JOHN HAWKINS INTRODUCES THE FOURTH ANNUAL ACT/MERCER PENSION FINANCIAL RISK MANAGEMENT SURVEY.

Maintaining the lead

Treasurers have taken the lead in developing the discipline of pension financial risk management. By participating in the fourth annual ACT/Mercer pension financial risk management survey, which is now available online (see link at end), you can contribute to the maintenance of this lead and help ensure that what treasurers are doing to contribute is well understood, both within the profession and outside.

HOLISTIC APPROACH The concept of applying financial risk management techniques to pensions in a holistic way, as opposed to concentrating only on investment risks, is still rather new. As recently as five years ago it was relatively uncommon for chief financial officers (CFOs) and treasurers to be involved actively in pensions risk management. But that has changed. Although senior financial managers are constrained practically as to the influence they can exert over pension schemes as a result of the trust structure under which almost all schemes exist in the UK, nearly all now make some attempt to wield some influence. Where sponsor companies do seek to influence pension scheme risk, treasurers are almost invariably involved. This is apparent both anecdotally and through the results of previous ACT/Mercer surveys.

There are at least two ways in which the results of surveys such as this can be important.

First, as long as there is a substantial number of respondents each year, they can provide a good snapshot of what is actually happening in the real world, as opposed to simply being talked about. Just over 100 treasurers and other finance managers have responded to the questionnaire for each of the last two years and we are hoping for at least this number in 2008.

Second, over a period of time, genuine trends can emerge and be identified more promptly than by using other techniques. Although some of the questions do vary from year to year in the ACT/Mercer survey, the core questions have remained substantially unchanged. It is for this reason that we were able to establish the dramatic increase in derivatives usage in 2007, compared with previous years. Whether this growth has continued in 2008 is likely to be one of the most interesting results of this year's survey.

THIS YEAR'S SURVEY The survey this year has been divided into three brief sections: funding and investment strategy; the use of derivatives; and PPF/Pensions Regulator issues. New rules on calculating the risk-based element of the PPF levy should have encouraged schemes and sponsors to strengthen funding levels and increase their use of contingent assets. The latter has not been a major trend in previous years, but 2008 could be different.

The survey also tries to be topical, while providing continuity of coverage. This year we will be seeking to understand what, if any, has been the impact on pension schemes of the credit crunch as far as treasurers are concerned.

There are at least two areas where this may have been felt: the perceived deterioration in the credit quality of some sponsors; and the arrangements in place for minimising derivatives counterparty risk – for example, through the use of collateral.

Although the most recent pronouncements of the Accounting Standards Board (on liability discount rates and the treatment of investment returns) and the Pensions Regulator (on longevity) may not yet have affected behaviour, the cumulative effect of previous similar changes no doubt continues to be felt.

Also, while revised assumptions are forcing reported pension liabilities ever upwards, competition is forcing the price of pension annuities downwards. Has this convergence increased your propensity to consider encouraging trustees to buy out liabilities?

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The survey is available online at www.treasurers.org/pensionssurvey. It comprises nine main questions and should take no longer than 15 minutes to complete.