

Pension Insights

Pension Surplus: A Wealth of Opportunities

Key Takeaways¹

- Well-funded, well-hedged frozen defined benefit (DB) plans may be largely self-sustaining, with a low risk of future contributions.
- Maintaining the plan may be more valuable to some plan sponsors than large-scale pension risk transfer (PRT) or plan termination, preserving strategic optionality to pursue corporate initiatives.
- In the meantime, plan sponsors can use a surplus for various permitted purposes, including funding retiree medical benefits, addressing workforce management initiatives within a DB plan, or shoring up an underfunded plan in an M&A transaction, all without deploying corporate cash.
- Large surpluses may enable a broader retirement program redesign, such as reopening a DB plan under a market-return or low-risk cash balance formula design and shifting part of the employer-funded defined contribution (DC) benefit to a DB plan, funded by the surplus. Depending on the specific circumstances, this approach could increase participants' retirement security, reduce plan sponsor cash contributions, and eliminate the need for a retirement income solution in the DC plan.

Historically High Funded Status Drives a Shifting Focus

Many U.S. corporate DB plans have been overfunded for more than four years. Of the 100 largest plans at the end of 2025, 61 were overfunded and 20 were at least 120% funded vs. 45 and 12, respectively, three years ago.² Thanks to strong equity market returns and rising discount rates in the first nine months of 2026, even more plans are likely overfunded today.

Against this backdrop and given extensive DB de-risking and regulatory relief over the last 5 to 10 years, surplus management is becoming a key topic for DB plan sponsors. While PRT and plan termination may still be the ultimate goal for some, a “wait-and-see” approach gives plan sponsors time to evaluate surplus capitalization options without irrevocably shrinking the plan. In the meantime, the surplus can contribute to pension income in the financial statements and offset administrative expenses, adverse plan experience, and assumption changes.

In this paper, we briefly illustrate how stronger funded status and robust hedging have reduced pension risk and touch on the costs of plan termination. We then discuss how the surplus can be actively used to address a range of corporate objectives and conclude by offering a sketch of a hypothetical retirement program redesign with the potential to benefit both plan participants and plan sponsors.

Better Funding & Better Hedging Mean Lower Risk

One of the main reasons plan sponsors seek to terminate a DB plan is the complete elimination of pension risk. En route, plan sponsors may execute large-scale PRTs to shrink the plan and, therefore, its risk to the plan sponsor.

Contributors



Alex Pekker, Ph.D., CFA, ASA
Liability Hedging Solutions
Strategist



Tony Brekke, CFA
Investment Committee Member
and Credit Sector Head



Mike Kiedel, CFA
Investment Committee Member
and Fixed Income Analyst

Yet an overfunded, appropriately de-risked, frozen plan is unlikely to become underfunded. Even if underfunding occurred, the resulting deficit and cash contributions would likely be relatively small for three reasons:

- The alignment of assets to liabilities materially reduces the impact of a downturn in the capital markets on funded status.
- The surplus serves as a cushion and reduces the risk of falling below 100% funded and triggering cash contributions.
- Even if a plan's funded status falls below 100%, the American Rescue Plan Act of 2021 (ARPA) has significantly lowered the required cash contributions, in many cases by roughly 50% compared to pre-ARPA requirements.

Additionally, PBGC³ variable-rate premiums have been fixed at 5.2% of unfunded vested benefits since 2024 (instead of being indexed to inflation), further reducing the cost of underfunding.

A frozen plan that is at least 100% funded can often generate sufficient returns to offset the interest cost of the liabilities, ongoing administrative expenses (including PBGC fixed-rate premiums which continue to be indexed to inflation), and adverse plan experience, making the plan largely self-sustaining. Materially overfunded plans are likely to keep growing their surpluses, especially as they may allow for riskier asset allocations. That said, PRT can be financially advantageous in certain situations, such as participant

groups with small benefits (though many plan sponsors have already taken advantage of these PRT opportunities). We illustrate these effects in the example below.

Termination May Not Be the Answer

Plan sponsors can *directly* access the surplus only upon plan termination. Even then, any surplus that reverts to the plan sponsor is subject to corporate income and excise taxes—up to 71% combined—unless the entirety of the surplus is used to increase benefits for existing plan participants or set up a qualified replacement plan.

Settlement accounting, which is required upon plan termination or large PRTs, can make termination unattractive for plans with large unrecognized pension losses because it creates a material one-time hit to income in the financial statements.

Other termination hurdles include data cleanup, participant communication, annuity search, actuarial, legal, and potentially independent fiduciary services. These can be substantial for complex plans with disparate participant groups and benefit formulas.

Still, as Kodak illustrated in 2025, termination with (partial) reversion may suit a cash-strapped plan sponsor that is not subject to income tax—though still subject to excise tax—and that can use the reverted assets to efficiently address a challenged balance sheet.⁴

Illustrative Example

We consider a hypothetical frozen plan that has a liability (projected benefit obligation) of \$1 billion, a duration of 10.1 years, a discount rate of 6.45%, and an administrative expense load of 0.5%, as of September 30, 2026.⁵ The hurdle rate to maintain its funded status is 7.0% if the plan is 100% funded and 6.3% if it is 110% funded.

The asset allocations shown in Figure 1 are illustrative. A plan that is 110% funded with an 85%/15% liability-hedging/return-seeking asset allocation is expected to grow its surplus as its return exceeds the hurdle rate by 0.7% (after rounding). Under a sample market stress scenario with an instantaneous 40% drop in global equities, a 2% decline in Treasury yields, and a 1% widening in AA credit spreads, the funded status *does* fall, but only to 104%.

As funded status improves, risk moderately increases, which raises both the return over the hurdle rate *and* funded status volatility. Even in the sample market stress scenario, if the plan starts at 110% funded or better, it is expected to remain overfunded and require no cash contributions.

Please see the Appendix for the actuarial and investment return assumptions used in this example.

Figure 1. Hypothetical Plan Asset Allocations

Funded Status	90%	100%	110%	120%	140%
Initial Surplus (\$M)	(100)	0	100	200	400
Credit	30%	65%	70%	65%	55%
Treasuries	30%	15%	15%	15%	15%
Return-Seeking Assets	40%	20%	15%	20%	30%
Interest Rate Hedge Ratio	80%	100%	100%	100%	100%
Credit Spread Hedge Ratio	41%	80%	90%	90%	90%
Expected Return	7.5%	7.2%	7.0%	7.1%	7.2%
Hurdle Rate*	7.7%	7.0%	6.3%	5.8%	5.0%
Expected Return Over Hurdle*	-0.2%	0.3%	0.7%	1.3%	2.2%
Funded Status Risk	3.5%	2.4%	2.1%	3.2%	5.9%
Impact of Stress Scenario					
Funded Status	81%	95%	104%	111%	122%
Surplus (\$M)	(214)	(52)	49	120	248

Source: Dodge & Cox. *The hurdle rate is (Liability Discount Rate + Administrative Expense Load) / Funded Status. For example, a plan that is 110% funded has a hurdle rate of (6.5% + 0.5%) / 110% or 6.3%. Values in the table reflect rounding.

A Surplus Creates Immediate Opportunities

Under circumstances where plan termination is unattractive and pension risk and expense are deemed manageable, hibernation—potentially with re-risking as the surplus increases (similar to Figure 1)—may be appropriate. This approach gives plan sponsors flexibility to draw on the surplus *indirectly*, either on an ongoing basis or in one-off situations, avoiding corporate cash outlays.

Permitted ongoing uses include funding benefit accruals (if applicable) and retiree medical benefits (up to 1.75% of assets per year, provided the plan remains at least 110% funded). In the illustrative example above, the hypothetical frozen plan that is 110% funded could budget up to 0.7% of assets, its excess over the hurdle rate, for these purposes and still maintain 110% funded status (assuming all actuarial and investment return assumptions are realized). Notably, at 140% funded, even an open plan may be able to sustain a service cost of as much as 2.2% of assets, or 3.1% of liabilities, and still remain well-funded, even in a moderate stress scenario.

A surplus can also fund workforce management initiatives, such as enhanced early or late retirement benefits and collective bargaining commitments. For example, in July 2026, PECO, an electric utility in Pennsylvania, agreed to offer newly hired union employees a pension benefit following a three-day strike.⁶

Further, a surplus could help in a future M&A transaction involving an underfunded plan. Merging overfunded and underfunded plans would reduce (or eliminate) the underfunded plan's deficit and the associated cash contributions and could reduce PBGC variable-rate premiums.

Finally, plan sponsors may wish to wait to see whether Congress takes up the Strengthening Benefit Plans Act of 2025, which would allow employers to fund DC plan contributions *directly* from the DB surplus, without first terminating the DB plan and provided the DB plan remains at least 110% funded. The bill has stalled since its introduction, but its potential positive impact on federal government revenue could help its prospects in future budget negotiations.⁷

In summary, maintaining an overfunded plan provides plan sponsors with valuable optionality to address a range of corporate objectives without deploying corporate cash. Even if plan termination remains the ultimate goal, depleting the surplus before termination would likely reduce associated taxes and the impact of settlement accounting.

A Bigger Possibility: Retirement Program Redesign

Surpluses exceeding 20% of plan assets may offer an interesting opportunity to restructure the retirement program

more broadly, in some ways similar to what IBM did in 2024.⁸ This type of restructuring can potentially improve participant outcomes and lower plan sponsor cash outlays, without materially increasing funding risk.

A potential redesign could consist of:

- Re-opening an overfunded DB plan under a cash balance (CB) design with a conservative or market-return interest crediting rate (ICR), such as those in Figure 2.
- Shifting part or all of the current employer DC contribution to the CB service credit and fund it from the DB plan surplus, rather than corporate cash.
- Adjusting the DB plan investment strategy such that:
 - Legacy liabilities and any new retiree annuity liabilities are supported by assets in a traditional liability-driven investment strategy; and
 - Accruing CB liabilities are supported by the remaining assets invested to match the CB ICR.
- Increasing risk in the DC plan's target date suite (or other QDIA⁹) if the CB ICR is conservative, so that the target combined DB plus DC benefit at retirement is similar to the current DC-only benefit.

Effectively, the DB plan serves as a conservative (or moderate) “floor” benefit with an annuity option, while the DC plan serves as a higher-risk supplementary lump-sum benefit, similar to how 401(k) plans were originally conceived.

Notably, this approach could result in lower plan sponsor costs and risk than DB plans from 10 or 20 years ago: contributions are funded from an existing surplus and investment risk can be greatly reduced (or even eliminated) by the choice of ICR. Specifically, the design avoids ICRs that are hard to hedge: fixed-rate, bond-based, and those with floors and ceilings. Longevity and demographic risks remain but could be mitigated because a lump sum is the normal form of benefit in a CB design. Depending on its size relative to the service credit, a surplus could last decades.¹⁰

A restructuring plan like the one sketched above has many nuances, including the CB Preservation of Capital Rule that could be meaningful for more aggressive ICRs, different actuarial treatments of market-return CB liabilities under ERISA funding requirements and U.S. accounting standards, demographic considerations, and participant communications.¹¹ Figure 3 summarizes some key benefits and risks of this design vs. a standalone DC plan for both a new participant (with no legacy DB benefit) and the plan sponsor.

Design variations—such as a variable annuity formula rather than a CB formula or a one-time DC-to-DB transfer option—may be worth the added complexity for some plan sponsors. The right approach depends on corporate objectives, the size of the surplus, employee demographics, and other factors warranting input from actuarial, legal, and investment advisors to develop a plan tailored to a plan's specific circumstances.

Figure 2. Sample Cash Balance Interest Crediting Rates

	1-Year Treasury Yield	Market Return—Conservative (e.g., 20% equities/80% fixed income)	Market Return—Moderate (e.g., 60% equities/40% fixed income)
Investment Strategy	1-year Treasury bill or slightly more aggressive	20% equities/80% fixed income or similar	60% equities/40% fixed income or similar
Risk of Triggering Preservation of Capital Rule	None	Lower	Higher
Risk of Depleting Surplus	Lower	Lower	Higher
Implication for DC QDIA	Likely add risk	Likely add risk	Potentially add risk

Source: Dodge & Cox. This is not a complete list of ICRs that might be considered appropriate for the hypothetical plan restructure.

Figure 3. Key Characteristics of Proposed Designs for New Participants

	Proposed Design (Re-Open DB + DC) (DB + DC Benefit for New Participants)	Frozen DB + Standalone DC (No DB Benefit for New Participants)
New Participants		
Target combined DB plus DC benefit at retirement	Substantially similar (Designed to be the same as standalone DC)	Substantially similar
DC account balance	Lower (due to lower employer contribution and possibly lower participant contributions if the employer match is lower)	Higher
DB benefit	Yes	No
Annuity option	Yes, in DB plan	Possibly in DC plan, requires retirement income solution
DC features (e.g., participant loans)	Available	Available
Plan Sponsor		
Target combined DB plus DC contribution (cash and non-cash/ DB surplus)	Substantially similar Partly funded by the DB surplus	Substantially similar
Target combined DB plus DC cash contribution (effectively DC only)	Lower Partly funded by the DB surplus	Higher
Administrative expenses	Potentially higher Partly funded by the DB surplus	Lower
DB investment risk	Possibly higher Depends on ICR and the CB Preservation of Capital Rule	Lower
DB longevity and other demographic risks	Higher Depends on annuity vs. lump sum elections in the DB plan	Lower
ERISA funding for DB plan	More complex Required cash contributions depend primarily on DB surplus	Less complex Likely no required cash contributions
Accounting for DB plan	More onerous FASB likely to simplify accounting for market-return CB plans	Less onerous

Source: Dodge & Cox. This is not a complete list of considerations. Considerations will vary based on specific participant, plan sponsor, and plan design characteristics.

In Closing

DB plan surpluses create actionable flexibility for plan sponsors and may make large-scale PRT and termination less attractive. A well-funded, de-risked frozen plan may be largely self-sustaining, allowing sponsors to put the surplus to work funding residual benefit accruals, retiree medical benefits, workforce initiatives, or an underfunded plan acquired in an M&A transaction. A more consequential decision is whether to rethink the retirement program more broadly by potentially re-opening the DB plan in an attempt to improve participant retirement outcomes and lower aggregate employer cash outlays without materially increasing employer risk. Whatever path is chosen, a pension surplus can be a valuable corporate asset.

As always, we welcome the opportunity to speak with you or your advisor about how Dodge & Cox investment solutions could support your pension investment and risk management efforts as you progress along your pension journey.

Appendix: Hypothetical Frozen Plan Analysis

Plan characteristics: Present value of liabilities: \$1 billion, duration: 10.1 years, convexity: 1.8. Discount rate: 6.45%, FTSE Above Median AA, as of September 30, 2026. Credit beta of investment-grade credit to the liability discount rate: 1.3. For purposes of funded status risk (i.e., the volatility of funded status), liabilities are represented as the following blend of market indices: 60% Bloomberg U.S. Long Credit Index, 17% Bloomberg U.S. Intermediate Credit Index, 15% Bloomberg Long Treasury Index, 8% Bloomberg Intermediate Treasury Index. This blend of indices was selected to match liability duration and credit beta.

Hurdle rate assuming 6.45% discount rate and \$5M load for administrative expenses: $(\$65M + \$5M)/(\$1,000M) = 7.0\%$ at 100% funded status and $(\$65M + \$5M)/(\$1,100M) = 6.3\%$ at 110% funded status. Values reflect rounding.

Hypothetical portfolios: Liability-hedging assets consist of Long Credit, Intermediate Credit, and a Treasury completion portfolio represented, respectively, by the Bloomberg U.S. Long Credit Index, the Bloomberg U.S. Intermediate Credit Index, and a blend of the Bloomberg Long Treasury Index, the Bloomberg Intermediate Treasury Index, and the Bloomberg 3-Month T-Bill Index, that achieve the target interest rate and credit spread hedge ratios. Index fixed income characteristics are calculated using PORT+. Return-seeking assets consist of global equities as represented by the MSCI ACWI Index.

Stress test: Stress test assumes an instantaneous return of -40% for the return-seeking assets, a 2% decrease in Treasury yields across all maturities, and a 1% increase in AA credit spreads across all maturities. Asset and liability returns are calculated based on these assumptions and index and liability durations, convexities, and credit beta, respectively.

Capital market assumptions: These assumptions are hypothetical and provided for illustrative purposes only. Actual returns may be materially different from those shown. While we believe these assumptions to be reasonable, other assumptions may be reasonable and may lead to results that differ significantly from those derived using these assumptions. Some assumptions have been made for modeling purposes and are unlikely to be realized; not all assumptions have been stated or fully considered; and changes in assumptions may have a material impact on the hypothetical results presented. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. These assumptions do not represent actuarial, accounting, or legal advice.

	Compound Return	Arithmetic Return	Standard Deviation	Correlation Matrix					
				Cash	Long Credit	Interm. Credit	Long Treasuries	Interm. Treasuries	Global Equities
Cash	4.1%	4.1%	0.5%	1.0	0.1	0.1	0.1	0.2	0.0
Long Credit	6.8%	7.5%	11.6%	0.1	1.0	0.9	0.8	0.7	0.6
Intermediate Credit	6.3%	6.4%	4.3%	0.1	0.9	1.0	0.7	0.8	0.6
Long Treasuries	5.9%	6.7%	12.7%	0.1	0.8	0.7	1.0	0.9	0.2
Intermediate Treasuries	5.5%	5.5%	3.3%	0.2	0.7	0.8	0.9	1.0	0.2
Global Equities	8.1%	9.2%	14.7%	0.0	0.6	0.6	0.2	0.2	1.0

Fees: Assumptions are for broad market indices. You cannot invest directly in an index; actual investments will be subject to investment management fees and other investment-related expenses.

Market indices: Indices used in the development of the assumptions are as follows: Bloomberg 3-Month T-Bill Index, Bloomberg U.S. Long Credit Index, Bloomberg U.S. Intermediate Credit Index, Bloomberg Long Treasury Index, Bloomberg Intermediate Treasury Index, and MSCI ACWI Index net of international dividend taxes when available, and gross otherwise.

Equity expected returns: Returns for equities reflect Dodge & Cox model expectations for dividend yield, EPS growth, and change in valuations (P/E ratios) for the relevant market indices over a 10-year time horizon, as of September 30, 2026.

Cash and fixed income expected returns: Compound returns for cash and fixed income reflect the yield and roll-down on the respective market indices as of September 30, 2026.

Standard deviations and correlations: Standard deviations and correlations reflect monthly observations for the 10-year period ending September 30, 2026; standard deviations are annualized.

Funded status risk accounts only for the investment component of funded status risk and does not reflect any potential alpha in excess of index returns, potential tracking error to the index, or deduction of any investment management fees.

The above information is not a complete analysis of every material fact concerning any market, industry, or investment. Data has been obtained from sources considered reliable, but Dodge & Cox makes no representations as to the completeness or accuracy of such information. Opinions expressed are subject to change without notice. Information regarding yield, quality, maturity, and/or duration does not pertain to accounts managed by Dodge & Cox. The above returns represent past performance and do not guarantee future results. Dodge & Cox does not seek to replicate the returns of any index. The actual returns of a Dodge & Cox managed portfolio may differ materially from the returns shown above. This is not a recommendation to buy, sell, or hold any security and is not indicative of Dodge & Cox's current or future trading activity. The securities identified are subject to change without notice and may not represent an account's entire holdings.

Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance, L.P. and its affiliates (collectively "Bloomberg"). Bloomberg or Bloomberg's licensors own all proprietary rights in the Bloomberg Indices. Bloomberg does not approve or endorse this material, guarantee the accuracy or completeness of any information herein, or make any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, shall have no liability or responsibility for injury or damages arising in connection therewith.

MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This publication is not approved, reviewed, or produced by MSCI.

See dodgeandcox.com/disclosures for a full list of financial terms and Index definitions.

1. The information in this paper should not be considered fiduciary investment advice under the Employee Retirement Income Security Act. This paper provides general information not individualized to the particular needs of any plan and should not be relied on as a primary basis for investment decisions. The fiduciaries of a plan should consult with their advisors as needed before making investment decisions.
2. Source: Milliman 2026 Corporate Pension Funding Study and 2023 Corporate Pension Funding Study; <https://www.milliman.com/en/insight/2026-corporate-pension-funding-study> and <https://www.milliman.com/en/insight/2023-corporate-pension-funding-study>.
3. PBGC is the Pension Benefit Guaranty Corporation, a U.S. federal agency that insures and guarantees private-sector defined benefit pension plans, ensuring retirees receive their pension benefits even if their employer's plan fails.
4. In 2025, Kodak terminated its DB plan and used the surplus to settle plan liabilities, establish a qualified replacement plan offering similar benefits, and pay down corporate debt. The surplus assets used to pay down corporate debt constituted a reversion to the company.
5. This corresponds to the FTSE Pension Liability Index—Short discounted with the FTSE Above Median AA Curve.
6. In July 2026, PECO, a subsidiary of Exelon Corporation, reopened its DB plan to approximately 600 union employees hired since 2021 who previously were not eligible for DB benefits.
7. Compared to current law, the bill would likely result in lower aggregate contributions to DC plans (as a portion would be replaced by the transfer of DB plan surpluses) and therefore higher corporate income subject to federal income tax.
8. In 2024, IBM re-opened its overfunded DB plan under a cash balance design and eliminated its contributions to the DC plan. Under the cash balance design, employees receive a service credit that is similar to the prior DC contribution, but the service credit can be funded from the DB plan's surplus rather than corporate cash.
9. Qualified default investment alternative.
10. For example, if the surplus is \$500 million, the service credit is \$40 million, and the estimated market-return crediting rate is 6%, then the surplus return is lower than the annual service credit, and so the surplus is expected to diminish every year but could still last well over a decade. On the other hand, if the surplus is \$1 billion, then the surplus return exceeds the service credit and is likely to grow indefinitely.
11. The CB Preservation of Capital Rule requires that the lump sum benefit at retirement is at least as large as the sum of the service credits. Consequently, cumulative negative returns in a market-return CB plan could trigger it. Under ERISA funding requirements, actuaries typically calculate the present value of market-return CB liabilities by projecting participant account balances forward at an assumed interest crediting rate and discounting them back to present value using corporate bond yields. In contrast, under a proposed amendment to ASC 715 (for which the comment period closed in August 2026), the discount rate is set to the assumed interest crediting rate, resulting in assets and liabilities being equal.