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Managing Pension Risk & Liabilities 3

Coronavirus highlights the effectiveness of derisking 4

No answer for cash calls 6

A pause in pension risk transfer 8

The resiliency of liability-driven investing 10

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Coronavirus highlights the effectiveness of derisking

Plans that stuck to their glidepaths in recent years weathered the crisis much better than those with significant allocations to risk assets and lower funded status

The coronavirus pandemic struck when many plan sponsors, their managers, and advisers all thought the economic cycle was about to turn. Few, though, could have predicted the global effect of the health crisis, and fewer still know where it will leave them in years to come.

That said, many defined benefit plans are in much better financial shape than they were in, say, in 2008, when the global financial crisis hit.

“Many pension plans’ funded statuses attained new heights in 2019 and some plan sponsors used that opportunity to implement derisking or LDI strategies,” said Sumit Kundu, head of defined benefit actuarial at MassMutual. “Some plan sponsors missed that opportunity, were stuck with higher equity allocations and lost some funded status ground. Now, there’s a renewed focus on LDI.”

“The economic cycle we’re living through now is very different from at least three that you can point to over the past 15 or 18 years because of the amount of derisking that has already taken place,” said Glenn O’Brien, head of the U.S. market for Prudential’s pension risk transfer business. “We’ve created a situation where there are winners and losers.”

“If you think about client asset allocations today vs. 2008,” said Rick Ratkowski, director, investment strategies, at NISA Investment Advisors, “you see that the impact of the pandemic could have been a lot worse.”

In 2008, hedge ratios were lower and equity allocations higher. The significant derisking steps taken over the past 10 years resulted in funded status being 6 to 8 percentage points higher than if 2008 asset allocations were maintained, he said.

Corporate managers are also focusing on the effect of the pension plan on the larger enterprise. The availability of cash has been a major concern, but the longer-term effects of funded status volatility and other implications have also weighed on corporate minds.

“Plans with limited optionality now are probably doing slightly better because they have clearer expectations of their cash flows,” said Melissa Moore, vice president, head of pension solutions, at MetLife. “A cash balance plan, where participants can take lump sums at any time, without the appropriate demographic-based investing, is probably experiencing a lot of volatility that could potentially impact earnings for some of those companies.”

The crisis has highlighted the importance of all the tools to dampen volatility, none more than diversification for defined benefit plan sponsors, particularly at the individual investment manager level.

Gary Veerman, head of LDI solutions at Capital Group, pointed to a 600-basis-point deviation from top- to bottom-performing long credit managers in the first quarter.

“Many plan sponsors have gravitated toward scale and cost-effectiveness in recent years, leading to a less diversified manager lineup in their plans, both in size and investment management style,” he said. “In periods of volatility, when equity markets fall and credit spreads widen, having a long duration manager that underperforms by 200 to 300 basis points can significantly exacerbate unfavorable funded status outcomes.”

“For those clients that went into the crisis with a significant hedge in place vs. their liabilities, they’ve weathered the storm quite well, some even increasing their funded status,” said Cheryl Hanson, managing director, client services, at NISA Investment Advisors. “Those with a lower hedge ratio didn’t fare as well as a result of the lower-rate environment. Now those clients need to consider how to close that gap.”

This point is even more important today as the reasons for changes in funded status aren’t always obvious.

“You need to dig down to understand how much the change in interest rates this year may have impacted your funded status.”
status,” said Ari Jacobs, senior partner, global retirement solutions leader at Aon. That’s because the impact on credit and Treasuries has been quite different. So the composition of a bond portfolio is critical to determining the effect.

“Plans that were more invested in Treasuries will look a lot different from those that were more invested in credit, even though both plans would claim to be following a derisking path,” Jacobs said.

**What funded status?**

Pension plan sponsors may not be sufficiently aware of their funded status, said Frank Maniaci, actuarial consultant and resource actuary at MassMutual. “They might see it once a year, or quarterly, but we expect sponsors to ask to see this more frequently so they can react to changes more quickly,” he said.

MassMutual’s Kundu reported that more plan sponsors are asking for up-to-date information on their plans’ funded status. He pointed to one client that asked that this information be provided on a biweekly basis due to extreme market volatility, and as a result was able to rerisk on April 1 and take advantage of the market upswing.

Although repositioning from fixed income was a fleeting prospect early in the crisis, by the end of March the idea of taking advantage of widening credit spreads became expensive.

“Much of the selling in the fixed income market in early March was from shorter-dated portfolios, not necessarily the longer-dated assets that are typically part of an LDI program,” said Stephen Mullin, head of long duration and LDI strategies at MetLife Investment Management. “If you didn’t have Treasuries, the levels at which you could reposition the portfolio became unattractive within a few days.”

Some plans are now further away from their end goal, others are closer. So whether it’s a deep dive into their hedging strategy to see if it’s fit-for-purpose for a post-coronavirus world, pulling back from a planned pension risk transfer transaction or simply reconsidering the decision to hibernate, many plan sponsors have gone back to the drawing board.

Plan sponsors unable to terminate their plan in the near future, even if they wanted to, are re-evaluating derisking strategies, according to Kundu. “They are looking at their glidepath and overall LDI strategy with the aim of continuing to reduce the overall pension footprint and risk,” he said.

Although market volatility dampened pension risk transfer activity in the first half of the year, MetLife Investment Management’s Mullin said it would only further push plan sponsors to engage in risk reduction trades going forward. “The crisis will serve as a constant reminder of why plans are implementing LDI, hibernation or ultimately a pension risk transfer trade to reduce funded status volatility,” he said.

“Companies still have an appetite for risk transfer activity, there are just short-term obstacles that need to be managed,” said Aon’s Jacobs. Indeed, by the end of the second quarter, interest in fourth-quarter transactions had rebounded. That said, some plan sponsors continue to question whether to transfer liabilities or maintain the plan.

“To us the question of hibernation vs. buyout is what is the lowest cost solution to the plan sponsor?” said NISA’s Ratkowski.

He advised weighing the cost of maintaining the plan in hibernation, including active management fees net of added alpha, fixed rate Pension Benefit Guaranty Corp. premiums, and ongoing expenses vs. an annuity buyout quote. “To get an apples-to-apples quote, though, you need a good estimate of the longevity of your particular population,” he continued.

Others put the answer simply. “If the cost you will pay to the insurance company is greater than the economic cost of keeping the plan, it may not make sense to transfer liabilities at that time,” said MetLife’s Moore.

For those still contemplating transfer, the crisis may have brought the issue into sharper focus.

“CFOs and treasurers can focus on the issues of the business,” said Prudential’s O’Brien. “The supply chain issues, employee safety, liquidity and investors rather than worry about what credit exposure they might have accumulated in the pension fund. The question remains as it has in the past, what business do you want to be in?”

For those continuing to wrestle with these questions, the U.S. government hasn’t provided much support. The $2.2 trillion Coronavirus Aid, Relief, and Economic Security Act, also known as the CARES Act, passed and signed into law in March, provided for a short-term reprieve in contributions, but the jury is still out on whether more meaningful, longer-term relief will reappear in later bills.

“We would not be at all surprised to see further extension of funding relief in future legislation,” said Colyar Bridgen, senior LDI strategist at Capital Group. “Allowing lighter pension contributions gives sponsors an opportunity to intentionally choose to shelter fewer dollars from taxation.”
No answer for cash calls

Corporate liquidity demands push risk transfer and other derisking steps to the back burner

It’s no surprise that pension risk transfers slowed significantly in the spring of 2020. They almost always require an injection of cash to complete. And when the pandemic hit, corporate cash was needed to keep businesses afloat and pay employees and suppliers.

The question that remains unanswered is whether cash will be available later in the year. Some observers think the answer is yes because risk transfer can have a significant, positive long-term effect on a company’s finances.

“As the crisis unfolded, companies needed to prioritize activities,” said Glenn O’Brien, head of the U.S. market for Prudential’s pension risk transfer business. “Doing a significant risk transfer transaction may not have been as important as having the cash available to pay your employees” he said.

“What we are now seeing is the realization that reforming the capital structure is much higher on the agenda,” he continued. “Where a well-hedged plan might have been considering two or three transactions over the next few years, now the sponsor is thinking, ‘Can we just get this done at once?’”

But for some plan sponsors, concerns over company liquidity because of the pandemic have limited their ability to take major derisking steps such as termination, risk transfer or lump sum window projects.

“We have a client that had notified participants and was on track to terminate the plan in late 2020. Despite knowing that the cash needed to terminate in 2021 was expected to be double the amount in 2020, they chose to delay the termination project in order to preserve cash reserves,” said Frank Maniaci, actuarial consultant and resource actuary at MassMutual.

Limits on access to cash also meant that companies weren’t always able to take advantage of the tax relief available through the Coronavirus Aid, Relief, and Economic Security Act, the $2.2 trillion economic stimulus bill also known as the CARES Act that was passed by Congress and signed into law in March by President Donald Trump.

“Under this legislation, employers can take current year tax losses and offset them against pre-2018 tax year gains and get the benefit of the 35% marginal tax rate from pre-2017,” Maniaci explained. “But you need to have the cash to take advantage of this relief.”

With cash still in short supply for many plan sponsors, it can be hard to prioritize pension risk transfer above other issues, according to Colyar Pridgen, senior LDI strategist at Capital Group. “These deals often trigger a settlement charge, so accounting can be a stumbling block,” he said. “And from a governance perspective, bandwidth just isn’t available. These are tremendous hurdles for many companies.”

“Cash is king,” added Melissa Moore, vice president, head of pension solutions, at MetLife. “Cash within the company may need to be deployed elsewhere instead of paying for a retiree buyout. That’s one of the main reasons, along with potential accounting impacts, that companies are not doing opportunistic retiree-only transactions today.”

Cash not a total block

“We joke that the insurance companies never get calls back from pension plans saying, ‘Can I have my liabilities back, please?’” said Ari Jacobs, senior partner, global retirement solutions leader at Aon. “So, we do expect that the crisis will bring risk management even more into focus for many companies and with it more pension risk transfers.”

“The challenge,” he continued, “is around cash and whether the company can afford to put cash into an initiative that may not be as high a priority as others. This will be a very different discussion at an airline than it will be at a consumer products company.”

“The priority for our plan sponsor clients has been ensuring they have ample liquidity to make benefit payments,” said Gary Veerman, head of LDI solutions at Capital Group. “That’s resulted in a tremendous amount of activity in rebalancing.”

He cited the iEvestment statistic that $70 billion flowed out of long duration strategies in the first quarter and that there was a $330 billion increase in cash across all investor groups.

Although he does not think this represented a wholesale rejection of LDI and a tactical move back into equities, he does think that many sponsors have been shoring up their cash positions to have many quarters of benefit payments on tap.

“We do expect to see a renewed focus on liquidity,” said Rick Ratkowski, director, investment strategies at NISA Investment Advisors. “Sponsors that used cash overlay strategies to maintain additional liquidity were a bit more relaxed in the month of March because they didn’t have to go to multiple managers to raise cash in tough physical markets.” ♦
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The year began fine, but when COVID-19 hit, financial markets – including the pension risk transfer market – ground to a halt. The outlook was bleak.

But as the second quarter began, market activity returned, even though no one quite knew what to expect.

“We are hopeful that the pension risk transfer market will rebound in the second half of the year,” said Sumit Kundu, head of defined benefit actuarial at MassMutual. “With the equity markets coming back in the second quarter and interest rates stabilized somewhat, we think the market will return to something more like normal, if these conditions continue.”

Last year, pension risk transfer volume rose to $30 billion from $28 billion in 2018. “The first quarter of 2020 was similar to the same period in 2019, but then activity slowed,” said Megan Nichols, partner at Aon.

“At the beginning of the crisis, the pension risk transfer market went very quiet,” said Glenn O’Brien, head of the U.S. market for Prudential’s pension risk transfer business. “But recently, we’ve been made aware of several multibillion-dollar deals that are slated for the fourth quarter.”

“There’s certainly been a slowdown in buyouts,” said Cheryl Hanson, managing director, client services at NISA Investment Advisors. “But those transactions already in motion did complete.”

At the beginning of lockdown, O’Brien said he saw seven or eight meaningfully large – $600 million to $1.5 billion – transactions put on hold. “A couple thought cash was needed elsewhere; several were pulled because they weren’t as hedged as they thought they were and funded status dipped,” he said.

Many organizations elected to defer but not cancel the pension risk transfer transactions that were in the works. “We’re seeing deals that were on the docket for early this year moving to later this year or next year,” Nichols said.

“We expect sponsors with pension plans that are fully funded, and with intentions to terminate their plan this year, will go ahead,” added Kundu.

The pension risk transfer market has evolved recently toward plan terminations, perhaps reflecting the fact that some plans that had been carving out chunks of retirees and beneficiaries for pension risk transfer transactions over the years had reached the end of the road.

“Last year, we were close to plan terminations being 40% of the market; in previous years that was somewhere between 15% and 25%,” said Melissa Moore, vice president, head of pension solutions at MetLife.
“This year it could be higher unless we see a few really large retiree buyouts close in the fourth quarter.”

Aon data shows that plan terminations are an increasing element of the pension risk transfer market, rising in 2019 to $12.2 billion from $5.7 billion in 2018. “We expect this trend to continue as plan sponsors become more comfortable with – or fatigued by – the current interest rate environment,” said Nichols. The rate of growth, however, will likely be slower than normal.

Amid lingering COVID-19 gloom, there are some rays of light. “Due to the drop in rates this year, it may be a tactically advantageous time to offer bulk lump sum windows for less than current market value,” said Colyar Bridgen, senior LDI strategist at Capital Group. “But sponsors may face financial and logistical implementation huddles.”

Frank Maniaci, actuarial consultant and resource actuary at MassMutual, agreed, and said he expects increased activity this year in lump sum windows. “We’ve seen declining interest rates vs. 2019, and that could create some interest rate arbitrage, with sponsors being able to make lump sum payments using the more favorable rates from last year,” he said.

Another factor: Anticipated dips in funded status would result in more companies being subject to the Pension Benefit Guaranty Corp. premium cap. “This makes the economics of offering a lump sum window more compelling,” Maniaci said.

As plan sponsors take a pause, industry experts suggest they take the time to work through the numerous hurdles in pension risk transfer, such as cleaning up their data on participants. “The first important element of pension risk transfer implementation is good data,” said MetLife’s Moore.

Keep communications open
Companies in the midst of a pension risk transfer transaction should consider keeping participants in mind because, as ever, a well-thought-out communications strategy is often the key to ensuring that participants understand the impact – or lack of impact – of the transaction on their pension benefits.

This is especially true in the current environment. “Are participants going to be upset that the company is doing this right now?” asked Moore.

“In today’s market environment, many employers have constraints on staffing,” said MassMutual’s Maniaci. “They may have to deliver plenty of bad news, furloughing and laying off employees. So there may be an aversion to considering buyout strategies if the employer thinks the news will be perceived negatively by participants.”

According to Moore, one communications component often overlooked is including all plan participants. “Not just those whose benefits are transitioning to the insurance company but also those who are left behind in the plan,” she said. “There can be confusion – why me? Why not me?”

Devil in the details
Experts warn that the mechanics of transferring assets to an insurance company can be more complicated than they look.

“Many plans create asset-in-kind portfolios that can be used to transfer premium smoothly,” said Moore. “That’s incredibly important because it lowers the risk of portfolio volatility during the transfer process; if a portfolio needs to be liquidated, there can be a three- to five-day lag to move into cash and hedging costs that increase the cost of the transaction overall and can delay the closing.”

“There’s a size component that matters with asset-in-kind portfolios,” said Stephen Mullin, head of long duration and LDI strategies at MetLife Investment Management. “Due to competitive dynamics, we see smaller deals typically get transacted in cash. For larger ones, there’s often a pricing advantage to transferring securities.” Deals under $100 million are more likely to transfer in cash; those over that number could benefit from an in-kind transfer, he said.

For plans in a holding pattern, adjustments may need to be made. “Some have had to adjust their asset allocation because of portfolio shifts,” said Aon’s Nichols.

Technology has played an important role in keeping the pension risk transfer business running smoothly. “We’ve seen standardization of documents, processes and asset transfers,” said Prudential’s O’Brien. “But technology will continue to evolve, with faster execution and more efficient interfacing with participating data.”

But there’s still room for improvement.

“The way that the final auction is done in a U.S. pension risk transfer deal is not as efficient as it could be,” said MetLife’s Moore. “Insurers put in final bids around 10 a.m., hear whether they win or lose at 3 p.m., and then wait for three to five days for the premium. That’s a lot of exposure when Treasuries are moving 50 to 100 basis points a day that often the plan sponsor is paying for, especially in an all-cash deal.”

BUY-INS OFFER HALFWAY HOUSE TO RISK TRANSFER

Buy-ins, popular in Europe, particularly in the U.K., are gaining popularity in the United States.

“We saw some buy-ins in the U.S., recently, and this market may grow,” said Sumit Kundu, head of defined benefit actuarial at MassMutual.

Buy-ins increased last year and have been discussed more frequently this year, reported Megan Nichols, partner at Aon. “Buy-ins in the U.S. are, for the most part, short-term bridges to buyouts,” she said. “They allow a plan to lock in some pricing and provide more certainty in some cases, like as part of a plan termination. You could see a pattern where buy-ins become more common as they allow a company to manage its cash needs differently.”

Glenn O’Brien, head of the U.S. market for Prudential’s pension risk transfer business, reported a significant uptick in buy-in inquiries. “The goal here is to get away from the active management of credit,” he said. Many plans have derisked by moving money from equities into bonds, but then find that they have significant exposure to credit.

“I meet with sponsors that regularly tell me that they have 40%, 50% or 60% of their credit portfolio in triple-Bs,” he said. “Now sponsors are saying, ‘I need to be risk-off for at least a portion of my portfolio. While I can’t settle those liabilities today because I don’t have the cash, I want to limit the mortality and investment risk, setting myself up to exit.’ That might take two or three years, so I’m interested in a buy-in.”

Advantages of buy-ins include that they allow a plan to crystallize a set of assets and liabilities without the need to take the accounting hit that would be involved if they were transferred through a buyout.

A buy-in is a proxy for a double-A bond with a guaranteed spread. “Unlike any other bond product, a buy-in has an embedded yield,” said O’Brien. “With any other bond or portfolio that a pension sponsor might buy, you are only hoping that it will mimic the spread that your liability is earning. And that’s been difficult for the last 15 years.”
The resiliency of liability-driven investing

When put to the test, glidepath strategies held up

Liability-driven investing proved its worth this spring. Those plans with higher funded ratios weathered the initial pandemic-induced storm with the least trauma but even plans in less favorable positions were able to maintain funding by sticking to their glidepaths and utilizing derivatives when volatility spiked and liquidity dried up.

“Our clients have been maintaining their hedge ratios and staying true to their LDI programs,” said Cheryl Hanson, managing director, client services, at NISA Investment Advisors. “Very few have taken off any hedges. In fact, we’ve seen more clients adding duration during this volatile period with the recognition that rates could continue to go lower and they needed to protect on the downside.”

Plan sponsors that implemented full LDI strategies before 2019, particularly in 2018, maintained their funded status even through the first quarter of 2020, according to Sumit Kundu, head of defined benefit actuarial at MassMutual. “Those that implemented nearly 100% hedge ratios and immunized their portfolios were much better placed to help weather the COVID storm.”

Different approaches

The market volatility of 2020 has been an unfriendly reminder of the power of derisking. “If you are going to keep the liability on the balance sheet, given the volatility we’ve experienced this year, an LDI approach just becomes more palatable for those sponsors that haven’t done it yet,” said Stephen Mullin, head of long duration and LDI strategies at MetLife Investment Management. “Those that are using LDI already will accelerate the process of reining the approach to get a closer match relative to liabilities.”

Plan sponsors can take different approaches to developing a glidepath. “Some plan sponsors derisk on a monthly basis, using information about their funded status to stick to a set glidepath,” Kundu said. “They use trigger points – most often based on funded status – and when one trigger point is reached, the plan moves to the next stage of derisking.” In any of these glidepaths, it is possible to allow for rerisking should the funded status drop, but that isn’t as common as a single-direction glidepath.

With or without LDI, the first half of 2020 was a wild ride for plan sponsors. Some found that they didn’t have the tools to react appropriately. Others found that their investment policy statements didn’t allow their managers to make potentially effective rerisking decisions or limit forced selling. And for plans that have eschewed derivatives for years, the lack of liquidity in the physical bond markets proved challenging.

“Volatility and the speed of the repricing made it very challenging for plans to stick to their glidepaths in March and April,” Mullin said. “But the volatility may have also unearthed some inconsistencies in how the original glidepath was designed and what its original intentions were.”

Today, as plans move closer to full funding, portfolios will shift from equities to bonds, and corporate bonds will often dominate the fixed income allocation.

“It can feel good to be moving up the capital structure,” said Gary Veerman, head of LDI solutions at Capital Group. “But you need to consider credit risk – and consider it holistically across the entire portfolio.” Plans that were credit-risk heavy across growth and hedging portfolios suffered poor performance in the first quarter of 2020.

Some plan sponsors incorporate rerisking options into their glidepaths and investment policy statements. The long-term strategy should always be derisking and implementing a fully matched portfolio, said MassMutual’s Kundu. “But some plan sponsors want the option to rerisk periodically to capitalize on market or interest rate movements. We are seeing more plan sponsors opting for this two-way glidepath strategy, which can be very successful.”

Not all managers advocate this approach. “Fundamentally, we believe that keeping the portfolio in balance relative to strategic asset allocation targets is an important part of good governance, but continued on page 12
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rebalancing can be tricky in a market with extreme volatility,” Veerman said.

If a plan sells bonds out of an LDI strategy to buy equities and rebalance, it may have to buy those bonds back when another trigger is reached, a move that could incur significant transaction costs, especially if liquidity is tight, he said.

Another alternative, Veerman suggested, would be to widen the plan’s rebalancing ranges to minimize transaction costs and let asset values float a bit more.

“We are proponents of partial rebalancing or rebalancing halfway back to your target as a way to maintain the governance structure and keep sight of the objective without incurring outsized transaction costs,” he said.

If a plan is considering rerisking, Veerman said, it is imperative that it “incorporates worst-case scenario outcomes and thinks about its ability to withstand them. Stress testing should be as much of a focal point for sponsors as mean-variance analysis.”

**Derivatives can play a key role**

Some plans used a different approach to recalibrate portfolios in the wake of 2020’s torrid markets. “Derivatives were and are incredibly valuable to those clients that have the ability to use them,” said Rick Ratakowski, director of investment strategies, at NISA Investment Advisors. “In many respects, the derivative markets maintained liquidity throughout the crisis and that allowed clients to rebalance without having to sell physical assets. Derivative liquidity was a bright spot in March.”

“Having Treasuries and STRIPS was critical to having a resilient LDI strategy in the wake of the crisis because spreads moved significantly wider,” said MetLife Investment Management’s Mullin. “It was the worst quarter on record for credit assets, so having a Treasury anchor provided plans with flexibility to reposition the portfolio.”

Veerman said he and his team are “big believers” in using capital efficiently, whether that’s through Treasury STRIPS, futures or swaps. “It’s absolutely prudent, particularly if you are still reasonably invested in equities because it allows you to capture the equity risk premium over time, while maintaining a significant hedge relative to your liabilities,” he said.

At MetLife Investment Management, Mullin said the firm uses futures “to manage the term structure of the asset portfolio and align that with the liabilities.” He added that futures can also be used to diversify a portfolio into market sectors that might have less interest rate risk than the liabilities “or augment the duration of the portfolio synthetically.”

To be sure, many plans held pat during the first half of the year, neither rerisking nor rebalancing.

“For more aggressive plans or those that had specific rerisking designed into their glidepath, we did see a reallocation to return-seeking assets from government bonds into equities,” said Mullin. “But mainly we think many sponsors spent the first two quarters just catching their breath, re-evaluating their long-term plans rather than reacting to market dislocation.”

As plan sponsors continue to adjust to the current market and economic environments, some will likely re-evaluate their long-term pension strategy. For many, the choice between hibernation and termination had already been made. But this analysis may change in the future.

“Often, it’s the finance folks driving the charge for derisking strategies,” said Frank Maniaci, actuarial consultant and resource actuary at MassMutual. “They will do a cost-benefit analysis around the various scenarios – hibernation, buyouts, lump sums, etc. – based on different economic scenarios.”

“Though it might seem self-evident that companies that had already transferred pension liabilities would be happy, that’s not necessarily the case.”

“A hibernation portfolio weathered the recent storm quite well,” said NISA’s Ratakowski. “Those with heavy fixed income allocations – 90%-plus – found their funded status barely moved. That’s a compelling story and means that you don’t necessarily have to contribute additional assets and go through the buyout process. However, you would still be able to down the road because you have a very stable portfolio.”

‘Eyes wide open’

Despite the performance of LDI strategies, it’s not a risk-free approach.

“If you want to be an LDI company – one with a pension plan in hibernation – do that with your eyes wide open,” advised Glenn O’Brien, head of the U.S. market for Prudential’s pension risk transfer business. “Make sure you understand the risks associated with that choice and what you need to achieve to outrun your liabilities. We have reminded people for years that one-standard deviation models are nice but have not captured the real cost and risk of holding a pension plan over the medium term.”

Again, the detail is important here because not all hibernation portfolios are created equal, nor did they all perform well in recent quarters.

“Even the concept of hibernation depends on the implementation of the LDI glidepath,” said An Jacobs, senior partner, global retirement solutions leader at Aon. “If you were heavier in Treasuries going into the crisis, you probably did better than if you were heavier in credit – you probably gained some funded status, even if that wasn’t your intention.”

It’s also important to understand the impact of what many are calling lower for longer. If interest rates remain at historically low levels for an extended period of time, “When rates fall, sponsors focus on how their funded status is dropping,” said Colyar Pridgen, senior LDI strategist at Capital Group. “But low rates also mean that liabilities are expected to grow at a slower pace going forward, and that serves to lower the hurdle for what plans need to earn on their assets.”

That’s not the end of the story, though, he said. Because of the positive convexity baked into liabilities, each basis point that rates fall hurts more in terms of liability increases than the basis point before. “The need for returns is lower when rates are lower, while the potential pain from unhedged liabilities is perhaps higher,” he said.
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With MetLife, you can help secure your retirees’ financial future and protect your company’s finances.¹ Our experienced team of pension risk transfer experts has been helping Fortune 500 companies like yours navigate the de-risking process for decades, and they know how to help. Your journey to a pension de-risking solution that provides real peace of mind starts here, together with MetLife.

Discover more at www.metlife.com/pensionrisk

¹MetLife’s Retirement & Income Solutions division, the company’s institutional retirement business, issues products through Metropolitan Life Insurance Company and Metropolitan Tower Life Insurance Company, two wholly owned subsidiaries of MetLife, Inc.

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