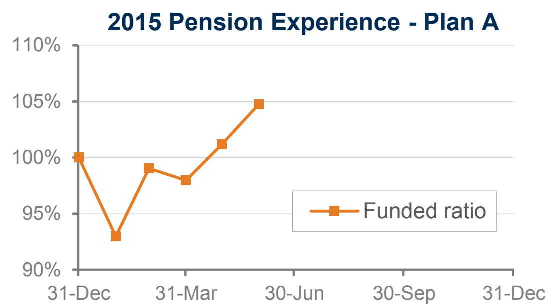
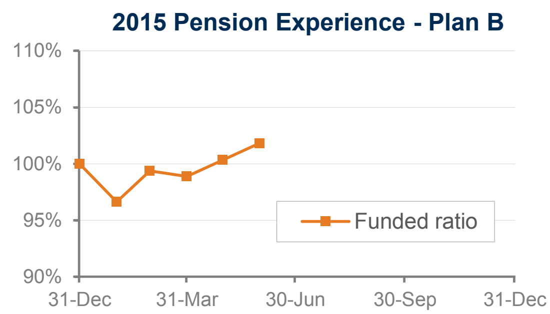
Pension Finance Update

as of May 31, 2015

Pension sponsors enjoyed another strong month in May, due largely to higher interest rates reducing pension liabilities. Both model plans we track[1] saw improvements in funded status last month and both are now 'in the black' for 2015, with Plan A ahead almost 5%, and Plan B up 2%, since 12/31/2014:





Assets

Stocks were mostly up last month. The S&P 500 gained 1%, the NASDAQ added more than 2%, and the small-cap Russell 2000 was up 2%, while the overseas EAFE index was flat on the month. Year-to-date, the S&P 500 is up 3%, the NASDAQ has gained 7%, the Russell 200 is ahead 4%, and the EAFE index is up more than 9% during the first five months of 2015.

A diversified stock portfolio gained 1%-2% in May and is up 5%-6% so far during 2015.

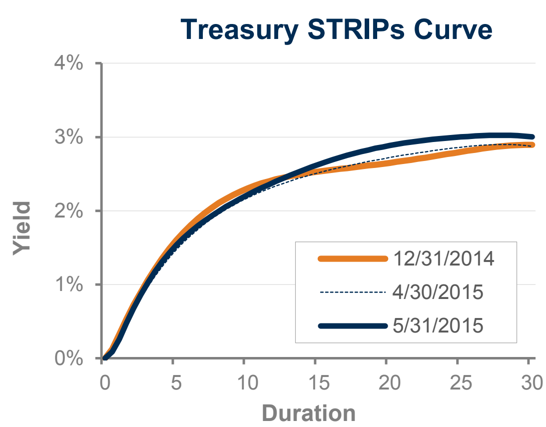
Bonds lost close to 1% again during May, due to interest rates rising more than 0.1% during the month. For the year, a diversified bond portfolio has gained about 1%, with short duration bonds enjoying the best performance.

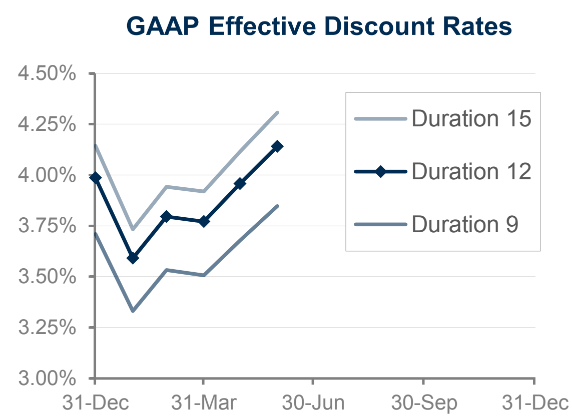
Overall, our traditional 60/40 portfolio gained close to 1% in May and is now up 3%-4% for the year, while a conservative 20/80 portfolio lost a fraction of 1% last month and is now ahead 1% so far during 2015.

[1] Plan A is a traditional plan (duration 12 at 5.5%) with a 60/40 asset allocation, while Plan B is a cash balance plan (duration 9 at 5.5%) with a 20/80 allocation with a greater emphasis on corporate and long-duration bonds. For both plans, we assume the plan is 100% funded at the beginning of the year and ignore benefit accruals, contributions, and benefit payments in order to isolate the financial performance of plan assets versus liabilities.

Liabilities

Both funding and accounting liabilities are now driven by market interest rates. The graph on the left compares Treasury STRIPs yields at December 31, 2014, and May 31, 2015, and also shows the movement in rates last month. The graph on the right shows our estimate of movements in effective GAAP discount rates for pension obligations of various duration during 2015:



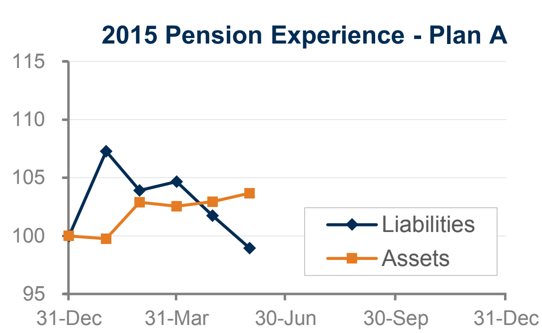


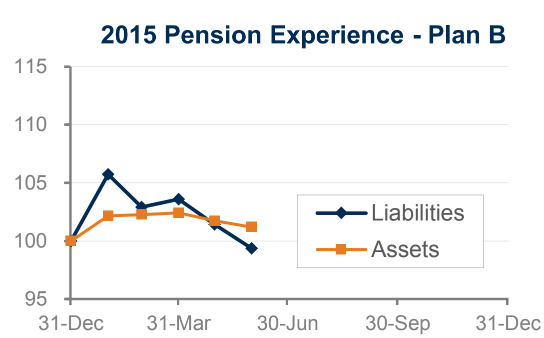
Interest rates moved up close to 0.2% during May and are now just a couple basis points below 2014 year-end rates at shorter maturities and more than 0.2% higher at longer maturities. Last month's move pushed pension liabilities down about 3%, leaving them about 1% lower than at the end of 2014, with long duration plans seeing the biggest decreases.

Summary

Through the first five months of 2015, pension assets have mostly made incremental ground, while pension liabilities have gyrated, jumping in January as interest rates flirted with all-time lows, then falling back as rates have risen more than a half percent since then.

The graphs below summarize the behavior of assets and liabilities for our two model plans so far during 2015:





Looking Ahead

Due to 2014 pension funding relief legislation, pension funding requirements over the next few years *will not* be appreciably affected by current low interest rates (unless these rates persist for several years). Required contributions for 2015-2020 will be lower and more stable than under prior law.

The increase last month pushed rates above year-end 2014 levels. Most pension sponsors are using rates of 3.6%-4.4% to measure pension liabilities for accounting purposes in today's environment.

The table below summarizes rates that plan sponsors are required to use for IRS funding purposes for 2015, along with estimates for 2016. Pre-MAP-21 rates, both 24-month averages and December 'spot' rates, which are still required for some calculations, such as PBGC premiums, are also included.

2015 PPA interest rates

	24-month average		December	HATFA
	Max Lookback	No Lookback	2014	Floor
1st segment	1.15%	1.22%	1.48%	4.72%
2nd segment	4.06%	4.11%	3.77%	6.11%
3rd segment	5.15%	5.20%	4.79%	6.81%
Effective interest rate				
Duration 9	4.15%	4.20%	3.87%	6.13%
Duration 12	4.44%	4.49%	4.15%	6.30%
Duration 15	4.61%	4.64%	4.31%	6.41%

2016 PPA interest rates

	24-month average		December	HATFA
	Max Lookback*	No Lookback*	2015*	Floor*
1st segment	*1.30%*	*1.32%*	*1.36%*	*4.43%*
2nd segment	*4.01%*	*3.89%*	*3.87%*	*5.91%*
3rd segment	*5.03%*	*4.91%*	*4.86%*	*6.65%*
Effective interest rate				
Duration 9	*4.10%*	*4.00%*	*3.93%*	*5.94%*
Duration 12	*4.37%*	*4.27%*	*4.23%*	*6.12%*
Duration 15	*4.53%*	*4.42%*	*4.39%*	*6.23%*

* October Three estimate, based on rates available as of 5/31/2015.

October Three, LLC is a full service actuarial, consulting and technology firm that is a leading force behind the reemergence of defined benefit plans across the country. A primary focus of the consultants at October Three is the design and administration of comprehensive retirement benefits to employees that minimize the financial risks and volatility concerns employers face.

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