SPECIAL REPORT THE PPA @ 10

Unforeseen consequences one legacy of pension law

HOW IT ALL STARTED: President George W. Bush signed the Pension Protection Act in August 2006.

PPA seen as pushing sponsors away from keeping DB plans

By HAZEL BRADFORD

MORE ON THE PPA

- Pension Protection Act becomes a boon for defined contribution plans **Page 15**.
- P&I speaks with industry players including Rep. John Kline, Tom Harkin, Dallas Salisbury, Michael Kreps and Karen Friedman about the PPA. Find the videos at **pionline.com/ppa-at-10**.

Like many pension-related laws, the Pension Protection Act that passed a decade ago was designed to address a crisis.

At the time, underfunded pension plans were threatening the financial stability of the Pension Benefit Guaranty Corp. But while the act did help strengthen the federal agency, it also had the unintended effect of discouraging defined benefit plan sponsors and hastening the switch to defined contribution plans, observers say.

"It was sold on the basis that we were going to shore up funding to protect workers," but most people involved in passing the PPA didn't understand the impact that new funding rules would have on the cost and volatility of funding plans, and how that would scare away "thousands" of plan sponsors, said Earl Pomeroy, a former North Dakota Democratic representative and House Ways and Means Committee member who now works with the Washington law firm Alston & Bird LLP.

By the time lawmakers sat down to hammer out the details in 2006, the PBGC was reeling after absorbing nine of the 10 largest pension plan claims in the five-year period preceding the act's passage.

The size of those claims sparked concerns about the agency's solvency as well as about how to protect taxpayers from having to cover its deficits.

Additionally, alarm over the number of poorly funded pension plans, a changing workforce and retirement adequacy in general convinced lawmakers that it was time to undertake the most comprehensive pension law reform since enactment of the Employee Retirement Income Security Act of 1974.

"It was eye-opening for me," recalled Rep. John Kline, R-Minn., who at the time was a new member of the House Education and the Workforce Committee and now is its chairman. "I could see pretty quickly this was a big problem."

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Hedge Funds

Quants ease into fundamental firms

WHEN WORLDS COLLIDE: Sonia De Zordo said convergence of the quant and fundamental disciplines was not smooth.

Managers use experts to decipher macro trends to get investing edge

By CHRISTINE WILLIAMSON

Rather than grasping for straws in the face of lackluster market conditions, fundamental equity and multistrategy hedge fund managers are grabbing quantitative specialists to help them interpret macro trends and hopefully improve returns.

Hedge fund managers as large as Tudor Investment Corp., with $11 billion under management, have brought in teams of experts to help portfolio managers better understand complex market data and to improve real-time trading.

Megamanager BlackRock Inc., with $4.89 trillion under management, decided in January to combine its $200 million active fundamental equity strategy business, including hedge

| SEE **QUANTS** ON PAGE 25

Money Management

Bridgewater making waves with dual-party valuation

By CHRISTINE WILLIAMSON

Bridgewater Associates LLC is the first money manager to have instituted a dual-party valuation process for its complicated suite of hedge fund and long-only portfolios with aggregate assets of $150 billion, achieving its goal of having iron-clad confidence in the safety of its assets and the accuracy of portfolio valuations.

Financial administration experts said the process and infrastructure that Bridgewater created with its primary outsourcing partner, Bank of New York Mellon Corp., and shadow processor Northern Trust Corp. represents a major milestone that likely will become the gold standard required by asset owners of their money managers.

Bridgewater's project began five years ago as the brainchild of Eileen K. Murray soon after she was named co-CEO. Ms. Murray had extensive treasury, finance and operations experience before joining the alternative investment manager in 2009.

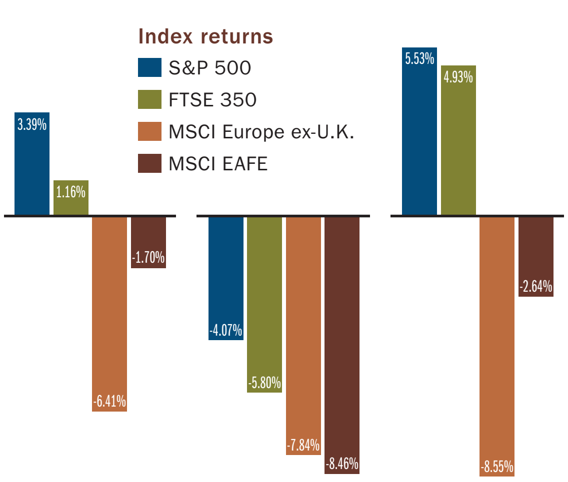
Ms. Murray's idea — which turned out to be more revolution-

SEE **BRIDGEWATER** ON PAGE 29

The markets react to Brexit

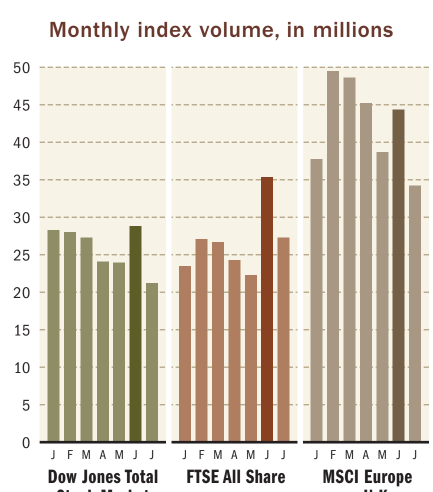
The broader markets appeared to take the U.K.'s June 23 vote to exit the EU in stride after the immediate shock.

Index blip: Equity index returns dipped in the days following the Brexit vote, but then picked up where they left off. Non-U.S. equities saw some initial improvement but continued to underperform into August, while mid- and large-cap U.K. equity growth accelerated.

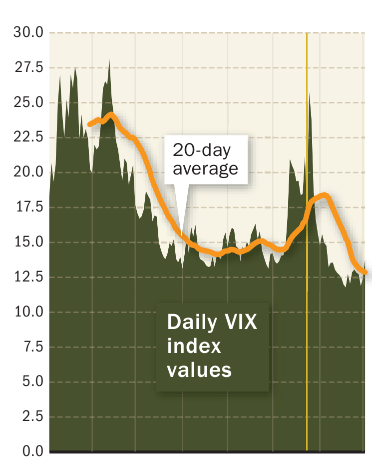


Source: Bloomberg LP

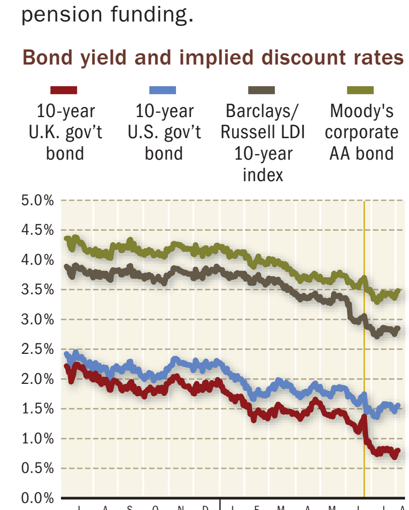
Volume ticked up: Volume among major equity indexes rose in the days following the vote, but the uptick was short lived as volume continued the downward trend that began in the first quarter.



Volatility spiked: Volatility shot up in the days surrounding the vote, but has since declined more than 50%. The pound, euro and yen saw significant volatility against the dollar before settling down.



Yields plummeted: Yields have fallen throughout 2016 with 10-year rates reaching historic lows in the weeks following the vote. The low rates have led to wide gaps in pension funding.



Compiled and designed by Charles McGrath and Gregg A. Runburg

SPECIAL REPORT | THE PPA @ 10

A real boon for defined contribution

Law gave structure to evolving regulations, but there's room for improvement

By ROBERT STEYER

Without the Pension Protection Act, retirement plan participants would be less equipped for retirement than they are today as the retirement industry makes the transition to defined contribution from defined benefit plans.

That's the consensus of DC plan experts who also say there's plenty of room for improvement, which they believe can be achieved primarily through greater efforts by sponsors rather than by new laws or regulations.

"The big thing for the defined contribution industry was the building of some structure around automatic enrollment, automatic escalation and target-date funds (through qualified default investment alternatives)," said Lew Minsky, executive director of the Defined Contribution Institutional Investment Association.

Without the PPA, participants likely would have "less well-diversified portfolios, lower participation rates and lower contributions rates," he said.

Although there "was definitely movement" among sponsors to automatically enroll participants prior to the passage of the PPA, "adoption rates were spotty at best," Mr. Minsky said. "The Pension Protection Act put forward a workable framework. It gave sponsors comfort and led to widespread adoption."

Mr. Minsky and other DC industry members said sponsors must move away from offering a 3% initial deferral rate — a common industry practice — to a higher initial rate. They also must be willing, he added, to go beyond the 10% contribution cap on auto features — auto-enrollment plus auto-escalation — covered by Department of Labor non-discrimination rules.

Too many participants view a sponsor's initial deferral rate as an endorsement, and don't raise their contributions. Sponsors practice an "unfortunate overreliance" on safe-harbor rules, he added.

"We don't need a legislative change" to increase participant contributions, he said. "The industry needs to get beyond the misperceptions. We can get there within the existing legislative and regulatory structures."

Helped deal with shift

The PPA helped sponsors deal with the "shift of defined contribution from a supplement to the cornerstone of workplace-based retirement," said Anne Lester, managing director at J.P. Morgan Asset Management, New York, who is the portfolio manager and head of retirement solutions.

PPA's importance to the DC industry will have greater impact in the next decade as participants rely more on defined contribution than traditional pension plans, she said. "Many pre-retirees still have some defined benefit plans," she said. "Right now, we are on the cusp of a big generational change from defined benefit to defined contribution."

David Toerge

ONE THING LEADS TO ANOTHER: Lew Minsky believes the widespread adoption of auto enrollment was rooted in the passage of the Pension Protection Act.

Future DC plan improvements will depend more on sponsor initiatives than on new laws or regulations, she said. "One real challenge" is the sponsors' fear that employees will complain about or reject plan design changes such as auto features — a concern J.P. Morgan Asset Management has found to be unwarranted.

In a 2015 study, for example, "fear of employee pushback appears to be a deterrent to adoption automatic features, (but) research shows those fears are overstated," said a J.P. Morgan Asset Management report describing the survey results.

"I can't believe it's been 10 years," said Ann Combs, a Vanguard Inc. principal and head of the firm's government relations office, who was the Department of Labor's assistant secretary for employee benefits security from 2001 to 2006.

"I don't think we anticipated how much the industry would change," said Ms. Combs, adding the degree of growth for target-date funds has been a surprise.

Ms. Combs said two key DC issues — auto-enrollment and QDIAs — were aided by the debate over the PPA that focused primarily on defined benefit plans. "They were under the radar," she said. "They weren't pulled apart or picked apart" in the legislative process because "the political battle was over defined benefit plans."

Among plans for which Vanguard is record keeper, 41% offered auto-enrollment in 2015 vs. 10% in 2006, according its latest analysis of DC plan clients.

Also, 90% of clients offered target-date funds in 2015 vs. 43% in 2006. Among plans offering target-date funds, 70% of participants invested in this option last year vs. 22% in 2006.

Establishment of QDIA

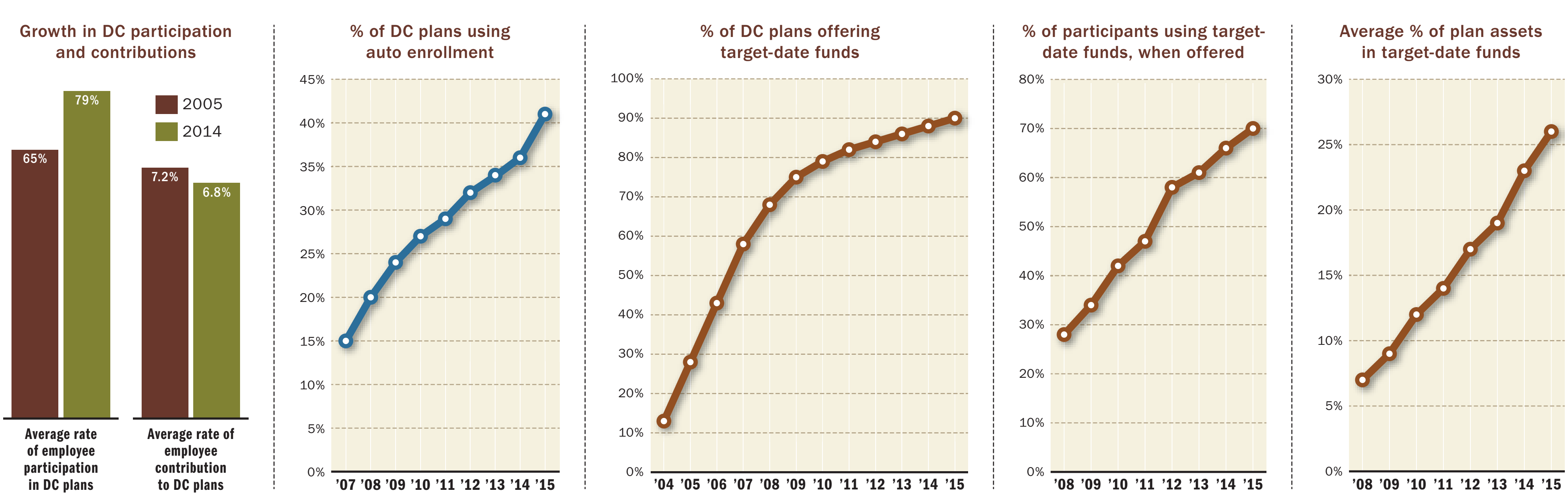
Consultant Michael Webb said the biggest impact of PPA was the establishment of qualified default investment alternatives that has led to significant growth of target-date funds. Balanced funds and managed accounts are the other QDIAs.

Before PPA, the "primary defaults were fixed income or stable value," said Mr. Webb, a New York-

SEE BOON ON PAGE 18

DC evolution

Employee participation in DC plans grew 14 percentage points between 2005 and 2014, thanks in part to auto enrollment. Target-date funds continue to grow.

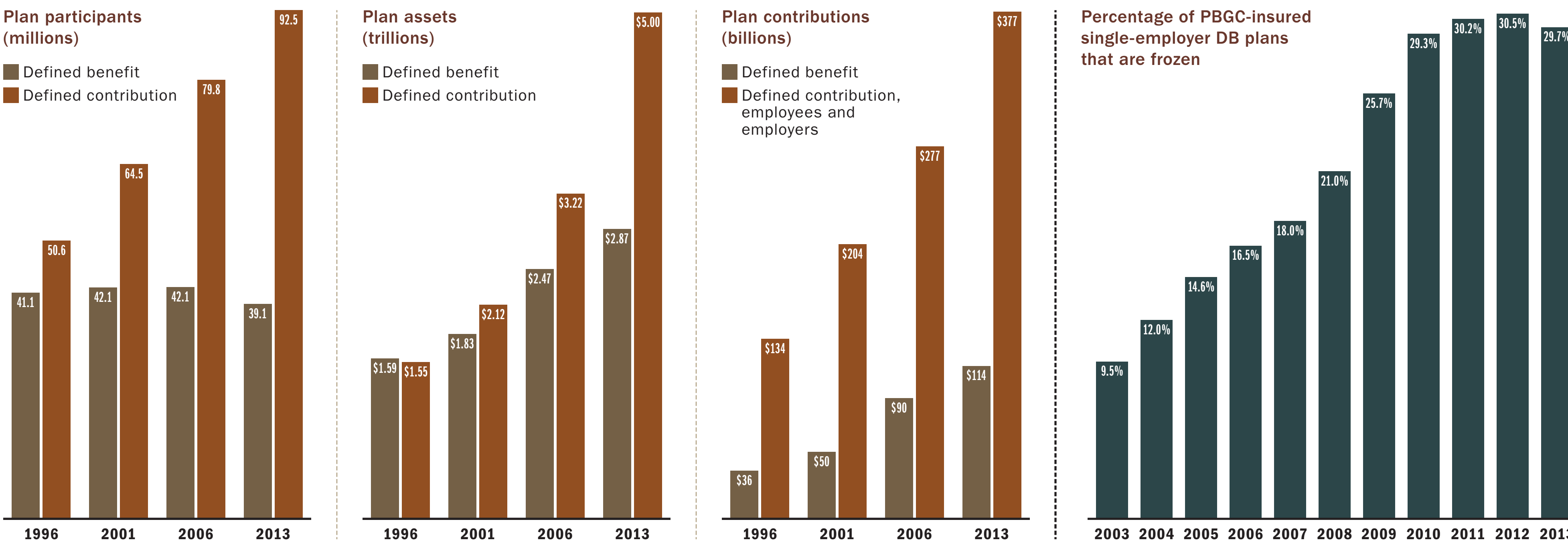


Sources: Data taken from Vanguard's annual client survey "How America Saves" and represents data of plans administered by Vanguard.

THE PPA @ 10

DC dominance

In the private sector, DC plan growth has skyrocketed compared with DB plans.



Source: PBGC; U.S. Department of Labor

Protection

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To improve funding levels of defined benefit plans, the PPA established new funding requirements and shorter time frames and called for plan assets and liabilities to be measured the same way.

Sponsors of underfunded plans saw more demands from the legislation to improve funding levels, and sponsors of cash balance plans received some legal clarity along with more rules aimed at preventing age discrimination and other abuses. Sponsors of well-funded plans gained more flexibility in their funding decisions, but moderately funded plans saw a significant increase in funding requirements, and poorly funded plans saw tighter amortization rates and higher PBGC premiums.

For the multiemployer plans, also experiencing underfunding problems, the PPA gave trustees a new color-coded zone system and funding requirements based on plan funding levels, with green for healthy plans funded at 80% or better, yellow for endangered plans funded between 65% and 79%, and red for critical plans funded less than 65%.

Yellow- and red-zone plan trustees had to adopt funding improvement or rehabilitation plans, respectively.

Perhaps the biggest impact of PPA was on defined contribution plans.

The law created the legal framework for automatic enrollment and automatic escalation of contributions. On the investment side, it created qualified default investment alternatives, allowing plan sponsors to steer assets toward age- and risk-appropriate choices when participants do not make their own choices

"It was intended to provide an offset to lethargy" that had kept people from participating in defined contribution plans in the first place, said Dallas Salisbury, president emeritus of the Employee Benefit Research Institute in Washington.

Achieved most goals

"PPA accomplished what it set out to do, in large measure," said Mr. Kline. In addition to shoring up the PBGC, "it prevented plans from promising benefits they couldn't provide."

Furthermore, Mr. Kline said, "it set the example for how you can do bipartisan pension reform."

On the multiemployer plan side, "we accomplished what we set out to do," agreed Randy DeFrehn, executive director of the National Coordinating Committee for Multiemployer Plans in Washington. "PPA changed the rules so employers would have to put in more money," he said, and the zone system led to more funding discipline — at least in theory, until the financial crisis on top of the dot-com bubble changed it all, with assets shrinking faster than any additional contributions or benefit reductions could compensate for.

Douglas Graham/Roll Call)

UNINTENDED: Earl Pomeroy said people didn't realize how funding rules of the PPA inadvertently hurt defined benefit plans.

"Had that not happened, if those eight years would have been normal markets, these plans would have been extremely well funded," said Mr. DeFrehn. "Timing is everything."

Despite the boost to defined contribution plans, critics say the PPA's big mistake was not specifying default contribution rates, which made skittish employers reluctant to venture higher than the 3% example given in subsequent regulations.

For Thomas Harkin, an Iowa Democrat and chairman of the Senate Health, Education, Labor and Pension Committee from 2009 until his retirement in 2014, the PPA's emphasis on defined contribution plans "was the wrong basis," and as a result, "I don't think it accomplished much."

Mr. Pomeroy of Alston & Bird is even more critical of what he calls "the Pension Prevention Act."

"I felt it was intentionally designed to encourage employers to end their DB system," Mr. Pomeroy said.

Mr. Pomeroy, who as a former North Dakota insurance commissioner was one of the few congressional negotiators who knew what pension amortization meant. "Expense, volatility and uncertainty all came from PPA," said Mr. Pomeroy, who points to the six subsequent legislative changes to funding rules "if there's any doubt that Congress got it wrong."

Karen Friedman, executive vice president and policy director of the Pension Rights Center in Washington, acknowledges the PPA's tougher funding rules "may have possibly driven some employers out of the DB system. I think a lot of employers thought the funding rules were too tight."

One "really bad" part of PPA, she said, was the new multiemployer zone rules that allowed trustees of troubled plans to trim future benefits.

"I think there's a clear line from the PPA to MPRA," the Kline-Miller Multiemployer Pension Reform Act of 2014, which allowed deeply troubled plans to more widely cut benefits even for retirees, she said.

What's next?

"Did PPA solve all the problems? We'd say no," said Ms. Friedman. "You still have abysmal savings rates. We are still seeing companies breaking promises to workers (by freezing plans or cutting back on contributions) and we still have a private workforce where 50% don't have any savings. We think there needs to be all the stakeholders coming together to find a universal system."

Ideas for new approaches continue to bubble up from many quarters, including think tanks, the private sector, and legislators such as Rep. Joe Crowley, D-N.Y., vice chairman of the House Democratic Caucus who introduced a bill creating

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Stanching the flow

The PBGC received more than $19 billion in claims by terminated plans in the years leading up to the passage of the PPA.

Plan sponsor	Year terminated	Claim amount (millions)
United Airlines	2005	$7,094
Bethlehem Steel	2003	$3,654
US Airways	2003, 2005	$2,862
LTV Steel	2002-2004	$1,960
National Steel	2003	$1,161
Weirton Steel	2004	$690
Trans World Airlines	2001	$668
Kemper Insurance	2005	$566
Kaiser Aluminum	2004	$566
Total		$19,221

Source: PBGC

Protection

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universal retirement accounts for American workers in July.

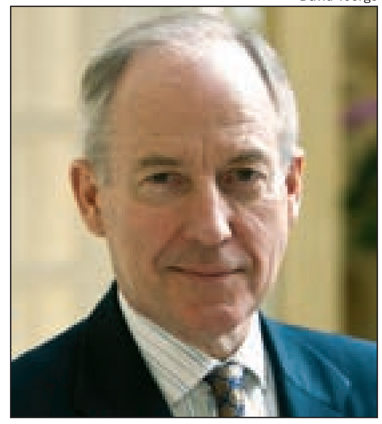
At *Pensions & Investments'* Global Future of Retirement Conference in Washington in June, prominent speakers all presented options for national savings programs. Those speakers included Blackstone Group LP's Hamilton E. "Tony" James, New School economist Teresa Ghilarducci, State Street Global Advisors' Ronald O'Hanley, Bipartisan Policy Center's Co-Chairman James B. Lockhart III and Kent Conrad, and Mr. Harkin (*P&I*, June 27).

Aliya Wong, executive director of retirement policy for the U.S. Chamber of Commerce, thinks that while PPA took a broader look at the retirement system at the time, "I think what we need now is more of a precision focus."

"We have a successful system but not everybody participates," Ms. Wong said.

"I do think we need to start focusing on solutions," added Ms. Wong, who also said policymakers need to "really listen to plan sponsors and to what requirements they say are overly burdensome. Remember, they have businesses to run."

David Toerge



A REMEDY: Dallas Salisbury said the PPA helped counter the 'lethargy' that discouraged DC plan participation.

Boon

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based vice president for Cammack Retirement Group Inc.

The PPA's impact on target-date fund investing is illustrated by Callan Associates Inc.'s quarterly DC index. For the first quarter of 2006, target-date funds represented 4.7% of participants' asset allocations; by the end of 2015, target-date funds accounted for 25.3%.

Mr. Webb said sponsors need to build upon the opportunities created by the PPA.

"Auto enrollment has had a dramatic impact for new hires," he said. "You can argue that contributions are too small, but something is better than nothing. For new employees, the important thing is to start saving in the first place."

Mr. Webb said sponsors must encourage, nudge or even push participants to expand their contributions beyond the initial auto-enrollment default rate. Sponsors should employ auto-escalation and, if necessary, automatic re-enrollment, he said.

Auto-enrollment "adds participants who would not have enrolled," said Jeri Savage, partner in charge of defined contribution research for Rocaton Investment Advisors LLC, Norwalk, Conn.

She said there's room for improvement among plans offering a 3% initial deferral rate. "We know some participants would save more, but because the sponsor started at 3%, they see this as an endorsement," she said.

When she talks to clients about starting the auto-enrollment deferral rate at 6%, "some agree, but some push back because there is a concern about the cost," Ms. Savage said.

Because many sponsors still automatically enroll only new hires, Ms. Savage recommends re-enrolling everyone to improve their asset allocations and allowing participants to opt out.

ERISA attorney Marcia Wagner said the PPA created a safe harbor for an investment trend that has recently accelerated — robo-advisers, the online services that provide automated portfolio management advice.

"Robo-advisers is a big deal," said Ms. Wagner, managing director of the Wagner Law Group, Boston. "Robo-advisers could not have arrived without the statutory safe harbor" of the Pension Protection Act.