THE TREASURER
21ST CENTURY PENSIONS

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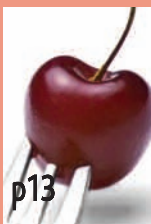

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INTRODUCTION

Pensions – a new application of a treasurer's skills?

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Treasurers and pensions make uncomfortable bedfellows. Once upon a time their paths rarely crossed, and suddenly pensions are one of the biggest financial risks for many businesses. Maybe this is no coincidence… Now companies, analysts and rating agencies recognise pensions as debt-like – with minds focused by the marking-to-market of pension liabilities. Companies' credit-worthiness has also come into sharp focus with the Pensions Regulator's interest and the Pension Protection Fund (PPF) levies.

Financial risk, debt and creditworthiness fall squarely in the treasurer's area of expertise. So surely treasurers should simply apply their tried and tested skills and tools to pensions? Yes and no.

The risks to a business from defined benefit pension schemes are numerous. Pensions can impact on balance sheet flexibility, financing costs, reported performance, cashflow and transaction opportunities. The nature of pensions risks are also varied. These include investment risk, interest rate risk, regulatory risk and longevity risk. Assessment of these risks is under-developed, and it is common for companies to be hedging interest rate exposure, oblivious to the natural hedge in the pension scheme.

The financial risks lend themselves well to conventional analysis and solutions.But the conclusions need to be put in the context of the broader pension risks and uncertainties. For example, there is little value in building a precise portfolio of financial instruments to cashflow match uncertain pension payments. The whole question of valuation is another tricky area – and with no market to act as the ultimate arbiter.

Pension liabilities are collateralised – often with assets invested in equities. The debt-like nature of pensions doesn't apply to the pensions deficit; it applies to the entire pensions liability. Any actions have to be seen in this context and need to bring the assets and the liabilities into play.

Finally, the role of pension trustees is crucial. They have lent a lot of money, now have power to collect it, and are worried – a dangerous cocktail. Treasurers don't wait until facilities expire and then let the bank dictate renewal terms. Similarly, managing pension liabilities and cashflow will require companies to take the initiative in approaching trustees – and soon.