Modest increase in 2010 funded status as a result of record employer contributions

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Record levels of employer contributions lead to a small gain in funded status

The Milliman 100 companies contributed a record $59.4 billion to their defined benefit pension plans in 2010, producing an improvement in funded status of $12.4 billion for the year. The $59.4 billion far exceeded the expected level of contribution of $30.3 billion for 2010 (the $30.3 billion was disclosed in the companies' 2009 year-end footnotes). The $29.1 billion worth of greater-than-expected contributions turned a $16.7 billion deterioration of funded status into a $12.4 billion improvement.

If interest rates in 2011 remain at the same 2010 levels (or decline), cash contributions and associated pension cost should increase even further this year. The contributions for 2010 could have been even higher if Congress had not granted modest contribution reductions with the enactment of the Pension Relief Act of 2010 in June.

2010 asset gains offset liability losses from declining interest rates

The record cash contributions and the investment gains (12.8% actual returns for 2010 fiscal year vs. 8.0% expected returns) were offset by the 7.7% increase in liabilities generated by the decrease in discount rates (5.43% at year end 2010, down from 5.82% in 2009 and 6.36% in 2008) that are used to measure pension plan liabilities. This resulted in only a small improvement in funded ratio in 2010 to 83.9%, up from 81.7% in 2009 and 79.3% in 2008.

Pension expense continued to increase in 2010

The continued decline in discount rates led to record levels of pension expense in 2010: a $30.0 billion charge to earnings (up from $25.8 billion in 2009), the highest level in the 11-year history of the Milliman Pension Funding Study. There were 11 companies with pension income (i.e., negative expense) in 2010, down from 16 in 2009. Even with the improvement in funded status in 2010, pension expense is projected to continue to increase for 2011 as companies using asset smoothing are still reflecting the impact of the asset losses in 2008.

Accounting changes adopted by some companies

At least three companies (Honeywell, Verizon, and AT&T) adopted significant changes in their U.S. GAAP accounting in 2010 for their domestic defined benefit plans. While each company's approach was unique, the changes involved full or substantive recognition of accumulated losses, resulting in a significant charge to their 2010 year-end balance sheet. Looking forward to 2011, there is an expected reduction of future years' pension expense through the elimination of the annual charge to earnings for those losses. If the rest of the Milliman 100 companies had adopted similar accounting changes, we estimate that there would have been a $342 billion charge to their cumulative balance sheets in 2010 and a reduction in their 2011 pension expense (and increase in corporate earnings) of about $19.9 billion.

A proposed change to International Accounting Standards would eliminate the pension expense credit for Expected Return on Assets (8.0% for the Milliman 100 companies in 2010). Companies would only have a pension expense charge equal to the discount rate on the excess of liabilities over assets (or a similar credit if the plan were more than 100% funded). If that change had been adopted for U.S. GAAP accounting in 2010, the pension expense for the Milliman 100 companies (and the charge to corporate earnings) would have increased by about $30.0 billion.

Overall asset allocation did not change significantly during 2010

The percentage of pension plan assets invested in equities decreased from approximately 45% to 44%, fixed income allocations were unchanged at 36%, and allocation to other investments increased from 19% to 20% during 2010. The minor increase to other asset classes reflects, in part, greater diversification of portfolios to help reduce funded status volatility. We believe that companies should consider employing dynamic investment policy strategies for de-risking their plans as they move from underfunded levels to fully funded levels, reducing their equity allocations and increasing liability-matched fixed income allocations.

Who are the Milliman 100 companies?

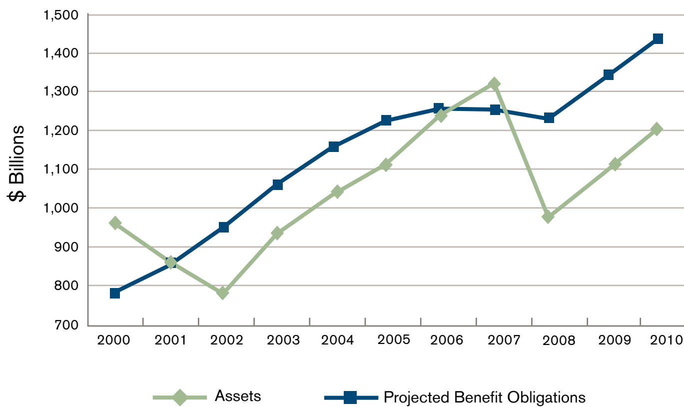
Our study covers 100 U.S. public companies with the largest defined benefit pension plan assets for which a 2010 annual report (Form 10-K) was released by March 3, 2011.

The results of the Milliman 2011 Pension Funding Study were based on the pension plan accounting information disclosed in the footnotes to the companies' annual reports for the 2010 fiscal year and for previous fiscal years. These figures represent the GAAP accounting information that public companies are required to report under Financial Accounting Standards Board Accounting Standards Codification Subtopics 715-20, 715-30, and 715-60 (formerly known as Statements of Financial Accounting Standards Numbers 87, 88, 106, 132, and 158). In addition to providing the financial information on the funded status of their U.S. qualified pension plans, the footnotes may also include figures for the companies' nonqualified and foreign plans, both of which are often unfunded or subject to different funding standards than those for U.S. qualified pension plans. They do not represent the funded status of the companies' U.S. qualified pension plans under ERISA.

This is Milliman's 11th annual study of the financial reports of the 100 largest U.S. public corporations that sponsor defined benefit pension plans. As a group, these companies had pension plan assets of over $1.2 trillion at the end of 2010.

The funded ratio of the Milliman 100 pension plans increased slightly during 2010, reaching 83.9%. The aggregate pension deficit of $231.6 billion had decreased by $12.4 billion during the 2010 fiscal years, partially reducing an aggregate deficit of $244.1 billion at the end of 2009.

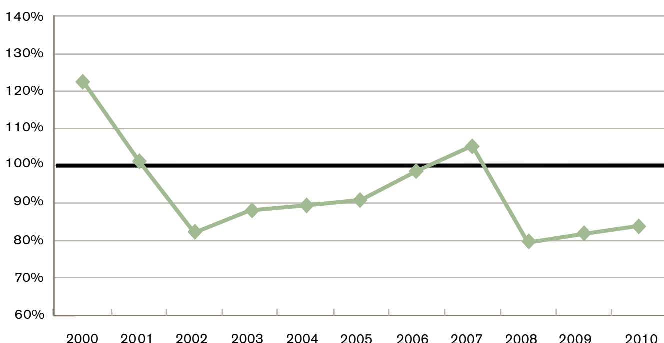
PLAN ASSETS AND LIABILITIES



The companies' balance sheets only improved by about $10.1 billion during their 2010 fiscal years, when the $2.3 billion loss in funded status for other post-employment benefit plans (OPEBs) was added to the pension gains.

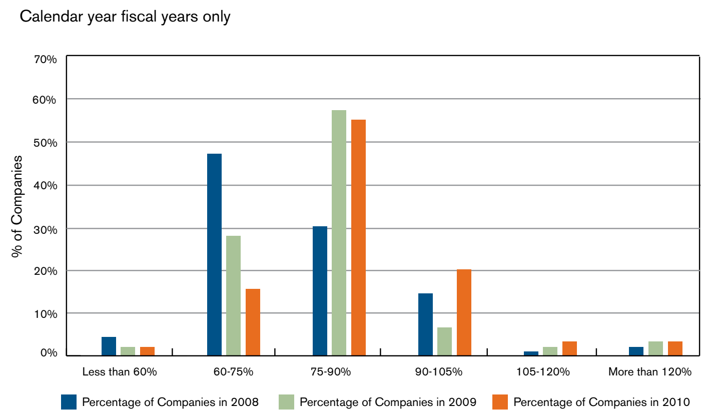
For their 2010 fiscal years, projected benefit obligation (PBO) funded ratios ranged from a low of 47% to a high of 162%. For the group, funded ratio increased to an average of 83.9% from the prior year's 81.7%, but was still below the funded ratio of 105.4% at the end of 2007. Even with two consecutive years of asset returns in excess of expected returns, the market value of assets for the Milliman 100 companies is still $119 billion below the value at the end of 2007, before the financial crisis, and the funded status is almost $300 billion lower.

FUNDED RATIO - ASSETS / PROJECTED BENEFIT OBLIGATION



The favorable investment returns during 2010 were offset by the increase in liabilities generated by the decrease in discount rates used to measure pension plan liability. This resulted in a small improvement in funded status during 2010. Only seven out of the 89 companies with calendar-year fiscal years reported their PBO funded status in a surplus position at the end of 2010. This compares with six in a surplus position at the end of 2009; 50 reported a surplus in 2007. Seventy-four of the Milliman 100 companies reported an increase in their PBO funded ratio during 2010, compared with 68 that increased their funded ratio during 2009 and none that increased their funded ratio during 2008.

DISTRIBUTION BY FUNDED STATUS - 2008 - 2010



The average actual investment return on pension assets for the companies' 2010 fiscal years was 12.8% (12.5% for calendar-year fiscal years), which was above the expected rate of return of 8.0%, partially reversing the historic 2008 losses.

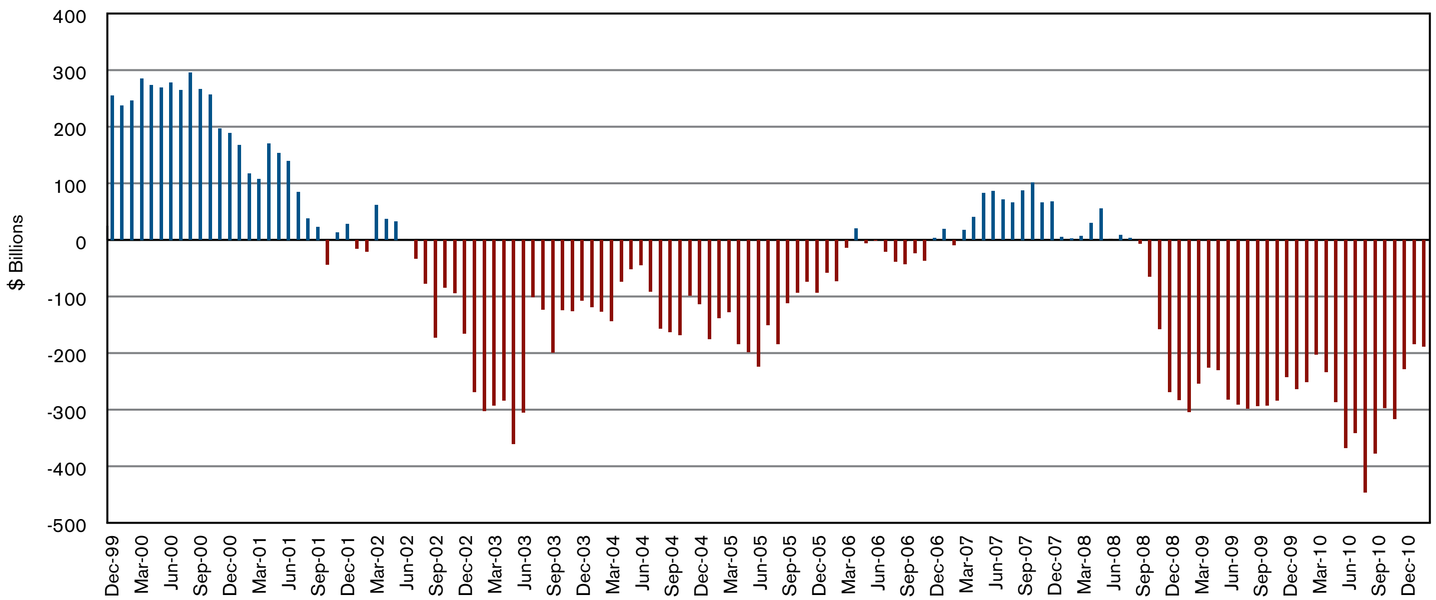
During 2010, the plans recovered $115 billion in market value, $46 billion more than expected based on an average expected rate of return of 8.0%. Over the past five years, the pension funds have averaged a 5.3% annual rate of return. Since the end of 1999, the plans have earned, on average, an annual investment return of only 5.1%.

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Expected Return	9.4%	9.4%	9.2%	8.5%	8.4%	8.3%	8.3%	8.2%	8.1%	8.1%	8.0%
Actual Return	4.4%	(6.3%)	(8.7%)	19.3%	12.4%	11.3%	12.9%	9.9%	(18.9%)	14.%	12.8%

Pension expense increased by $4.2 billion during 2010, producing an aggregate pension expense of $30.0 billion. Both pension expense and employer contributions are expected to remain high during 2011.

Eleven companies reported pension income during 2010, a decrease from the 16 that did so during 2009 and well below the high point of 63 companies in 2001.

MILLIMAN 100 PENSION FUNDING INDEX PENSION SURPLUS/DEFICIT



Employer contributions increased to $59.4 billion for 2010, up from $54.1 billion in 2009. By comparison, contributions averaged $36.5 billion for the five prior years. More companies will be subject to quarterly contribution requirements in 2011 and many companies continued to make extraordinary contributions in the first quarter of 2011 to avoid benefit restrictions that could apply under the 2006 Pension Protection Act (PPA). For these reasons, even though the Milliman 100 companies have reported a lower level of expected contributions ($40.5 billion) for 2011, we expect contributions for 2011 to remain at the current higher levels.

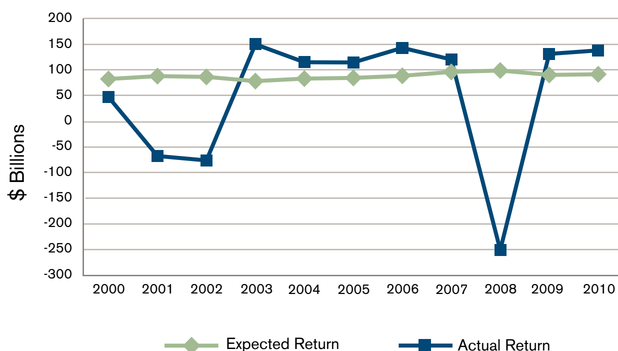
Discount rates used to measure plan liabilities continued to decrease during 2010. The lower discount rates increased pension liabilities, offsetting the asset gains in 2010.

Median discount rates decreased to 5.43% at the end of 2010, from 5.82% in 2009 and the prior historic low of 5.5% in 2005, after declining incrementally each year from 7.5% from the end of 1999. Discount rates were almost 100 basis points higher at the end of 2008. The drop in rates over the past two years greatly accelerated the erosion in funded status. Based on the movement of corporate bond rates during 2010, discount rates were expected to drop even further than they did. However, companies have maintained higher discount rates through the use of various bond selection methods in setting their rates.

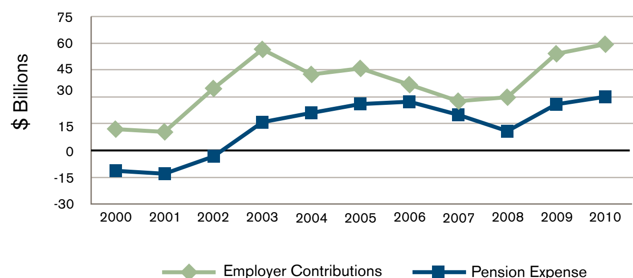
The decrease in discount rates drove pension liabilities up 7.7% in 2010 and 8.2% in 2009, after falling by 1.9% in 2008 and by 0.2% in 2007.

Overall, companies maintained their expected rate of return (8% for 2010 as compared with 8.1% for both 2009 and 2008), after steady declines from the expected rate of return of 9.4% for 2001.

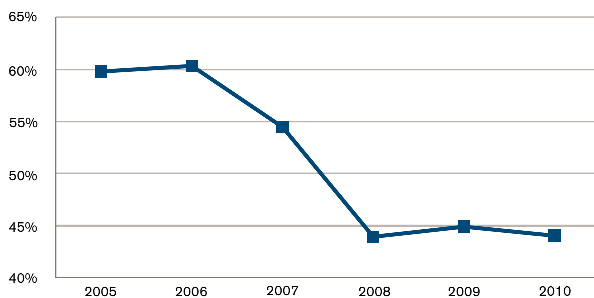
INVESTMENT RETURN ON PLAN ASSETS



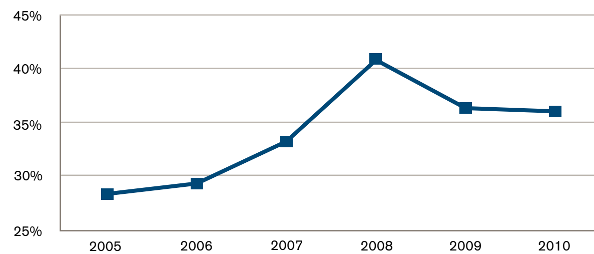
PENSION EXPENSE (INCOME) AND CONTRIBUTIONS



ASSET ALLOCATION - EQUITIES



ASSET ALLOCATION - FIXED INCOME



Only three companies in the group continued to assume an expected rate of return for 2010 that is at least 9.0%, down from five companies in 2009 and a high of 80 in 2000. Asset allocations have not changed significantly, so we do not expect any significant change in expected returns for 2011.

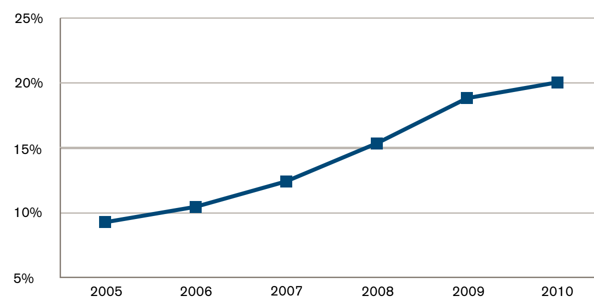
There were minor changes in asset allocation during 2010. Overall, the companies studied invested 44% of their pension fund assets in equities (down from 45% at the end of 2009 and down from 54% at the end of 2007); 36% in fixed income assets (unchanged from 2009 but up from 33% at the end of 2007). The remaining 20% of pension fund assets were invested in other asset classes (up from 19% at the end of 2009 and 12% at the end of 2007), including real estate, private equity, hedge funds, commodities, and cash equivalents.

Overall allocations to equities decreased slightly in 2010. Eight companies decreased their equity allocations by more than 10% in 2010, compared with nine companies that had decreases of over 10% in equity allocations in 2009 and 47 companies in 2008. None of the 100 companies had increases to its equity allocations by more than 10% in 2010. Given the strong performance of the equity markets during 2010, equity allocations should have increased to over 47%. However, the impact of companies rebalancing their portfolios kept the equity allocations from moving to higher levels. We expect equity allocations to remain at current levels or decrease during 2011 if the funded status of the study group improves.

Overall allocations to fixed income investments were unchanged in 2010. Only one company had a decrease of over 10% in its fixed income allocation. Five companies, however, increased their fixed income allocations by more than 10% in 2010, compared with five companies that had increases in fixed income allocations over 10% in 2009 and 28 companies in 2008.

Overall allocations to other asset classes increased in 2010. Twelve companies increased their allocations more than 5% to other asset classes. We believe that the allocation increase to other asset classes in 2010 was partially attributed to diversification strategies and partially attributed to changes in GAAP disclosure reporting requirements under FASB ASC Subtopic 820-10 (formerly known as Statements of Financial Accounting Standards Number 157), which required significantly greater detail about asset allocation.

ASSET ALLOCATION - OTHER



WHAT TO EXPECT IN 2011 AND BEYOND.

Plan sponsors are still responding to 2008 asset losses and historically low levels of interest rates. Even with the improvement in funded status during 2009, 2010, and thus far in 2011, most plan sponsors will still face increases in pension expense and contribution requirements.

Overall, the plan sponsors in this study group have a significant asset-liability mismatch, thereby exposing their plans to relatively high funded status and future cash contribution volatility. We believe that plan sponsors should balance long-term goals with potential short-term risks that can adversely impact the company's cash flow, balance sheet, and earnings. Pension fund sponsors should consider employing pension risk management practices through liability-driven investing and risk-budgeting (risk-allocation) techniques. Despite the current low interest rate environment, fixed income portfolios can still be aligned to track the plan liabilities, while public equity allocations are diversified into alternative investments including real estate, private equity, hedge funds, commodities, and infrastructure, subject to liquidity and governance considerations.

As the funded status of pension plans improves over time (either through investment returns or cash contributions), plan sponsors can employ a dynamic investment policy strategy that provides a glide path for de-risking their pension plans as they move from underfunded levels to fully funded levels. A dynamic investment policy strategy adjusts the plan's asset allocation according to pre-established rules ("trigger points") based on funded status value at risk (VaR). If adopted, the plan's investment policy statement should reflect the dynamic investment policy program, including trigger points to de-risk the plan.

HISTORIC VALUES

FUNDED STATUS

Fiscal Year	Market Value of Plan Assets	Change From Prior Year	Projected Benefit Obligation	Change From Prior Year	Funded Ratio	Change From Prior Year	Funded Status	Change From Prior Year
2010	$1,203,027	$115,408	$1,434,652	$102,981	83.9%	2.2%	($231,625)	$12,427
2009	$1,087,618	$111,437	$1,331,671	$101,398	81.7%	2.3%	($244,053)	$10,039
2008	$976,182	($345,916)	$1,230,273	($23,942)	79.3%	-26.1%	($254,092)	($321,974)
2007	$1,322,097	$83,008	$1,254,216	($2,375)	105.4%	6.8%	$67,882	$85,382
2006	$1,239,090	$126,146	$1,256,590	$31,414	98.6%	7.8%	($17,500)	$94,733
2005	$1,112,943	$80,405	$1,225,176	$69,384	90.8%	1.5%	($112,233)	$11,021
2004	$1,032,538	$98,079	$1,155,792	$93,897	89.3%	1.3%	($123,254)	$4,182
2003	$934,459	$155,581	$1,061,895	$112,067	88.0%	6.0%	($127,436)	$43,513
2002	$778,878	($84,169)	$949,827	$98,461	82.0%	-19.4%	($170,949)	($182,630)
2001	$863,047	($97,626)	$851,366	$68,702	101.4%	-21.4%	$11,680	($166,328)
2000	$960,672	n/a	$782,665	n/a	122.7%	n/a	$178,008	n/a

RETURN ON ASSETS

Fiscal Year	Expected Rate of Return	Actual Rate of Return (Estimated)	Actual Rate of Return (Estimated for Plans With Calendar Fiscal Years)	Expected Return	Actual Return	Difference
2010	8.0%	12.8%	12.5%	$90,933	$137,309	($46,376)
2009	8.1%	14.1%	17.2%	$89,669	$130,485	($40,815)
2008	8.1%	-18.9%	-22.2%	$98,185	($250,540)	$348,725
2007	8.2%	9.9%	8.9%	$95,513	$119,643	($24,130)
2006	8.3%	12.9%	12.7%	$87,912	$142,221	($54,309)
2005	8.3%	11.3%	10.7%	$83,835	$113,899	($30,064)
2004	8.4%	12.4%	11.5%	$82,485	$114,302	($31,818)
2003	8.5%	19.3%	19.0%	$77,634	$149,254	($71,621)
2002	9.2%	-8.7%	-8.2%	n/a	n/a	n/a
2001	9.4%	-6.3%	-6.2%	n/a	n/a	n/a
2000	9.4%	4.4%	3.4%	n/a	n/a	n/a

PENSION COST

Fiscal Year	Pension Income/(Cost)	Change From Prior Year	Employer Contribution	Change From Prior Year	Discount Rate
2010	($30,009)	$4,183	$59,406	($5,328)	5.43%
2009	($25,826)	$15,005	$54,077	($24,309)	5.82%
2008	($10,821)	($9,092)	$29,769	($2,198)	6.36%
2007	($19,914)	($7,336)	$27,571	$9,221	6.20%
2006	($27,250)	$1,306	$36,793	$9,081	5.75%
2005	($25,944)	$4,943	$45,874	($3,351)	5.50%
2004	($21,001)	$5,149	$42,523	$13,997	5.75%
2003	($15,852)	$19,217	$56,519	($21,865)	6.01%
2002	$3,365	$9,652	$34,654	($24,266)	n/a
2001	$13,017	($1,628)	$10,388	$1,526	n/a
2000	$11,389	n/a	$11,914	n/a	n/a

ASSET ALLOCATIONS

	2010	2009	2008	2007	2006	2005
Equity Allocation	43.98%	44.85%	43.88%	54.44%	60.33%	59.79%
Change From Prior Year	-1.93%	2.20%	-19.39%	-9.77%	0.91%	n/a
Fixed Allocation	36.00%	36.30%	40.81%	33.18%	29.24%	28.26%
Change From Prior Year	-0.82%	-11.05%	22.99%	13.47%	3.48%	n/a
Other Allocation	20.02%	18.80%	15.31%	12.38%	10.42%	9.23%
Change From Prior Year	6.45%	22.83%	23.67%	18.75%	12.94%	n/a

OTHER POSTEMPLOYMENT BENEFITS (OPEB) FUNDED STATUS

Fiscal Year	OPEB MV of Assets	Change From Prior Year	OPEB APBO	Change From Prior Year	OPEB Funded Status	Change From Prior Year	OPEB Funded Ratio	Change From Prior Year
2010	$56,698	$5,895	$249,813	$10,166	($193,116)	($2,296)	22.7%	1.5%
2009	$50,803	($7,323)	$239,648	($43,520)	($190,819)	$34,223	21.2%	0.7%
2008	$58,126	($29,959)	$283,168	($44,190)	($225,042)	$14,723	20.5%	-6.4%
2007	$88,085	$4,520	$327,358	($11,077)	($239,765)	$15,602	26.9%	2.2%
2006	$83,564	$5,759	$338,435	($18,300)	($255,367)	$23,601	24.7%	2.9%
2005	$77,805	$6,854	$356,735	$14,501	($278,968)	($7,664)	21.8%	1.1%
2004	$70,951	$15,285	$342,234	$16,908	($271,303)	($1,642)	20.7%	3.6%
2003	$55,666	n/a	$325,327	n/a	($269,661)	n/a	17.1%	n/a

ABOUT THE STUDY

The results of the Milliman 2011 Pension Funding Study are based on the pension plan accounting information disclosed in the footnotes to the companies' annual reports for the 2010 fiscal year and for previous fiscal years. These figures represent the generally accepted accounting principles (GAAP) accounting information that public companies are required to report under Financial Accounting Standards Board Accounting Standards Codification Subtopics 715-20, 715-30 and 715-60 (formerly known as Statements of Financial Accounting Standards Numbers 87, 88, 106, 132, and 158). In addition to providing the financial information on the funded status of their U.S. qualified pension plans, the footnotes may also include figures for the companies' nonqualified and foreign plans, both of which are often unfunded or subject to different funding standards from those for U.S. qualified pension plans. The information, data, and footnotes do not represent the funded status of the companies' U.S. qualified pension plans under ERISA.

This study includes the 100 U.S. public companies with the largest defined benefit pension assets whose 2010 annual reports were released by March 3, 2011. Eleven of the companies included in the 2011 study had fiscal years other than the calendar year. Private companies, mutual insurance companies, and U.S. subsidiaries of foreign parents were excluded from the study.

Projections for 2011 are based on the Milliman 100 Pension Funding Index, which has been updated to reflect the data from this study. This index is published on a monthly basis and reflects the effect of market returns and interest-rate changes on pension-funded status, utilizing actual reported asset values, liabilities, and asset allocation from the Milliman Pension Funding Study.

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