Sibson Consulting
Segal Rogerscasey

Prism
A QUARTERLY REVIEW OF FUNDED STATUS

Strategic HR Consulting Investment Solutions Second Quarter 2015 Pension Plan Experience

Pension Plan Funded Status Rises Due to Liability Decreases in Q2 2015

During the second quarter of 2015 (Q2 2015), the funded status of the model pension plan examined in each issue of *Prism* increased by 8 percentage points: from 79 percent to 87 percent. This increase was the result of a 10 percent liability decrease and flat investment performance during the quarter. See Graph 1.

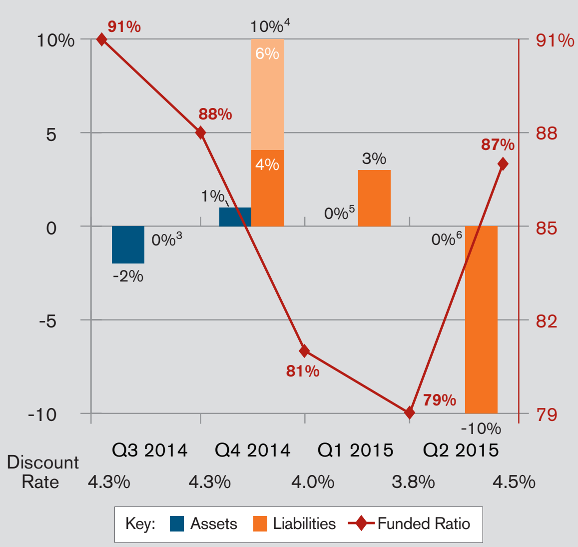
About *Prism*

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, both domestic and international equities had relatively small gains in Q2 2015. A potential default in Greece along with China's monetary stimulus in response to the Shanghai exchange sell-off heightened uncertainty. Higher-risk stocks underperformed, while stocks with positive momentum outperformed. In the U.S., small-cap stocks beat their large-cap counterparts, while growth stocks and value stocks posted similar returns. Performance for developed and emerging market equities was comparably positive and greater than U.S. equities. Fixed income performed poorly. Treasury rates rose on strong U.S. economic data for employment and consumer spending. The Federal Reserve also signaled that, despite the positive economic news, it would take a balanced approach to removing policy accommodation that has kept the benchmark federal funds rate near zero since 2008. In international markets (both equity and fixed income), local currency returns were weaker than U.S. dollar (USD)-denominated returns, due in part to a depreciating USD.

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.

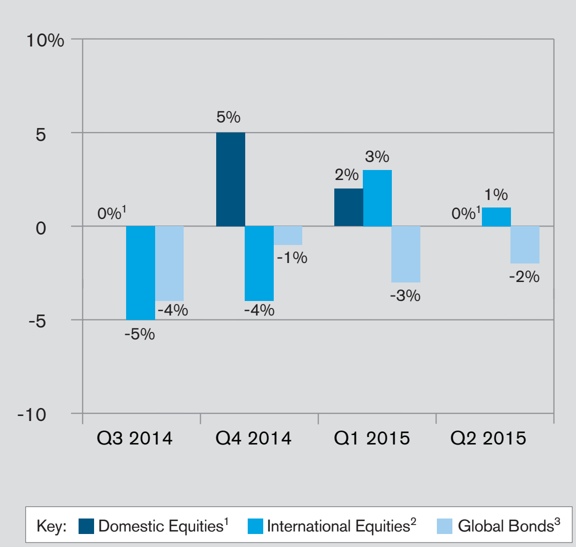
[3] In Q3 2014, liabilities decreased 0.5 percent.

[4] The darker orange portion of the bar represents liability change due to interest rate movements; the lighter portion represents liability change due to new mortality assumptions adopted by many plan sponsors at year-end to reflect improved longevity.

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

[6] In Q2 2015, assets decreased 0.5 percent.

Graph 2: Investment Performance



[1] Russell 3000 (The return for domestic equities was 0.01 percent in Q3 2014 and 0.14 percent in Q2 2015.)

[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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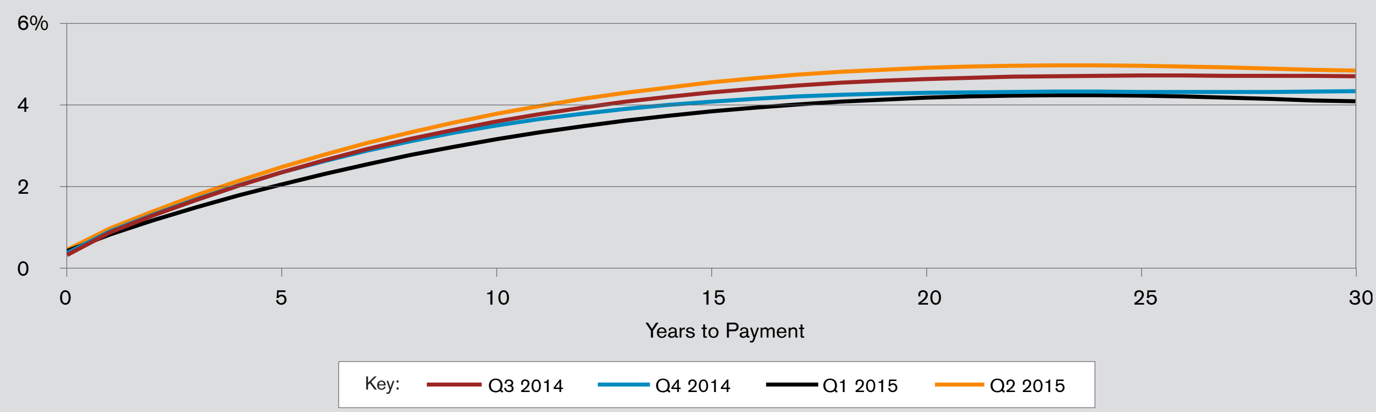
Changes in the Yield Curve

High-quality corporate yields increased 60 basis points* during Q2 2015. This increase is the net result of a 45 basis-point increase in Treasury rates and a 15 basis-point increase in credit spreads. The yield curve steepened during the quarter, with longer-term yields increasing more than short-term yields, although the general 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 increase in the yield-curve level during Q2 2015 resulted in an increase in the effective interest rate and, consequently, a decrease in the model pension plan's liability of about 10 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/media/2051/s2015primer.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.

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