U.S. pension deficit largest since WWII—Mercer

By Editor Test *Wed, Oct 5, 2011*

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The aggregate deficit in pension plans sponsored by S&P 1500 companies increased by $134 billion during September, to $512 billion, as of September 30, according to new figures from Mercer.

The plan's aggregate funded ratio was 72% as of September 30, compared to 79% at the end of August and 81% at the end of 2010. Mercer believes that the end-of-month pension funding levels for the S&P 1500 are at a post-World War II low.

The estimated aggregate pension assets of the S&P 1500 were $1.31 trillion, compared with the estimated aggregate liabilities of $1.83 trillion as of September 30, 2011. The previous low point for funding was August 31, 2010 when the aggregate funded ratio was 71% and the deficit was $507 billion.

The decline in funded status was driven by a 7% drop in equities, and a fall in yields on high quality corporate bonds during the month. Discount rates for the typical US pension plan decreased approximately 30-40 basis points during the month. Mercer's analysis indicates the S&P 1500 funded status peaked at 88% at the end of April, and has since seen a 16% decline.

"The end of September marks the largest deficit since we have been tracking this information," said Jonathan Barry, a partner in Mercer's Retirement Risk and Finance business. "Over the past 3 months, we have seen nearly $300 billion of funded status erode. This will have significant consequences for plan sponsors. It will be particularly painful for organizations with September 30 fiscal and/or plan year ends.

"With no expectation for a quick recovery, plan sponsors should evaluate the effects of the recent turmoil on their future cash requirements, as well as the impact on their P&L and balance sheet," said Mr. Barry. "For some sponsors, the recent drop could result in falling below certain funding level thresholds under PPA which could lead to restrictions on lump sum payments and at the more extreme end, could result in a total freeze of benefit accruals."

"The recent market turmoil is a reminder to plan sponsors of the need for a pension risk management strategy that is aligned with corporate objectives," said Kevin Armant, a principal with Mercer's Financial Strategy Group.

"Those that were aware of the risks and can deal with the increased cash funding and P&L charges associated with the current market downturn may choose to stay the course. Those that can't will continue to evaluate risk reduction opportunities, including increasing interest rate hedging programs, moving more into long corporate bond allocations or transferring risk through the introduction of a lump sum payment option or purchasing annuities.

For both types of organizations, it's likely that additional cash funding will be required and it may be useful to look at the option of accelerating those contributions, as some sponsors may have the capacity to take advantage of the low interest rate environment by borrowing to fund."

The estimated aggregate value of pension plan assets of the S&P 1500 companies at December 31, 2010, was $1.37 trillion, compared with estimated aggregate liabilities of $1.68 trillion. Unless otherwise stated, the calculations are based on the Financial Accounting Standard (FAS) funding position and include analysis of the S&P 1500 companies.