

# 2H Pension Perspectives

## Key Takeaways<sup>1</sup>

- **Large U.S. corporate DB plans overfunded:** The aggregate funded status of corporate defined benefit (DB) plans rose to 108.1% by year-end 2025, its highest level in 20 years. A modest year-over-year decline in liability discount rates was more than offset by strong global equity returns.
- **Tactical positioning considerations:** Based on our macro outlook and current valuations, plan sponsors may wish to tactically underweight U.S. equities and investment-grade (IG) credit, consider a curve-steepening bias, and emphasize non-U.S. equities and diversification in their return-seeking portfolios.
- **Surplus governance:** As plan sponsors with material surpluses shift from a pure de-risking focus, evaluating surplus monetization, re-calibrating funded status risk tolerance, and aligning operational processes with updated plan objectives may be appropriate.
- **Regulatory developments:** Noteworthy developments include ongoing pension risk transfer (PRT) lawsuits, pending legislation to allow direct funding of defined contribution (DC) plans from DB surpluses, and a Department of Labor (DOL) exemption for a novel plan termination involving a plan-sponsor-affiliated captive insurer.

## Funded Status Drivers

Figure 1. Funded Status Drivers

	December 31, 2025	June 30, 2025	December 31, 2024
Milliman 100 Funded Status	108.1%	105.3%	103.6%
Discount Rate (Aa)	5.46%	5.52%	5.59%
10-Year U.S. Treasury Yield	4.17%	4.23%	4.57%
30-Year U.S. Treasury Yield	4.85%	4.78%	4.78%
Bloomberg U.S. Long Credit Spread (OAS)	95 bps	102 bps	100 bps
Global Equities (MSCI ACWI Index) Net Total Return		2H 2025: 11.17% 2025: 22.34%	

Source: Bloomberg Index Services, Milliman, MSCI. The funded status and discount rate are for the Milliman 100 Pension Funding Index.

In the second half of 2025, the U.S. Treasury yield curve steepened, U.S. investment-grade credit spreads tightened, and global equities, particularly emerging market equities, delivered strong returns. The spread between 2- and 30-year Treasury yields rose 31 basis points (bps), bringing the full year curve steepening to 83 bps. Front-end Treasury yields fell due to Federal Funds rate cuts and labor market concerns, while longer-end yields, although volatile, ended the period essentially unchanged due to ongoing inflation, fiscal, and monetary policy uncertainty. Long-term IG credit spreads

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traded in a relatively tight 14 bps range, ending the year a touch lower, at 95 bps. In contrast, global equities returned a whopping 11.2% and 22.3% for the year, buoyed by a resilient global economy, easing trade tensions, and enthusiasm related to rapidly growing AI investment.

In this environment, liability discount rates fell modestly, and assets generally outperformed liabilities. The aggregate funded status of the 100 largest corporate DB plans rose to 108.1%, its highest level since 2007 (see Figure 2).

**Figure 2. Milliman 100 Pension Funding Index's Funded Status**



Source: Bloomberg Index Services, Milliman.

### Tactical Investment Considerations

Over the next few years, our base case macro outlook calls for a growing global economy and slowing inflation as AI-driven investment, potential productivity gains, and fiscal stimulus from the One Big Beautiful Bill Act offset disruptive trade and immigration policies and a weakening labor market. Additional sources of uncertainty include (somewhat) unpredictable Administration policy, upcoming Supreme Court decisions relating to tariffs and other aspects of these policies, geopolitical tensions, and the payoff from elevated investment in AI infrastructure.

Within liability-hedging assets, interest rate volatility and historically tight IG credit spreads continue to be our main focus. From a tactical standpoint, plan sponsors may wish to:

- **Maintain target interest rate hedge ratios but consider a curve-steepening bias.** While the market is pricing in two Fed cuts, a more dovish Fed may result in further curve steepening as front-end yields fall but long-end yields remain relatively stable due to higher inflation expectations, fiscal concerns, and a potential perception of diminished Fed independence.
- **Underweight target credit spread hedge ratios and favor high-quality, credit-adjacent assets.** Although the macro backdrop remains largely positive and corporate fundamentals are strong, valuations are demanding. Many factors, including larger expected new issuance (especially at the long end), could drive spreads wider. In addition, exogenous spread-widening events—such as the

2025 Liberation Day tariff announcements or a crack in AI-related optimism—may provide attractive opportunities to rebalance into credit.

Within our liability-hedging portfolios, we maintained a duration-neutral stance and reduced credit beta in 2025. In particular, we shifted exposure away from certain below-IG and tight BBB-rated credits toward higher quality corporates trading at fair-to-attractive valuations, including regulated utilities and select high-quality technology companies. We also maintained defensive out-of-benchmark allocations to Agency<sup>2</sup> commercial and residential mortgage-backed securities and AAA-rated credit card and auto loan asset-backed securities, which also serve as source of dry powder should credit spreads widen.

Within return-seeking assets, the high concentration and rich valuations in the U.S. equity market warrant attention. The largest five companies now comprise 30% of the S&P 500 Index (and the largest 10, 41%), and forward price-to-earnings (P/E) ratios and other valuation metrics remain very high. Consequently, plan sponsors may wish to:

- **Emphasize diversification**, including allocating away from the largest and most highly valued U.S. stocks and sectors and considering diversifying strategies that may be less correlated to domestic equity index performance.
- **Overweight non-U.S. equities**, as they are trading at a large discount to U.S. equities (see Figure 3), could benefit from further U.S. dollar weakening, and exhibit a broader sector diversification compared to the tech-heavy U.S. equities (see Figure 4).

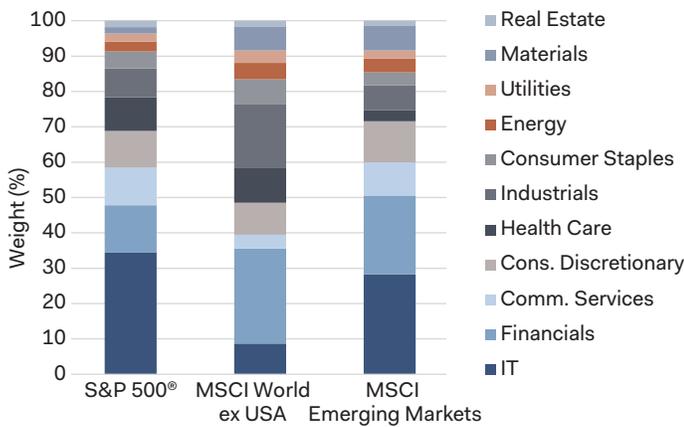
Reflecting our value-oriented approach, our U.S. equity strategy favors Health Care and Financials, while underweighting Information Technology, Consumer Discretionary, and Consumer Staples sectors relative to the S&P 500. In addition, 14% of this strategy's assets are invested internationally, while our Global Equity strategy is 13% underweight to the U.S. compared to the MSCI ACWI Index.

**Figure 3. Forward Price-to-Earnings Ratios**



Source: MSCI.

**Figure 4. Sector Composition**



Source: MSCI, S&P. Data is as of December 31, 2025.

### Strategic Considerations

With funded status over 100% and rising for several years, many plan sponsors are likely re-assessing the objectives, risk tolerance, and operations for their frozen plans.

For those seeking hibernation or eventual termination, a closer alignment of assets and liabilities, participant data clean-up, plan simplification, and monitoring of buy-out annuity pricing likely remain top of mind. However, in certain situations, terminating the plan via a plan-sponsor-affiliated captive insurance company could be an interesting, and cost-saving, alternative, as described in the next section.

Deploying the surplus to fund employee retirement benefits, either by re-opening the DB plan (and providing a DB benefit in addition to the employer DC contribution) or shifting the employer DC contribution into a DB benefit, may also be worthwhile. In addition to saving corporate cash, this approach may also address the lack of lifetime income options in many DC plans. That said, we are not aware of any high-profile plan sponsors besides IBM and Eversource Energy tapping the DB surplus in this way.

Significantly overfunded plans with longer time horizons may also consider increasing risk tolerance, including illiquidity risk, within their strategic asset allocation and/or adopting a U-shaped glide path, as higher potential returns may outweigh the implications of elevated funded status volatility.<sup>3</sup> For example, the penalties (i.e., minimum required contributions, PBGC<sup>4</sup> variable-rate premiums, and balance sheet implications) associated with a 5% decline in funded status from 108% to 103% are much lower than from 103% to 98%. Of course, a tight asset-liability match, incorporating non-surplus assets, should remain in place.

Finally, operational requirements for overfunded plans may also evolve. Plans pursuing hibernation or termination typically move toward simplification as they incorporate fewer investment managers and less frequent rebalancing. In contrast, re-risking plans likely engender greater complexity as

they can incorporate more tactical positions, alternative asset classes, and derivative overlays serving both hedging and non-hedging purposes. For all plans, operational efficiency and derivative overlays can be especially helpful for taking advantage of sharp market dislocations.

### PRT and Regulatory Developments

PRT activity was 48% lower in the first nine months of 2025 compared to the same period in 2024, as there were only two jumbo transactions, including the long-anticipated termination of the Kodak pension plan, which included a partial asset reversion and a qualified replacement plan. The recent wave of PRT-related lawsuits likely weighed on the market, though the tides may be turning: more than half of the cases have been dismissed so far and in January 2026, the DOL filed an amicus brief supporting the plan sponsors. Still, several cases have been allowed to proceed, are on appeal, or have yet to be decided.

Despite broad industry support, the Strengthening Benefit Plans Act of 2025 is still pending in the Senate. The bill would allow plan sponsors to use surplus assets in excess of 110% of liabilities to fund DC plans directly, provided certain other conditions are met. If enacted, the bill would provide another, and likely more straight-forward, avenue for plan sponsors to monetize surplus assets.

Finally, in early 2025, the DOL issued an ERISA-prohibited transaction exemption to Memorial-Sloan-Kettering (MSK), allowing it to terminate its overfunded pension plan via an MSK-affiliated captive insurer, rather than a traditional life insurance company. By using its own captive, MSK was able to access the surplus and realize significant savings as it did not have to:

- Subsidize life insurer profit margins in the PRT premium;
- Pay heightened PRT premiums associated with complex plan features; and
- Liquidate illiquid assets (estimated at 20%-30% of total assets), typically at a discount (and could instead transfer them to the captive).

The DOL granted the exemption in part because MSK provided a benefit increase to plan participants, which was estimated to consume 51% of the cost savings compared to a traditional plan termination.

Although this approach is quite complex, it may serve as a reference point for similarly situated large plan sponsors.

As always, we welcome the opportunity to speak with you or your advisor about our pension risk management solutions as you progress along your pension journey.

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  3. In a U-shaped glide path, the weight to liability-hedging assets (LHA), as a percentage of total asset allocation, increases as funded status increases up to a certain point (e.g., 80% LHA at 110% funded) and then decreases as funded status continues to increase. Please see our paper [Long-Term Solutions for Overfunded Plans](#) for more on U-shaped glide paths.
  4. Pension Benefit Guarantee Corporation.