



## Defined Benefit Plans

Although most sponsors of DB plans realize that the Pension Protection Act may result in the need for larger contributions, many (63 percent) expect the actual impact to be manageable. Seventeen percent of respondents say they are likely to eliminate their plans for future hires, and 5 percent will likely freeze benefits for current employees; however, **almost half (49 percent) intend to continue their current pension plans with the same or similar benefits as are offered today.**<sup>7</sup>

Forty-five plans with plan services provided by The Principal froze or terminated in 2005; most plans were from smaller employers, and the average size of DB plan that is freezing is just over \$1 million.

**Many larger employers, however, are using a total retirement solutions approach — consolidating all retirement plans with one service provider — as a way to keep their DB plans.** In 2005, 30 larger companies saw the value of total retirement solutions and moved their plan services to The Principal. The assets received from the new plan sales are three times greater than the assets in the terminated and frozen plans.

### DB Fast Facts

*DB retirement payments made:*  
**\$2.7 million**

*Number of retirees receiving DB payments:*  
**217,167**

*Average pension accounting funded status:* **83%**

*Plans that are 100% funded or higher for pension accounting:* **17%**

*Average preretirement interest rate:* **7.1%**

*Average postretirement interest rate:* **6.8%**

*As a leader in total retirement solutions, The Principal saw a 168% increase in new defined benefit assets from 2004 to 2005.*

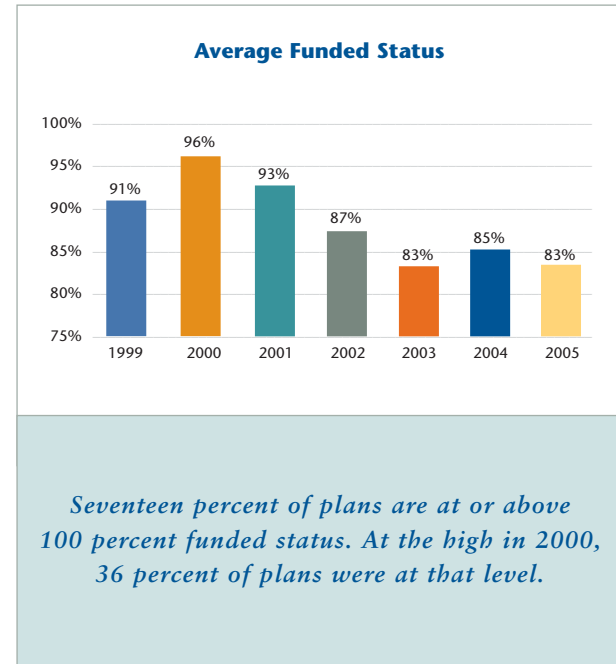
<sup>7</sup>Towers Perrin survey, October 2006

# Accounting for Defined Benefit Plans

A DB plan's funded status, as defined by Generally Accepted Accounting Principles (GAAP), is a comparison of plan assets and liabilities. At The Principal, most plans use the market value of assets for this comparison. Liabilities include all benefits based on service accrued to date along with a projection of future salary increases to the benefit commencement date. A discount rate is used to calculate the value of plan liabilities. This rate is determined by the plan sponsor and based on current economic conditions. As discount rates drop, plan liabilities increase.

**Among DB plans with plan services provided by The Principal, the average funded status is 83 percent.** Over the past seven years, the average funded status reached its peak in 2000 at 96 percent. Seventeen percent of plans are at or above 100 percent funded status. The highest percentage of plans at or above 100 percent funded status during the past seven years was 36 percent, which occurred in 2000.

Discount rates have been on a steady decline since 2000. In 2005, the average discount rate dropped to 5.6 percent. Over the past seven years, the average discount rate reached its highest level of 7.0 percent in 2000.



## Funding for Defined Benefit Plans

One way to measure a plan's funded status is to compare the actuarial value of plan assets to the Retirement Protection Act of 1994 (RPA) current liability. The RPA current liability, for plans complying with ERISA, is the present value of accrued plan benefits based on the interest and mortality rates prescribed by the RPA.

**The average RPA current liability funded status is 106 percent for DB plans with plan services provided by The Principal.** The average RPA current liability funded status was at its highest in 2002 at 114 percent. Plans with a funded status below 90 percent are subject to an additional funding requirement.

One significant assumption used in determining the required annual funding of DB plans is the interest rate. The interest rate helps estimate

the value of plan liabilities. The preretirement interest assumption may differ from the postretirement rate that is used to value liabilities on or after retirement. The preretirement interest rate reflects what plan assets are expected to earn, while the postretirement interest rate reflects the value of the liability at retirement.

The average preretirement interest rate remains unchanged from 2004 at 7.1 percent. The maximum also remains unchanged at 8.5 percent, while the minimum has declined to 3.5 percent from 4.0 percent since 2004.

The maximum and minimum postretirement interest rates are the same as the preretirement rates. The average postretirement interest rate is lower at 6.8 percent.

DB plan data shown here was collected from approximately 900 DB plans for which The Principal provides actuarial services.