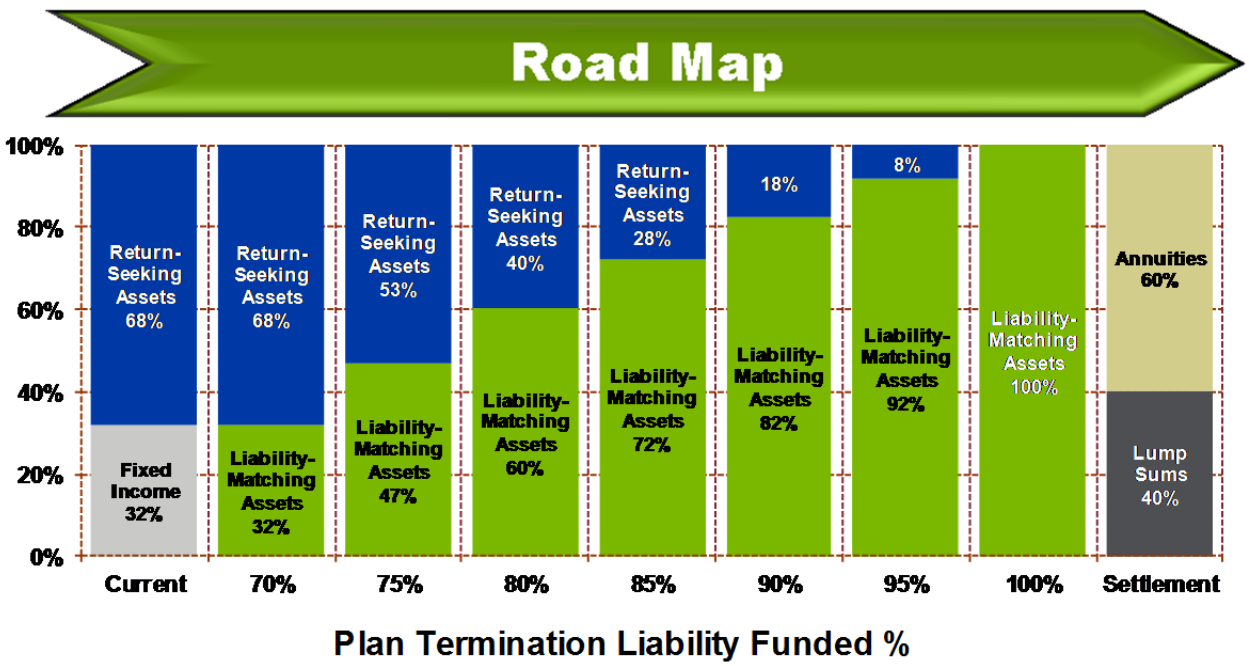
hedge path establishes a framework for extending the duration of a plan's fixed income holdings and, in turn, the plan's hedge ratio—or the percentage of the interest rate exposure that is hedged—as interest rates move. This allows the plan to take advantage of the current interest rate environment.

Collectively, the glide and hedge paths help insulate the plan against funded status deterioration, while reducing the expected cost and risk associated with eradicating the deficit.

Illustrative Glide Path



Phase 2: Strategy Execution—Deficit Reduction, De-Risking and Opportunistic Settlements

After mapping out your path for future plan management, you can turn your attention to executing the strategy. As you progress through this phase, it's critical that you adhere to the full spectrum of ongoing actuarial, administration, investment and compliance activities associated with plan management, including:

Deficit Reduction. By implementing the glide path and hedge path strategies developed in Phase 1, the plan deficit can be reduced while avoiding significant funded status deterioration.

De-Risking. Continuing to adjust the plan's asset allocation as you move down the glide path and hedge path will serve to reduce contribution and P&L expense volatility as the plan's funded status improves.

Opportunistic Settlements. Plan sponsors should consider lump-sum settlements and annuity purchases to offload segments of the plan's liabilities at more attractive costs than may be available through plan termination, especially as the plan becomes better funded and economic conditions change. Timing lump-sum windows in advance of required changes to mortality assumptions to maximize cost savings may also be beneficial.

It is also important to revisit your strategy regularly as market conditions change. Much can be gained from maintaining a flexible strategy that reacts opportunistically when favorable conditions arise.

Phase 3: Plan Wind-Down and Termination

This final phase entails executing the wind-down and termination of your pension plan, while adhering to all compliance requirements associated with the process. Generally, this process takes about 18 to 24 months, and includes several regulatory and compliance requirements.

At this stage in the process, it will be necessary to devise a custom investment strategy, including liquidity management and development of a fully hedged completion portfolio. If a lump-sum window will be offered during the plan termination process, you will need to perform benefit calculations and develop, distribute and process election packages. These carefully crafted strategies will help avoid trapped surplus, which could be subject to an excise tax of up to 85%.

Delegated Pension Manager (DPM): Our Turnkey Delivery Model

Even with a clearly articulated road map in place, it is still easy to feel overwhelmed by the multitude of responsibilities associated with managing a closed or frozen pension plan. At Aon Hewitt, we have a deep understanding of the situation you are facing. Our integrated end-to-end pension management solution, Delegated Pension Manager (DPM), can help. This turnkey delivery model eases the administrative burden, lowers costs, reduces risk exposure and strengthens compliance by integrating investment policy, funding policy, benefit policy, settlement strategy and risk management.

Our DPM solution provides a single point of contact to ensure strategic decisions are integrated and executed in a timely and efficient manner. It delivers the support and efficiencies needed to guide plan sponsors through each facet of the process. The following graphic illustrates the key tenets of our DPM solution:

Integrated Plan Management

Integrated Delivery Model that is streamlined through a single point of contact at Aon Hewitt to coordinate investment, actuarial and administration strategy
Budget Certainty by providing an "all-in" basket of services for a single price

Develop and Execute Integrated Strategies

Investment Consulting

- Implement and execute a custom glide path and hedge path
- Serve as an ERISA 3(38) Fiduciary
- Lower investment manager fees—typically 15%–25%
- Lower contributions and downside risk compared to a static allocation
- Delegate responsibility for strategy execution
- Monitor funded status daily
- Access to more diverse investment options
- Maintain fee transparency

Actuarial and Compliance

- Proactive strategic consulting on funding and accounting issues
- Develop strategies to minimize PBGC premiums and other expenses
- Monitor annuity and lump-sum environment to make tactical settlement decisions
- Serve as co-fiduciary in annuity provider search and purchase process
- Help prepare you for the lengthy and complex plan termination process

Administration

- Flexible solutions to fully outsource or allow you to retain responsibilities in-house
- Customized to your plan provisions with complete requirements documentation
- Designed to support increased volume under lump-sum windows or plan termination
- Personalized participant communications
- Fully trained call center resources
- Quarterly reporting on volumes

Why Aon Hewitt?

With more than 50 years in the retirement plan business, Aon Hewitt is a premier provider of defined benefit services in the United States. In short, we're not in this business to be a great alternative. We're in it to lead it. We have deep expertise in all aspects of pension plan management—and the experience with our clients to prove it.

Since 2010, more than 35 organizations have already turned to Aon Hewitt's Delegated Pension Manager solution to help manage their closed or frozen pension plans. A true turnkey delivery model, DPM has been proven to help plan sponsors overcome their challenges, while allowing them to remain focused on their core business. With so much on the line, why trust your pension plan management to anyone else?

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About Aon Hewitt

Aon Hewitt empowers organizations and individuals to secure a better future through innovative talent, retirement and health solutions. We advise, design and execute a wide range of solutions that enable clients to cultivate talent to drive organizational and personal performance and growth, navigate retirement risk while providing new levels of financial security, and redefine health solutions for greater choice, affordability and wellness. Aon Hewitt is the global leader in human resource solutions, with over 30,000 professionals in 90 countries serving more than 20,000 clients worldwide. For more information, please visit aonhewitt.com.

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