Sibson Consulting
Segal Rogerscasey
Prism
A QUARTERLY REVIEW OF FUNDED STATUS
Strategic HR Consulting | Investment Solutions | Fourth Quarter 2014 Pension Plan Experience

Pension Funded Status Decreases Due to Decline in Interest Rate Levels in Q4 2014

During the fourth quarter of 2014 (Q4 2014), the funded status of the model pension plan examined in each issue of *Prism* decreased by 3 percentage points: from 91 percent to 88 percent. This decrease was driven by a liability increase of 4 percent and an asset return of 1 percent. See Graph 1. **The Q4 change in the funded status of the model pension plan does not reflect new mortality assumptions, which typically would decrease the funded status by 6 to 8 percent.**

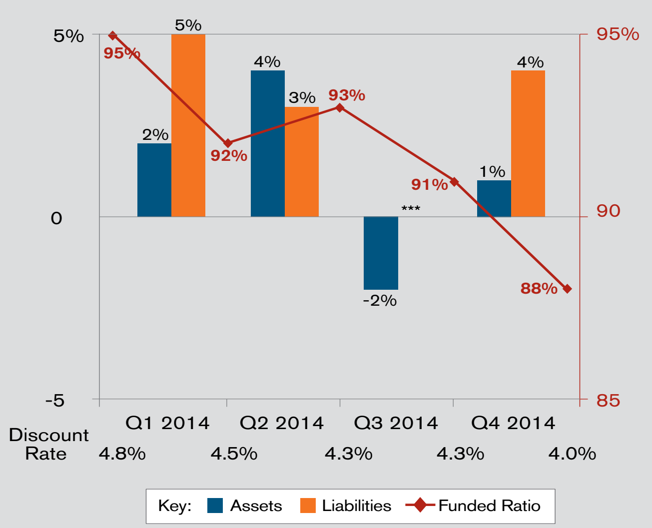
About *Prism*

Prism examines the effect of changes in the assets and liabilities of a model pension plan on its funded ratio over the four most recent quarters, viewing such changes through a marked-to-market lens. The primary focus is to understand the combined impact of asset movement and interest rate shifts on perhaps the most important financial metric to plan sponsors: the plan's funded status.

Aspects of Investment Performance

Domestic equities finished the year on a strong note, posting gains of 5.24 percent in Q4, as investors embraced solid economic data. Higher beta small-cap stocks handily beat their large-cap counterparts, while growth and value stocks performed roughly in line with one another. International stocks did not fare as well, falling 3.87 percent during the quarter. The U.S. dollar (USD) strength dampened the returns of international stocks, as did the weakness in emerging markets, which have greater exposure to falling oil prices. The global fixed-income market posted its fourth consecutive monthly decline and finished the quarter down 1.49 percent. This drawdown has been entirely due to the USD strength, as the local currency return for the quarter was positive.

Graph 1: Change in Assets,* Liabilities and Funded Ratio**

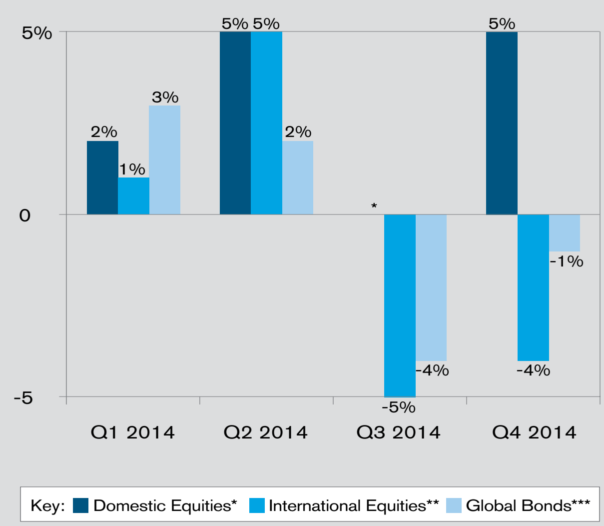


* The model plan's portfolio has a simple, passively invested asset allocation of 45 percent to domestic equities, 15 percent to international equities and 40 percent to global bonds.

** This is the ratio of a defined benefit (DB) plan's assets to accrued liabilities. The funded ratio data in the graph is the ratio at a point in time at the beginning or end of the quarter. The funded percentage for the model DB plan was reset as of January 1, 2014 to reflect the average actual funded percentage of large pension plans.

*** In Q3 2014, liabilities decreased 0.5 percent.

Graph 2: Investment Performance



* Russell 3000 (In Q3 2014, the return for domestic equities was 0.01 percent.)

** Morgan Stanley Capital International All Country World Index Ex-U.S. (MSCI ACWI Ex-U.S.)

*** Citigroup World Government Bond Index (WGBI) Unhedged, which includes U.S. and international bonds

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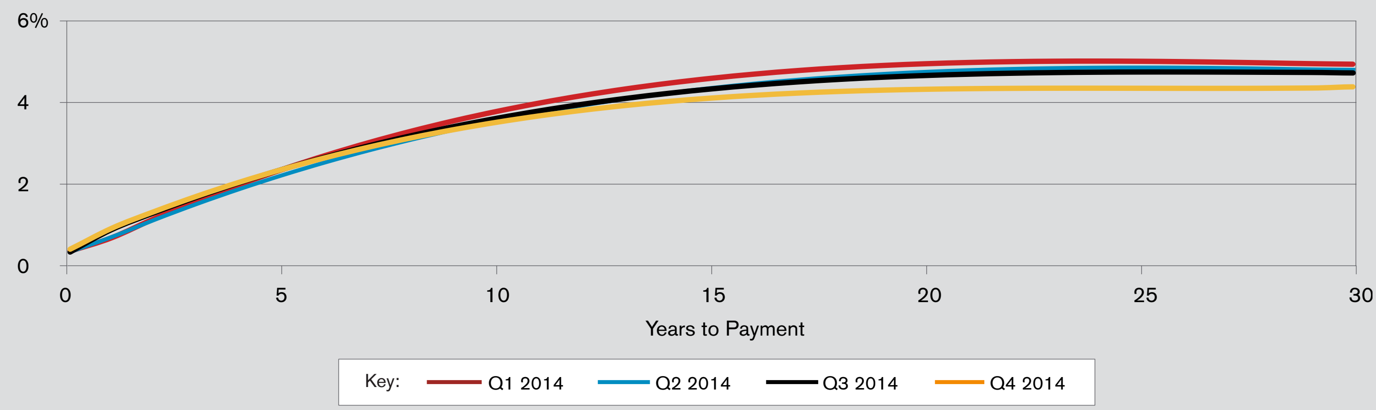
Changes in the Yield Curve

High-quality corporate yields decreased 20 basis points* during Q4 2014. This decrease was comprised of a 40 basis point drop in Treasury rates and a 20 basis point widening in credit spreads. The overall shape of the yield curve remained similar to the previous quarter: an upward-sloping yield curve that peaks at about 25 years and then levels off (although there was a slight flattening of the yield curve during the quarter, with long bond yields *falling* dramatically while very short duration bond yields *increased* slightly), as illustrated by the above-median curves shown in Graph 3.

The decrease in the yield-curve level during Q4 2014 resulted in a decrease in the effective interest rate and, consequently, increased the model pension plan's liability by about 4 percent. Any change in the shape of the yield curve could have a different impact on liabilities for plans with different maturities. (For background on yield curves, see the following webpage: http://www.sibson.com/publications/presentations/2015PrismYCprimer.pdf)

Graph 3: Changes in the Yield Curve*



* This curve reflects the average yield, at each duration, for corporate bonds rated AA that have yields above the median for that duration.

Important: Examine Your Own DB Plan's Experience

Plan sponsors should examine changes in their own DB plans' assets, liabilities and funded ratios from the vantage point of both accounting and funding metrics. Individual plan results will differ from this model for a host of reasons, including different funded positions, liability duration and contribution patterns.

Segal Rogerscasey and Sibson Consulting can help employers to project their DB plans' funded ratios through asset-liability modeling (ALM). For more information about ALM, contact your Segal Rogerscasey investment consultant or your Sibson retirement consultant.

* As a reminder, 10 basis points (bps) equals 0.1 percent.

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