



AMERICAN BENEFITS COUNCIL

February 4, 2010

FUNDING RELIEF: HELP NEEDED FOR 2011

One key issue that we have been discussing is whether funding relief could apply to 2011. Under our proposal, which is attached, employers would be able to elect to apply the funding relief to any two consecutive years during the 2008 to 2011 period. So the relief would not apply for a longer period; rather, employers would simply have the flexibility to use the relief when it is most needed.

The concern that has been raised with respect to providing relief for 2011 is that the funding obligations for 2011 are still uncertain, and a lot can happen between now and January 1, 2011, that could significantly alter 2011 funding obligations. We have been talking to the actuarial firms about that. Most of the 2011 funding problems are already locked in and cannot change. In fact, according to Hewitt Associates and Mercer (which will be issuing a report on 2010 the week of February 1st), the chances that the funding obligations for 2011 will be smaller than the funding obligations for 2010 are extremely unlikely. Both organizations would be more than happy to meet or provide any further information to explain why this is so. In the meantime, here are the factors that underlie their conclusion.

- (1) The last third of the 2008 market losses will, pursuant to the smoothing rules, be recognized in 2011. Thus, by 2011, all of the 2008 losses will be recognized.
- (2) Only two thirds of the unexpected 2009 gains will be reflected in the actuarial value of assets in 2011. Thus, a good part of the market recovery will not be recognized in 2011.
- (3) Even if 2010 is a very good year in the market, generally only one third of the unexpected gains will be reflected in asset values in 2011. The only exception would be if 2010 is such an exceptional year in the market that the 90% component of the asset smoothing corridor applies. Even then, a good part of the asset returns would not be recognized. So we would need such an extraordinary year that the funding problems are solved by taking into account only 90% of plan assets, hardly a likely scenario.

- (4) In 2011, the funding target effectively moves from 96% to 100%, which effectively locks in a “loss” of approximately 4% of a plan’s funding target. This creates an additional funding obligation of approximately .7% of a plan’s funding target. For example, this would mean an additional \$70 million contribution for a large plan with a \$10 billion funding target.
- (5) If interest rates stay flat for the rest of 2010, the effective interest rate for 2011 for a typical plan (using the segment rates) will be approximately 50 basis points lower than the effective interest rate for 2010. In order for the effective interest rate for 2011 to be the same as it is for 2010, interest rates would need to rise an average of approximately 15 basis points per month (assuming, for simplicity, the same increase each month), for a total increase between now and the end of the year of approximately 180 basis points. That type of increase would have extremely adverse effects on the economy and would probably reflect or trigger a market downturn, causing further funding problems. Even if such interest rate increases were to happen, the funding obligations for 2011 would still be materially higher than the 2010 obligations due to factors 1-4 above. It would take an enormous increase in interest rates for the 2011 funding obligations to be lower than the 2010 funding obligations. Such an enormous increase in interest rates would likely trigger or reflect a massive downturn in the market.

Moreover, for every month that there is not an increase in interest rates, the increase needed just to get us back to the 2010 interest rate level is higher. For example, if interest rates stay flat through June, we would need rates to be on average approximately 200 basis points higher for the last six months of the year, just to get the effective interest rate back to the 2010 level. Even then, as noted, 2011 would be far worse than 2010, due to the other factors described above.

In short, for the above reasons, it is almost certain that 2011 will be at least as challenging as 2010 from a funding perspective. If relief is granted for 2010, the bulk of the 2011 obligations will not be due until 2012. But starting in the next few months, creditors and analysts will start pressuring companies to deal with the 2011 obligations, since those obligations lock in on 1/1/11. That means that in a few months, companies will have to start working on layoffs to deal with 2011, just as layoffs to deal with 2010 have already started. So the key issue is the fact that jobs will be lost if 2011 is not addressed.

In short, 2011 is almost certainly locked in as a bad year. So help is badly needed for 2011.