Atlanta Consulting Group: Defined Benefit Approach

Managing a defined benefit plan in today's regulatory environment can be very challenging. Assets must be protected with a goal that investment returns can outpace liabilities. At the same time, the need for transparency and proper governance increases the importance of following and documenting a well thought-out and repeatable process.

The Atlanta Consulting Group works with both corporate and public pension plans, and offers investment program solutions, implementation, and monitoring. We have successfully helped a number of plans transition to a Liability Driven Investing (LDI) approach – more effectively managing the assets of their plans. Through asset/liability modeling, we have helped plan sponsors determine the asset growth needed to fund future liabilities as well as understand the risks associated with different asset allocations.

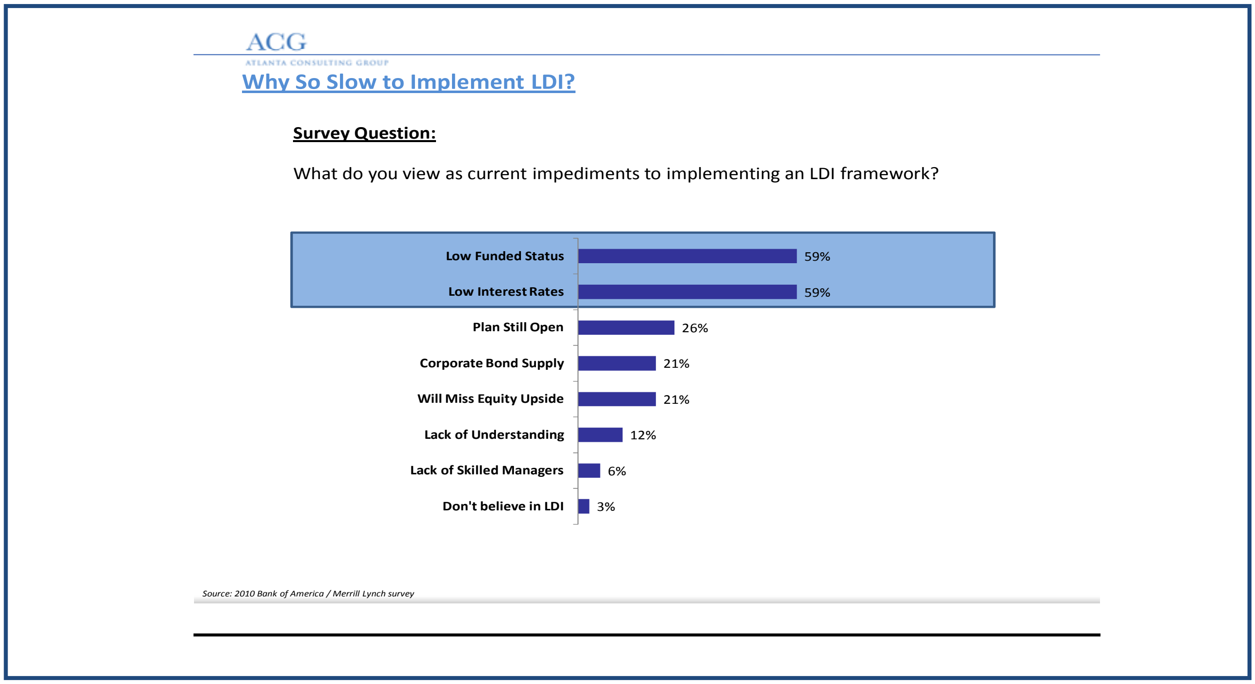
LDI involves constructing an asset allocation with liabilities in mind. It is a form of Asset Liability Management. The investment target of the DB plan is no longer linked only to an asset-only benchmark, but also to a stream of liabilities. We take a dynamic or "glide path" approach to LDI - as the plan's funded ratio improves, the plan should be de-risked by changing asset allocation to reduce surplus volatility and eventually close a plan's funding gap.

Our process involves the following four steps:

1. Understand the specific plan on a variety of qualitative and quantitative factors
    - Size of plan vs. sponsor, funded status, open vs. frozen plans, financial health, etc.
2. Understand the plan's liabilities
    - Combine the projected liabilities of the retired and active members of a plan to get a view of the aggregate plan liability
    - Find a liability benchmark that matches its characteristics
3. Optimization
    - View the plan's asset allocation in terms of surplus return and surplus volatility. (Surplus = Assets minus liabilities)
    - Stress test a range of possible asset allocations across a wide range of possible capital market outcomes
4. Stress test and monitor the plan
    - Stress tested the impact on funded status of a variety of asset allocations under a number of different interest rate and market return assumptions
    - It is important to increase the frequency of monitoring the plan to opportunistically take advantage of changes in funding status

Case Study Series: Liability Driven Investing

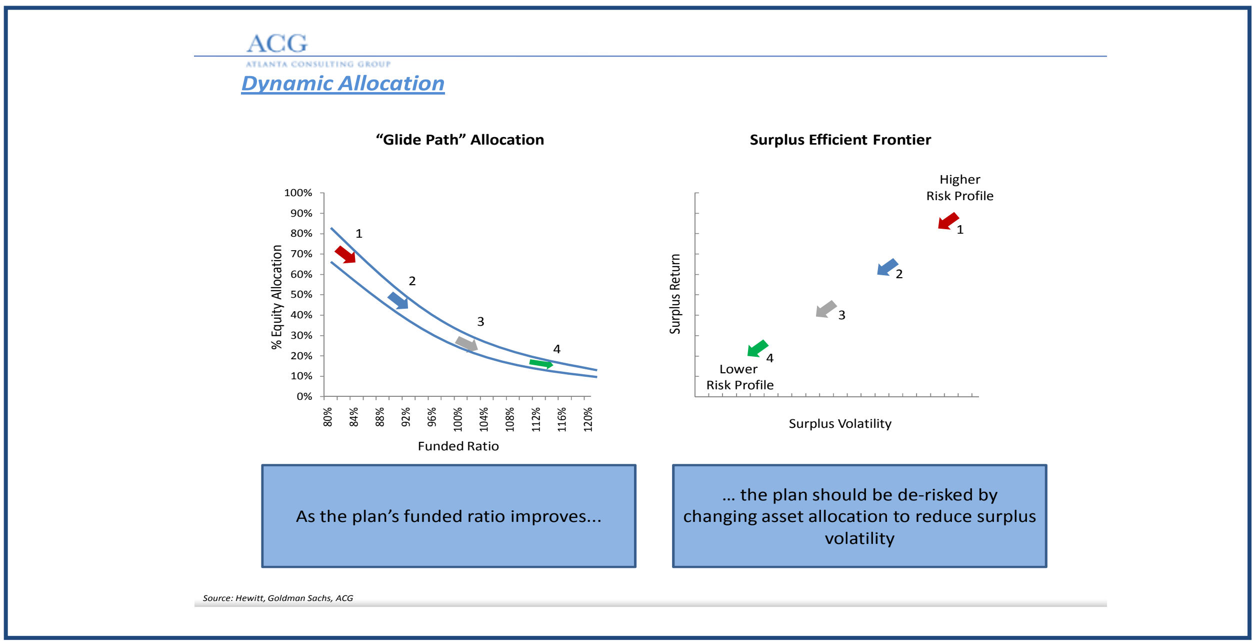
Background - While working with a large client of ours on updating their Investment Policy Statement (IPS), we presented our client with some recent research on methods to improve the funding status of their plan as well as lower the volatility of the plan assets versus the liabilities. Having experienced a decline in funding status during the recent crisis, the client was interested in exploring strategies designed to better protect the plan's funded status in times of market stress. Specifically, a few members of the investment committee had heard of Liability Driven Investing (LDI), but were reluctant to allocate to long duration fixed income in such a low rate environment (see chart below). The client also wanted us to educate members of the investment committee on the topic of LDI. In addition to the DB plan, which was recently frozen to new participants, the client also has a 401k plan. Their current asset allocation was 70% stocks and 30% bonds. The stocks were diversified amongst large cap, small-cap and international, while the bonds were intermediate duration.



ACG Solution - We met with the client's investment committee to present "An Introduction to Liability Driven Investing" with the goal of educating the committee in anticipation of our research findings. We worked with the client to test a range of possible asset allocations across a wide range of possible capital market outcomes. In addition to looking at the return and risk of the various allocations, we looked at the ***surplus*** return versus ***surplus*** risk of the portfolio – taking into account the total assets of the plan (assets minus liabilities). We stress tested the impact on funded status of a variety of asset allocations under a number of different interest rate and market return assumptions. Ultimately, we presented the client with three alternative asset allocation scenarios, all aimed at addressing the initial goals of the exercise.

Client Actions - The Client adopted a "glide path" approach to liability driven investing – with an eye toward taking advantage of increases in funding status by lowering their allocation to risk assets and making a corresponding increase in their liability matched assets over time.

- The client decided to switch a portion of their overall fixed income allocation to long duration to more closely match the characteristics of the plan's liability.
- We worked with the plan's investment committee to better reflect their "glide path" approach (see chart below) in the client's customized Investment Policy Statement (IPS).
- The client decided to increase the frequency of monitoring the plan to opportunistically take advantage of changes in funding status.
- Based on our asset allocation studies, the client also agreed to replace a small portion of their traditional portfolio with an allocation to alternative assets seeking to take advantage of potentially lower volatility and slightly higher correlation to the plan's liability.
- Knowing the cash flow needs of the plan (periodic benefit payments) this allocation was accomplished while also maintaining adequate portfolio liquidity.



Contact Us

For more information on our approach to Liability Driven Investing as well as our other capabilities, please contact us at info@theatlantaconsultinggroup.com or visit us on the web at www.theatlantaconsultinggroup.com