Milliman analysis: October's $45 billion funded status decline pushes pension deficit to $498 billion

After two months of improvement, funding status declines due to lower discount rates and flat investment experience

John Ehrhardt, FSA, MAAA, EA
Zorast Wadia, FSA, MAAA, EA

Pension liabilities of the 100 largest corporate defined benefit pension plans increased by $43 billion in October while the assets backing those pension promises dropped by $2 billion, bringing the Milliman 100 PFI funded status deficit to $498 billion and a 72.6% funded ratio, down from 74.5% at the end of September. The erosion in funded status follows funded status improvements in both August and September.

HIGHLIGHTS

	$ BILLION			
	MV	PBO	FUNDED STATUS	FUNDED PERCENTAGE
SEP 2012	1,325	1,778	(453)	74.5%
OCT 2012	1,322	1,821	(498)	72.6%
MONTHLY CHANGE	(3)	+43	(45)	-1.9%
YTD CHANGE	+76	+237	(161)	-6.1%

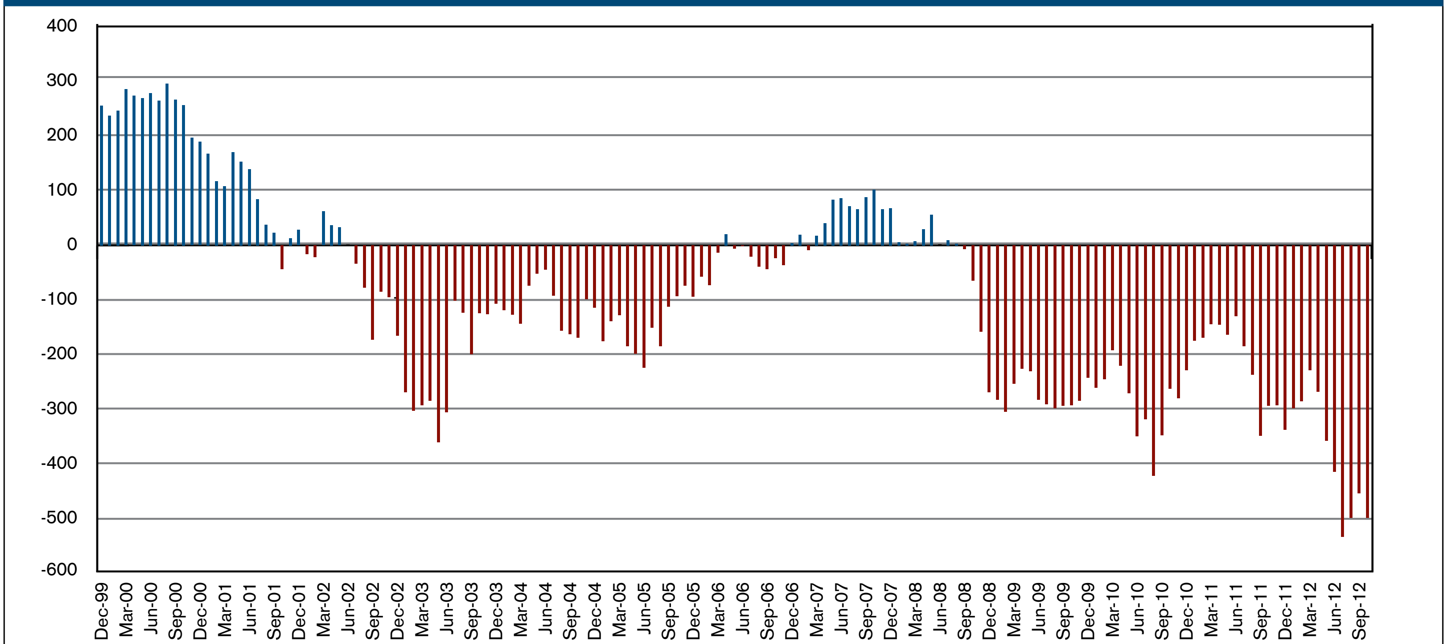
NOTE: NUMBERS MAY NOT ADD UP PRECISELY DUE TO ROUNDING

October's funded status decline was primarily due to a decrease in the corporate bond interest rates that are the benchmarks used to value pension liabilities.

The projected benefit obligation (PBO), or pension liabilities, increased by $43 billion during October, raising the Milliman 100 PFI value to $1.821 trillion from $1.778 trillion at the end of September. A decrease of 12 basis points in the monthly discount rate—to 3.96% in October from 4.08% for September—drove the liability increase.

The Milliman 100 PFI asset value decreased by $2 billion during October, to $1.322 trillion from $1.324 trillion at the end of September. The decrease was due to October's investment loss

FIGURE 1: MILLIMAN 100 PENSION FUNDING INDEX PENSION SURPLUS/DEFICIT



of 0.01%. By comparison, the Milliman 2012 Pension Funding Study published in March 2012 reported that the monthly median expected investment return during 2011 was 0.63% (7.80% annualized).

Over the last 12 months (November 2011 to October 2012), these plans have experienced a cumulative robust investment gain of 10.5% while, unfortunately, experiencing a total funded status decrease of $206 billion. For these 12 months, the funded ratio of the Milliman 100 companies dropped to 72.6% from 80.9%, primarily due to declining discount rates.

2012-2013 PROJECTIONS

If the Milliman 100 PFI companies were to achieve a 7.8% median asset return (as per the 2012 pension funding study) expected for their pension plan portfolios and the current discount rate of 3.96% were to be maintained during years 2012 through 2013, we forecast the funded status of the surveyed plans would increase. This would result in a projected pension deficit of $489 billion (funded ratio of 73.2%) by the end of 2012 and a projected pension deficit of $413 billion (funded ratio of 77.6%) by the end of 2013. For purposes of this forecast, we have assumed 2012 aggregate contributions of $67 billion and 2013 aggregate contributions of $81 billion.

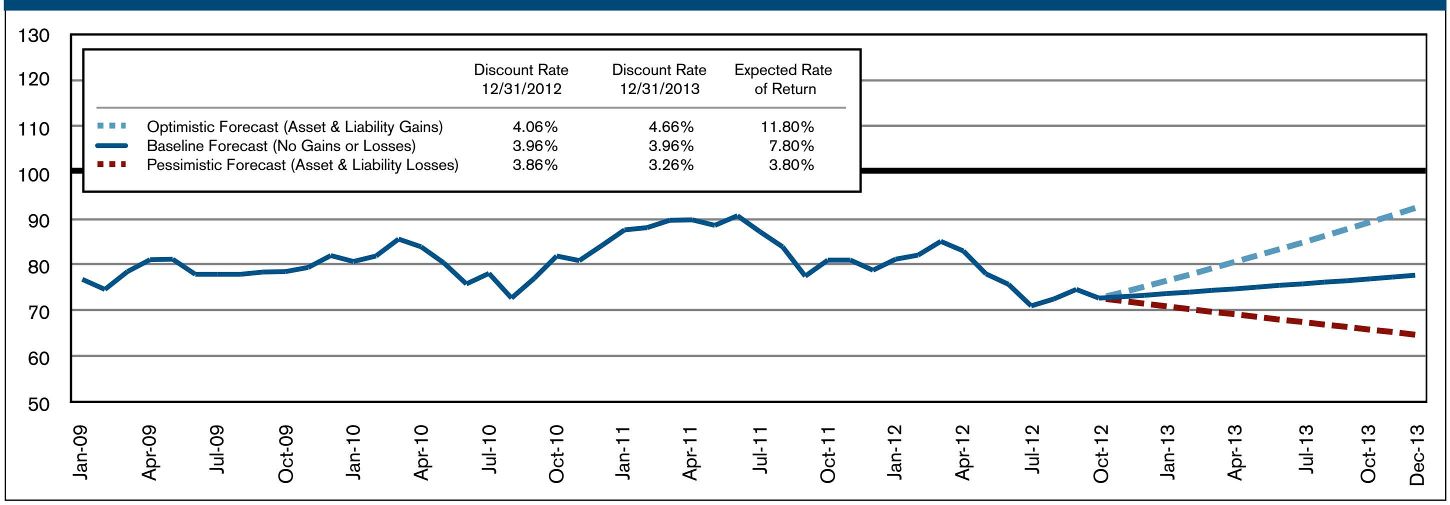
The expected loss in funded status during 2012 (more than $150 billion) will result in a charge to corporate balance sheets at the end of the 2012 fiscal year. The expected loss will produce an estimated increase of more than $17 billion in pension expense for the 2013 fiscal year.

Please note that the contribution assumptions have not been adjusted to reflect the potential impact of the Moving Ahead for Progress in the 21st Century Act (MAP-21), which includes pension funding stabilization provisions. While several plan sponsors have announced reduced contributions, we feel that a majority of the Milliman 100 companies will continue to prudently fund the pension deficits in their respective plans and presumably continue with their existing pension de-risking funding strategies rather than lower their contribution level to satisfy minimum standards.

Under an optimistic forecast with rising interest rates (reaching 4.06% by the end of 2012 and 4.66% by the end of 2013) and asset gains (11.8% annual returns), the funded ratio would climb to 75% by the end of 2012 and 92% by the end of 2013. Under a pessimistic forecast with similar interest rate and asset movements (3.26% discount rate at the end of 2012 and 3.86% by the end of 2013 and 3.8% annual returns), the funded ratio would decline to 71% by the end of 2012 and 65% by the end of 2013.

John Ehrhardt is a principal and consulting actuary with the New York office of Milliman. Zorast Wadia is a principal and consulting actuary with the New York office of Milliman. Contact them at john.ehrhardt@milliman.com or at 646.473.3000.

FIGURE 2: MILLIMAN 100 PENSION FUNDING INDEX – PENSION FUNDED RATIO



MILLIMAN 100 PENSION FUNDING INDEX – OCTOBER 2012 (ALL DOLLAR AMOUNTS IN MILLIONS)

END OF MONTH	YEAR	MARKET VALUE OF ASSETS	PROJECTED BENEFIT OBLIGATION (PBO)	FUNDED STATUS	CHANGE IN FUNDED STATUS	FUNDED RATIO
OCTOBER	2011	1,241,510	1,534,408	(292,898)	N/A	80.9%
NOVEMBER	2011	1,235,787	1,527,813	(292,026)	872	80.9%
DECEMBER	2011	1,246,235	1,583,613	(337,378)	(45,352)	78.7%
JANUARY	2012	1,274,884	1,572,630	(297,746)	39,632	81.1%
FEBRUARY	2012	1,294,521	1,579,548	(285,027)	12,719	82.0%
MARCH	2012	1,297,681	1,526,122	(228,441)	56,586	85.0%
APRIL	2012	1,293,677	1,561,169	(267,492)	(39,051)	82.9%
MAY	2012	1,263,136	1,620,957	(357,821)	(90,329)	77.9%
JUNE	2012	1,283,703	1,697,711	(414,008)	(56,187)	75.6%
JULY	2012	1,298,087	1,830,942	(532,855)	(118,847)	70.9%
AUGUST	2012	1,309,312	1,807,731	(498,419)	34,436	72.4%
SEPTEMBER	2012	1,324,634	1,777,759	(453,125)	45,294	74.5%
OCTOBER	2012	1,322,430	1,820,929	(498,499)	(45,374)	72.6%

PENSION ASSET AND LIABILTY RETURNS (ALL DOLLAR AMOUNTS IN MILLIONS)

		ASSET RETURNS			LIABILITY RETURNS	
END OF MONTH	YEAR	MONTHLY	YEAR-TO-DATE	DISCOUNT RATE	MONTHLY	YEAR-TO-DATE
OCTOBER	2011	4.07%	2.64%	4.53%	0.40%	16.41%
NOVEMBER	2011	-0.47%	2.15%	4.53%	0.38%	16.85%
DECEMBER	2011	3.00%	5.22%	4.67%*	-1.80%	14.74%
JANUARY	2012	2.46%	2.46%	4.71%	-0.37%	-0.37%
FEBRUARY	2012	1.70%	4.20%	4.69%	0.76%	0.39%
MARCH	2012	0.40%	4.62%	4.88%	-3.05%	-2.67%
APRIL	2012	-0.15%	4.46%	4.76%	2.63%	-0.11%
MAY	2012	-2.21%	2.15%	4.56%	4.14%	4.03%
JUNE	2012	1.79%	3.98%	4.32%	5.03%	9.26%
JULY	2012	1.28%	5.31%	3.92%	8.11%	18.12%
AUGUST	2012	1.02%	6.38%	3.99%	-1.01%	16.93%
SEPTEMBER	2012	1.32%	7.79%	4.08%	-1.39%	15.30%
OCTOBER	2012	-0.01%	7.78%	3.96%	2.69%	18.40%

* Reflects a change in our discount rate methodology in moving from the Citigroup Pension Liability Index to the Citigroup Above Median Pension Liability Index.

ABOUT THE MILLIMAN 100 MONTHLY PENSION FUNDING INDEX

For the past 12 years, Milliman has conducted an annual study of the 100 largest defined benefit pension plans sponsored by U.S. public companies. The Milliman 100 Pension Funding Index projects the funded status for pension plans included in our study, reflecting the impact of market returns and interest rate changes on pension funded status, utilizing the actual reported asset values, liabilities, and asset allocations of the companies' pension plans.

The results of the Milliman 100 Pension Funding Index were based on the actual pension plan accounting information disclosed in the footnotes to the companies' annual reports for the 2011 fiscal year and for previous fiscal years. This pension plan accounting disclosure information was summarized as part of the Milliman 2012 Pension Funding Study, which was published on March 29, 2012. In addition to providing the financial information on the funded status of 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.

Milliman 100 Pension Funding Index

John Ehrhardt, FSA, MAAA, EA, and Zorast Wadia, FSA, MAAA, EA

One Pennsylvania Plaza, 38th Floor
New York, NY 10119
+1 646 473 3000
www.milliman.com