Newsletter
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From volatility to clarity

Corporate defined benefit plans

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STATE STREET INVESTMENT MANAGEMENT

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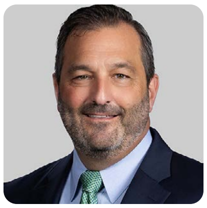
Insights for corporate defined benefit plans



Christopher McNeillie
Managing Director, Global
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The beginning of 2025 saw corporate pension plans weathering sharp market volatility amid uncertainty about economic growth, the persistence of inflation, and the direction of monetary policy.

But as we enter a new year, many of those concerns have abated. The markets rebounded to deliver another year of strong equity returns as investors welcomed declining inflation and the Federal Reserve's decision to begin cutting interest rates—a cycle that's expected to continue into this year.

As a result of this positive environment, corporate pension plans enjoyed further gains in funded status in 2025, which reached an average of 108.1% at the end of December.[1]

Now is an opportune time for employers to take risk off the table and consider additional strategies to strengthen their ability to support participants' retirement needs. That's why we are focusing this newsletter on helping corporate defined benefit (DB) plans position themselves for a successful 2026:

- State Street Investment Management's head of US Defined Benefit Investment Strategy, Francois Pellerin, shares historical data to show why it's important for plans to lock in last year's funded status gains.
- Conventional wisdom says that the corporate DB system is going to disappear eventually, but we at State Street disagree. We discuss why market-based cash balance plans could provide an attractive growth area for the corporate DB plan system if policymakers enact a few regulatory changes.
- Finally, we're introducing our new "Ask the Actuary" column, in which Francois Pellerin will answer plan sponsors' questions about pension plan management and investment strategy. In this newsletter, he explains how to improve liability hedging portfolios by embracing investment style diversification in the corporate bond fund asset class.

As always, we create our corporate DB plan newsletters to keep you up to date and ready to navigate the challenges of pension management. Continue reading for insights to help you prepare for a corporate pension plan for this year—and many years to come.

Our 2026 macro outlook for corporate defined benefit plans

Dane Smith
Managing Director and Head of
Investment Strategy and Research

Conditions look positive, but plans should continue to de-risk.

The US economy continued to grow during the second half of 2025, supported in part by strong AI-related capital spending. The pace of economic growth slowed, however.

The six-week government shutdown restrained growth, and although consumer spending remained solid in aggregate, it split along income lines: Higher-income households generally fared well, while lower-income households struggled.

The labor market softened, with unemployment rising from 4.1% in June to 4.6% in November.[2] Meanwhile, the interruption in government data caused by the shutdown made it difficult to gauge the extent to which the job market was weakening. The Federal Reserve attempted to support employment by lowering its target short-term interest rate by 25 basis points in September, October, and December, and as of December 18, the bond market was pricing in another cut in April 2026.[3] A pickup in inflation complicated the Fed's decision-making, however. Inflation rose to 3% for the 12 months through September, up from an annual rate of 2.3% in April 2025.[4]

Equity markets bounced back from the downturn they suffered in early spring, with the S&P 500 gaining 16% year-to-date through December 15. The MSCI EAFE Index of international stocks rose 27% over the same period, as attractive valuations supported price appreciation and the US dollar weakened. In fixed income, the yield curve steepened. The yield on the 30-year Treasury bond ended November at 4.8%, higher than it had been one year earlier, while the two-year Treasury note yield fell from above 4% to near 3.5%.

These conditions were favorable for pension plans, which benefited from strong returns by growth assets as well as fixed income yields near cyclical highs. Funded ratios generally improved, with the Milliman Corporate Pension Funding Index rising to 108.1%.

We believe the macroeconomic outlook entering 2026 is positive for pension plans, on balance. State Street Investment Management has increased our estimate for 2025 US GDP growth from 1.7% to near 2%, and we project GDP growth to increase to 2.4% in 2026.

Several tailwinds could support continued economic growth. The recently enacted tax and spending law known as the One Big Beautiful Bill Act (OBBBA) provides fiscal stimulus, and we believe it may lead to tax refunds that help bolster consumer spending. We expect the Fed's recent rate cuts to make their way through the economy over the coming year, and we think the Fed is likely to cut interest rates two or three more times. Meanwhile, the AI-fueled boom in capital expenditures should continue to contribute to economic growth. We have some concerns about the labor market and consumer spending, but we believe, in aggregate, these developments should help the economy strengthen.

We do not expect inflation to accelerate, despite tariff-driven price pressures on certain goods. We think the Consumer Price Index may anchor around 3%, as declines in some areas, notably shelter costs, help offset tariffs' inflationary impacts.

This backdrop gives us a constructive outlook for risk assets. A generally positive macro environment may support corporate profits and help allay investors' concerns about inflation and growth, laying the groundwork for gains in the equity market.

That said, there are a number of risks to that outlook, starting with high equity valuations. Some investors argue that US stocks are experiencing an AI-driven bubble akin to the dot-com frenzy of the late 1990s. We don't believe that is the case.

Past investment bubbles have been characterized by poor business fundamentals, including debt-fueled spending on economically dubious investments. By contrast, fundamentals today look healthy. We don't see excess leverage in the system; much of the money being pledged for AI research and development is coming out of free cash flow (though some companies have begun issuing debt to fund AI investments); and the companies that are responsible for most of it have strong earnings. Although we acknowledge that valuations are high, elevated valuations have been the norm during periods around technological inflection points, and in those situations, high valuations have tended to persist for extended periods.

Uncertainty around the direction of monetary policy presents another key risk for pension plans. It is impossible to say with certainty whether or how much interest rates may decline. Significantly lower discount rates could increase plans' liabilities, exerting downward pressure on their funded ratios.

Geopolitics and government policy changes also could introduce risks. The Trump administration's policy goals and approaches can change quickly and unpredictably, at times leading to volatility in financial markets. That said, we think the most consequential policy areas for the markets have largely been addressed: The passage of the OBBBA provided clarity on taxation and stimulus, and we believe the largest tariff announcements are likely to be behind us.

Implications for corporate defined benefit plans

Pension plans have benefited from an exceptionally positive environment in recent years. Equities have exceeded expectations for much of the past half-decade, producing total returns near 100% during the five years through December 4. At the same time, relatively high interest rates have kept discount rates above 4.5%, helping restrain liabilities.

Although we have a constructive macro outlook for growth assets over the coming year, we think corporate plans should prepare for the possibility that conditions may not remain quite as favorable as they have been recently. High valuations in both public and private equity could cause growth assets to produce more modest returns, even as normalizing monetary policy may reduce discount rates. In addition, we think we could face renewed interest rate volatility, given the US government's growing indebtedness and the range of macro risks in the current environment.

Plans may wish to take some risk off the table while continuing to pursue a degree of growth. We suggest that plans with surpluses continue to weigh their de-risking options, potentially including liability-driven investment strategies and pension risk transfers.

For more information about State Street Investment Management's macro outlook, de-risking options for corporate pension plans, or other DB-related topics, please contact us.

A defined benefit plan that works like a defined contribution plan: A possible path forward

With some policy reforms, market-based cash balance plans could offer companies an attractive alternative to traditional pension plans and defined contribution plans.

For many years, conventional wisdom has held that the corporate DB plan system is in a gradual decline that will inevitably lead to extinction. It seems the only uncertainty is the rate of that decline and the form of each company's transition to a purely defined contribution (DC) approach.

We question whether that conventional wisdom is correct. Contrary to the notion that the corporate DB system is in a death spiral, there is an alternative that could slow the decline or even lead to additional growth: A type of a DB plan known as a market-based cash balance plan.

These plans eliminate many of the negatives driving employers out of the DB plan system and offer advantages over DC plans. To date, regulatory issues have slowed the adoption of market-based cash balance plans, but potential policy changes could eliminate those barriers and attract more employers to this alternative DB solution.

How market-based cash balance plans work

A market-based cash balance plan provides interest credits based on the rate of return on plan assets, subject to the statutory capital preservation rule. That rule requires employers to offer participants a lump sum benefit at least equal to the sum of the contribution amounts credited to their accounts.

For example, assume that a participant earns exactly $100,000 for 10 years and is in a market-based cash balance plan that provides 5% contribution credits, meaning she receives a total of $50,000 in credits over 10 years. The participant would receive the greater of the $50,000 in contribution credits over the 10-year period (the capital preservation rule) or the $50,000 in contribution credits adjusted by the plan's actual earnings on those credits over 10 years. Unless the market endures extended stretches of negative returns, the capital preservation rule will have limited impact and this type of market-based cash balance plan will function effectively as a DC plan, but with participants receiving the advantages of professional asset management.

Market-based cash balance plans have exploded in popularity in recent years among smaller employers, such as law firms and doctors' offices, because they allow companies to contribute far more on behalf of higher paid employees than a DC plan. The maximum contribution on behalf of any employee to a DC plan for 2025 is generally $70,000 (plus $7,500 catch-up contributions for employees over age 50 or $11,250 for employees between 60 and 63). The limits on cash balance plan credits for higher paid employees vary widely based on age but can routinely exceed $200,000 or $300,000.

This far higher limit—which is separate from and does not affect how much employees can contribute to a DC plan—has made market-based cash balance plans especially popular with professional organizations. But market-based cash balance plans have started to show signs of life in larger companies, too, such as major carriers in the airline industry.[5] And more growth could be on the way, due to potential regulatory developments on the horizon.

Potential policy changes that would eliminate barriers to adoption

An often-overlooked provision in SECURE 2.0 has already eliminated one artificial barrier to market-based cash balance plans. Before SECURE 2.0, an arcane set of rules prohibiting "backloading" benefits in a DB plan precluded market-based cash balance plans from rewarding older, longer-service employees. Section 348 of SECURE 2.0 rationalized those rules and allows market-based cash balance plans to provide higher contribution credits to older or longer-service employees.

That change leaves two main challenges for companies offering cash balance plans: uncertainty regarding their accounting treatment and negative treatment for funding and Pension Benefit Guaranty Corporation (PBGC) premium purposes.

1. Accounting uncertainty

Uncertainty around the proper way to calculate liabilities for accounting purposes has been a major impediment to the growth of market-based cash balance plans, because it creates the potential for companies to take on artificially inflated liabilities for accounting purposes.

For example, assume that a company has a market-based cash balance plan with a total of $1 billion in account balances. Since participants generally take their benefit in the form of a lump sum, one might assume that for accounting purposes, the company has a liability of $1 billion. However, the Financial Accounting Standards Board's (FASB) guidance on this issue is not clear, and large accounting firms differ on whether this interpretation is valid or whether companies should instead follow the general approach to valuing non-market-based cash balance plan liabilities.

In that method, each participant's account balance is projected to normal retirement age based on the expected rate of return on plan assets and then discounted back to present value using the FASB discounting rate, such as a corporate bond yield curve. However, if the plan's expected rate of return is higher than the discount rate—such as a projected 6% rate of return and a 4% discount rate—then the liability for accounting purposes would end up higher than $1 billion.

FASB's Emerging Issues Task Force has recognized the lack of clarity on this issue and has recommended changes to address the potential problem—namely, that market-based cash balance plans should use the expected rate of return as the discount rate.[6] In our example, that would mean projecting the $1 billion in total account balances to normal retirement age at 6% and then discounting it back to the measurement date at 6%, resulting in a far more rational $1 billion liability.

We don't know exactly when FASB will take action on this recommendation, but the issue may be addressed in the relatively near future because there is growing consensus that the current guidance is inadequate at best.

2. Negative treatment for funding and PBGC premium purposes

The rules for determining an employer's funding and PBGC premium obligations for market-based cash balance plans are clear. Unfortunately, those rules adversely affect employers offering such plans.

Federal regulations require all cash balance plans to determine their funding obligation by projecting the account balance to the expected payment date based on expected future interest credits, and then discounting that future value to the current date based on statutorily required corporate bond rates.[7] As with the accounting uncertainty described above, this process has plan sponsors using different rates to project future liabilities and then discount that figure back to a present value. A discount rate that's lower than the rate of projected returns will result in a liability that is larger than actual account balances—even if participants are expected to elect a lump sum upon retirement.[8]

A similar anomaly applies to the process of calculating a cash balance plan's funded status under the PBGC variable rate premium rules. PBGC permits two ways to determine such funded status, both of which have the same flaw. In both cases, the value of the vested account balances is projected forward to the expected payment date under the plan's funding rules. Then, plan sponsors can use a discount rate based on corporate bond rates over a one-month period or a two-year period.[9] Either way comes with the same potential for liabilities that are much higher than the sum of the account balances, creating an artificial underfunded status that would inappropriately impact PBGC variable rate premiums.

At this point, there is no active public policy dialogue around changing the funding and PBGC variable rate premium rules to conform to economic reality for market-based cash balance plans. However, with FASB on a path to possibly revisiting the accounting guidance issue, there is potential for regulators to similarly rationalize the funding and PBGC premium rules. We are keeping a close eye on this issue because reform is very much needed.

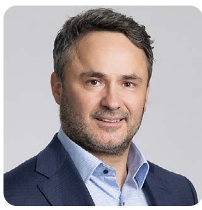
The future of market-based cash balance plans

Most companies have moved toward DC plans for their retirement benefits—and that is not going to change. However, we don't believe this shift means that the corporate DB system will disappear entirely.

Potential reforms could rationalize the accounting, funding, and PBGC premium treatment of market-based cash balance plans. These changes would eliminate some of the key issues driving employers out of the DB plan system, such as balance sheet liability management, funding volatility, PBGC premiums, and accounting and earnings volatility.

With these improvements, we may see market-based cash balance plans become broadly popular outside of the smaller professional organizations that have eagerly embraced them so far—helping extend the life of the corporate DB system to future generations of employees. That's why we will be carefully watching potential policy changes around market-based cash balance plans to help companies determine whether this solution makes sense for their own benefits strategy and participant base.

Ask the Actuary: Improving an LDI portfolio through investment style diversification



Francois Pellerin, CFA, CERA, FSA
Head of US Defined Benefit
Investment Strategy

In a new feature of our newsletter, we're inviting corporate DB plan sponsors to send their investing or plan management questions to State Street Investment Management's head of US Defined Benefit Investment Strategy, Francois Pellerin, CFA, CERA, FSA. For this issue, he answers a question about additional steps sponsors can take to refine their liability hedging portfolios.

Our company's plan is frozen and fully funded. We have implemented a hedging strategy to immunize against interest rate fluctuations, which we see as an uncompensated risk. Our program is customized to our own liabilities, with an overall hedge ratio of 100% and duration matching along five "key rates." Finally, we dynamically rebalance that portfolio to reflect market fluctuations and demographic changes. Are there other steps we could take with our hedging portfolio to reduce funded ratio risk?

Those best practices you've implemented have helped many sponsors substantially reduce pension risk. However, an unintended consequence has emerged from most LDI implementations: investment style concentration.

Due to their ability to closely match cash flows discounted using AA yields, high-quality corporate bonds are the main component of most custom hedging portfolios. The drawback is that virtually all corporate bond assets under management are with managers that use the same investing strategy: fundamental active management. As a result, while there are nuances, most corporate bond fund portfolios tend to look quite alike, holding similar issuers and sector exposures.

The similarity among these portfolios means that their gains are highly correlated in positive markets, but so are their drawdowns during challenging times. Management style concentration, therefore, can be a hidden risk in LDI hedging portfolios.

One way to mitigate this risk is to invest in funds that don't follow the same security and sector selection path. The State Street family of systematic active fixed income (SAFI) strategies is specifically built to address this issue. SAFI takes a systematic approach to active fixed income investing, using quantitative signals in the form of factor scores to identify mispriced securities. This data-driven, rules-based process can deliver excess return and lower tracking error against a plan's liabilities, with lower overall management costs.

More importantly for diversification purposes, the SAFI strategy portfolio construction process results in lower correlations to fundamental active management strategies, as shown in Figure 1. For example, the Systematic US High-Quality Intermediate Corporate Strategy would have had a 0.37 correlation on average to seven major fundamental active strategies between January 2024 and September 2025.

With their risk/reward profile and lower correlations, SAFI strategies complement the fundamental active corporate bond funds that make up most LDI hedging portfolios. Sponsors may consider substituting up to 25% of their current allocation to traditionally managed credit for less correlated strategies like SAFI. This change would allow sponsors to maintain exposure to the high-quality corporate bonds that are the best hedge for plan liabilities, but with additional diversification within that asset class. The result could be a smoother (and potentially higher) "alpha ride" for increased funded ratio stabilities, overall plan cost reduction from lower net fees, and higher downside protection by taking advantage of increased diversification—the only free lunch in investing.

Have a question about managing your corporate plan? Ask the actuary by filling out this form: https://comms.ssga.com/na-inst-csh-ask-the-actuary-question.html.

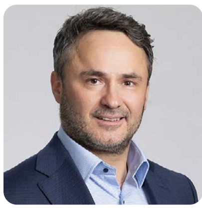
Figure 1: Low alpha correlations
SAFI's excess return profile is differentiated relative to active peers

	SAFI HQ Interm. Corp	Manager A	Manager B	Manager C	Manager D	Manager E	Manager F	Manager G
SAFI HQ Interm. Corp	1.00							
Manager A	0.59	1.00						
Manager B	0.58	0.67	1.00					
Manager C	0.39	0.48	0.52	1.00				
Manager D	0.60	0.51	0.56	0.87	1.00			
Manager E	0.24	0.73	0.41	0.55	0.44	1.00		
Manager F	0.04	0.53	0.57	0.48	0.28	0.56	1.00	
Manager G	0.17	0.47	0.32	0.00	0.03	-0.02	0.13	1.00
Mean	0.37	0.57	0.52	0.47	0.47	0.42	0.37	0.16

High correlation Low correlation

Source: State Street Investment Management, eVestment, Bloomberg Finance, L.P., as of September 30, 2025. Analysis is conducted on a sample of large fundamental active credit managers by assets under management as of September 30, 2025 using monthly excess returns vs. manager-preferred benchmarks from January 2024 to September 2025. Our Systematic US High-Quality Corporate Bond strategies were converted to the SAFI investment process on December 31, 2023. Manager returns are gross of fee. Past performance is not a reliable indicator of future performance.

Accelerate de-risking to lock in 2025 funded status gains



Francois Pellerin, CFA, CERA, FSA
Head of US Defined Benefit
Investment Strategy

Corporate DB funded ratios rose strongly again in 2025, but history shows how quickly those improvements can be wiped out—unless plans take steps to protect them.

Thanks to positive market conditions, most corporate pension plans have enjoyed strong improvements in funded status over the past several years. Last year was no exception. Strong monthly investment returns boosted the average funded ratio to 108.1%[10] in December 2025, the ninth consecutive month of improvements to corporate plan funded ratios.

Rising surpluses are worth celebrating. But as we've seen in the past, a sudden market downturn can quickly wipe out funded status gains—unless a plan has taken steps to protect those improvements.

No one knows when market conditions might change and reverse this trend of improving funded ratios. That's why we encourage corporate plans to look for opportunities to speed up their de-risking and lock in funded status gains early in 2026.

Avoiding the mistakes of the past

When plans have not adopted a rigid glidepath that frequently adjusts assets, there is typically a lag between improvements in a plan's funded status and its adoption of additional assets in a liability hedging portfolio. The generally slow process of decision-making that's common in DB governance often contributes to this lag in adjusting investments to reflect changes in funded status. Likewise, allocations to less-liquid assets can slow down the pace of asset allocation adjustments. But extended periods of strong market returns can also lead to overexuberance among plan sponsors who want to maximize funded status improvements by maintaining larger allocations to return-seeking assets.

Whatever the reason for the delay, waiting too long to de-risk has led to several painful experiences for corporate DB plans over the past 25 years. The dot-com market bubble saw corporate plans riding high with an average funded ratio that peaked at 123.4% in 2000. When the bubble burst shortly after, that average funded ratio fell to 82.2% by 2002. The gradual recovery of the markets through the early 2000s pushed the average funded ratio back up to 105.8% by

2007—only to see those improvements wiped out the next year, when the financial crisis sent the average funded ratio down to 79.1%.[11]

More recently, we saw the same pattern in 2019, when DB plans' average funded ratios increased nearly 10% in less than six months. Because most plans did not move to de-risk, sponsors saw those gains evaporate when lower rates and an equity market correction caused a 12% decrease in average funded ratios in less than three months.[12]

Closing the hedging gap

Reducing equity exposure to increase allocation to hedging assets remains a simple yet efficient way to protect funded ratio improvements from sudden market changes. Plans may also seek to improve their risk/return profile by investing in strategies that can both hedge liabilities *and* seek returns. Examples of such "bridge assets" include high yield, leveraged loans, emerging market debt, and global low volatility equity.

As corporate DB plan sponsors plans know, market levels as of December 31, 2025, will drive firms' P&L and contributions for years to come. Because pension "perfect storms" can happen abruptly, sponsors may consider taking additional de-risking steps now in order to stabilize their future financials.

These timely adjustments to a plan's asset allocation can help corporate plans take full advantage of the funded status gains they've recently enjoyed. Doing so can also help ensure that the plan will meet its long-term obligation to pay out benefits to participants, no matter what direction the markets take in the future.

Contact State Street Investment Management to learn more about de-risking strategies and LDI investing solutions.

Endnotes

1 Milliman Corporate Pension Funding Index, January 2026, https://us.milliman.com/en/insight/pension-funding-index-january-2026.

2 Bureau of Labor Statistics, as of December 8, 2025.

3 CME Group, as of December 5, 2025.

4 FRED, Federal Reserve Bank of St. Louis, as of December 8, 2025.

5 https://larrypollack.substack.com/p/airline-pilots-new-defined-benefit

6 https://www.fasb.org/page/ShowPdf?path=EITF%20Issue%20Summary%20-%20Application%20of%20Topic%20715%20to%20Market-Return%20Cash%20Balance%20Plans.pdf and https://www.fasb.org/page/ShowPdf?path=EITF-Meeting%20Summary-20250909.pdf

7 See Treasury Regulation Section 1.430(d)-1(f)(5).

8 See Treasury Regulation Section 1.430(d)-1(f)(9), Example 13 (account balance of $150,000 for a 61-year-old employee, funding liability for that employee is $158,525.81 (spread would be larger for younger employees)).

9 PBGC Regulation Sections 4006.4(b)(2), 4006.5(g).

10 Milliman Corporate Pension Funding Index, January 2026, https://us.milliman.com/en/insight/pension-funding-index-january-2026.

11 Milliman Corporate Pension Funding Study, 2025, https://www.milliman.com/en/insight/2025-corporate-pension-funding-study.

12 State Street Investment Management.

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* This figure is presented as of September 30, 2025, and includes ETF AUM of $1,848.02 billion USD of which approximately is $144.95 billion USD in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Investment Management are affiliated. Please note all AUM is unaudited.

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Foreign investments involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations, all of which may be magnified in emerging markets.

Equity securities may fluctuate in value and can decline significantly in response to the activities of individual companies and general market and economic conditions.

Hedging involves taking offsetting positions intended to reduce the volatility of an asset. If the hedging position behaves differently than expected, the volatility of the strategy as a whole may increase and even exceed the volatility of the asset being hedged.

Foreign investments involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations, all of which may be magnified in emerging markets.

Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates rise, bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

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