ADMINISTRATION | July 11, 2011

PwC Finds Drop in Pension Discount Rates, Projected Returns

July 11, 2011 (PLANSPONSOR.com) - A new report finds a drop in pension and OPEB discount rates, while the median expected long-term rate of return on plan assets decreased approximately 10 basis points since 2009.

Reported by NEVIN E. ADAMS

PricewaterhouseCoopers' Pension/OPEB 2011 Assumption and Disclosure Survey notes that pension and OPEB discount rates were approximately 40 to 50 basis points lower, on average, than discount rates at the end of 2009, reflecting the overall decline in long-term interest rates over that one-year period. The median pension discount rate at the end of 2010 was 5.40% (compared with 5.86% at the end of 2009) while the median OPEB discount rate at the end of 2010 was 5.25% (compared with 5.75% at the end 2009), according to the report. The report notes that over the past five years, the discount rate has trended downward consistent with the overall movement of interest rates.

Additionally, the median expected long-term rate of return on plan assets of 8.00% decreased approximately 10 basis points compared with 8.11% at the end of 2009. The report said that the decrease generally reflects more caution by companies in assessing expected returns on plan assets and changes in asset mix.

Report authors Ken Stoler and Gina Klein note that, at the median, plan funding levels improved somewhat, with pension plan assets increasing from 77% of the projected benefit obligation (PBO) at the end of 2009 to 81% at the end of 2010 – a shift attributed primarily to higher returns in the equity markets in 2010. Unamortized losses for pensions decreased from 36% of the projected benefit obligation at the end of 2009 to 33% at the end of 2010, in large part the report notes, due to actual returns on plan assets that were higher than expected.

The survey was based on an analysis of 100 companies, comprising Fortune 100 and other large and established companies, with a December 31 measurement date. Ten of the companies had frozen their plans as of 2010, a number that has been increasing each year, according to the report. In 2007, only one company had a frozen plan, while six companies had a frozen plan in 2008, and eight companies had a frozen plan in 2009.

Asset Allocation

The survey also included a breakdown of asset allocations for funded pension plans, as of each plan's measurement date. The final analysis showed that, at the median, approximately 52% of assets were allocated to equity securities and 32% were invested in debt instruments for 2010; a 4% decrease in assets allocated to equity, and assets allocated to debt instruments were approximately unchanged, compared to 2009, according to the report. At the median, nearly 12% of assets were allocated to all other investment categories (cash and cash equivalents, real estate, company stock and other), essentially remaining unchanged from 2009 levels.

Pension Funding Levels

The median and the mean ratio of pension funding (pension plan assets as a percentage of projected benefit obligation) increased to approximately 81% in 2010, compared to 77% and 79% respectively, in 2009, according to the report. "This positive movement in the funded status of the pension plans is due in large part to the higher returns on plan assets in 2010, offset in part by declines in discount rates," according to the report.

For pension plans, unamortized losses as a percentage of the projected benefit obligation decreased from a median percentage of 36% in 2009 to 33% in 2010, due primarily to higher returns on plan assets, according to the PwC analsysis.

For OPEB plans, unamortized losses as a percentage of the accumulated postretirement benefit obligation increased to a median percentage of 18% in 2010 compared to 16% in 2009. OPEB plans saw similar improvements in the percentage of unamortized losses to pension plans despite that many OPEB plans are unfunded, according to the report.

The median percentage of prior service cost to the defined benefit obligation (projected benefit obligation for pension plans and accumulated postretirement benefit obligation for OPEB plans) remained nominal at approximately 0% for all plans in 2010, while on a combined pension and OPEB basis, the median funding level increased to approximately 73% in 2010 from 68% in 2009.

OPEB Assumptions

The mean OPEB discount rate for 2010 decreased 52 basis points to 5.22%. The median discount rate decreased 50 basis points from 2009 to 5.25% in 2010, decreases the PwC researchers characterized as "consistent with overall declines in interest rates from 2009 to 2010".

The mean initial health care rate decreased slightly for 2010, dropping 7 basis points to 8.07%, and the median initial rate remained unchanged at 8%. Median ultimate trend rates stayed at 5%, and the median time to reach ultimate increased to 8 years, though a number of companies extended their years-to-ultimate to 11 years or more, according to the report.

The PwC report was based on a review of the public annual reports for the companies selected, specifically financial information regarding pension and other postretirement benefit (OPEB) plans.

Tags Actuarial issues, Pension funding

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