



February 2005
Asset / Liability Scoreboard

Index	Returns YTD 2005	Estimated Weights
Liabilities :		
Market (Treasury STRIPS)	2.07 %	100 %
Pension Act (Corporates)	1.86	
ROA (8% constant rate)	1.33	
Assets :		
Ryan Cash	0.33 %	5 %
Lehman Aggregate	0.03	30
S&P 500	-0.38	60
MSCI EAFE Int'l	2.44	5
Asset Allocation Model	-0.07 %	100 %
Assets – Liabilities		
Market	-2.00 %	
Pension Bill	-1.79	
ROA	-1.26	

A strong showing by both domestic and international equity combined with negative liability growth in February helped Asset growth outperform Liability growth by 2.67% in February. This reduced the year to date 2005 disparity to **-2.00%** using market valuations (i.e. STRIPS); by **-1.79%** using the new Pension Act valuation (moving average of three corporate indexes); and by **-1.26%** using the ASOP 27 methodology of a constant ROA (i.e. 8.00%). Most pension funds enjoyed a funded ratio surplus in 1999. However, this funded ratio has been reduced by about **-48%** since then (see table below).

Total Returns						
	2000	2001	2002	2003	2004	2005
Pension Assets	- 2.50	- 5.40	-11.41	20.04	8.92	-0.07
Pension Liabilities	25.96	3.08	19.47	1.96	9.35	2.07
Difference	-28.46	- 8.48	-30.89	18.08	-0.43	-2.00
Cumulative		-34.53	-54.75	- 46.57	-46.80	-47.87



Treasury Proposal for Pension Discounting

On February 7, 2005 the Department of the Treasury Office of Economic Policy issued a white paper on their recommendation for a new pension discount rate methodology to replace the Pension Equity Act of 2004. Our full critique can be found on our web site (www.ryanalm.com/research). In summary, the Treasury recommends a spot yield curve (zero-coupon bonds) based on high grade corporate bonds. The Treasury almost got it right. **A zero-coupon yield curve is the best way to price liabilities** but corporate zeroes don't exist in any meaningful quantity. **The only well defined zero-coupon yield curve that is liquid is the Treasury STRIP curve.**

The Treasury favors a 90-day smoothing rather than the four year moving average that now exists to reduce interest rate volatility and help make contributions more predictable. We are confused on why smoothing is ever used. Smoothing creates distortions versus accurate current valuations which may result in reduced contributions and/or increased benefits when they are not merited. Financial inconsistencies should not be tolerated or promoted. Didn't we learn our lessons from the S&L crisis, Enron and now a pension crisis. Pensions need to know the **economic value** of pension liabilities accurately and frequently in order for the plan and the asset side to function.

Given the fact that a Treasury STRIP yield curve exists since 1985 and is functional as a defeasance strategy to match assets to liabilities (i.e. Lotteries) and given the fact that America is facing a rising federal deficit, it is hard to rationalize why the Treasury recommends a hypothetical corporate zero-coupon yield curve.

Custom Liability Index

Since 1991, I (Ron Ryan) have been on a mission to provide accurate pricing and valuation of pension liabilities. I feel that this is best accomplished through a Custom Liability Index that best represents the present value of the projected benefit payment schedule. Although I feel that the rates used should be **real market rates** and purchasable, Ryan ALM builds Custom Liability Indexes based on any rate structure the client and their consultants and actuaries feel is appropriate. Currently, Ryan ALM prices liabilities using :

1. **Market Rates** (STRIPs)
2. **Single Discount Rates** (ROA, New Pension Bill, Moody's AA rate, etc.)
3. **Swap Curve**
4. **Annuity Rates**

Pension Solutions !

Ryan ALM has begun a series of Pension Solutions research papers.

Please refer to our **RESEARCH** section on our web site for our latest releases :

Pension Solution # 1... Custom Liability Index

Pension Solution # 2... Portable Alpha Liability System (PALS)

Press

Ryan ALM is a vigilant **watchdog** on pension trends, news and events. We created a **PRESS** section on our web site to isolate those stories we feel are the most newsworthy for our readers. Please browse for any important story and give us your thoughts.

God Bless Pension America !