THE RISE OF MEGA-DEFINED CONTRIBUTION

(AND THE UNASSUMING GROUP BEHIND ITS ASCENDANCE)

On a cold night in early December, in a Ritz Carlton ballroom on the southern tip of Manhattan, chief investment officers from across the globe gathered for dinner. Scattered across 30 tables and interspersed with asset managers and the odd consultant, ostensibly they were there to collect awards. For most of them the real purpose, however, was to socialize—to spend time with peers they may see only once a year, to compare notes, and to ponder the state of their industry. However, for one group of CIOs, the dinner was more of a continuation of a constant stream of contact.

Unlike many other CIOs, this group knows each other's problems intimately. They are familiar with each other's portfolios, relied-upon lieutenants, and investment board issues. They know each other's spouses, their alma maters, the schools their children attend, and where they vacation. As the dinner progressed, their assigned seats—centered around two managers shared by most, Bridgewater Associates and NISA Investment Advisors—became more suggestion than obligation. Increasingly they stood off to the side, gossiping like the close friends they are.

"Did you see who got up on stage to get Prudential's award?" one was overheard asking a colleague. "That woman from that bank, the one pushing PRT [pension risk transfer] on my CFO."

"Her and about six others," another responded, chuckling.

"It takes a village...."

These CIOs are not the rock-star endowment managers frequently asked to be talking heads on CNBC. They are not the public pension heads who band together against a hostile press and creeping conservative criticism. They aren't the sovereign wealth leaders, sought after by every asset management unit on earth. They are the CIOs of America's corporate pension systems. And of all these groups, they are the tightest knit, brought together by regulation, interest rates, and, increasingly, their accelerating involvement in the defined contribution (DC) plans that now dominate the retirement landscape.

"So, this dinner is only focused on defined benefit [DB]?" one CIO asked the host of the event as the evening moved from ballroom to bar. For the pensions in attendance, at least, it was. "That's a pity. What we're doing with our DB plan is pretty normal. What we're doing with our DC plan, though—that's the really challenging, the really interesting stuff."

Another corporate CIO, wine in hand, agreed. "You really should look into that stuff. Actually, you really should talk to CIEBA."

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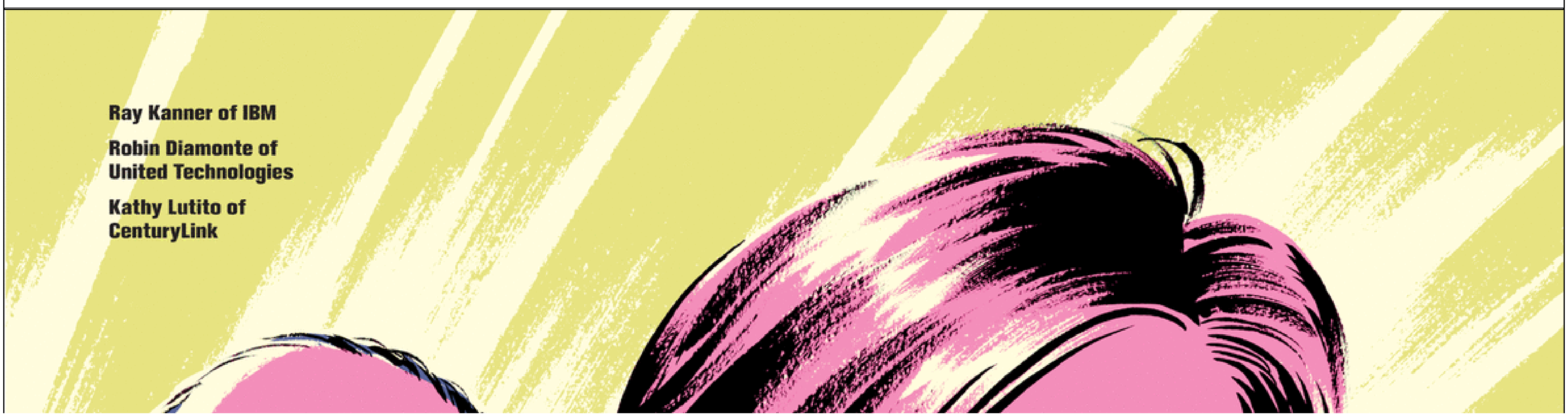
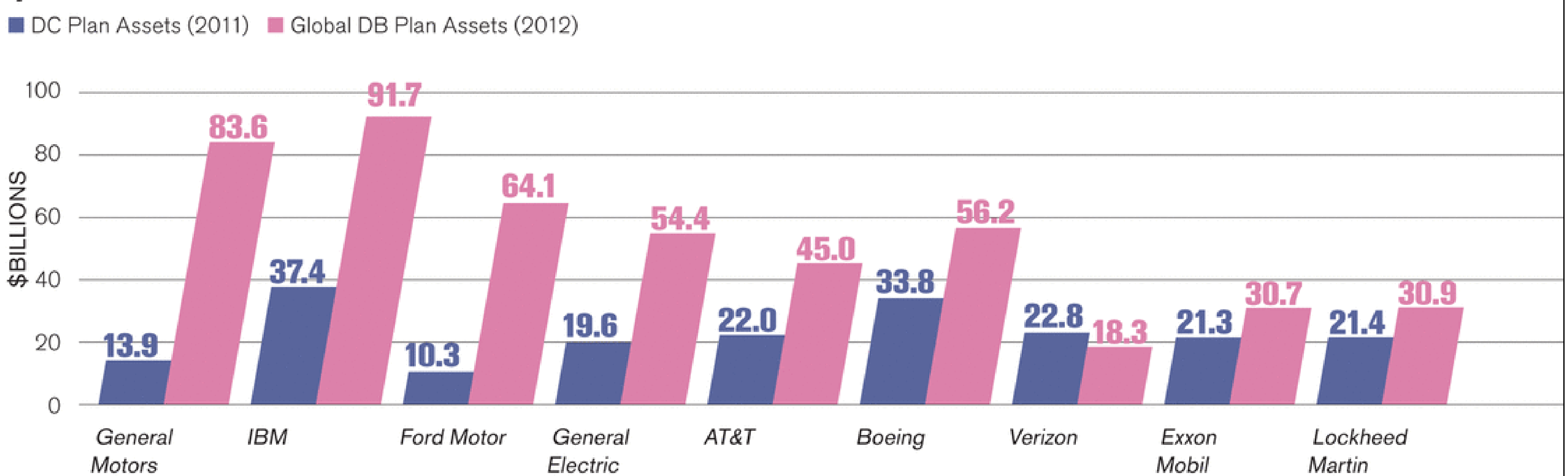


Ray Kanner of IBM

Robin Diamonte of United Technologies

Kathy Lutito of CenturyLink

$20 BILLION CLUB—WITH A TWIST



CIEBA, unsurprisingly, is not a person. It is a group—the Committee on Investment of Employee Benefit Assets—the

Walter Borst, fresh off the largest pension-risk transfer in US history, chairs Defined Benefit; Dow Chemical's Gary McGuire, organization that represents America's largest corporate pension plans and the industry group under whose auspices they most frequently interact.

It was with the purpose of "talking to CIEBA" that two months later, in early February, three dinner attendees—Robin Diamonte, Ray Kanner, and Kathy Lutito—met again, this time on the 21st floor of a non-descript Manhattan office building. Diamonte had travelled from Hartford, Connecticut; Kanner from Rye, New York; Lutito from Denver, Colorado. Despite being the lead defined benefit pension managers at their organizations—United Technologies, IBM, and CenturyLink, respectively—and overseeing, in total, nearly $100 billion in DB assets, they were not there to speak about investing this capital.

Instead, they were there as the chair and two vice-chairs of CIEBA, and they were talking about how, under pressure from events far beyond their control, the organizations they lead are changing. Defined benefit plans are closing and de-risking. Increasingly, politicians in Washington are involving themselves in retirement issues. Defined contribution is ascendant.

And CIEBA that existed 10 years ago is no longer.

Change, of course, comes at a measured pace to an organization that meets four times a year—three times for a core group of working group members, once for all members—and represents more than 100 organizations (largely Fortune 500 companies), controlling north of $1 trillion in assets across DB and DC plans. Like the organizations that it represents, CIEBA is a cruise ship: it can turn, but it turns slowly and deliberately.

"The structure of the working group meetings—which are central to the organization—hasn't changed all that much since I got involved about a decade ago," said Diamonte, who became the group's chairwoman at the beginning of 2013. "We have four committees that meet on day one—Defined Benefit, Defined Contribution, Investments, and International—and then we bring in speakers and have panels on the second day." The committees are run by the titans of this niche industry: GM's

thought by many to be one of the smartest CIOs in the business, heads Investments; Procter & Gamble's Mark Davis chairs International, and industry-veteran Judy Mares of ATK runs Defined Contribution.

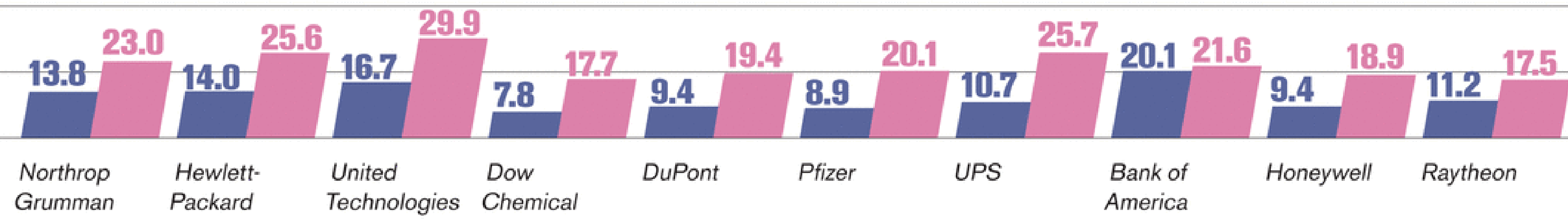
With dues topping out at $5,000 per year, members are paying for the ability to interact with peers, largely void of vendors. "Asset managers can't pay to be in the room," says Lutito, who, along with Kanner, is an incoming vice-chair. "We often invite asset managers to speak on a specific topic or present their research—for instance, DoubleLine's Jeffrey Gundlach is coming in April—however, they do not pay to attend and they are not allowed to sell. If they make a sales pitch, they will not be invited back."

For anyone familiar with the typical institutional investment conference—where pension CIOs can feel more like bait than guest—the advantages of the CIEBA meeting structure are obvious. "It's truly different from any other organization or conference for corporates," Lutito said. "Since we all have different liabilities, we are not really competing with each other. I can turn to Robin or Ray or anyone else and ask 'Hey, what are you doing with this? How should I approach that?' And it's untainted by someone selling something."

Increasingly, these questions are not revolving around the DB, or international, or investment space. Instead, it's the DC committee and the topics discussed within that are most on the lips of members. And that's where CIEBA, while always the cruise-ship, is turning the fastest.

"I think there's always been a focus on defined contribution," the bearded Kanner said. "What has changed is the recognition of how much *more* important DC is to all of us than it once was. So, we are spending a lot more time on that issue and thinking about how to engage more DC participants from other, currently non-member corporations." Of course if they are to be successful, it will require a slight adjustment of the schedule: "How do we get a technology company with only a DC plan, for example, to come to our April meeting when probably 70% of the meeting is focused

Russell Investments keeps close tabs on the "$20 Billion Club"—its list of America's largest corporate pension plans. For aiCIO, however, they went further, digging into financial records to show the DC assets associated with this exclusive group.



on DB issues?" Kanner asked.

But it will also require a focus on value.

"Last year, I argued that we should stop referring to our defined contribution plan as a 401(k) plan. Everyone recognizes the 401(k) plan as a 'supplemental *savings* plan.' I was thinking we just might change behavior if we started referring to the plan as a 'Self-Directed *Retirement* Plan.' There is so much going on in the DC arena—I joined the DC committee because I wanted to be part of the action."

Thus began a conversation with Judy Mares, the CIO of Alliant Techsystems Inc (ATK), and the chair of the DC committee within CIEBA. Mares is a "lifer," as she calls it, having started her career at General Mills in the 1970s and being "present at the creation" of CIEBA. "I've probably been the person involved with CIEBA longer

recently, left alone to handle DC problems—would seem to be just that: HR problems. But Mares disagrees.

"To do our job well, we need to stop thinking about just the investment pieces of the DC puzzle," she said. "We need to be more holistic. We've always thought about DC investment, and we will continue to focus on defined contribution investment-only (DCIO). But now—and this is what we're trying to do going forward with the DC committee—we also need to open the lens and look at the wider picture."

The wider picture of defined benefit assets is well understood. A CIO has four main job responsibilities: asset allocation, portfolio construction, manager selection, and risk management. However, the wider picture for defined contribution has been less than clear—or at least less publicized. Mares was clear on the four roles she believes encompasses her, and CIEBA's, roles in this space.

CIEBA: "I've probably been the person involved with CIEBA longer than any other person involved now," she said.

CIEBA was formed, Mares said, as a "safe environment with people who know what you know and do what you do. For those of us who work as corporate CIOs, there are very few people within our companies who know what we know and do what we do."

She stopped for a moment, seemingly pondering something. "Smart people get smart by hanging out with smart people—that's what CIEBA is about."

A result of managing defined benefit assets, Mares, for years, focused more on the DB side of the CIEBA equation. But that changed recently. "I was in the defined benefit committee," she continued. "But this year I asked to work on the defined contribution one."

The reason: "DC is a reflection of a change in the environment," she said. "There has been a huge sea change. The *Wall Street Journal*, for example, said yesterday that something like only 11 of 100 biggest [American] companies have open DB plans." The point, Mares explained, was that "DC is no longer a supplemental savings plan. It will be, if it isn't already, the primary retirement plan of millions."

CIEBA members could be forgiven for taking a narrow view on this problem. They are, after all, largely chief *investment* officers. The worries of most human relations executives—until relatively

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"There are four general categories we need to take care of if we're doing our job," she said. "One, getting money into the plan. Traditionally, as an investment person, I never spoke about that—that was on the HR side of the house. But now I, and we, need to look at the company match, at auto-enrollment, at auto escalation, and education around budgeting. This has largely been the focus of the HR environment. We don't want to do *their* job, but we need to know how these factors impact *our* jobs."

"Second, we need to focus on keeping money in the plan," she continued. "Money leaves via loans, rollovers, and distributions. In our next CIEBA meeting, we're doing a deep dive on this—on the benefits of keeping money in the plan. It involves all sorts of things, most importantly behavioral economics. We CIOs know what participants *should* do—but we need to know what participants *will* do as we do our job."

"Third, how to invest wisely. There are a number of options for participants: Optimal target-date funds, stable-value funds, company stock, and brokerage windows. We need to figure out how best to educate participants—how to talk about what's working and what's not working."

"Fourth, and last, how to distribute wisely," she said. "That's this whole issue around lifetime income. In a DB plan, the normal

form of benefit was an annuity. We conditioned people to and facilitated that lifetime income stream. The normal form of benefit in DC is a lump sum. So how do we change the mindset to view this transition from accumulation to decumulation?"

These four responsibilities are relatively new to the CIO—as

Office tension isn't the only political issue confronting CIOs. While CIEBA members navigate the internal politics of their evolving roles, they must also navigate external politics via the often-dirty underbelly of American democracy: lobbying.

"We're not pro-regulation, we're not anti-regulation," opposed to the HR—side of the house. "We've always focused on number three," Mares said. "Now, at CIEBA and in general, we're starting to talk about one, two, and four."

The move toward "opening the aperture," as Mares calls it, is garnering interest from the plan sponsor community. "Yesterday, I had breakfast with a friend," she said. "He's a finance guy, and he only has a DC plan. I've been trying to get him to join CIEBA for years. I told him about what we're doing with DC, about opening the aperture. He said 'I was never drawn to CIEBA as you described it before, because it was too DB focused—but now you have my interest.'"

Diamonte jumped in when the topic arose—she's acutely aware of the connotations associated with billion-dollar companies lobbying Washington, DC. "We're for smart regulation."

"Agreed," said Kanner. "In 2005, with the Pension Protection Act [PPA] coming in, we lobbied to make sure that the PPA was something that made sense, something that pensions could live with."

"Of course, we really haven't lived with it," Diamonte interjected. "It's changed constantly because of the market environment since 2006."

As the conversation progressed, it became obvious that

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Back in Manhattan, the issue of this interest is front and center—as is the accompanying issue of what happens when CIOs get more involved in the traditional HR functions of DC benefits. Organizational structures differ, and so do opinions—but the general consensus is that turf wars aren't likely to break out between CIOs and HR managers—no matter what some have suggested.

"I don't see that at all," Diamonte said when the issue arose. "What do you think, Ray?"

Kanner was slightly less absolute. "I think there probably is a tension—at least at smaller funds. Think about it: The growth of the DC was really a benefit, it was a savings plan—and that traditionally came out of HR. So, if you look at the evolution of it, it probably did start more on the HR side and has evolved into the treasury department. So, I think there's probably some tension in some organizations, but it's much more collaborative in our organization and a lot of bouncing ideas off of each other."

Letitia agreed. "I don't sense any tension with HR as we work-

CIEBA's lobbying isn't the lobbying of Jack Abramoff—the infamous power broker now in jail for corruption—and Bridges to Nowhere. Instead, it's as much education *about* benefits as lobbying *for* benefits. "We do our own lobbying," Diamonte said. "It's actually much more effective, we found, than hiring a traditional lobbying firm. We'll get together and write a letter, compile data from our surveys, all in an effort to prove our point. We'll then set up meetings with key legislators, and CIOs will come and present the issue." Unsurprisingly, CIEBA keeps close tabs on who the "retirement geeks" in Congress are. A recent email from the organization highlighted all new and existing members of the Senate HELP (Health, Education, Labor & Pensions) committee, as well as various subcommittees.

While recent examples of these efforts include the MAP-21 legislation that tied highway funding to DB pension funding relief, CIEBA, as it is with its meeting agendas, is shifting its focus toward defined contribution. CIEBA believes that Washington is looking for tax revenue and that some proposals include putting caps on

Lutito agreed. "I don't sense any tension with HR as we work closely to provide the best DC investment options for the employees and plan participants. In fact, if you don't have that close-knit of a group and if there's tension there, you can't provide a good outcome. Collaboration is key."

Diamonte chimed in. "I've heard of companies saying they want new retirement-income solutions, but they can't get HR on board or they can't get legal on board, and you really have to work together. We don't see that—and I think that's a symptom of poor governance more than anyone trying to move in on someone else's role."

for tax revenue and that some proposals include putting caps on what employees can save in tax-deferred vehicles like 401(k)s, and also on tax deductions for companies when they do company matches. Thus, the new place for negotiation is with DC—and CIEBA is responding. According to an internal memo, of the top 15 legislative priorities for CIEBA in 2013, number one is "tax reform impacting 401(k) plans." Numbers eight through twelve deal with defined contribution issues, as well.

But what happens to those CIEBA members, and other defined benefit investment plans, not involved with defined contribution

plans? Is CIEBA risking its main squeeze by spending too much time with its girl-on-the-side?

To answer that question, look no further than the foothills just north of downtown Atlanta. There, nestled amidst quotidian shopping malls, stoplights, and sprawling office parks, sits one of the rarest beasts in corporate America: the open defined benefit plan.

The $26 billion pot belongs to the employees of UPS and is stewarded through financial markets by CIO Brian Pellegrino, a New Jersey native who's been in his current role for seven years. "I think CIEBA needs to maintain its focus on DB," Pellegrino said in early March, as he sat in the light-filled atrium of the company's global headquarters—a complex that doesn't so much sit in a manicured forest as emerge from it. "DB assets aren't going away anytime soon. Look at us: We manage assets for four trusts that are still accruing benefits."

Pellegrino, of course, is in a much different situation than many of his peers. In terms of plan status, only a smattering of

Kanner, few have. "We haven't cracked that nut yet."

"Sometimes an institution has an uncanny way of embodying the society to which it belongs," *New Yorker* Editor David Remnick wrote in an early March profile of an acid attack at Russia's Bolshoi Ballet. "For decades, the office of heavyweight championship of the world—and the battles for that crown, from Jack Johnson to Mike Tyson—said something about the racial dynamics of twentieth-century America. So it is at the pinnacle of Russian dance." The recent attack, organized by a disgruntled dancer on a now nearly-blind artistic director, was simply the contemporary iteration of an organization that has changed with, and mirrored, "imperial Russia, Soviet Russia, and, now, Vladimir Putin's Russian."

As it is with ballet, so it is with pensions. CIEBA is, in one sense, the collective needs and desires of America's largest corporate retirement systems. Yet in a larger sense, it is the embodiment of the rapid alteration of how Americans retire. Or can't retire—for there is, almost all commentators agree, a retirement crisis in many of his peers. In terms of plan status, only a smattering of funds mirror his—namely, the insanely profitable oil and gas companies that still use their defined benefit plans to entice engineers into long-term employment. Open status brings a different paradigm from the contemporary closed plan: where the latter has largely bought into liability-driven investing and de-risking, the former embraces, in some cases, an absolute return-seeking framework. UPS is one of those cases, and either by chance or design, Pellegrino has largely stayed clear of the company's nearly $11 billion in defined contribution assets.

Fortunately, Pellegrino said, he has no concern about CIEBA abandoning his needs. "CIEBA is more interesting now than it was five years ago," he offered, unprompted. "The surveys done before the financial crisis [at the meetings], with few exceptions, showed little variation in asset allocation. Everyone was pretty much doing the same thing, with the same returns. Now... not even close. Some people have 50% to 60% of their duration matched, and some people have an 80% equity exposure."

But even Pellegrino and his team can't stay in the DB world forever. "Actually, we've kind of made our first foray into DC," he said. "Right now, we're looking to unitize the DB allocation as an option in the DC plan. If it makes sense for DB, why wouldn't we want to offer something like that to DC participants? They're all employees of UPS, after all."

Pellegrino, while more singularly focused on defined benefit issues, was echoing a theme expressed by Kanner three weeks earlier. "One of the things that we're grappling with is how to bring alternatives into the DC space," the IBM pension chief remarked. "We invest in them with defined benefit assets for a reason—we feel they are worth the money paid—and so if that belief holds true, there isn't any reason we wouldn't want them in the defined contribution plan." This goes against the grain of many DC trends, of course: passive investments dominate defined contribution, and daily valuation weigh heavy on the minds of CIOs and HR professionals alike. But alternatives-in-DC is a puzzle that CIEBA leaders, like Pellegrino and others, want to solve. As of yet, according to for there is, almost all commentators agree, a retirement crisis in America. With defined benefit in decline, defined contribution has, by default, stepped in to take its place. Individual employees are typically less able to manage capital for such long periods of time than a company—or company chief investment officer—is. One key to maintaining retirement integrity, and one common theme running throughout discussions with CIOs who are increasingly involved in DC plans, is that DC should be managed, at a company level, like the best DB plans of old were.

CIEBA, and its members, have been adapting to this reality for some time. "People are more focused on defined contribution as plan sponsors than they used to be," Jay Vivian, the former IBM pension chief and unofficial CIEBA historian, believes. "CIEBA members have always taken their fiduciary duty seriously, but 20-plus years ago, it was largely a defined benefit focus. With 401(k) plans, that wasn't what happened at some companies I saw, typically smaller ones with small staffs. They'd hand the whole thing over to Fidelity or T. Rowe Price or whoever the record-keeper was. The 401(k) was small, it was just a supplemental savings plan, and some viewed it as just another employee benefit." In the past 10 or 15 years, that changed—dramatically, Vivian said. "As defined contribution assets grew, in some cases eclipsing a company's defined benefit assets, they sat up and noticed, and included it in their responsibility mandate."

It is due to this dynamic that a new class of retirement systems is emerging. They are, in once sense, simply larger versions of any company's 401(k) plan. But they are also something else: the new centers of investment power and innovation. As these plans reach size parity with the largest of company defined benefit plans—likely within half a decade—they will command attention in line with their clout, namely from hedge funds. And, as these external service providers partner with internal CIOs increasingly engaged with DC issues, innovation will pool here, as opposed to within DB plans. And for America's workforce, staring down retirements-in-crisis, this is improvement. This is progress.

This is The Rise of Mega-Defined Contribution. –*Kip McDaniel*