Deficits at largest pension funds keep growing: Milliman

By Editor Test *Thu, Mar 28, 2013*

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Pension funds continue to suffer from the low-rate environment, according to Milliman's 2013 Pension Funding Study, which cover the 100 largest US corporate pension plans. These plans ended 2012 with a $388.8 billion deficit—a $61.1 billion increase over 2011.

Since the end of 2010, declining discount rates (4.02% at year-end 2012) have widened the pension funding deficit by more than $150 billion, driving record deficits in each of the last two years, Milliman said in a release.

The pension funding ratio stood at 77.2% at year's end, down from 79.2% at the end of 2011. The deficit increase and reduced funding ratio in 2012 occurred despite plan sponsors' efforts to halt the decline through de-risking and despite rising stock prices.

"There was no fighting the inevitable gravity of these low interest rates, as the 100 pension plans in our study saw a cumulative deficit increase in excess of $60 billion. All this in spite of strong asset performance that exceeded the expectations of most plan sponsors," said John Ehrhardt, Milliman consulting actuary and co-author of the study.

"Pension funding status will continue to be tied to interest rates. If rates stay low—and all indications are that they will through 2014—these pension plans will struggle to fill their funding gap."

Major pension stories for 2012 include:

De-risking results in shakeup at the top of the Milliman 100. IBM's plan replaced General Motors' in 2012 as the largest in the Milliman 100, after GM sold much of its obligation to Prudential. Other large plan sponsors, including Ford and Verizon, also pursued de-risking. Across the entire Milliman 100, de-risking by at least 15 plan sponsors resulted in a cumulative $45 billion reduction in plan obligations.

Asset increases and $61.5 billion in contributions were not enough to close the deficit. With an 11.7% investment return in 2012, the Milliman 100 pension plans performed better than they expected but not enough to offset the ballooning deficit. Nor were contributions in excess of $60 billion.

Record contributions in 2012—but not at the level expected. While the $61.5 billion in contributions during 2012 was significantly greater than most prior years, it exceeded the 2011 total by only $6.3 billion and the 2010 total by only $1.8 billion. Many plan sponsors apparently changed their contribution strategy after the MAP-21 interest rate stabilization legislation passed.

Another record year for pension expense. Following a $38.5 billion charge to earnings in 2011, the

Milliman 100 pension plans again set a new record for total pension expense, with a $55.8 billion charge to earnings. The $17.3 billion increase in pension expense is consistent with the prediction of $16 billion reported by last year's study. This year's study predicts a $7.6 billion increase in pension expense in 2013.

Asset allocations relatively stable. In 2011, plan sponsors decreased their equity allocation by more than 5%. In 2012, the equity allocation dropped just 0.2% (to 38% from 38.2%), as the move toward liability-driven investments (LDI) slowed. In 2012, the bull market favored plans with relatively higher equity allocations.

What to expect in 2013. With the Federal Reserve Board indicating its intention to keep interest rates low through 2014, pension obligations will remain high. The bull market has continued into 2013, and de-risking may continue this year. But the pension funding deficit is likely to last until interest rates rise.