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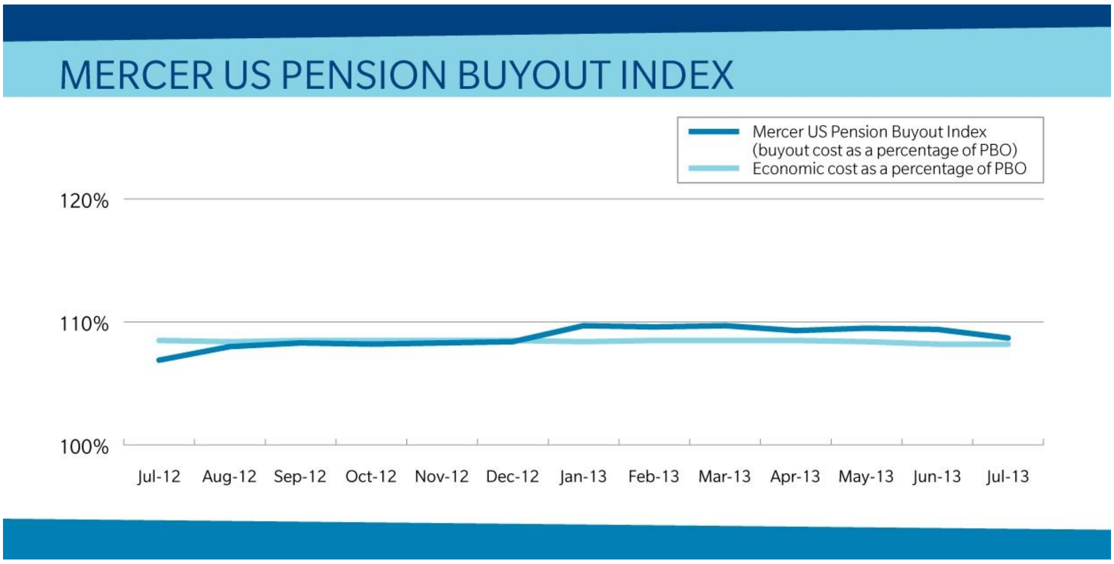
## Mercer US Pension Buyout Index

The Mercer US Pension Buyout Index ("the Index") allows plan sponsors to see at a glance the relative cost of a buyout by an insurer of retiree liabilities of a defined benefit plan, and how that cost changes over time. In addition, the index shows the approximate long-term economic cost of retaining the retiree liabilities on a sponsor's Balance Sheet, which includes an allowance for the future expenses and risk margin needed to maintain the obligations. Based on this evaluation, sponsors can compare the approximate current cost of risk transfer through annuitization with the total cost of retaining obligations on the balance sheet.

Published monthly, the Index tracks the relationship between the accounting liability for a hypothetical traditional defined benefit plan and two cost measures: the approximate total economic cost of retaining the obligations on the balance sheet and the estimated cost of transferring those liabilities to an insurance company.

Annuity pricing data from a number of leading US life insurance companies are used to compile the Index. These insurers include American General, Massachusetts Mutual Life Insurance Company (MassMutual), MetLife, Principal, Pacific Life, Prudential and United of Omaha (Mercer is not associated with any of the aforementioned insurers). On a given month the Index may be compiled from pricing data from some or all of these insurers.

In Figure 1 below, we show the estimated buyout cost for a sample plan comprised of retirees only. As of July 31, 2013 the indicative buyout cost for retirees was 108.7% of the accounting liability. This compares to an estimated long-term economic cost of retaining the plan of 108.2% of the accounting liability. This economic cost includes an allowance for future retention costs (administrative, PBGC premiums and asset related costs) as well as a reserve for future improvements in mortality. These additional costs and reserves are not included in the accounting liabilities published by plan sponsors, but do represent future costs that should be reflected in any risk transfer comparisons and evaluations. These costs will vary depending on the specifics of each plan.




## Commentary on the Mercer US Pension Buyout Index results for July 2013

- Figure 1 indicates that the cost of purchasing annuities for retirees decreased moderately over July 2013, from 109.4% to 108.7% of the accounting liability and the economic cost of retaining the retirees remained level at 108.2% of the accounting liability.
- The cost of annuitization relative to the economic cost of retaining the liabilities decreased during July and is currently only approximately 50 basis points indicating that buyout premiums are potentially

attractive for sponsors when compared with all-in retention costs (e.g. PBGC premiums, administrative costs, investment expenses). Reviewing total retention costs in a more comprehensive way illustrates that annuity purchases may be a cost effective risk transfer option for many sponsors, either today or when their plans become better funded.

- As we noted previously, some plan sponsors have expressed a view to wait until interest rates rise when buyout costs will be less expensive. The rise in interest rates recently has led to a decrease in the absolute cost of buyout, but importantly the margin of the buyout cost over the accounting liability has decreased in a month where interest rates have remained broadly flat. This illustrates the importance of not only considering the level of interest rates but the costs and their causes relative to the liability (and assets).
- In addition to the decreasing buyout cost compared to the accounting liability, strong equity returns in recent months along with the increase in the yields of corporate bonds used in setting discount rates has led to a significant rise in funding levels for many sponsors, reducing the potential cash and funded status impact of a buyout. The aggregate funded status of pension plans sponsored by S&P 1500 companies increased to an estimated 89% as of July 31, 2013, up from 74% at the end of 2012.
- For sponsors that wish to incorporate annuity buyout options to their strategic planning, the recent improvement in funding level and the current small margin between the buyout and economic cost heightens the need to be prepared to act quickly. We believe plan sponsors should consider evaluating, well in advance of any planned buyout, the steps required to facilitate an annuity buyout and gauge the financial and investment strategy impact.

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*For the current value of the Mercer US Pension Buyout Index and full information about the Index, including Methodology for preparation and Important Notices, please visit our website at* www.mercer.com/US-pension-buyout-index