Perspectives

Accounting for Pensions and Other Postretirement Benefits, 2011

Reporting Under U.S. GAAP Among the *Fortune* 1000 Companies

TOWERS WATSON

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Introduction

In this report, Towers Watson analyzes disclosures for fiscal year (FY) 2010 under the Financial Accounting Standards Board's (FASB's) Accounting Standards Codification (ASC) topic 715 *Compensation-Retirement Benefits.* The disclosures are from the most recent annual reports or financial statements of the nation's largest public companies — those in the most recent listing of the *Fortune* 1000.

This report summarizes the assumptions used by companies in the calculation of pension expense and obligations, the disclosure of pension assets and obligations under ASC 715, and disclosures regarding postretirement benefits other than pensions, primarily retiree health and life insurance benefits. This summary report is the 24th in a series by Towers Watson of annual analyses of pension disclosures and the 18th summary report to analyze postretirement disclosures.

ASC 715, the Accounting Standards Codification Topic, *Compensation-Retirement Benefits,* that superseded FAS 87, FAS 106, FAS 132 and FAS 158 outlines the standards of financial accounting and reporting for employers that offer pension and other postretirement benefits to their employees under U.S. generally accepted accounting principles (GAAP). While this standard is used across the world, it is mostly utilized by U.S. firms and/or multinational firms based in the United States.

This report focuses on the disclosures in the fiscal 2010 annual reports of the *Fortune* 1000 companies with fiscal years ending after September. Therefore, data on economic assumptions or on values that rely on economic assumptions, such as discount rates or funded status, do not include values from companies with fiscal years ending January through September. Results on economic assumptions are summarized for roughly 80% of the companies reporting pension disclosures. Results on prevalence, however, incorporate all companies — even those with fiscal years ending before October 2010.

If you have questions about this report, or are interested in a more detailed or specialized analysis, please contact your local Towers Watson consultant.

Key Findings

Measurement of Pension Costs and Obligations

- For FY 2010, the discount rate used to calculate the present value of pension obligations ranges from 3.60% to 6.50%. The average value of the discount rate is 5.39%. In FY 2009, the discount rate for companies represented in this year's report ranged from 3.80% to 6.88%, with an average value of 5.84%.
- The salary scale assumption used to project current pay ranges from 0.90% to 6.94%. The average value of the salary scale is 3.90%. In FY 2009, the salary scale assumption for companies represented in this year's report ranged from 1.88% to 8.25%, with an average value of 3.99%.
- The expected rate of return on pension plan assets ranges from 4.38% to 10%. The average value of the expected rate of return is 7.87%. In FY 2009, the expected rate of return for companies represented in this year's report ranged from 4% to 10%, with an average value of 7.93%.

Funded Status of Pension Plans

- At the end of 2010, 52% of companies had a projected benefit obligation (PBO) funded status of less than 80%. This represents an improvement from the prior year: 63% of companies in this report had a PBO funded status of less than 80% in 2009.
- The average PBO funded status was 80% in FY 2010. In 2009, the average PBO funded status for companies represented in this report was 77%.
- The average accumulated benefit obligation (ABO) funded status was 85% in FY 2010. In 2009, the average ABO funded status for companies represented in this report was 81%.
- Target equity allocations for 2011 are 53%. Targeted equity positions declined slightly over the last year. For companies in last year's report, the average targeted equity position for 2010 was 55%.
- 38% of companies in this report have a Pension Risk Index (PRI) score of 1% or less. For companies in last year's report, 35% had a PRI score of 1% or less. Overall, the 2011 median pension risk score for companies in this year's report was 1.50%. Companies in last year's report had a median PRI score of 1.80% in 2010. A PRI score of 1% or less means that under adverse market conditions these firms could experience a loss in their pension funds worth 1% of their firm value or less.
- The average return on plan assets in FY 2010 was 12.60%. During FY 2009, the average rate of return on plan investments for companies in last year's report was 18.09%.

Other Postretirement Benefits

Analysis of the prevalence of postretirement benefits reported here is limited to companies that sponsor a pension plan.

- 87% of companies in this report provide postretirement medical benefits.*
- 65% of companies in this report provide postretirement life insurance benefits.*
- The 2010 discount rate for postretirement benefits ranges from 3.74% to 6.50% in the current survey, with an average of 5.24%. In FY 2009, discount rates for companies included in this year's report ranged from 4.33% to 6.63%, with an average value of 5.74%. Pension and health plans might have different patterns of cash flows for benefits, although 25% of companies report using the same discount rates for both pension and postretirement purposes.
- Among companies that use the same health care cost trend rate for all retirees regardless of age, that cost trend rate for the current year ranged from 3% to 11.50% in the current survey, with an average value of 7.98%.
- The ultimate health care cost trend rate for companies that use a single rate for all employees ranged from 3% to 6.50%, with an average value of 4.89%.
- The median number of years to reach the ultimate health care cost trend rate is seven.
- 38% of companies with postretirement medical benefits reported an expected long-term rate of return, implying that there are assets associated with their postretirement benefit plans. For companies with assets supporting their postretirement benefit plan, the median level of assets as a percentage of accumulated postretirement benefit obligation (APBO) was 37% in FY 2010. For those with assets attributed to their postretirement obligations, APBO funding levels increased from the end of year 2009. According to last year's report, the median level of assets as a percentage of APBO was 33% in FY 2009.

*A firm is classified as providing a postretirement benefit if it is still managing the plan obligations. Many other post-employment benefit (OPEB) plans are closed to new entrants. According to the most recent Towers Watson Benefit Data Source, 52% of companies offer retiree medical plans to newly hired employees, and 28% offer retiree life insurance.

Background

Pensions

The current structure of accounting and financial reporting for pensions was designed to:

- Provide disclosures that will allow users of financial statements to understand the extent and effect of an employer's undertaking to offer employee pensions and related financial arrangements
- Improve reporting of financial positions
- Provide a measure of net periodic pension cost that is understandable and comparable, because it reflects the terms of the underlying plan and approximates the recognition of the cost of an employee's pension over that employee's service period (although many believe that the availability of accounting alternatives and smoothing mechanisms limits its usefulness)

Any pension accounting method that recognizes the cost of benefits before the payment of benefits to retirees must be based on estimates or assumptions about future events that will determine the amount and timing of benefit payments.

This report focuses on:

- The discount rate, salary scale and expected-return-on-asset assumptions
- The funded status of benefit obligations under the plan or plans
- The targeted asset allocation of the firm's plan assets

Other Postretirement Benefits

As with accounting for pensions, reporting rules require employers to accrue the cost of their postretirement benefits other than pensions — primarily medical and life insurance benefits — over a period of years until the date employees become fully eligible for the postretirement benefits. The standard primarily affects accounting for single-employer plans that provide benefits on a defined benefit basis.

A defined benefit postretirement plan is one that defines the benefit in monetary terms, such as $10,000 of life insurance, or in terms of benefit coverage to be provided, such as 80% of the cost of doctors' covered services. Compliance with ASC 715 requires extensive disclosures about the plan, the costs and obligations created by the plan, and the assumptions used to determine such costs and obligations.

This report focuses on:

- The discount rate, salary scale and expected-return-on-asset assumptions
- The benefit obligations under the plan or plans
- The assumed health care cost trend rate

Companies Analyzed

Pension and other postretirement benefit information was compiled and analyzed for 615 companies on the 2010 *Fortune* magazine list of 1,000 companies maintaining a qualified pension and/or a postretirement benefit, even if not for their main workforce. The names of the companies for which pension and other postretirement benefit information were gathered are included in the Appendix (page 21).

Measurement of Pension Costs and Obligations

The determination of pension costs and obligations is based on the attribution of pension benefits to periods of employee service and the use of actuarial assumptions to calculate the present value of such benefits. Actuarial assumptions reflect the time value of money and the probability of payment. The following three key economic assumptions determine pension costs under ASC 715:

- The discount rate
- The salary scale
- The expected long-term rate of return on plan assets

Figure 1 shows the trends in key economic assumptions for determining costs and obligations under ASC 715.* The average values shown in Figure 1 represent the assumptions of companies surveyed in FY 1999 to FY 2010. The data reflect values for companies with fiscal years ending after September.

The average discount rate assumption decreased noticeably from the end of last year. The average was 5.84% in 2009. This year, the average was 5.39%. The average salary scale decreased 13 basis points from last year's report, to 3.90% in 2010.

The one-year drop in the average expected long-term rate of return — nine basis points, to 7.88% in 2010 — reflects a slight lowering of expectations of future investment returns. The average expected rate of return reported in the survey has declined by more than 100 basis points since 2001.

Figure 2 represents the fiscal dates used by the analyzed companies when determining pension obligations to be disclosed under ASC 715. Most companies have a fiscal-year-end date in the last quarter of the year.

Figure 1. Trends in discount rate, salary scale and expected-rate-of-return assumptions, FY 1999 – 2010

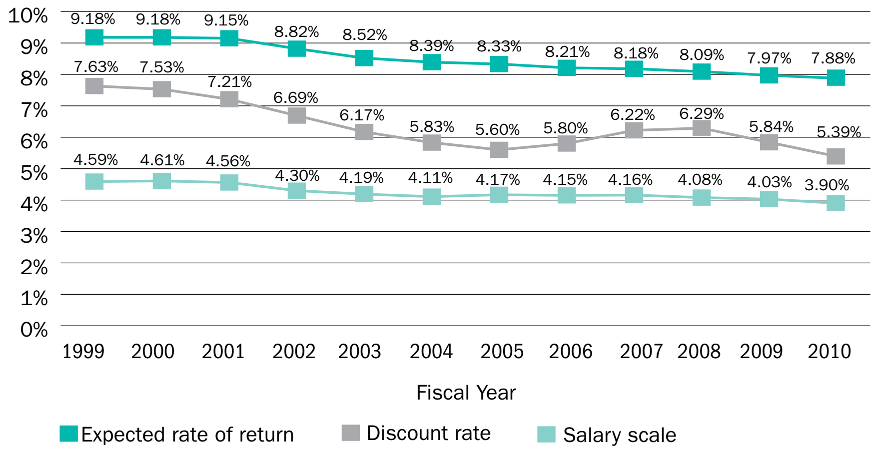
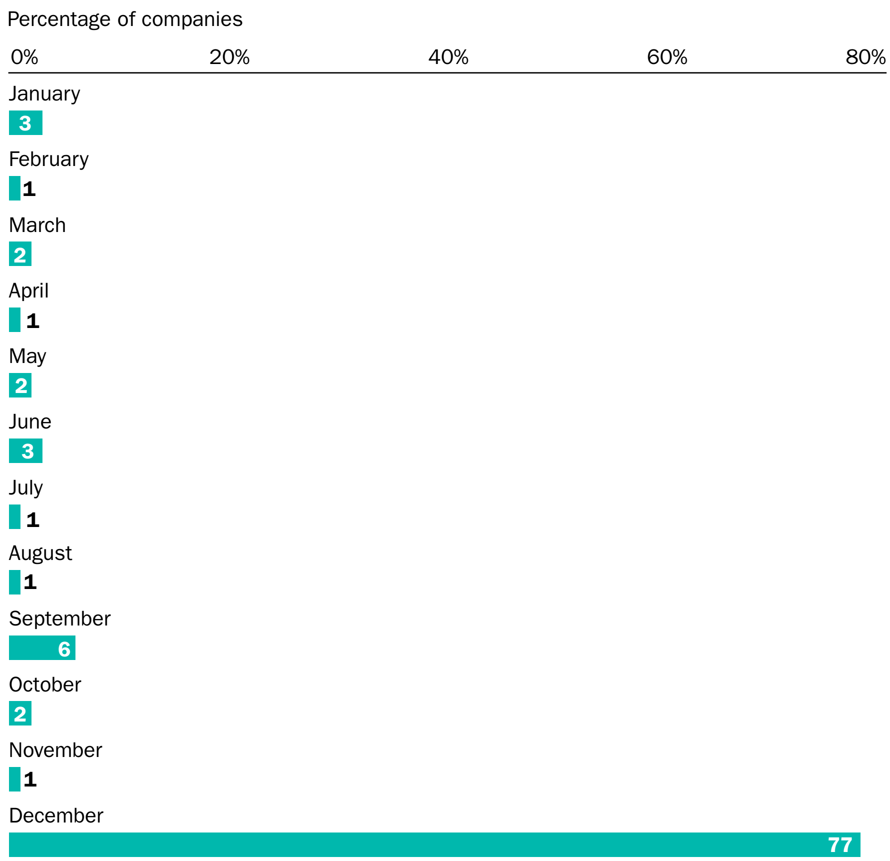


Figure 2. Distribution of fiscal-year-end dates, 2010



n = 590

*Historical values shown in Figures 1, 11, 14, 15, 17, 21, 22, 27 and 28 are derived from prior studies, using their values and samples. Last year's values described in all other figures and text are derived from this year's sample but use last year's values.

Discount Rate

Discount rates are used to calculate the present value of pension obligations and the service and interest cost components of net periodic pension cost. The discount rate is intended to represent the rate at which pension benefit obligations could be effectively settled. According to the Financial Accounting Standards Board, a variety of measures can be used as bases for determining the discount rate, including rates implicit in current annuity rates or available rates on high-quality corporate bond yields.

The disclosure of obligations in the financial statement is based on the discount rate selected at the end of the fiscal year. Components of pension cost are based on the discount rate selected at the prior year-end.

Figure 3 compares the average discount rates for pensions with the Citigroup Pension Liability Index, the Moody's AA Corporate Bond Rate, the Treasury 20-Year Constant Maturity Rate and the IRS Composite Corporate Bond Rate.

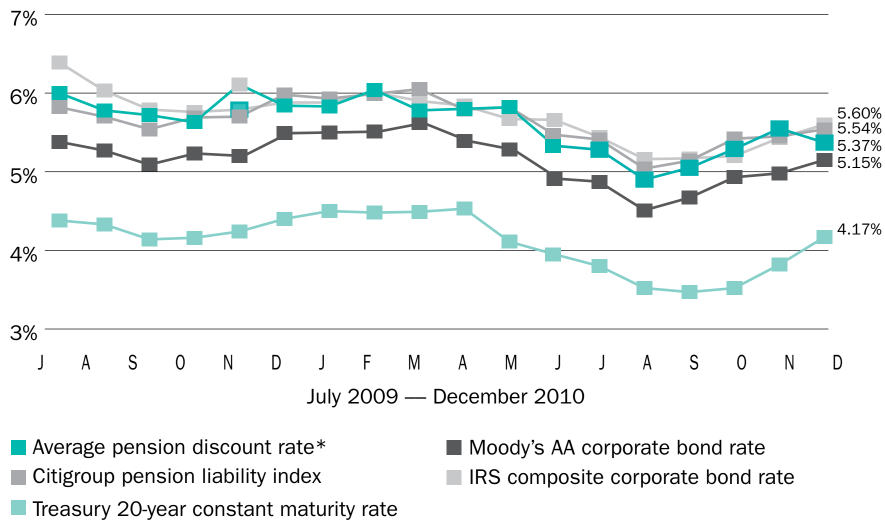
Discount rates are typically based on corporate bond yields. It has been increasingly common to match expected cash flows from the plan either to a portfolio of bonds that generate sufficient cash flows or a notional yield curve generated from available bond information. During 2010, there were similar movements between corporate and government bond yields and discount rates as shown in Figure 3.

Figure 4 shows the distribution of discount rates at year-end 2010 for the analyzed companies. Discount rates range from 3.60% to 6.50%, with an average rate of 5.39%. The median discount rate is 5.40%. Seventy percent of companies used a discount rate of 5.50% or less in FY 2010. In FY 2009, 13% of companies represented in this report used discount rates of 5.50% or less.

Figure 5 shows the distribution of the differences between the discount rates reported in FY 2009 and FY 2010 for companies represented in this report that provided rates in both years.

Ninety-seven percent of companies decreased their discount rate assumption from 2009 to 2010. For 57% of companies in this analysis, discount rates decreased by more than 50 basis points.

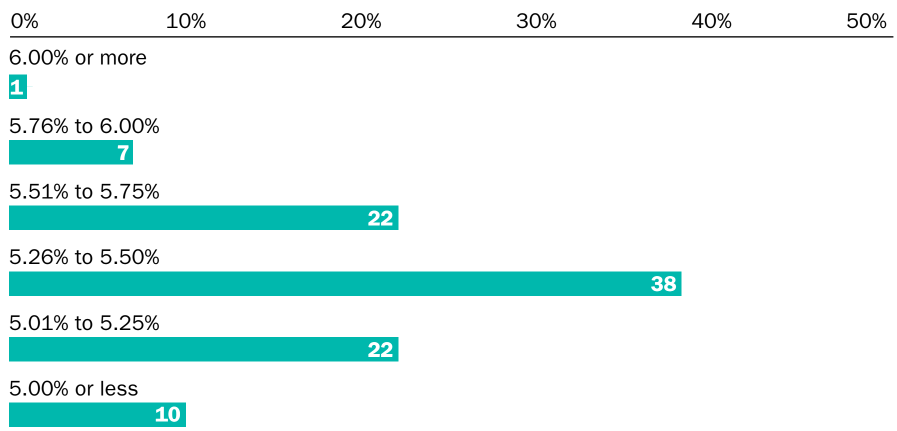
Figure 3. Fixed income and pension discount rates, 2009 – 2010



*Sample sizes vary per month for pension discount rates

Figure 4. Distribution of pension discount rates, FY 2010

Percentage of companies



n = 464

Figure 5. Change in pension discount rates, FY 2009 – 2010*

	Percentage of companies
Current-year rates greater than prior-year rate	**1%**
Rates are the same in both years	**2%**
Current-year rates less than prior-year rate	**97%**
1 to 49 basis points	40%
50 to 99 basis points	56%
100 or more basis points	1%
Total	**100%**

n = 464

*For companies in this year's report

Salary Scale

The salary scale assumption is used to project current salaries into the future. The assumption is a factor for pay-related plans in determining the PBO and the service cost.

Year-to-year growth in compensation results from long-term trends in:

- Productivity improvements
- Price inflation
- Merit or promotional increases
- Seniority raises

The range of salary scale assumptions is from 0.90% to 6.94%, with an average rate of 3.90% in FY 2010. By comparison, last year, for companies included in this year's report, the salary scale had a range of 1.88% to 8.25%, with an average rate of 3.99%.

Figure 6 shows the distribution of salary scale assumptions for companies at the most recent fiscal year-end.

Fifty-eight percent of the companies used a salary scale assumption between 3.51% and 4.50% in FY 2010.

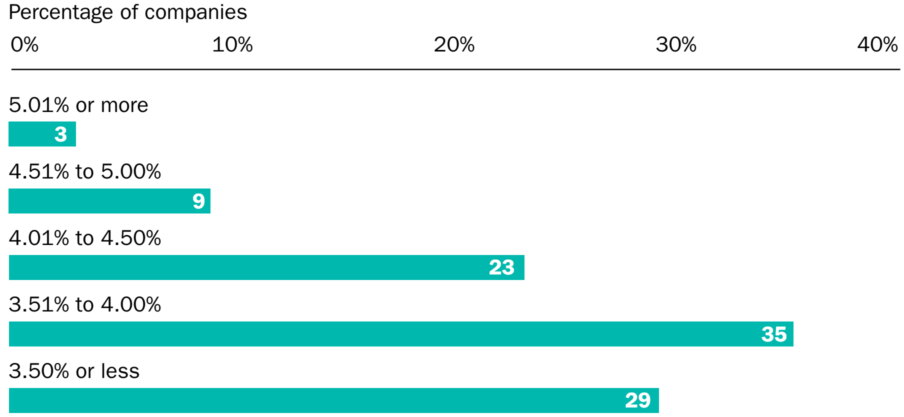
Figure 7 shows the distribution of the difference between the salary scale assumptions reported at the current and prior fiscal year-ends for companies reporting salary scale assumptions in both years.

Forty-six percent of companies changed their salary scale assumption from FY 2009 to FY 2010: 16% increased their salary scale assumption, and 30% decreased it.

Changes in the discount rate and salary increase rate have opposing effects on the pension obligation: The higher the discount rate, the lower the obligation, but the higher the salary increase, the higher the obligation. The spread between the two assumptions (discount rate minus salary increase), therefore, plays a bigger role than the individual assumptions. The larger the spread between the two measurements, the lower the obligation, and vice versa.

For companies represented in this report, the average spread between the discount rate and the salary scale assumptions decreased by 37 basis points — from 1.86% to 1.49% — from FY 2009 to FY 2010. This was mostly due to a decrease in discount rate assumptions utilized in fiscal 2010 reporting. The median spread between the discount rate and salary scale assumption for FY 2010 was 1.5 percentage points.

Figure 6. Distribution of pension salary scale assumptions, FY 2010



n = 401

Figure 7. Change in pension salary scale assumptions, FY 2009 – 2010*

	Percentage of companies
Current-year rate less than prior-year rate	**30%**
100 or more basis points	4%
50 to 99 basis points	5%
1 to 49 basis points	21%
Rates are the same in both years	**54%**
Current-year rate greater than prior-year rate	**16%**
1 to 49 basis points	12%
50 or more basis points	4%
Total	**100%**

n = 399

*For companies in this year's report

Figure 8 shows the distribution of the difference between the discount rate and the salary scale assumptions at the most recent fiscal year-end for all companies.

For 50% of companies, the spread between the discount rate and the salary scale was 1.5 percentage points or more in FY 2010. In FY 2009, the spread between the discount rate and the salary scale for 75% of companies represented in this report was greater than 1.50%.

Expected Rate of Return

The expected rate of return on assets is the long-term expectation of the pension fund's annual earnings rate. The expected return on assets is a credit component of net periodic pension cost. *Figure 9* shows the distribution of expected rates of return on assets for FY 2010.

The expected rates of return on assets range from 4.38% to 10%, with an average rate of return of 7.88%. The median expected-rate-of-return assumption was 8%.

Sixty-two percent of companies had an expected-rate-of-return assumption between 7.51% and 8.50%.

Figure 10 shows shows the distribution of the difference between the expected-rate-of-return assumption reported for the current FY and prior FY for companies reporting such rates in both years.

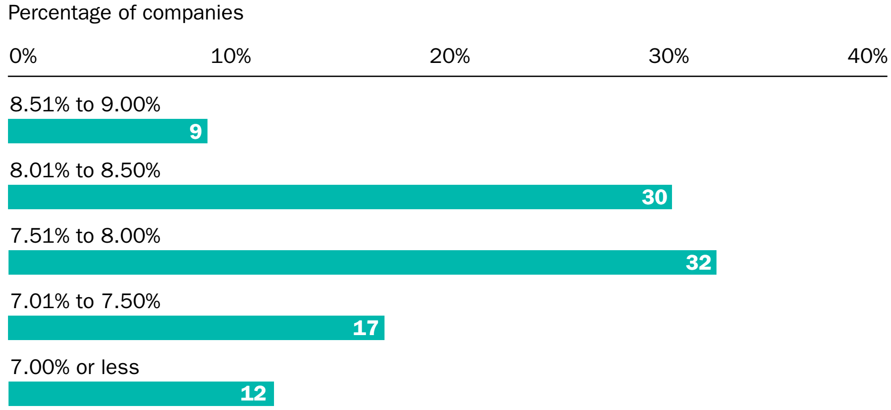
Fifty-five percent of companies maintained their expected-rate-of-return assumption from FY 2009 to FY 2010, and 45% reported a change in their rate-of-return assumption, most decreasing it. On average, the expected-rate-of-return assumption fell by six basis points for companies reporting a value in both years.

Figure 8. Spread between discount rate and salary scale assumptions for pension purposes, FY 2010

	Percentage of companies
Discount rate greater than salary scale	**97%**
300 or more basis points	2%
250 to 299 basis points	5%
200 to 249 basis points	15%
150 to 199 basis points	28%
100 to 149 basis points	29%
50 to 99 basis points	14%
1 to 49 basis points	4%
Rates are the same	**0%**
Discount rate less than salary scale	**3%**

n = 399

Figure 9. Distribution of pension expected rates of return on assets, FY 2010



n = 463

Figure 10. Change in pension expected rates of return on assets, FY 2009 – 2010*

	Percentage of companies
Current-year rate greater than prior-year rate	**11%**
Rates are the same in both years	**55%**
Current-year rate less than prior-year rate	**34%**
1 to 49 basis points	22%
50 to 99 basis points	9%
100 to 149 basis points	2%
149 or more basis points	1%
Total	**100%**

n = 458

*For companies in this year's report

Actual Rate of Return on Pension Assets

The actual rate of return on assets is the investment growth realized in the pension fund during the plan year. Typically, the actual return on investments is a main driver in the change of the value of a pension plan's assets.

Figure 11 depicts the average actual annual rate of return on plan assets from FY 1999 to FY 2010. The average rate of return on plan assets in 2010 was 12.64%. The median rate of return on pension plan assets was 12.60%.

Figure 12 depicts the distribution of actual rates of return on assets for FY 2010. Eighty percent of companies had an actual return on their assets of between 10% and 15%.

Figure 11. Average returns on plan assets, FY 1999 – 2010

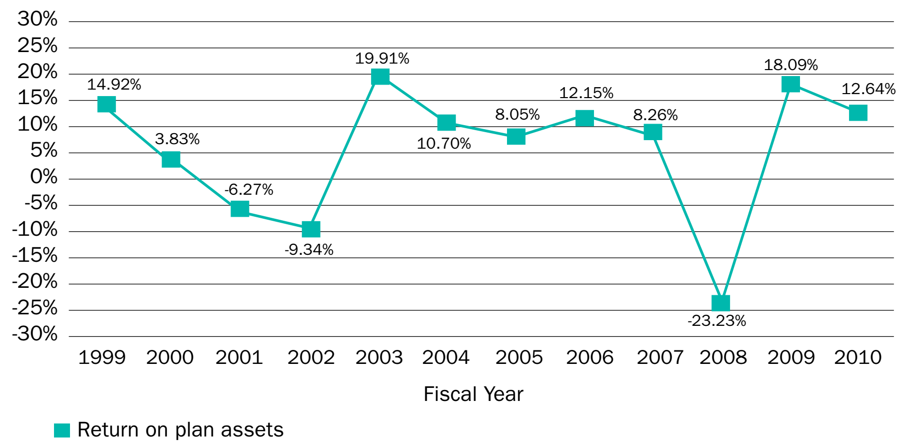
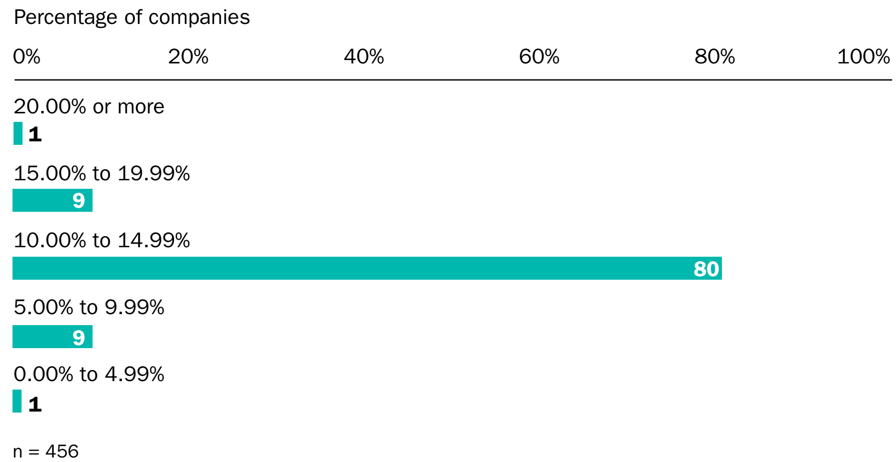


Figure 12. Distribution of actual rates of return on assets, FY 2010



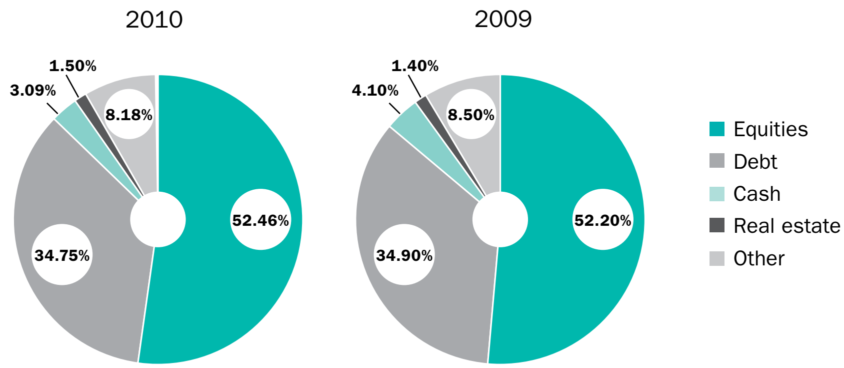
Asset Allocation of Pension Plans

ASC 715 requires the disclosure of the allocation for pension plan assets. The allocation of assets in pension plans is an important determinant of the plan's overall investment performance. More specifically, asset allocation strongly influences volatility in the plan's funded status and the plan sponsor's cash and accounting cost. The sponsor's creditors, investors, regulators and participants as well as other interested parties want to know about asset allocation in order to evaluate the plan's risk exposure and long-term cost.

Figure 13 depicts the average asset allocation for sponsors in this analysis. The average allocations of assets stayed nearly constant from FY 2009 to FY 2010.

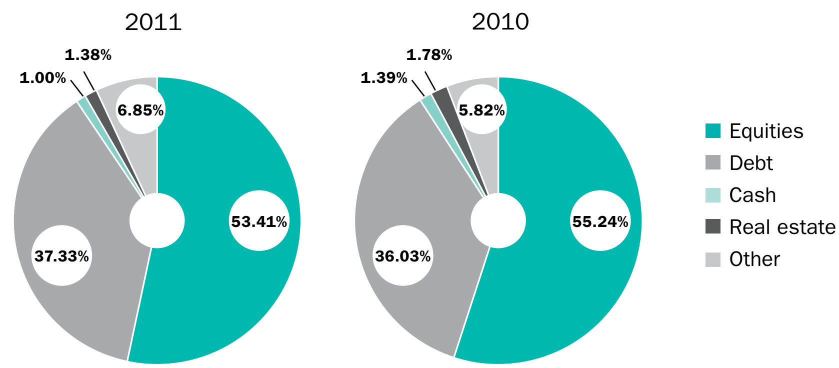
Companies are also required to disclose their target asset allocation for plan assets. Some firms used a single value as their target allocation; others used a range to denote their allocation target. For purposes of *Figure 14,* if the target allocation was shown as a range, results were normalized to equal 100%. The average target equity allocation for 2011 is 53.41%. For companies in last year's report, the average target equity allocation for 2010 was 55.24%. The decline in targeted equity share suggests some companies have been looking for ways to de-risk their pension plans.

Figure 13. Average allocation of pension plan assets, FY 2010 vs. FY 2009*



*2009 results are from last year's report, based on last year's sample.

Figure 14. Average target allocation of pension plan assets, FY 2011 vs. FY 2010*



*2010 results are from last year's report, based on last year's sample.

Funded Status of Pension Plans

Funded status measures the financial health of pension plans and is typically defined as the relation between plan assets and obligations. Under ASC 715, projected benefit obligation (PBO) and accumulated benefit obligation (ABO) are required to be disclosed. If a plan has a funded status greater than 100%, it means that the benefit obligation is fully funded.

PBO Funded Status

The PBO funded status is defined as the fair value of plan assets over the plan's PBO. The PBO is the actuarial present value of all benefits attributed by the benefit formula to service before the measurement date. This includes the effect of expected future compensation increases on plans where that is part of the benefit formula or where benefit increases connected to salary raises are likely.

Figure 15 shows the trends in the PBO funded status from FY 1999 to FY 2010.

For companies in this report, the average PBO funded status increased from 77% at the end of 2009 to 80% at the end of 2010. The funded status increased in 2010 due to positive asset returns coupled with large employer contributions, but was mitigated by a decrease in interest rates. The median funded status was 79% at the end of 2010.

Sixty-three percent of companies had a PBO funded status of less than 80% in 2009. By the end of 2010, 52% of companies had funded status of less than 80%.

Figure 16 shows the distribution of PBO funded status for companies in this report for FY 2009 and FY 2010.

Companies in this report with a fiscal year-end after September had roughly $1,493 billion in PBOs and $1,253 billion in pension plan assets in aggregate at the end of 2010.

Figure 15. Average PBO funded status, FY 1999 – 2010

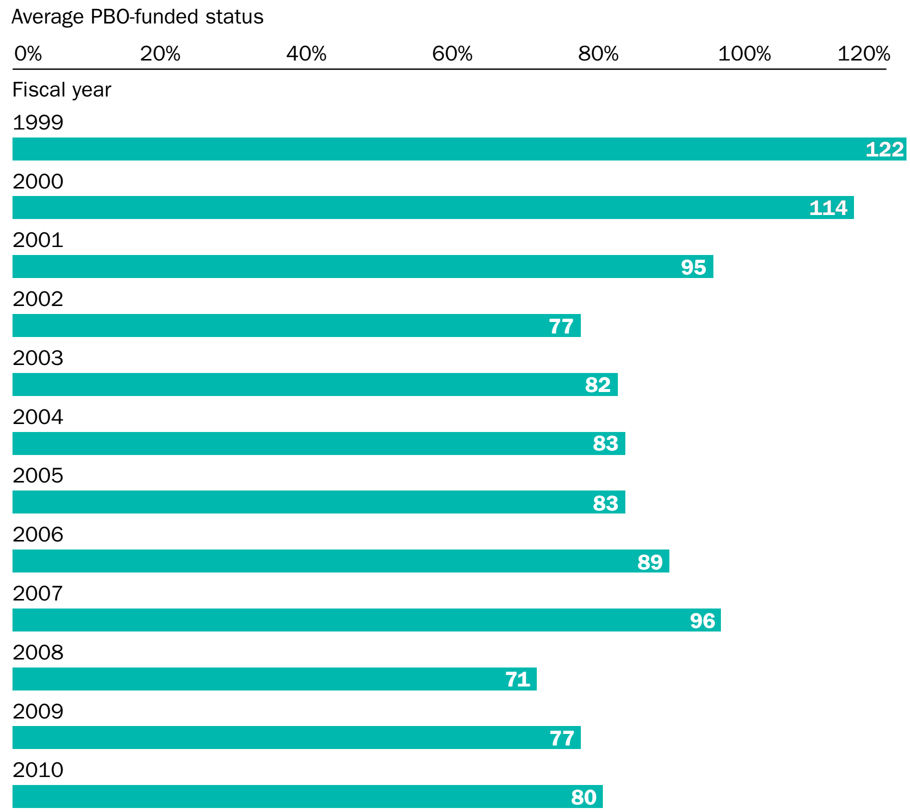
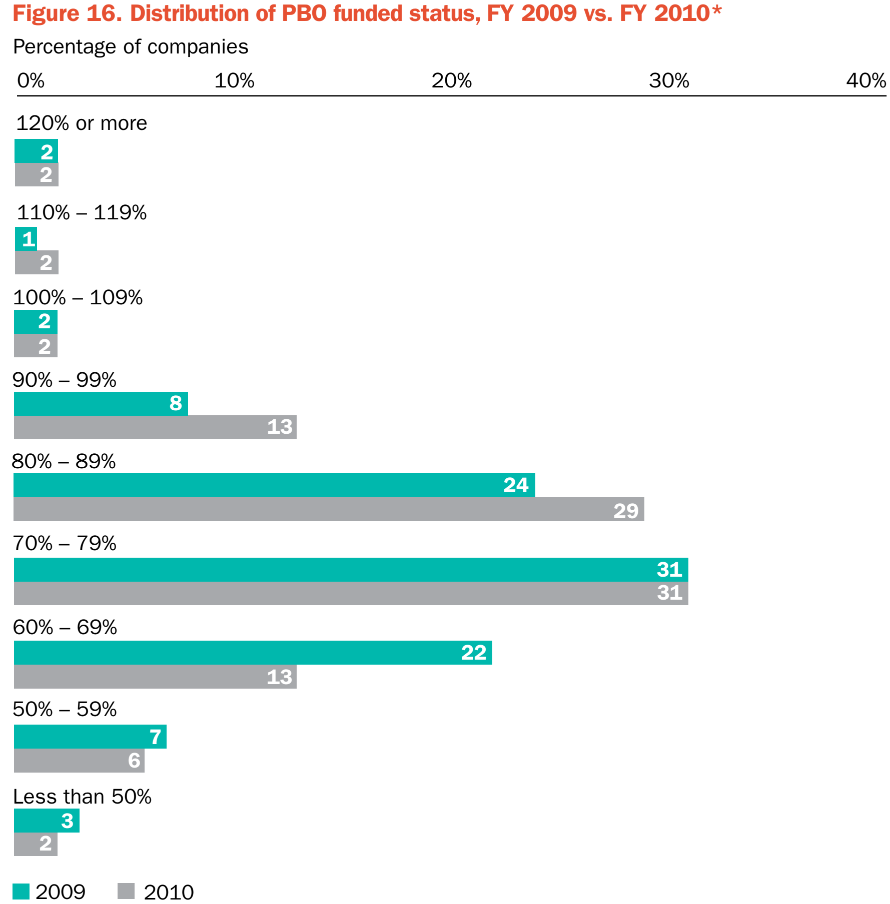


Figure 16. Distribution of PBO funded status, FY 2009 vs. FY 2010*



n = 467

*For companies in this year's report

ABO Funded Status

The ABO funded status is defined as the fair value of plan assets over the plan's ABO. The ABO is the actuarial present value of all benefits attributed by the benefit formula to service before the measurement date, not including the effect of future compensation increases.

Figure 17 shows the trends in the ABO funded status from FY 2003 to FY 2010.* The average ABO funded status for companies in this report is 85%, an increase from 83% in 2009. The median ABO funded status in 2010 was 84%.

Figure 18 shows the distribution of ABO funded statuses for companies in this report for FY 2009 and FY 2010. Sixty-one percent of firms have an ABO funded status of 80% or more at the end of 2010. Fifty percent of companies in this report had an ABO funded status of 80% or more at the end of 2009.

*Values shown in Figure 17 are only for FY 2003 and later because the disclosure of ABO was required beginning with fiscal years ending after December 15, 2003.

Figure 17. Average ABO funded status, FY 2003 – 2010

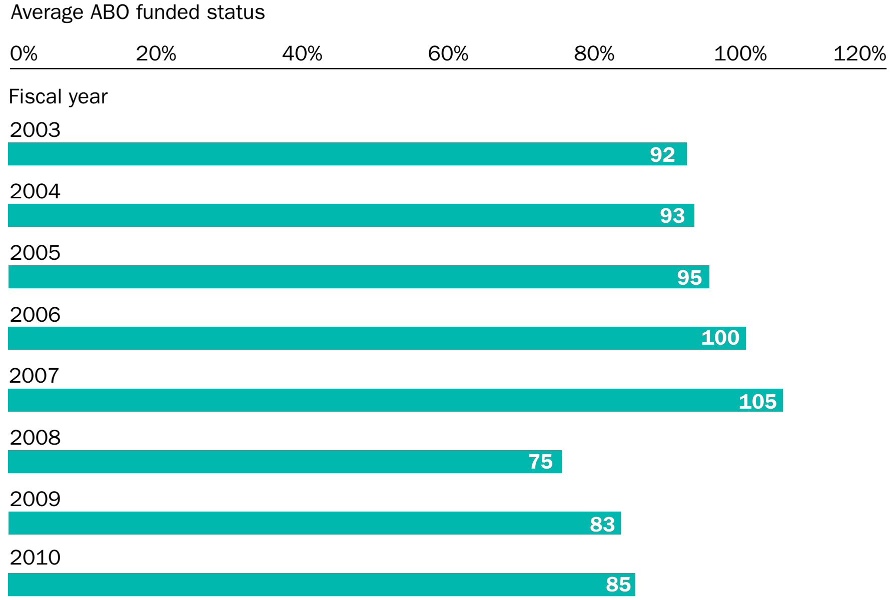
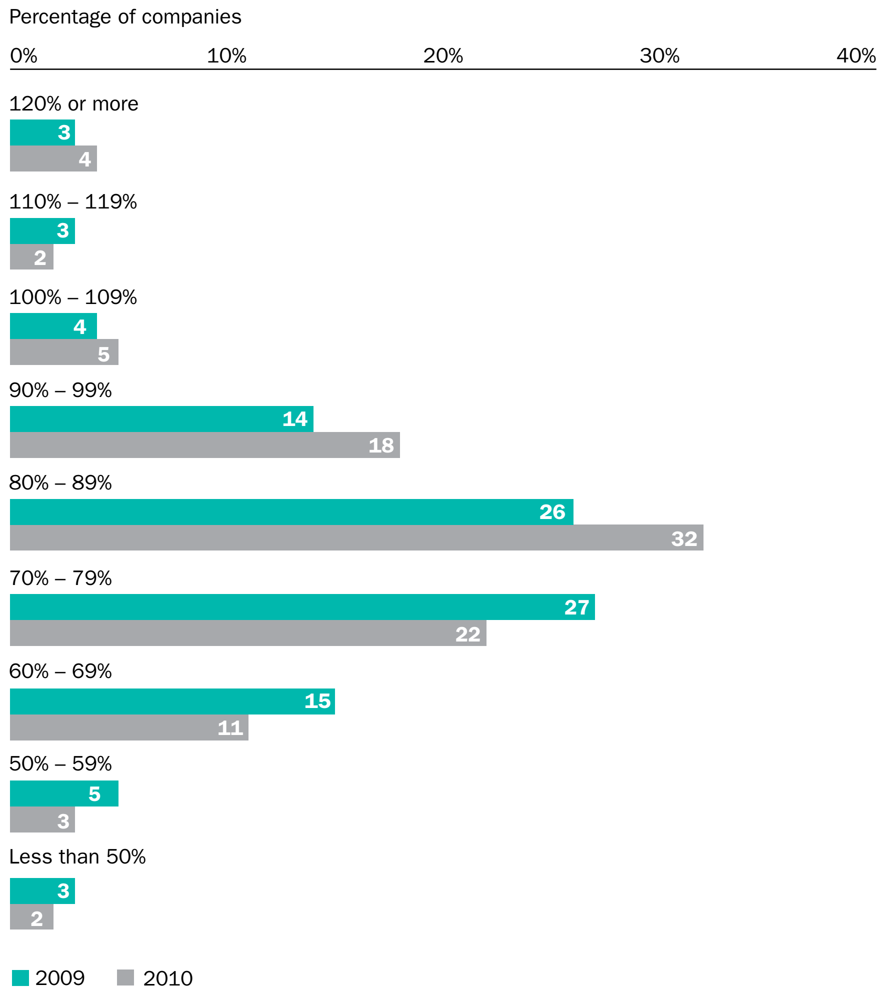


Figure 18. Distribution of ABO funded status, FY 2009 vs. FY 2010*



n = 406

*For companies in this year's report

Pension Risk Index (PRI)

The value at risk (VaR) is the simulated future dollar reduction in the pension fund's funded position over a year, under adverse financial market conditions, given the plan's asset allocation, liability structure and sensitivity to interest rates. An unfavorable VaR scenario is defined as having a 5% probability outcome, and is calculated using Towers Watson's capital market assumptions and proprietary asset/liability modeling technology.

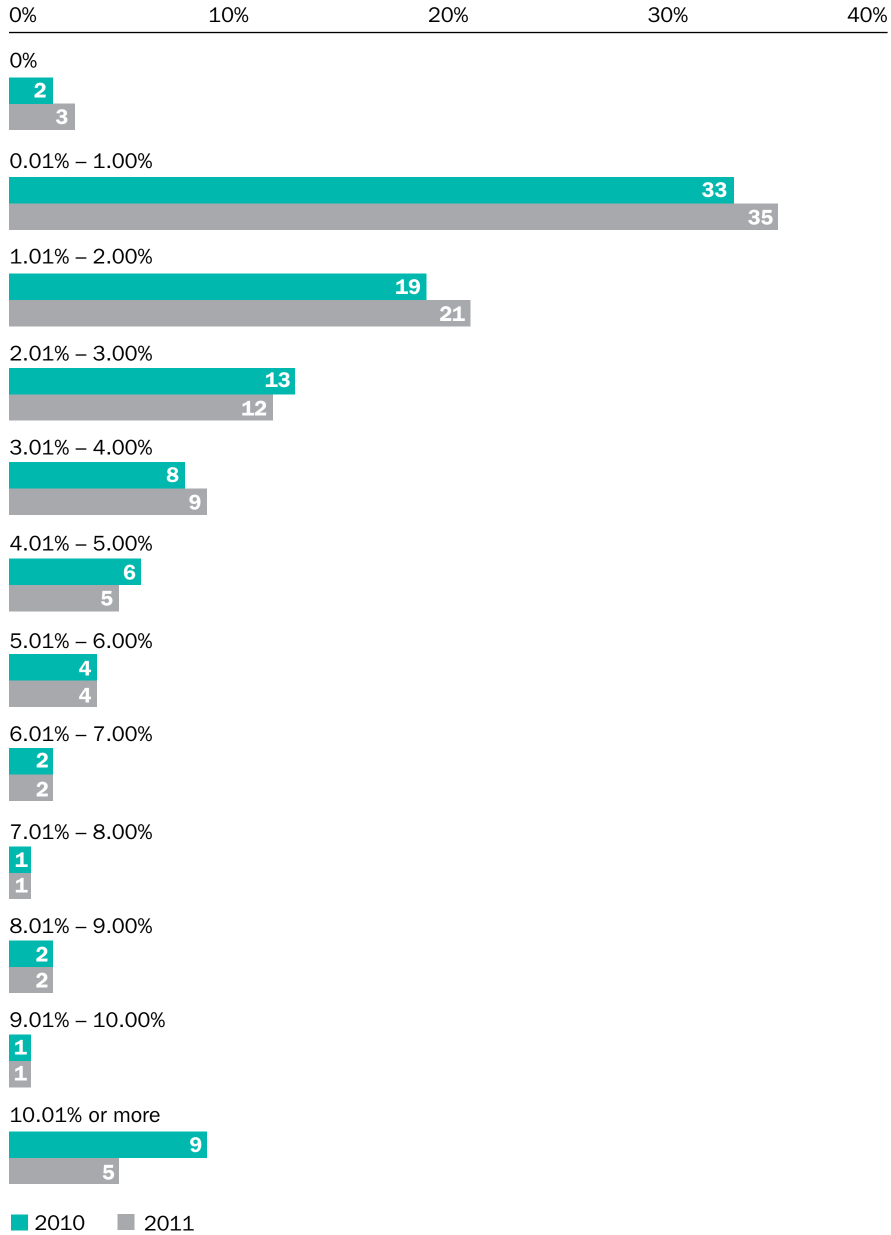
The dollar value of this outcome is then compared with the market capitalization of the plan sponsor. For example, a PRI value of 4% implies that, given the plan's current financial position and asset allocation, there is a 5% likelihood that the firm will experience a loss in its pension funded position worth 4% of the company's market capitalization during that year. *Figure 19* shows the distribution of 2010 and 2011 PRI values.*

Seventy-one percent of companies have a PRI score of 3% or less in 2011, meaning that, with another poor market outcome, these firms could experience a loss in their pension funds worth 3% of their market capitalization or less. Five percent of the companies have PRI scores higher than 10%, meaning that dismal market performance could mean a loss in their pension fund of more than 10% of their market capitalization. PRI values above 10% might cause a large disturbance to the core business for these companies.

The median PRI score for companies in this analysis is 1.50%. For companies in last year's report, the median PRI value was 1.80%. This decrease in employers' PRI scores over the last year can be attributed to the following:

- Towers Watson's latest capital market assumptions
- Larger increases in company market capitalization than in plan liabilities, although aggregate market capitalization is still below pre-financial-crisis levels

Figure 19. Pension risk index scores in 2010* and 2011



*The 2010 PRI values are derived from last year's sample.

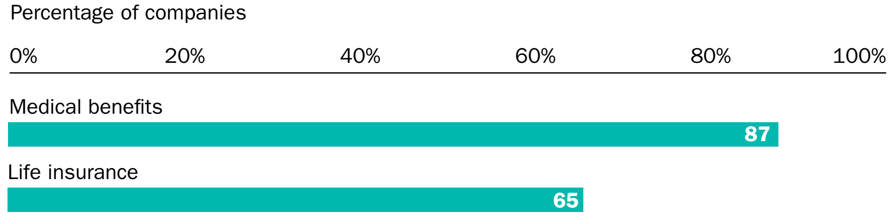
Other Postretirement Benefits

As noted, nearly all of the companies in this report disclosed information about pension plans. *Figure 20* shows the percentage of companies in this survey that provide postretirement medical and/or life insurance benefits. The figure includes all companies regardless of their fiscal-year-end dates.

Most companies that provide defined benefit pensions also provide postretirement medical and life insurance benefits, but postretirement life insurance benefits are less prevalent.

Eighty-seven percent of companies provide postretirement medical benefits, and 65% provide postretirement life insurance benefits.*

Figure 20. Percentage of companies with pensions also providing postretirement medical or life insurance benefits, FY 2010



*A firm is classified as providing postretirement benefits if it is still managing the plan obligations. Many other post-employment benefit (OPEB) plans are closed to new entrants. According to the most recent Towers Watson Benefit Data Source, 52% of companies offer retiree medical plans to newly hired employees, and 28% offer retiree life insurance.

Measurement of Other Postretirement Benefit Costs and Obligations

The determination of the costs and obligations for postretirement benefits other than pensions is based on the calculation of the actuarial present value of the postretirement benefits that are expected to be paid to or on behalf of current and future retirees under the terms of the plan and the attribution of such present value to periods of service. Generally, the attribution period is from the date of hire to the date the employee gains full eligibility for benefits. Benefits are allocated equally to each year of service, unless the plan attributes a greater share of benefits to earlier years of service.

The accumulated post retirement benefit obligation (APBO) as of a particular date is the actuarial present value of expected benefits attributed to current and former employees' service rendered to that date. A postretirement benefit plan's APBO includes salary progression if the plan's benefits are pay-related.

Actuarial assumptions are used to determine the present value of expected benefits. The following actuarial assumptions are required to be disclosed:

- The discount rate
- The health care cost trend rate
- The salary scale assumption
- The expected long-term rate of return on plan assets

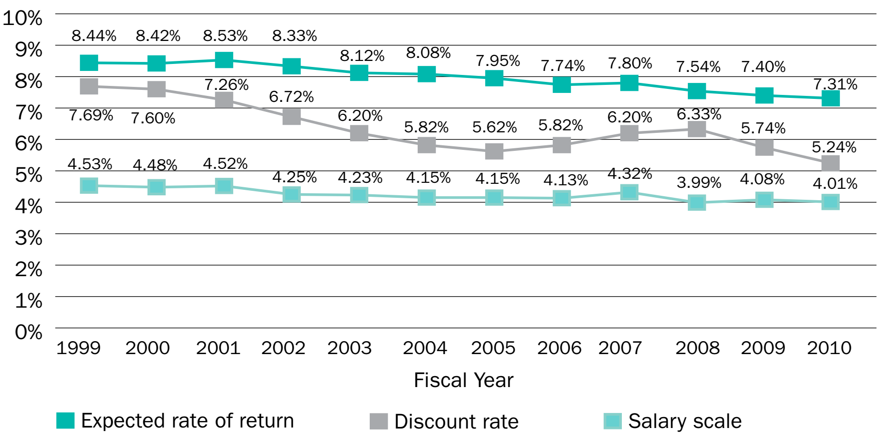
Figure 21 shows the discount rate, salary scale and expected-rate-of-return assumptions from the current and past reports. These assumptions and trends are often the same as or similar to the assumptions for pension plans, except for the expected-rate-of-return-on-asset assumptions, in which companies are utilizing lower rates for their other postretirement plans than for their pensions.

For the minority of companies that have assets associated with their postretirement benefits, the average expected rate of return reported in the survey has declined by 122 basis points since 2001. Over this period of time, average salary increase assumptions have declined by 51 basis points.

The Discount Rate

Assumed discount rates are intended to "reflect the time value of money as of the measurement date in determining the present value of future cash outflows currently expected to be required to satisfy the postretirement benefit obligation."

Figure 21. Trends in postretirement discount rate, salary scale and expected-rate-of-return assumptions, 1999 – 2010



Plan sponsors generally use rates based on the rates of return on high-quality fixed-income investments. The rate at which the obligation could be effectively settled with third-party insurers on a nonparticipation basis can also be used.

Discount rates for all companies range from 3.74% to 6.50%, with an average value of 5.24% in FY 2010. By comparison, discount rates in FY 2009 for companies included in this year's report ranged from 4.33% to 6.63%, with an average value of 5.74%.

Although the patterns of cash flows differ, 25% of companies with postretirement medical benefits and pension plans use the same discount rate for their pension and postretirement plans. Twenty-two percent of the companies use a higher discount rate for their postretirement plans than for their pension plans, and 53% use a lower rate.

Salary Scale

Comparison of the salary scale assumptions for pension and postretirement benefit purposes shows that most sponsors use the same salary scale assumption for both types of plans. Reasons for different assumptions include different employee groups covered under the plans.

The salary scale assumption for postretirement benefits ranges from 1.50% to 8%, with an average value of 4.01%.

Fifty-six percent of companies reporting a salary scale for postretirement benefits use the same assumption they use for pension purposes; 22% use a salary scale assumption greater than their pension assumption, and 22% use a lower assumption.

The Health Care Cost Trend Rate

The health care cost trend rate is one of several assumptions unique to measuring the obligation for and cost of postretirement health care benefits. Other assumptions unique to these measurements are the per capita claim cost at each age at which the participant is expected to receive benefits and medical coverage available from other providers, such as Medicare. Of these assumptions, only information on the health care cost trend rate is a required disclosure item in the annual report — in particular, on the initial health care cost trend rate, the ultimate rate and the year the ultimate rate is reached.

Initial and Ultimate Health Care Cost Trend Rates

Figure 22 shows the assumed health care cost trend rates from FY 1999 to FY 2010. The figure represents companies that use the same single trend rate assumption for health care costs for retirees above and below age 65.

The initial health care cost trend rate continued to decline during 2010. The initial health care trend rate has decreased by 76 basis points since 2001 and 195 basis points since 2003; the ultimate health care trend rate has declined by 35 basis points since 2001.

Figure 23 shows the distribution of the initial health care cost trend rate for companies that use the same assumption for cost for retirees above and below age 65. Eighty percent of companies in this report had a heath care cost trend rate between 7.01% and 9%. The median current-year health care cost trend rate is 8% for FY 2010.

For companies that use the same trend rate assumption for pre- and post-65 health care costs, the average initial health care cost trend rate is 7.98%, with a range from 3% to 10.25% in FY 2010. The initial health care cost trend rate ranged from 3% to 11.50%, with an average of 8.08% in FY 2009.

Figure 24 shows the distribution of the ultimate health care cost trend rate. The majority of companies in this year's report have an ultimate health care cost trend rate of 5%. The average ultimate health care cost trend rate was 4.89% in FY 2010, with a range of 3% to 6.50%.

Roughly 1% of companies in this year's report had an initial health care cost trend rate equal to the ultimate rate.

Figure 22. Initial and ultimate health care cost trend rate assumptions for companies using a single rate for pre- and post-65 costs, 1999 – 2010

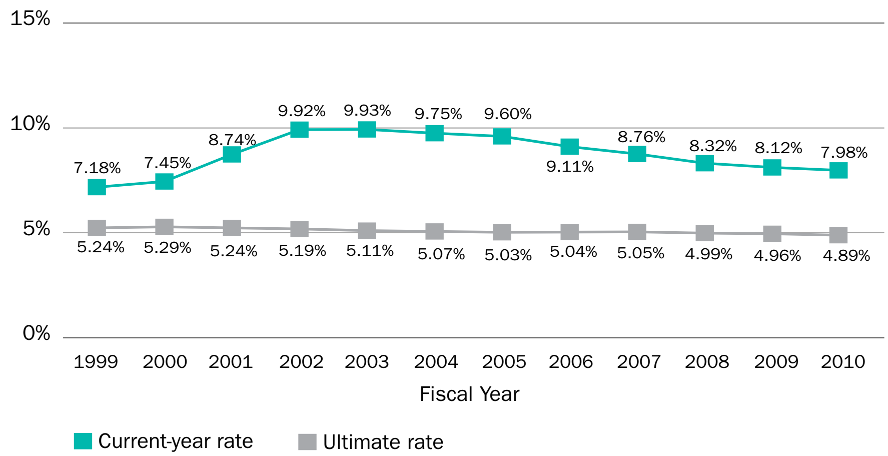


Figure 23. Distribution of initial health care cost trend rates for companies using a single rate for pre- and post-65 costs, FY 2010

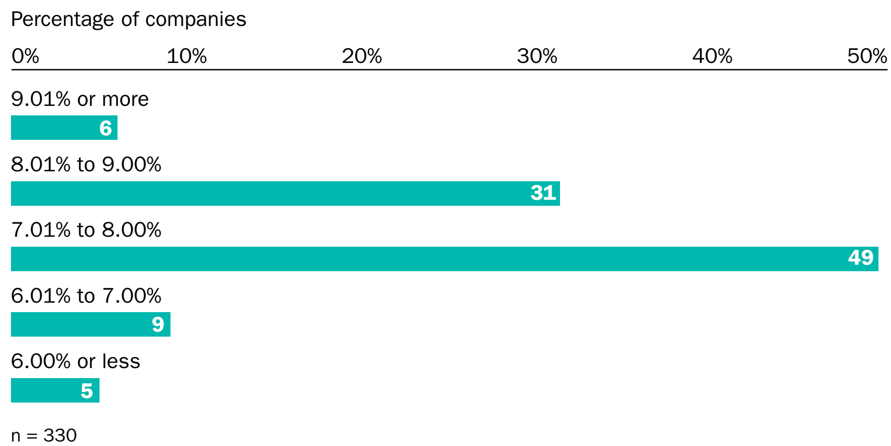
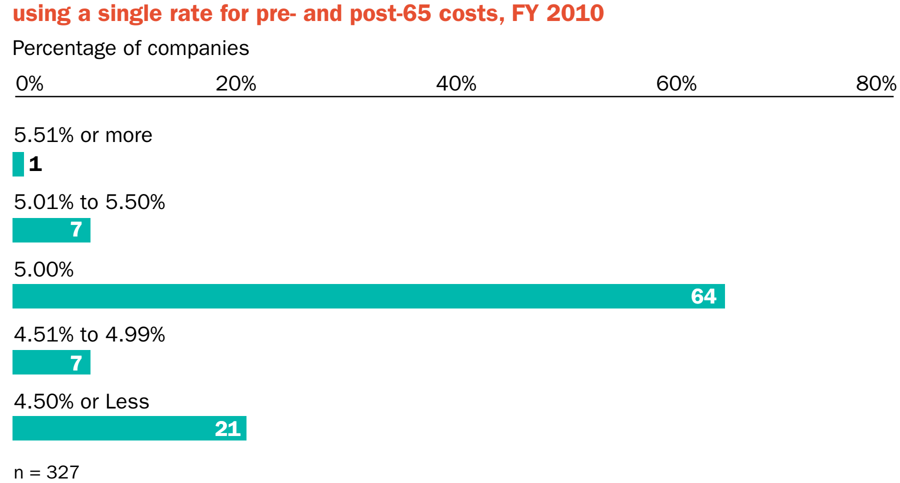


Figure 24. Distribution of ultimate health care cost trend rates for companies using a single rate for pre- and post-65 costs, FY 2010



Years to Reach Ultimate Health Care Cost Trend Rate

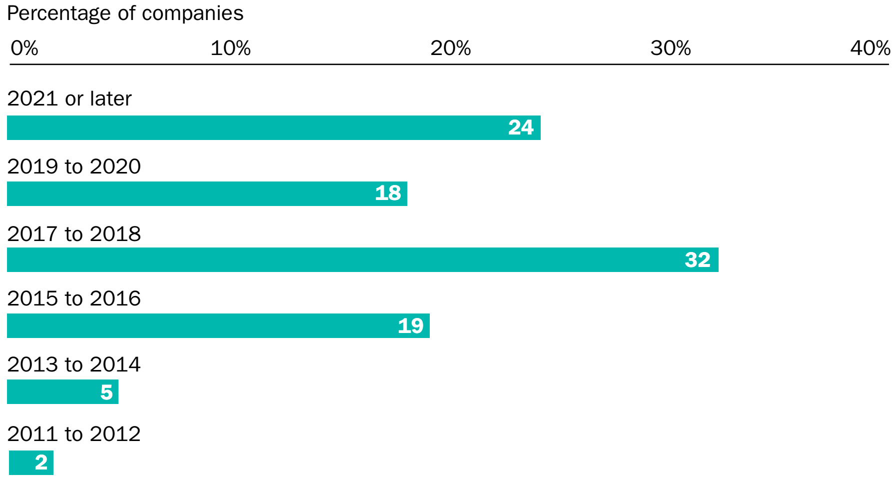
Figure 25 shows the distribution of the years in which the ultimate health care cost trend rate is achieved for companies that use a single rate for pre- and post-65 health care costs. For 69% of companies, the ultimate health care cost trend rate is achieved between 2015 and 2020. The median number of years to reach the ultimate health care cost trend rate is seven.

The Spread Between the Discount Rate and the Ultimate Health Care Cost Trend Rate

Figure 26 shows that the discount rate exceeds the ultimate health care cost trend rate for a majority of companies. Overall, 76% of companies reported a discount rate for postretirement plans that exceeded the ultimate health care cost trend rate.

The spread between the discount rate and the ultimate health care cost trend rate ranges from –2.30 percentage points to 2.00 percentage points, with an average value of 33 basis points. This spread has grown smaller over the past years mostly due to a decline in the discount rate used to measure postretirement benefits. This declining spread could potentially be leading to growth in postretirement benefit obligations, as the expected rate of increase in health care costs is now larger than the discount rate assumption for some companies in this report.

Figure 25. Distribution of years in which the ultimate health care cost trend rate is achieved, FY 2010



n = 320

Figure 26. Spread between the discount rate and the ultimate health care cost trend rate, FY 2010

	Percentage of Companies
Discount rate greater than ultimate health care cost trend rate	**76%**
150 or more basis points	2%
100 to 149 basis points	7%
50 to 99 basis points	28%
1 to 49 basis points	39%
Rates are the same	**5%**
Discount rate less than ultimate trend rate	**19%**
Total	**100%**

n = 325

Expected Long-Term Rate of Return on Plan Assets

An expected long-term rate of return on plan asset assumption was reported by about 38% of companies that provide postretirement benefits. The expected rates of return assumption for postretirement benefit plan assets range from 2% to 10%, with an average value of 7.28% and a median value of 7.60%.

Due to the lack of tax-effective methods for prefunding the promises to provide other postretirement benefits, most postretirement benefit plans other than pensions will remain unfunded. As noted, 38% of companies with postretirement medical benefits report an expected long-term rate of return assumption. For those companies with assets supporting their postretirement benefit plan, the median level of assets as a percentage of APBO was 37% in FY 2010.

Figure 27 depicts the APBO funded status for companies that have funded postretirement benefits from FY 1999 to FY 2010. Over the last 10 years, APBO funding levels have remained in the 23% to 37% range.

Figure 28 shows the percentage of companies that offer postretirement benefits that are not funded, from FY 1999 to FY 2010. While this ratio has declined over the last 10 years, the vast majority of plan sponsors are still choosing not to fund their OPEBs due to the lack of tax-effective vehicles. Instead, retirees' benefits are paid from corporate assets.

Figure 27. Median APBO funded status for firms with funded postretirement benefits, 1999 – 2010

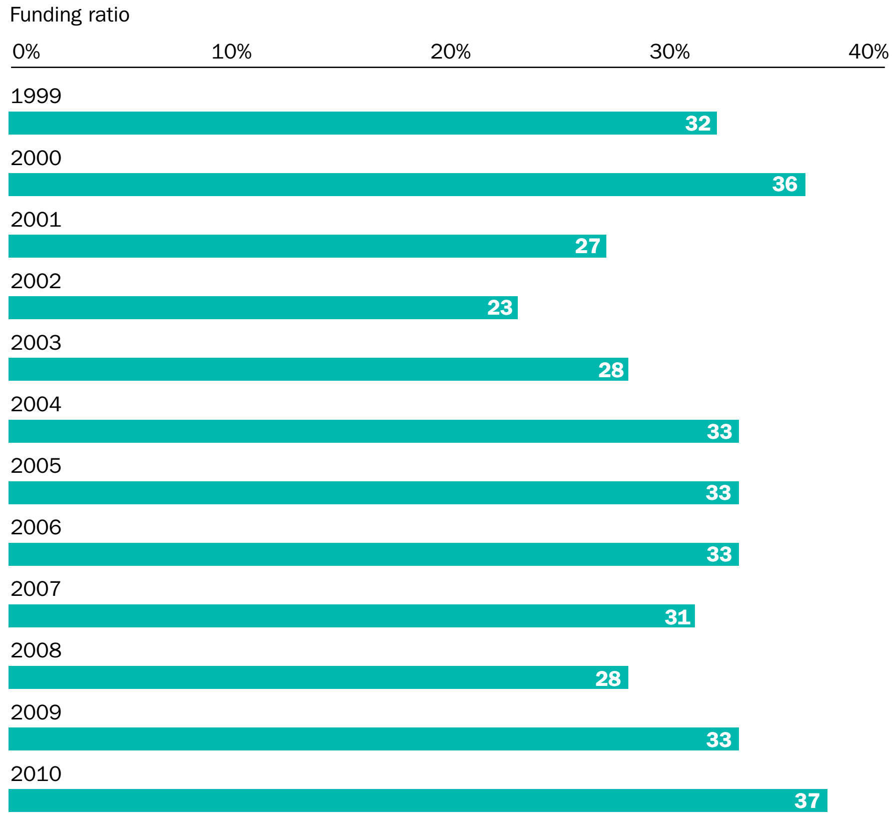
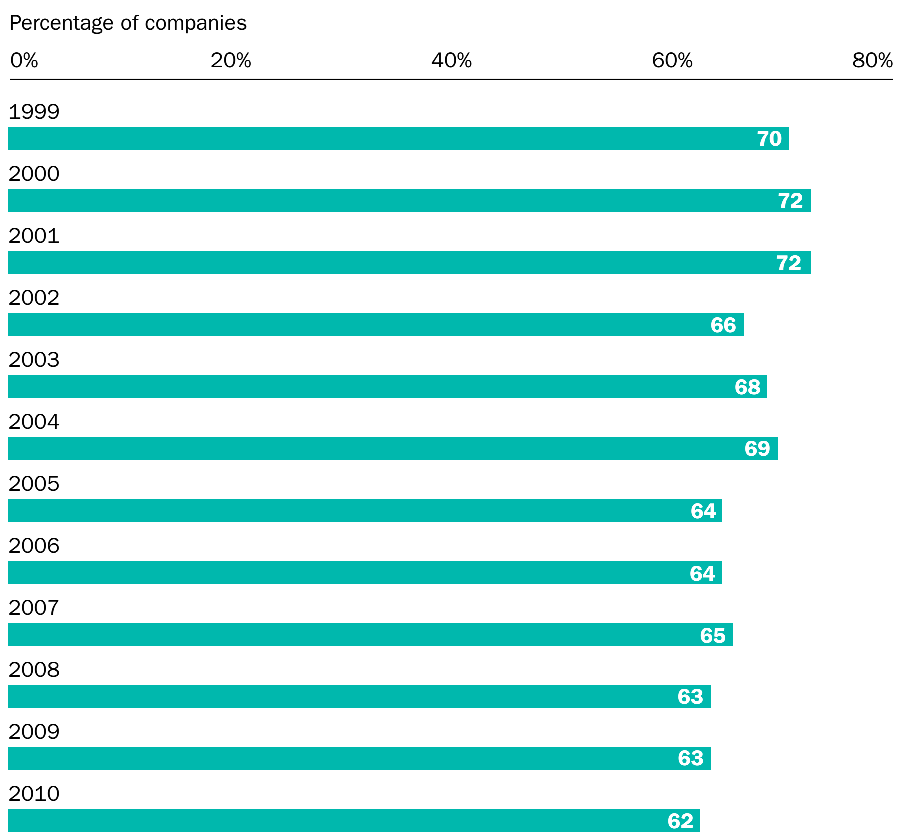


Figure 28. Percentage of companies without funded postretirement benefits, FY 1999 – 2010



Appendix — Companies analyzed

Abbott Laboratories
AbitibiBowater Inc
ABM Industries Inc.
Acuity Brands Inc.
Advance Auto Parts Inc.
AECOM Technology Corporation
AES Corporation
Aetna Inc.
AFLAC Inc.
AGCO Corp
Agilent Technologies Inc.
AGL Resources Inc.
Air Products and Chemicals Inc.
AK Steel Holding Corporation
Alaska Air Group Inc.
Albemarle Corporation
Alcoa Inc.
Aleris Corporation
Alexander & Baldwin
Allegheny Energy Inc.
Allegheny Technologies Inc.
Allergan Inc.
Alliance One International Inc.
Alliant Energy Corporation
Alliant Techsystems Inc.
Allstate Corporation
Ally Financial Inc.
Alpha Natural Resources Inc.
Altria Group Inc.
AMC Entertainment Inc.
Amerco
Ameren Corporation
American Axle & Manufacturing Holdings Inc.
American Electric Power Company Inc.
American Express Company
American Greetings Corporation
American International Group Inc.
American National Insurance Company
American Water Works Company Inc.
Ameriprise Financial Inc.
AmerisourceBergen Corporation
Ametek Inc.
Amphenol Corporation
AMR Corporation
Anadarko Petroleum Corporation
Andersons Inc.
Anixter International Inc.
Ann Taylor Stores Corporation
AON Corporation
A.O. Smith Corporation
Applied Industrial Technologies Inc.
AptarGroup Inc.

Arch Coal Inc.
Archer Daniels Midland Co.
Arkansas Best
Armstrong World Industries Inc.
Arrow Electronics Inc.
Arthur J. Gallagher & Company
Arvinmeritor Inc.
Ashland Inc.
Assurant Inc.
AT&T Inc.
Atmel
Atmos Energy Corporation
Autoliv Inc.
Automatic Data Processing
Autozone Inc.
Avaya
Avery Dennison Corporation
Avis Budget Group Inc.
Avnet Inc.
Avon Products Inc.

Babcock & Wilcox
Baker Hughes Inc.
Ball Corporation
Bank of America Corporation
Bank of New York Mellon Corporation
Barnes & Noble Inc.
Baxter International Inc.
BB&T Corporation
Beckman Coulter Inc.
Becton Dickinson and Company
Belden
Belk Inc.
Bemis Company Inc.
Berkshire Hathaway Inc.
Berry Plastics Holding Corporation
Big Lots Inc.
BJ's Wholesale Club Inc.
Bluelinx Holdings Inc.
Boeing Company
Boise Cascade Holdings
Boise Inc.
Bon-ton Stores Inc.
BorgWarner Inc.
Briggs and Stratton Corporation
Brink's Company
Bristol-Myers Squibb Company
Brown Shoe Company Inc.
Brown-Forman Corporation
Brunswick Corporation
Buckeye Partners
Bucyrus International Inc.
Burger King Holdings Inc.

Cablevision Systems Corporation
Cabot Corporation
Calpine Corporation
Calumet Specialty Products Partners L.P.
Campbell Soup Company
Capital One Financial Corporation
Carlisle Companies Inc.
Carmax Inc.
Carter's Inc.
Catalent Pharma Solutions Inc.
Caterpillar Inc.
CBS Corporation
Celanese Corporation
CenterPoint Energy Inc.
Centurylink Inc.
Cenveo Inc.
CF Industries Holdings Inc.
Chemtura Corporation
Chevron Corporation
Chiquita Brands International Inc.
Chrysler Group LLC
CHS Inc.
CH2M Hill Companies Ltd.
Chubb Corporation
CIGNA Corporation
Cincinnati Financial Corporation
CIT Group Inc.
Citigroup Inc.
Cliffs Natural Resources
Clorox Company
CME Group Inc.
CMS Energy Corp.
Coca-Cola Company
Coca-Cola Enterprises
Colgate-Palmolive Company
Collective Brands
Comcast Corporation
Comerica Inc.
Community Health Systems Inc.
Computer Sciences Corp.
ConAgra Foods Inc.
ConocoPhillips
Consol Energy Inc.
Consolidated Edison Inc.
Constellation Energy Group Inc.
Convergys Corporation
Con-way Inc.
Cooper Tire and Rubber Company
Cooper-Standard Holdings
Core-Mark Holding Company Inc.
Corn Products International Inc.
Corning Inc.

Covanta Holding Corporation
Crane Co.
C.R. Bard Inc.
Crown Holdings Inc.
CSX Corporation
Cummins Inc.
CUNA Mutual Group
Curtiss-Wright Corporation
CVS Caremark Corporation
Cytec Industries Inc.

Dana Holding Corporation
Danaher Corporation
Darden Restaurants Inc.
Dean Foods Company
Deere & Company
Del Monte Foods Company
Delta Air Lines Inc.
DENTSPLY International Inc.
Devon Energy Corporation
Diebold Inc.
DIRECTV Group Inc.
Discover Financial Services LLC
Diversey Inc.
Dole Food Company Inc.
Dominion Resources Inc.
Domtar Corporation
Donaldson Company Inc.
Dover Corporation
Dow Chemical Company
DPL Inc.
Dresser-Rand Group Inc.
Dr. Pepper Snapple Group Inc.
DTE Energy Co.
Duke Energy Corporation
Dun & Bradstreet Corporation
Dynegy Inc.

Eastman Chemical Company
Eastman Kodak Company
Eaton Corporation
Ecolab Inc.
Edison International
E.I. Du Pont De Nemours & Company
El Paso Corp.
Eli Lilly and Company
EMC Corporation
EMCOR Group Inc.
Emerson Electric Co.
Energizer Holdings Inc.
Energy Future Holdings Corp.
Entergy Corporation
Equifax Inc.
Erie Indemnity Company
Estee Lauder Companies Inc.
Exelon Corporation
Exide Technologies
Exxon Mobil Corporation

Federal Home Loan Mortgage Corporation
Federal National Mortgage Association
Fedex Corporation
Ferro Corporation
Fidelity National Financial Inc.
Fifth Third Bancorp
First American Financial Corporation
First Data Corporation
First Horizon National Corporation
FirstEnergy Corp.
Flowers Foods Inc.
Flowserve Corporation
Fluor Corporation
FMC Corporation
FMC Technologies Inc.
FM Global
Foot Locker Inc.
Ford Motor Company
Fortune Brands Inc.
Franklin Resources Inc.
Fred's Inc.
Freeport-McMoRan Copper & Gold Inc.
Frontier Communications Corp
Frontier Oil Corporation

Gannett Co. Inc.
Gardner Denver Inc.
General Cable Corporation
General Dynamics Corporation
General Electric Company
General Mills Inc.
General Motors Company
Genesco Inc.
Genon Energy
Genuine Parts Company
Genworth Financial Inc.
Georgia Gulf Corporation
Global Payments Inc.
Goldman Sachs Group Inc.
Goodrich Corporation
Goodyear Tire & Rubber Company
Graham Packaging Holdings Co. Inc.
Graphic Packaging Holding Corporation
Graybar Electric Company Inc.
Great Atlantic & Pacific Tea Company Inc.
Great Plains Energy Inc.
Green Plains Renewable Energy
Greif

Halliburton Company
Hanesbrands Inc.
Hanover Insurance Group Inc.
Harley-Davidson Inc.
Harsco Corporation
Hartford Financial Services Group Inc.
Hasbro Inc.
Hawaiian Electric Industries Inc.
Helmerich & Payne Inc.
Hershey Company
Hertz Global Holdings Inc.
Hess Corporation
Hewlett-Packard Company
H.J. Heinz Company
Holly Corporation
Honeywell International Inc.
Hormel Foods Corporation
Hospira Inc.
Hubbell Inc.
Hudson City Bancorp Inc.
Huntington Bancshares Inc.
Huntsman Corporation

Icahn Enterprises LP
Illinois Toolworks
Integrys Energy Group
Intel Corporation
International Business Machines Corporation
International FCStone Inc.
International Flavors & Fragrances Inc.
International Paper Company
Interpublic Group of Companies Inc.
ITT Corporation

Jack In The Box Inc.
Jacobs Engineering Group Inc.
Jarden Corporation
J.C. Penney Company Inc.
Jefferies Group Inc.
J.M. Smucker Company
John Wiley & Sons Inc.
Johnson & Johnson
Johnson Controls Inc.
Jones Apparel Group Inc.
Joy Global Inc.
J.P. Morgan Chase & Co.

Kansas City Southern
KAR Auction Services
KBR Inc.
Kellogg Company
Kennametal Inc.
Keycorp
Kimberly-Clark Corporation
Kinder Morgan Inc.
Kraft Foods Inc.
Kroger Co.

Laboratory Corporation of America Holdings
Laclede Gas Company
Land O'Lakes Inc.
Lear Corporation
Leggett & Platt Inc.
Lennox International Inc.
Levi Strauss & Co.
Lexmark International Inc.
Liberty Mutual Insurance Group
Life Technologies Corporation
Lincoln Electric Holdings Inc.
Lincoln National Corporation
Lockheed Martin Corporation
Loews Corporation
Lorillard Inc.
LSI Corp
L-3 Communications Holdings Inc.
Lubrizol Corporation

Macy's Inc.
Manitowoc Company Inc.
Manpower Inc.
Marathon Oil Corporation
Marsh & McLennan Companies Inc.
Marshall & Ilsley Corporation
Martin Marietta Materials Inc.
Masco Corporation
Massey Energy Company
MasterCard Inc.
Mattel Inc.
Maxim Integrated Products Inc.
McCormick and Company Inc.
McGraw-Hill Companies Inc.
McKesson Corporation
MDU Resources Group Inc.
Mead Johnson Nutrition
MeadWestvaco Corporation
Medco Health Solutions Inc.
Medtronic Inc.
MEMC Electronic Materials
Merck & Co. Inc.
MetLife Inc.
Mettler-Toledo International Inc.
M&F Worldwide Corporation
Molex Inc.
Molson Coors Brewing Company
Momentive Performance Materials Inc.
Momentive Specialty Chemicals Inc.
Monsanto Company
Moody's Corporation
Moog Inc.
Morgan Stanley
Mosaic Company
Motorola Solutions Inc.
M&T Bank Corporation
Mueller Industries Inc.
Murphy Oil Corporation
Mutual of Omaha Insurance

Nacco Industries Inc.
Nalco Holding Company
Nasdaq OMX Group Inc.
Nash Finch Company
National Fuel Gas Company
National Oilwell Varco Inc.
Navistar International Corporation
NCR Corporation
Neiman-Marcus Group Inc.
New Jersey Resources Corporation
New York Community Bancorp Inc.
New York Life Insurance
New York Times Company
Newell Rubbermaid Inc.
Newfield Exploration
Newmarket Corp.
Newmont Mining Corporation
NewPage Holding Corporation
News Corporation
Nextera Energy Inc.
Nicor Inc.
NiSource Inc.
NLV Financial Corp
Noble Energy Inc.
Norfolk Southern Corporation
Nortek
Northeast Utilities
Northern Trust Corporation
Northrop Grumman Corporation
NRG Energy Inc.
NSTAR
Nucor Corporation
NV Energy Inc.
NYSE Euronext

Occidental Petroleum Corporation
OfficeMax Inc.
OGE Energy Corporation
Old Republic International Corporation
Omnicare Inc.
Omnicom Group Inc.
ONEOK Inc.
Oshkosh Corporation
Owens Corning
Owens-Illinois Inc.

PACCAR Inc.
Packaging Corporation of America
Pall Corporation
Parker Hannifin Corporation
Patriot Coal Corporation
Peabody Energy Corporation
Pentair Inc.
Pep Boys — Manny Moe & Jack
PEPCO Holdings Inc.
PepsiCo Inc.
PerkinElmer Inc.
Perrigo Company
Pfizer Inc.
PG&E Corporation
PHH Corporation
Philip Morris International Inc.
Phillips van Heusen
Phoenix Companies Inc.
Pinnacle Foods Finance LLC
Pinnacle West Capital Corporation
Pioneer Natural Resources Company
Pitney Bowes Inc.
PNC Financial Services Group Inc.
PNM Resources Inc.
PolyOne Corporation
Portland General Electric Company
PPG Industries Inc.
PPL Corporation
Praxair Inc.
Precision Castparts Corporation
Principal Financial Group Inc.
Procter & Gamble Company
Progress Energy
Progressive Corporation
Protective Life Corporation
Prudential Financial Inc.
Public Service Enterprise Group Inc.
Publix Supermarkets Inc.
Puget Energy Inc.

QEP Resources
Quad/Graphics
Qwest Communications International Inc.

Ralcorp Holdings Inc.
Raytheon Company
RDA Holding Company
Realogy Corporation
Regal-Beliot Corporation
Regions Financial Corporation
Reinsurance Group of America Inc.
Reliance Steel and Aluminum Company
Republic Airways Holdings Inc.
Republic Services Inc.
Retail Ventures Inc.
Reynolds American Inc.
Rite Aid Corporation
Rock-Tenn Company
Rockwell Automation Inc.
Rockwell Collins Inc.
Rockwood Holdings Inc.
Rowan Companies Inc.
RPM International Inc.
R.R. Donnelley & Sons Company
Ruddick Corporation
Ryder System Inc.
Ryerson Holding Corp

Safeway Inc.
Saks Inc.
Sanmina-SCI Corporation
Sara Lee Corporation
Scana Corporation
Schnitzer Steel Industries
Scholastic Corporation
Scotts Miracle-Gro Company
Scripps Networks Interactive Inc.
Seaboard Corporation
Sealed Air Corporation
Sears Holding Corp.
Securian Financial Group
Sempra Energy
Sherwin-Williams Company
Sigma-Aldrich Corporation
Silgan Holdings Inc.
Smithfield Foods Inc.
Smurfit-Stone Container Corp.
Snap On Inc.
Solutia Inc.
Sonoco Products Company
Southern Company
Southern Union Company
Southwest Airlines Company
Southwest Gas Corporation
Southwestern Energy Company
Spartan Stores Inc.
Spectra Energy Corporation
Spectrum Brands Holdings Inc.
Sprint Nextel Corporation
SPX Corporation
Stancorp Financial Group Inc.
Stanley Black & Decker Corporation
Staples Inc.
State Street Corporation
Stater Bros. Holdings Inc.
Steelcase Inc.
Stryker Corporation
Sunoco Inc.
SunTrust Banks Inc.
Supervalu Inc.
Sysco Corp.

Target Corporation
Teco Energy Inc.
Teledyne Technologies Inc.
Teleflex Inc.
Telephone and Data Systems Inc.
Tellabs
Temple-Inland Inc.
Tenneco Inc.
Terex Corporation
Tesoro Corporation
Texas Instruments Inc.
Textron Inc.
Thermo Fisher Scientific Inc.
Thomas & Betts Corporation
3M Company
Tiffany & Company
Time Warner Cable Inc.
Time Warner Inc.
Timken Company
TJX Companies Inc.
Torchmark Corporation
Toro
Tower International
Towers Watson & Co.
TPC Group
Travelers Companies
Treehouse Foods
Trinity Industries Inc.
Triple-S Management Corporation
True Value Company
TRW Automotive Holdings Corp.
Tupperware Brands Corporation
Tutor Perini Corporation
Tyson Foods Inc.

UGI Corporation
Unified Grocers Inc.
Union Pacific Corporation
Unisys Corporation
United Continental Holdings
United Parcel Service Inc.
United Refining Company
United States Steel Corporation
United Stationers Inc.
United Technologies Corporation
Unitrin Inc.
Universal Corporation
Universal Health Services Inc.
Unum Group
URS Corporation
US Airways Group Inc.
U.S. Bancorp
USEC Inc.
USG Corporation

Valero Energy Corporation
Valhi
Valspar Corporation
Vectren Corporation
Verizon Communications Inc.
V.F. Corporation
Viacom Inc.
VISA Inc.
Vishay Intertechnology Inc.
Visteon Corporation
Vulcan Materials Company
VWR International Inc.

WABCO Holdings
Walgreen Company
Walt Disney Company
Warnaco Group Inc.
Washington Post Company
Waste Management Inc.
Waters Corporation
Wellpoint Inc.
Wells Fargo & Company
Westar Energy Inc.
Western Union Company
Westlake Chemical Corporation
Weyerhaeuser Company
WGL Holdings Inc.
Whirlpool Corporation
Williams Companies Inc.
Windstream Corporation
Winn Dixie Stores Inc.
Wisconsin Energy Corporation
Worthington Industries Inc.
W.R. Grace & Co.
W.W. Grainger Inc.

Xcel Energy Inc.
Xerox Corporation

YRC Worldwide Inc.
YUM! Brands

Zimmer Holdings Inc.
Zions Bancorp

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