Sibson Consulting

Segal Rogerscasey

# Prism

A QUARTERLY REVIEW OF FUNDED STATUS

Strategic HR Consulting | Investment Solutions | First Quarter 2015 Pension Plan Experience

## Pension Plan Funded Status Falls Due to Liability Increases in Q1 2015

During the first quarter of 2015 (Q1 2015), the funded status of the model pension plan examined in each issue of *Prism* decreased by 2 percentage points: from 81 percent to 79 percent. This decrease was the result of a 3 percent liability increase and flat investment performance during the quarter. See Graph 1. The Q4 funding ratio in this issue was reset to incorporate the fact that many plan sponsors changed their mortality assumption at year-end to reflect improved longevity.

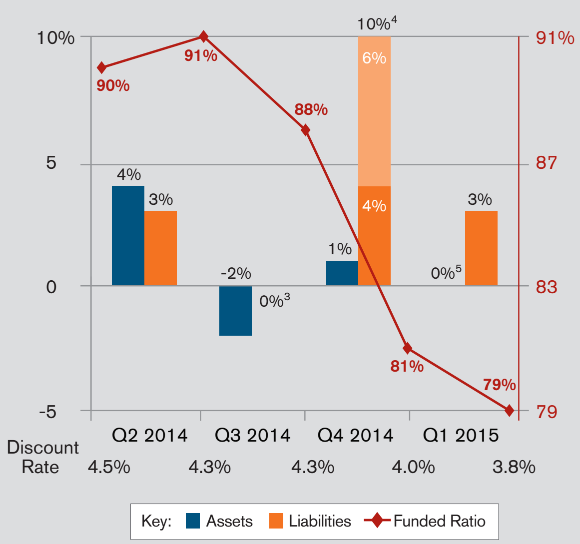
### About *Prism*

*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

As shown in Graph 2, domestic equities started the year on a solid note, posting gains of 1.80 percent in Q1. Higher beta small-cap stocks beat their large-cap counterparts, while growth stocks handily outpaced value stocks. International stocks also got off to a good start, gaining 3.49 percent in Q1. Developed markets continued to outperform emerging markets, where the decline in the price of oil has dampened returns. The global fixed-income market posted its seventh consecutive monthly decline and finished the quarter down 2.51 percent, due primarily to the strength of the U.S. dollar.

### Graph 1: Change in Assets,[1] Liabilities and Funded Ratio[2]




[1] 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.

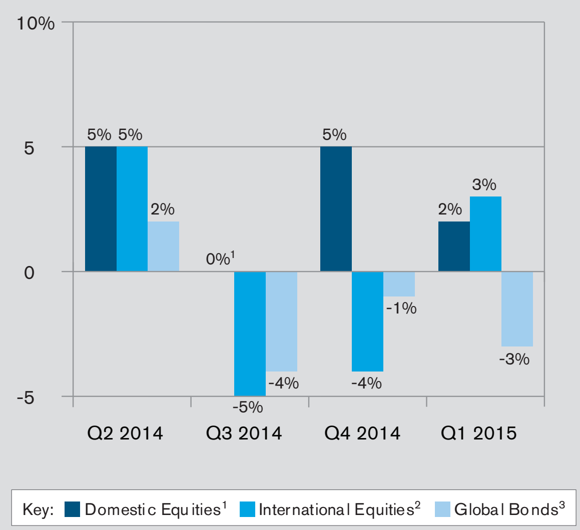
[2] This is the ratio of a defined benefit (DB) plan's assets to accrued liabilities. The funded ratio data in the graph is the ratio at a point in time at the beginning or end of the quarter. The funded percentage for the model DB plan was reset as of January 1, 2015, to reflect the average actual funded percentage of large pension plans.

[3] In Q3 2014, liabilities decreased 0.5 percent.

[4] The darker orange portion of the bar represents liability change due to interest rate movements, while the lighter portion represents liability change due to new mortality assumptions.

[5] In Q1 2015, assets increased 0.3 percent.

### Graph 2: Investment Performance




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

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

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

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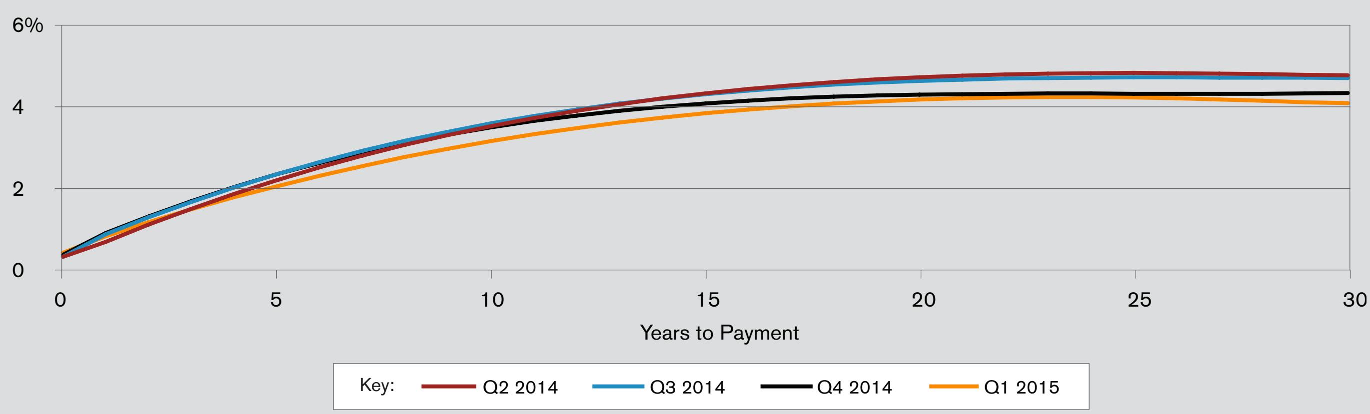
## Changes in the Yield Curve

High-quality corporate yields decreased 20 basis points[1] during Q1 2015. This decrease is the net result of a 20 basis-point decrease in Treasury rates and an immaterial change in credit spreads. The overall shape of the yield curve remained similar to the previous quarters: an upward-sloping yield curve that peaks at about 25 years and then levels off, as illustrated by the above-median curves shown in Graph 3.

The decrease in the yield-curve level during Q1 2015 resulted in a decrease in the effective interest rate and, consequently, increased the model pension plan's liability by about 3 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[1]**




[1] 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.

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*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.*

[1] As a reminder, 10 basis points (bps) equals 0.1 percent.

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