MERCER

DE-RISKING PENSIONS

SPECIAL EDITION

Based on an interview with Frank Oldham, a London-based Senior Partner with Mercer and global leader of the firm's Defined Benefit Risk Management consulting

Defined benefit (DB) pension obligations represent substantial financial commitments for many organizations. And, with yields on bonds at record lows, pension scheme liabilities are as big as they've ever been. This is a growing concern for CFOs and CEOs alike.

Mitigating this financial risk is critical because pension scheme liabilities are long-term in nature, making them very sensitive to changes in market conditions. For example, in July of this year, despite equity market gains of 1.4%, interest rates fell by 30 to 55 basis points, resulting in pension plan deficits in the S&P 1500 reaching all time highs of $689 billion. Given increasing accounting transparency, these pension deficits sit on company balance sheets, visible for all to see and offering a not-so-friendly reminder about the need to fully understand and address the issue.

Many plan sponsors have already taken steps to limit their exposure to DB risk by closing to new entrants or closing to future accrual. But this doesn't deal with what is already on the balance sheet, and there's more that businesses can and should do to begin mitigating exposure to pension risk over time.

MERCER

"More organizations are now beginning to see the benefit of having a longer-term plan in place."

For example, companies can work to better match assets to liabilities in order to reduce some of the volatility and exposure to market movements. Another strategy seeks to change the profile of the liabilities by offering members options that are less risky to the business. In fact, we've seen this strategy in play recently in both the UK and the US, where sponsoring employers have provided options to cash out benefits in favor of lump sums or to transfer benefits out of the plan. In some countries, we're also seeing an increase in insurance company buy-outs, effectively transferring the obligation to a third party or external provider.

Having a long-term plan in place helps companies seize opportunities to minimize risk when they arise. We've seen several missed opportunities during the past few years when funding levels in many parts of the world improved substantially, but organizations failed to take advantage to de-risk, change their investment strategies and lock in the gains that were made. We've seen it again in 2012 in the US, where funding levels improved generally over the first quarter of the year, only to fall again in the second quarter, leaving many organizations regretting their failure to act more quickly.

More organizations are now beginning to see the benefit of having a longer-term plan in place against which they can spot opportunities or triggers, allowing them to respond promptly to advantages in volatile market movements. However, companies need to think carefully about whether to fully manage a dynamic de-risking strategy within the organization or consider outsourcing certain pieces where they need greater expertise or prompt action. They should look at the skills they have within the organization for implementing a dynamic de-risking strategy. We're seeing a greater number of organizations outsource some of these activities, whereby pension professionals focus on strategies and opportunities for mitigating risk, and those within the company can focus on running the business.

CONTACT

Frank Oldham, *Senior Partner* (London)
frank.oldham@mercer.com
+44 20 7178 3355

To view a video version of this interview and other videos on pension risk, visit www.inside-employers-mind.mercer.com/IERM_Pension_Videos.

Copyright 2013 Mercer LLC. All rights reserved.