De-risking drives agenda

PETER MATZA AND **JOHN HODGSON** ANALYSE THE KEY FINDINGS THAT EMERGED FROM THE FIFTH ANNUAL ACT/MERCER SURVEY OF PENSION RISK MANAGEMENT.

In recent years, treasurers have taken the lead in developing the discipline of pension financial risk management. The ACT policy and technical team (through its pensions working group) has been closely involved in responding to regulators with the concerns of treasurers and finance professionals both in the UK and continental Europe. The participation of treasurers and pension managers in the recent ACT/Mercer survey of pension financial risk provides a good snapshot of what is happening in the real world right now.

During late 2009 and early 2010, pensions consultancy Mercer and the ACT approached the CFOs and treasurers of major corporates for our survey on managing pension financial risk. Although senior financial managers have limited influence over pension schemes as a result of the trust structure under which almost all schemes exist in the UK, nearly all are actively involved in pensions risk management. The survey looked at the impact of pension deficits on corporate behaviour, the accounting issues in pensions management, and the risk management actions under consideration by treasurers, trustees and corporates.

Pensions issues were already high on the agenda of stakeholders at the time of our previous survey in mid-2008, but the latest findings suggest that recent market events have persuaded stakeholders that pension risk is now even more critical to corporate health.

Just over half of respondents are now more likely to reduce risk after recent falls in pension scheme funding levels due to mismatched assets and liabilities. Most saw this as a long-term project. Some respondents felt the current trustee governance structure was not ready to implement a de-risking investment strategy, but most felt they either already have a framework in place or are getting there. It is critical that treasurers ensure effective governance or at least ensure the trustee board is properly advised and prepared.

Table 1: Secondary drivers for funding

General risk mitigation	31.3%
Ability to use as bargaining tool in other pension negotiations	31.3%
Defensive actions in case of possible credit rating downgrade	6.3%
Avoid Pensions Regulator invention	12.5%
Reduce PPF levy (D&B failure score, increase in scale factor)	43.8%
Tax benefits	18.8%
Other	25.0%

Respondents could select more than one category

Table 2: Use of derivative hedging

Credit protection	11.8%
Currency hedging	47.1%
Inflation hedging	29.4%
Interest rate hedging	35.3%
Other hedging purposes	3.9%

Respondents could select more than one category

Around half of respondents have received requests by their scheme trustees for additional financial support, usually in the form of cash injections. Where such requests were received, most had agreed to some support, and cash was the most common support offered.

For many companies agreeing to trustee requests, the main secondary driver for doing so was a desire to reduce Pension Protection Fund levies (see Table 1). Additional funding was sometimes agreed as a bargaining tool in other pension negotiations, demonstrating that companies are increasingly looking for a packaged solution to their various pension issues. Most had a balanced or positive view on the recent announcements by the Pensions Regulator about funding in the current economic climate, although a significant minority viewed these as negative or unclear.

Although most respondents were keen to de-risk, around 65% did not view the purchase of a bulk annuity policy

Box 1: ACT pensions conference

Look out for the ACT Annual Pensions Conference, 1 July 2010, Crowne Plaza, 19 New Bridge Street, London EC4V. The one-day conference will provide you with an essential update. Hear from corporate treasurers, regulators and pensions advisers on new challenges and what the latest developments mean for your business.

followed by a wind-up of the scheme as their ultimate goal, with the presumed alternative being to run the scheme down on an ongoing basis. A similar number had never transacted or sought quotations for a bulk annuity policy. In general, respondents felt the bulk annuity market offered less competition than we believe to be the case; their perception may be a carry-over from the reduction in annuity market activity in late 2008 and early 2009.

More than half of respondents had used derivatives in their pension schemes, mainly for currency hedging. Those undertaking interest rate and inflation hedges mostly carried them out directly using swaps; around one-third used pooled funds ('bucket funds') for the hedge. In general, reported derivative use has increased markedly since the 2008 survey (see Table 2).

Most respondents expressed a negative view on current pension accounting rules as an objective and transparent measurement of pension costs. Most also had concerns that users of accounts do not understand the true business impact of pension obligations. The most common change suggested was for greater disclosure of sensitivities to the assumptions used, to give users a greater understanding of the risks and uncertainties involved.

As ever, there is no single right or wrong level of risk for a pension scheme and its sponsor, but the need to consider such matters is now widely accepted. Only then can trustees and sponsors make informed decisions about whether to modify that level of risk and, if so, how.

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■ *The full survey results will be available shortly at:* **www.treasurers.org/pensionsurvey**

■ *The ACT policy and technical team welcome contributions from treasurers and others interested in pensions issues. If you are interested in joining the pensions working group, please email Martin O'Donovan, assistant director, at:* **modonovan@treasurers.org**