HIGHLAND'S DEFINED BENEFIT SERVICES

In Highland's 30-year history, we have worked extensively with defined benefit plans and their sponsors. Our goal is to improve participant outcomes by aiding in the plan sponsor's investment decision-making process.

Our support of defined benefit (DB) plans comes in many forms, including:

- Asset/Liability Studies
- Investment Policy Development
- Fiduciary Education
- Annual Governance Reviews
- Monthly Funded Status Calculation and Monitoring
- Glidepath/LDI Implementation and Monitoring
- Investment Manager Searches (specifically, ERISA-qualified vehicles)
- Negotiating Investment Manager Terms
- Fee Reviews and 408(b)2 Disclosures
- Alternative Asset Allocation Programs
- Investment Performance Reporting
- Reviews of Annuity Buyout Providers
- Limit Risks Related to the Sponsor (i.e., exposure to a sponsor's industry or securities)

Highland Defined Benefit Highlights

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Over $5 billion DB AUA

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12 plan sponsors

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175+ years of combined DB experience among the Highland team

Importantly, our structure and independence allow us to produce tailored solutions for our clients based on their specific goals and objectives. We pride ourselves on being a trusted partner to our clients.

TRANSFORMING PORTFOLIOS. ADVANCING MISSIONS.

Highland Associates, Inc. is an independent institutional investment advisor headquartered in Birmingham, Alabama. Highland was founded over 30 years ago, specifically to help develop, implement and maintain investment management programs for institutions. We serve a national client base of investors including not-for-profit healthcare organizations, foundations, endowments, defined benefit plans, defined contribution plans, and insurance portfolios. Please visit the website at www.highlandassoc.com to learn more.

HIGHLAND ASSOCIATES
2545 HIGHLAND AVENUE SOUTH
SUITE 200
BIRMINGHAM, ALABAMA 35205
P. 1-800-405-7729 / (205) 933-8664
F. (205) 933-7688

ST LOUIS:
7733 FORSYTH BLVD.; SUITE 1103
CLAYTON, MO 63105
P. 314-296-6171

How We View the Space

One way Highland ensures client goals are being met is by understanding the orientation of a client's defined benefit plan. DB plans tend to adhere to one of three orientations:

- Total Return
- Liability-Driven Investing (LDI)
- Pension Risk Transfer (PRT)

Each orientation will depend on the status of the plan, a plan's demographics, and the outlook of the plan sponsor.

Total Return

A total return orientation makes intuitive sense – the goal is to produce efficient returns based on client risk and return objectives. A plan spends much of its existence with a total return orientation – the goal being that the assets produce returns to meet the obligations of the plan, irrespective of the sponsor's ability to fund the plan. Total return oriented plans are often open to new participants, have long time horizons, and no intention of closing in the near-term. A total return plan is often able to take on more risk due to a longer time horizon. This higher capacity for risk-taking can manifest itself through a larger propensity for volatile assets, a higher tolerance for tracking error, or the inclusion of illiquid assets.

We work with various plan sponsors who have a total return orientation. We consult clients on proper allocations based on the results of our asset/liability modeling and identify world-class managers to implement those specific asset allocations within ERISA-qualified vehicles. We consistently provide asset class education and stress test portfolios to anticipate changes in the portfolio and develop contingency plans for when the unexpected happens.

Liability-Driven Investing (LDI)

Liability-driven investing is a de-risking strategy for plan sponsors. LDI shifts the plan's returns-based focus to one that seeks to reduce funded-status volatility. Rather than allocating to portfolios focused solely on returns, plans seek to invest in assets with return characteristics similar to those of liability and, thus, create a hedge.

Pension Refresher

Pension liabilities are simply future cash flows due to participants, discounted back to a present value. Depending on the plan, the discount rate is either an actuarial rate of return or a market-based borrowing rate that would be available to the plan sponsor (pension liabilities can be thought of as debt, after all). But what if a plan could invest in an asset that paid exactly those cash flows due to the participants? In doing so, the plan could neutralize – or perfectly hedge – its liabilities. In that scenario, any changes to the discount rates would be borne by both the asset and the liability. This is the general idea behind LDI: invest in assets that act similar to a specified liability. Fixed income securities with a duration and return profile similar to that of the liability are typically used to achieve the hedging characteristics for defined benefit funds.

LDI strategies are often guided by an allocation glidepath. A glidepath instructs the asset allocation based on the funded status of a plan. A plan with a lower funded status will have a higher allocation to return-seeking assets. As the plan gains funded status, the glidepath will require a portion of the return-seeking assets be reallocated toward hedging assets. This can be achieved by using a portion of the assets to purchase long-duration bonds. This achieves a dollar duration hedge but may expose the portfolio to key rate risks; groups in this category tolerate this risk because a portion of the portfolio is still return-seeking.

As clients prepare to engage in an LDI strategy, Highland takes a holistic review of the portfolio through an Enterprise Risk Management approach: stress-testing allocations, reviewing manager terms, enhancing portfolio liquidity, and exploring the secondary market's interest in a client's private investment holdings. Further, we often integrate pension risks with other portfolios, e.g., healthcare organization operating assets.

As plans enter an LDI glidepath, even the total-return portion of the portfolio must change to accommodate the modified mandate and shortened time horizon. For instance, the tolerance for tracking error will change within many asset classes. Should a manager underperform during a period where the glidepath calls for increased hedging assets, a plan may be required to realize that underperformance despite a positive long-term outlook on the manager. This is where Highland's holistic and non-siloed approach is so valuable: Our consultants and researchers are able to identify the right managers to fit the unique needs of the client. Highland also has a robust platform of LDI-oriented managers, particularly on the fixed income side, that our consultants can chose from based on specific client needs. A one-size-fits-all approach simply doesn't work – the teams need to work with and know the client to produce an optimal outcome.

For additional insights into LDI, view our June 2018 *Insight* report. That report – "Liability-Driven Investing: FAQ" – can be viewed on our website or by following this link.

Pension Risk Transfer (PRT)

Pension risk transfers consist of moving pension liabilities from the plan to another party. This other party can be a plan participant receiving a lump sum or a third party offering an annuity (usually an insurance company). The two forms of PRT can have very different effects on a plan, its demographic makeup, and the plan's asset allocation. Lump sum payments to existing participants serve the purpose of reducing operating costs and lowering future liabilities. The purchase of an annuity usually occurs when a sponsor is seeking to "get out of the pension business altogether." Both approaches require a great deal of communication among stakeholders and require sponsors to fulfill their fiduciary duties, including reviews of the annuity providers. Highland has extensive experience working with sponsors to meet these obligations and ensuring positive outcomes for plan participants.

Wherever your plan exists on the DB spectrum, Highland's credentialed advisors are ready to craft customized solutions that achieve your desired goals. Our experienced team has worked with all varieties of pensions, ranging from plans subject to FASB and GASB, from cash balance to traditional plans. We are ready to partner with your team as a fiduciary to help control the risks associated with pension investing and deliver the benefits as promised.