Pick your risk

JENNIFER CARRUTH REPORTS FROM THE CHANGING LANDSCAPES IN PENSIONS CONFERENCE, SPONSORED BY ABN AMRO AND MERCER HUMAN RESOURCE CONSULTING.

According to Raymond Haines, Managing Director of ABN Amro, there is a basic rule when assessing risks. At the conference's liability-driven investment (LDI) seminar, he advised delegates that risks should be assessed in two categories: affordable (those where disappointments are not disasters) and rewarded (those with a positive outcome).

But according to Colin Hately, Head of Pensions at Kingfisher, the key issue for the corporate is where to take the risk. In his talk he argued that a number of factors should be taken into consideration, such as tax efficiency, cashflow/accounting flexibility and financial leakage through benefit improvements, including trapped surpluses.

Hately also encourages trustees and sponsors to work together for the good of the schemes.

He said: "Joint sessions with trustee and sponsor would create good understanding of the financial dynamics of the pension scheme, including both financial and non-financial risks."

Older and riskier

Corporate treasurers looking for a solution for longevity risk should transfer the risk to scheme members, go to an insurer willing to take the risk for a premium, or speak to a specialist insurer, according to John H Fitzpatrick, CEO of Pension Insurance Corporation.

In his talk on longevity risk, Fitzpatrick considered the impending longevity problems that are likely to be faced by private individuals, corporate sponsors and the government.

There has been a 6% increase in longevity in the last 10 years, with an increase in life expectancy of two years over a 10-year period, which is set to cause a significant financial impact.

According to Fitzpatrick, the best owner of longevity risk in the long term will be global fixed income investors: "While historically longevity has not been a risk that corporate treasurers have actively measured, managed, hedged or sold, it is still important to be aware of current solutions where longevity risk is concerned. It is not efficient for corporate treasurers to carry the expertise to manage this risk – a risk that is not central to the core business."

Fitzpatrick recommends looking towards the future. To prevent new employees entering defined benefit plans, they should create a defined contribution plan and move existing defined benefit accrual into a defined contribution structure.

He also suggests that when the stock markets and interest rates are judged to be peaking, treasurers should move to LDI, leaving residual risks such as longevity, corporate covenant and Pension Protection Fund levies.

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EMBEDDED RISK EXPOSURE

"Risk embedded within a corporate pension scheme can be a significant contribution to the overall risk exposure," says Richard Giles, Head of Risk Consulting at Mercer.

Giles questions how much risk a company can actually withstand as pension issues may not be on the board's agenda, despite pension risk being greater than ever before.

"Listing risks is trivial," he says. "However, quantifying, comparing and managing them is rather more complex and requires a quantitive risk framework."

Mercer believes that pension scheme risk management is becoming a CEO/CFO priority.

ASSET DOORS OPEN

While traditional asset classes still remain in use, the conference heard that new investment opportunities are opening up from new classes such as high-yield bonds, property, hedge funds and convertible bonds.

According to Michael O'Brien, Head of Institutional Business at Barclays Global Investors, Europe, "to increase investment efficiency, the goal is to increase breadth".

O'Brien distinguishes between 'beta' returns, which reduce reliance on enterprise risk planning by including other sources of economic return, and 'alpha' returns, which add exposure to skill.

He believes that using the breadth within these sources of return will reduce concentration of bias and remove constraints to active management.