Managing Pension Risk & Liabilities Virtual Series tackled head on the impact of the Covid-19 pandemic, and the market volatility and continuing low rate environment today that has affected U.S. pension plans. Many DB plan sponsors are refocusing on how they can best meet their plan imperative to deliver future benefit promises and are exploring alternatives and seeking advice on how to be best positioned on the pension de-risking journey that will allow them to meet those objectives. A host of sessions provided practical and timely guidance from pension plan executives, asset managers, consultants and insurers. Here are some highlights, with the audience poll results.

To access the recorded sessions, go to www.pionline.com/MPRL2020Replay
A PURPOSEFUL JOURNEY

Pension de-risking involves a series of choices and decisions in a pension plan’s journey. In the face of current market volatility and an uncertain economic environment, increases in the volume of retirees and PBGC premium increases, more plan sponsors are looking at where they want to be on the de-risking path. Some plans may want to transfer the pension liability to an insurance company in an annuity buyout or buy-in, others may want to keep the plan on their books via a hibernation strategy. Both strategies can be seen on a continuum of liability-driven investing strategies, and plans can execute along the way to reach the plan outcome that they have set.

Advisors said that the sponsor’s strategic objectives for the plan should guide the path it follows in either terminating the plan or maintaining it on the balance sheet. Hibernation can be a low cost, low risk solution for sponsors who elect to continue managing the liabilities. Other plan sponsors may want to consider a buy-in, that is sometimes a precursor to a buyout, which is irrevocable. While buy-ins are not widely used, they allow for partial or full risk transfer and can be executed at a time when the sponsor determines favorable pricing terms. A plan sponsor advised that knowing the specific plan objective, with the time frame and funded status considerations, and getting internal resources in place to handle the de-risking strategy, all help to reach a successful outcome.

Hear more on the session: What is the End Game? Options for Pension De-Risking pionline.com/MPRL2020Replay

BENCHMARKS TO HEDGE PLAN LIABILITY

As LDI has evolved, plan sponsors are exploring ways to be more precise in hedging the plan liability. Do they use a combination of market-based benchmarks like the Barclays Long Government/Credit Index or custom benchmarks, or do they use a more extreme approach of a pure liability-based benchmark? Do they provide managers with leeway to tactically move within the fixed income mandate? How can they generate the alpha in the optimal risk-reward tradeoff and measure success for fixed income managers? Plan sponsors on this panel shared their multi-faceted perspective on benchmarking that works for them, which typically can be a composite benchmark for the asset allocation.

In general, any fixed income benchmark must be able to provide more clarity on how much risk exposure you have relative to liabilities, noted this panel. It needs to be accountable, measurable, clear, specified in advance and investable via a diversified universe of securities. Plan sponsors have different LDI outcomes to achieve, and the benchmark needs to have that liability hurdle context. Different metrics can be used and not all benchmarks may get to 100% precision. Still, as a panelist noted, 'maybe you’re missing the bull’s eye, but you’re getting on the dartboard’ and sponsors can explore tactical approaches with a host of options like Treasury strips and derivatives to get the yield they need. Sponsors also need to have realistic expectations around the tracking error of their fixed income liability, and keep their funded status and risk-reward tradeoffs in mind as the ultimate benchmark is being able to deliver on the paid benefit to the plan’s participants.

Hear more on the session:
The Pros and Cons to Managing your Hedging Portfolio Explicitly against a Liability Benchmark pionline.com/MPRL2020Replay
TAKING AN INFORMED PERSPECTIVE

At two separate fireside chats, Graphic Packaging’s Treasurer Brad Ankerholz and Global Economist Dr. Dambisa Moyo shared their perspectives on pension plans and the global economy. In the former, Ankerholz shared that Graphic Packaging completed a plan termination this year, following a four to five year LDI strategy with de-risking to push out the duration of the fixed income assets and making contributions where needed to address underfunding. He stressed that plan sponsors need to have a strategic vision to achieve the plan’s outcome, in their case to annuitize with assets-in-kind and cash, work with credible advisors, and to get involved in the plan termination early in the process.

AUDIENCE POLL: What options for pension de-risking have you considered or executed on?

- Buyout ................................................................. 25%
- Hibernation ......................................................... 17%
- Buy-in ................................................................. 2%
- All ............................................................................. 29%
- Other/Combination ............................................. 27%

The Covid-19 pandemic has exacerbated the pressures on global economic growth, with an increasing jobless class, lower educated workforce, more economic inequality, lower productivity and the impacts of climate change, according to Moyo. She quoted the IMF outlook of -4.4% global economic growth this year, with equity returns closer to 4% on a risk-adjusted basis. Investors can find opportunities in the structural shifts that are occurring globally, and she points to China which has a positive growth-trajectory as a data-driven and forward-leaning economy.

Hear the Fireside Chat: Graphic Packaging’s Brad Ankerholz on LDI strategy
Hear the Keynote: Dambisa Moyo on Five Things that will Define the Post-Pandemic World Economy
pionline.com/MPRL2020Replay

LDI 2.0 OFFERS A BETTER ROAD MAP

While LDI 1.0 has created a good foundation for pension de-risking strategies and hedging liabilities, plan sponsors today have a wider range of approaches to hedge liabilities and meet their plan objective. There’s more diversification within the liability hedging bucket, and a closer consideration of funded status volatility and optimizing both asset and liability targets in dynamic asset allocation. As plan sponsors consider their choices, they need to keep in mind that the long investment grade fixed income universe has shrunk, they face downgrade risks in the portfolio, and issuer concentration can be a concern. Diversification within the fixed income portfolio is important, via Treasury strips or derivatives, and high-quality private placements with good covenant packages can also be an alternative.

With the low rate environment that’s expected to persist, some plans may be considering whether to reduce hedging or hedge at all. But the key risk today is convexity at low rates and sponsors need to be more aware of the duration mismatch between their assets and liabilities, advised this panel. As LDI has evolved, so has benchmarking fixed income liabilities with a mix of custom benchmarks or pure liability-based benchmarks which allow managers to move tactically within the defined investable universe and still hedge the risk and meet the sponsor’s plan objective. Not all plan sponsors may follow a strict LDI benchmark, and aim to reduce funded status volatility, be P&L centric with their contribution requirement, meet a specific return assumption, or a mix of these targets and, ultimately, providers continue to respond with optimal portfolio construction that meets their specified objective.

Hear more on the session: The LDI Evolution
pionline.com/MPRL2020Replay

#LDI  #long duration  #liability hedging  #diversification  #benchmarking
PLANNING FOR AIK TRANSFERS

In the face of extreme market volatility following the pandemic outbreak earlier this year, plan sponsors have expressed more interest in asset-in-kind transfers and how to best prepare in advance for such transactions. AIK transfers, where the sponsor pays for a group annuity premium by transferring actual assets instead of paying by cash, can mean lower costs—between 100 and 150 basis points, depending on the deal specifics, insurer and the market environment—and reduce risk exposure for plan sponsors, shared this panel.

For sponsors interested in an AIK transaction, they need to consider deal size, transaction type to annuitize a portion or the whole plan, asset allocation, and the investment vehicle they are in. Typically, long high-quality corporate bonds with duration that matches the liabilities are best for these transactions. With the greater interest, insurers are considering even under $100 million AIK deals, a level that wasn’t always available before. Even if pension risk transfer is further down the line for some sponsors, they could prepare in advance by starting a dialogue with advisors on the components of an AIK transfer, and positioning their portfolio to be in the appropriate investment vehicles.

Hear more on the session: The Pension De-risking Journey: What Assets Should I be Holding? pionline.com/MPRL2020Replay

#assets-in-kind #pension de-risking #group annuity #transaction costs

DYNAMIC VIEW ON RISK

As plan sponsors try to figure out how to best manage pension risks in an extremely turbulent year, it may be helpful for them to examine their risk profile by asking, ‘What’s my ability to take risk?’ and ‘how much risk do I need to take to achieve my plan objectives?’, then stick to that target, with their funded status in mind, when they set portfolio strategy for growth assets and liability-hedging assets. Plan sponsors should also look at their portfolio holistically and have a dynamic view on their risk budget that changes over time. For frozen DB plans that have a defined set of liabilities, excess returns beyond what they need for their pension obligations doesn’t provide additional benefits. Two plan sponsors shared that they approach the strategic asset allocation process with their plan outcome in mind, and take a liability-aware approach to help optimize their outcome.

AUDIENCE POLL: When you embarked on your LDI journey, did you have an endgame strategy in mind?

Plan termination.................................................................35%
Hibernation........................................................................30%
Interim-settlement strategy (ex. retiree lift-outs)..............9%
Unsure/None......................................................................26%

Historically, LDI has meant having a growth bucket and a hedging bucket that can vary in size as one moves along the glidepath. Today, plan sponsors can be more opportunistic and efficient in the composition of these buckets. They can consider active and/or passive exposures, depending on their funded status, on the one side, and add long Treasury strips or other high quality long duration assets on the other.

In the current low rate environment, which arguably will persist for some time, some plan sponsors may be considering whether to hedge less as their funded status may be lower. But they need to remember that their liability-expected returns are also lower as a result of broadly lower rates, and if the discount rate is lower, they may directionally need fewer growth assets as well, shared the panelists. Diagnosing the interest rate scenario is a complicated process, that often requires going beyond one’s natural intuition, and plan sponsors need to be focused on their funding policy and plan outcome irrespective of rates per se.

Hear more on the session: What’s the Right Mix for LDI: Growth Assets vs Defensive Assets? pionline.com/MPRL2020Replay

#LDI #hedging portfolio #growth portfolio #rebalancing
A CASE-BY-CASE APPROACH

An all-plan sponsor panel shared current insights on managing global pension plans, both in plan governance outside the U.S. as well as managing global portfolio investments. A key challenge in managing global plans country by country is regulatory changes in each location and managing local trustee boards. Even though there can be a common investment strategy, for instance, to be largely passive or to have a more active approach with a glidepath mentality and de-risk over time, for all the organization’s global plans, plans in different countries may have unique benefit payment profiles and somewhat different funded status.

Plan sponsors also typically need local fixed income expertise, and managing global asset manager relationships since the Covid-19 pandemic broke out has actually resulted in more frequent virtual ‘face-to-face’ interactions and more transparency offered in regular communications, shared the panel. For sponsors with significant global asset exposures, the extreme market volatility earlier this year required more portfolio monitoring and some rebalancing to meet strategic asset allocation targets before moving back to more regular levels. Overall, the uncertain environment this year has reinforced the value of LDI strategies and the core focus on the plan sponsor’s objective for the pension plan.

Hear more on the session: The Complexities of Global Pension Management
pionline.com/MPRL2020Replay

#global pensions  #LDI  #governance #strategic asset allocation #remote work

HIBERNATION AND ANNUITY BUY-OUTS

Two workshops outlined the costs, benefits and challenges for plan sponsors in evaluating de-risking solutions such as hibernation or annuity purchases.

The workshop by NISA took a comparative cost review of a hibernation strategy versus an annuity buyout. The analysis included unpacking PBGC variable premiums and fixed premiums, the impact of credit downgrades and defaults on the fixed income portfolio, and the costs of active investment management fees. NISA, which is an advocate of hibernation in the de-risking solution set, calculated a net 2.1% cost of maintaining the plan on the sponsor’s balance sheet, i.e., the hibernation strategy, which is much lower than other industry analyses may estimate.

The workshop by Prudential Retirement focused on annuity buy-ins as an elegant and opportunistic solution to plan settlement. It pointed to historical data on the funded status roller coaster that U.S. pension plans have been on, that has led sponsors to ask if they want to keep pension liabilities on their balance sheet or move it to an insurer. While LDI to hibernation or annuity buyouts can also be considered, annuity buy-ins offer favorable pricing, opportunistic moves on a part of or the whole liability, flexibility in timing and potential conversion to an annuity buyout if preferred.

Hear Workshop: Decisions, Decisions, Decisions
Hear the Workshop: Getting Out with a Buy-In
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