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Open the Curtains and Take a Closer Look at Your Pension Plan's Experience

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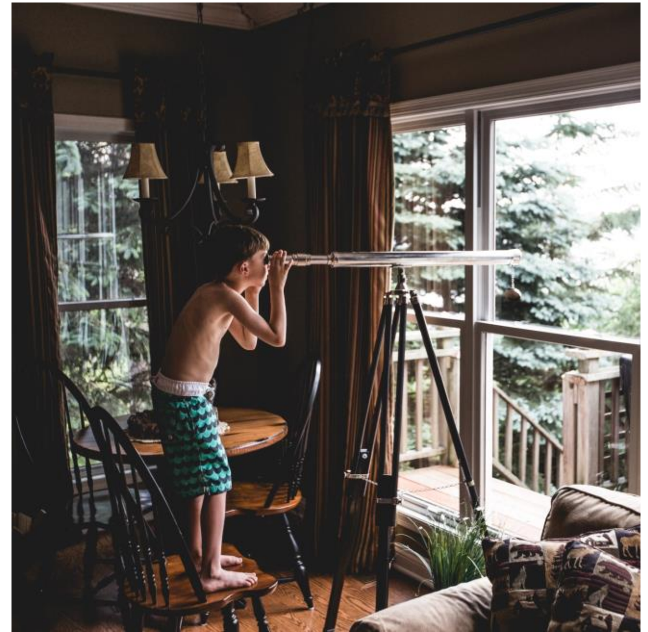
The assumptions used to value liabilities in a pension plan should be validated periodically by conducting an experience analysis to ensure employers are not over contributing or under contributing to the plan. The *experience* of a plan reflects the actual past results related to participant retirements, deaths, terminations, disabilities, and salary increases, as well as changing interest rates and asset returns. These results are compared to the assumptions used to quantify the plan's current and future liabilities to form an *experience analysis*. An experience analysis can shine the light on several interesting data points including those listed below:

- Do the current plan assumptions appropriately reflect what is actually occurring in the plan? If not, was it a one-time event, or a systemic shift? Should more analysis be done on the assumptions?
- What is causing the demographic changes being experienced? For example, if the turnover percentage has increased significantly versus past years, what is driving that turnover?
  - Are there wage or pay issues? Is the total rewards package competitive?
  - Is the workforce pool shrinking, thus making the retention of employees more difficult?
  - Are there industry challenges in general, which affect an employee's view of future opportunities? Is the business changing?
  - Does the company or organization retain a strong brand or reputation making it a desirable place to work and build a career?

An experience analysis looks back at the experience that occurred over a single period, typically a year, and determines the extent to which particular assumptions or factors affected the change in the plan over that time. The analysis will provide insight by evaluating the changes by factor as gains or losses to the plan.



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When should an experience analysis be completed?

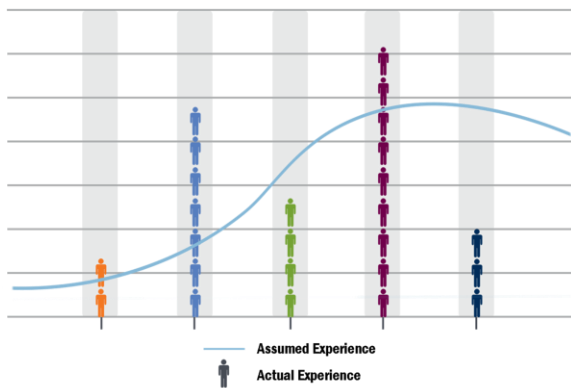
If a plan is expecting a significant event, an experience analysis could help identify the potential impact on the plan going forward. For example, if a plan sponsor made the decision to de-risk a pension plan by offering a lump sum window, the plan sponsor may have expected 60% of the participants to take the lump sum. If, however, fewer participants took the lump sum than expected, an experience analysis afterward could help determine if more de-risking should occur. It could also be an opportunity to see where gaps in communication occurred that may have contributed to the less than optimal final result.

Also keep in mind other significant corporate changes like eliminating a retiree medical plan may change participant retirement in the pension plan. It may be hard to determine how these will change without actual

participant elections, so the experience analysis will allow you to determine if your plan's expectation was set accurately or should be revised.

What about an experience study over a longer period of time?

It is important to occasionally look at multiple years of experience analyses to provide a picture of changing demographic trends or the market environment. A multiyear analysis, called an *experience study*, can highlight any assumptions that no longer adequately reflect market conditions to the degree desired and can point to new assumptions that should be used going forward.



Plan sponsors should be aware that even without significant events, assumptions can change over time. Years ago many plans sponsors assumed that participants would retire no later than age 65, but actual experience in these plans has shown that participants were changing their retirement habits and retiring at later ages. Many plan sponsors have changed their assumptions to reflect this deferred retirement. Assumptions should match participants' behaviors to ensure that the plan is not being over- or under-funded.

When reviewing an experience analysis or study, be aware that any variation in actual results versus the plan assumptions will have a greater impact on small plans (those with fewer than 100 participants) than large plans. The law of large numbers applies here. Going forward, it is a good idea to confirm the assumptions used each year when reviewing the plan valuation report. Periodically spending the time to compare actual plan experience to the assumptions being used for valuations can keep annual volatility down and can reveal trends among plan participants that may otherwise go unnoticed.

Ignoring the information that can be gained from an experience analysis is like keeping the curtains closed to the changing weather: it is better to take proactive measures than to be left unprepared for an advancing storm.

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