Rocaton

INSIGHTS

Pension "Smoothing" – The Highway and Transportation Funding Act of 2014

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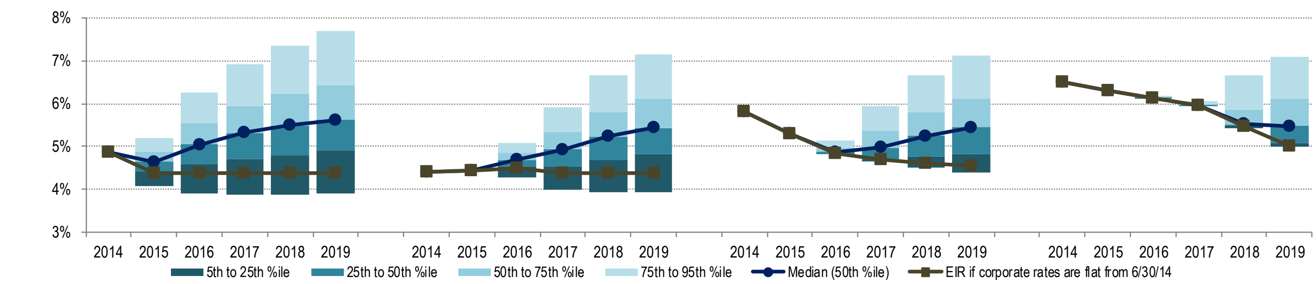
On August 8, 2014, President Obama signed into law the Highway and Transportation Funding Act of 2014 (HTFA). This legislation theoretically helps to fund the Highway Trust Fund by reducing corporate pension contributions, which are tax deductible. Required pension contributions will be reduced by extending the interest rate stabilization provisions that had been introduced by the Moving Ahead for Progress in the 21st Century Act (MAP-21).

These stabilization provisions created a corridor around a 25-year average of corporate bond rates outside of which the discount rates used to calculate funding liabilities could not fall. Under MAP-21, this corridor has been widening and would have continued to widen. Given today's low rates, the applicable discount rate (called the Effective Interest Rate or EIR) would have steadily decreased with the minimum allowable rate. Lower EIRs lead to higher calculated liabilities and thus higher contributions, all else equal. With this new stabilization (HFTA), the corridor widening will be shifted back by five years. Based on our understanding of this legislation, for a typical plan, we expect this change to result in EIRs that are as much as 70 to over 100 basis points higher for the next few years than they would have been without HTFA. The table below summarizes the application of this corridor.

Plan Year	MAP-21 Corridor	HTFA Corridor
2012	90% - 110%	90% - 110%
2013	85% - 115%	90% - 110%
2014	80% - 120%	90% - 110%
2015	75% - 125%	90% - 110%
2016	70% - 130%	90% - 110%
2017	70% - 130%	90% - 110%
2018	70% - 130%	85% - 115%
2019	70% - 130%	80% - 120%
2020	70% - 130%	75% - 125%
2021 and on	70% - 130%	70% - 130%

The chart and table below illustrate the progression of EIRs which might unfold for a typical pension plan over the next few years as used for various purposes. We show a range of EIRs implied by our June 30, 2014 capital markets model for this sample plan as well as the EIRs that would result if corporate rates were to remain unchanged from June 30, 2014.



Based on Rocaton's Capital Market Assumptions as of June 30, 2014

Mark-to-Market @ Preceding Dec. 31st

	2014	***2015***	***2016***	***2017***	***2018***	***2019***
95th %ile	4.9%	5.2%	6.3%	6.9%	7.4%	7.7%
50th %ile	4.9%	4.6%	5.1%	5.3%	5.5%	5.6%
5th %ile	4.9%	4.1%	3.9%	3.9%	3.9%	3.9%
EIR:	4.9%	4.4%	4.4%	4.4%	4.4%	4.4%

24-Month Avg., Four-Month Lookback

	2014	***2015***	***2016***	***2017***	***2018***	***2019***
95th %ile	4.4%	4.5%	5.1%	5.9%	6.7%	7.2%
50th %ile	4.4%	4.4%	4.7%	4.9%	5.2%	5.4%
5th %ile	4.4%	4.4%	4.3%	4.0%	3.9%	3.9%
EIR:	4.4%	4.4%	4.5%	4.4%	4.4%	4.4%

Original MAP-21

	2014	***2015***	***2016***	***2017***	***2018***	***2019***
95th %ile	5.8%	5.3%	5.2%	5.9%	6.7%	7.1%
50th %ile	5.8%	5.3%	4.9%	5.0%	5.2%	5.4%
5th %ile	5.8%	5.3%	4.8%	4.7%	4.5%	4.4%
EIR:	5.8%	5.3%	4.8%	4.7%	4.6%	4.5%

HTFA

	2014	***2015***	***2016***	***2017***	***2018***	***2019***
95th %ile	6.5%	6.3%	6.1%	6.1%	6.7%	7.1%
50th %ile	6.5%	6.3%	6.1%	6.0%	5.5%	5.5%
5th %ile	6.5%	6.3%	6.1%	5.9%	5.4%	5.0%
EIR:	6.5%	6.3%	6.1%	6.0%	5.5%	5.0%

(EIR rows: **If Corporate Rates Remain Stable from June 30, 2014**)

Based on Rocaton's Capital Market Assumptions as of June 30, 2014. These are long-term, forward-looking expecations and are not guaranteed to be realized.

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Importantly, while PBGC premium rates were not further increased with HTFA (as they were with MAP-21 and then after that with the Bipartisan Budget Act of 2013), PBGC premiums will continue to be calculated without regard to any 25-year corridor. The EIR used for this purpose is reflected in the chart above by the 24-month average, which tends to be used by a majority of plans at this time. Presently, this means that PBGC premiums will be assessed based on a higher calculated liability value.

HTFA's impact will ultimately vary across plan sponsors. Generally speaking, however, plans' minimum required funding levels will be lower than they would have been over the next few years and the volatility of contribution requirements will be dampened in the near-term. Plan sponsors should work with their consultants to understand what it means for them and if it should dictate any changes to any funding, investment, de-risking, or other policies.