



December 2009

# Risks and Pension Schemes- Navigating Slippery Slopes

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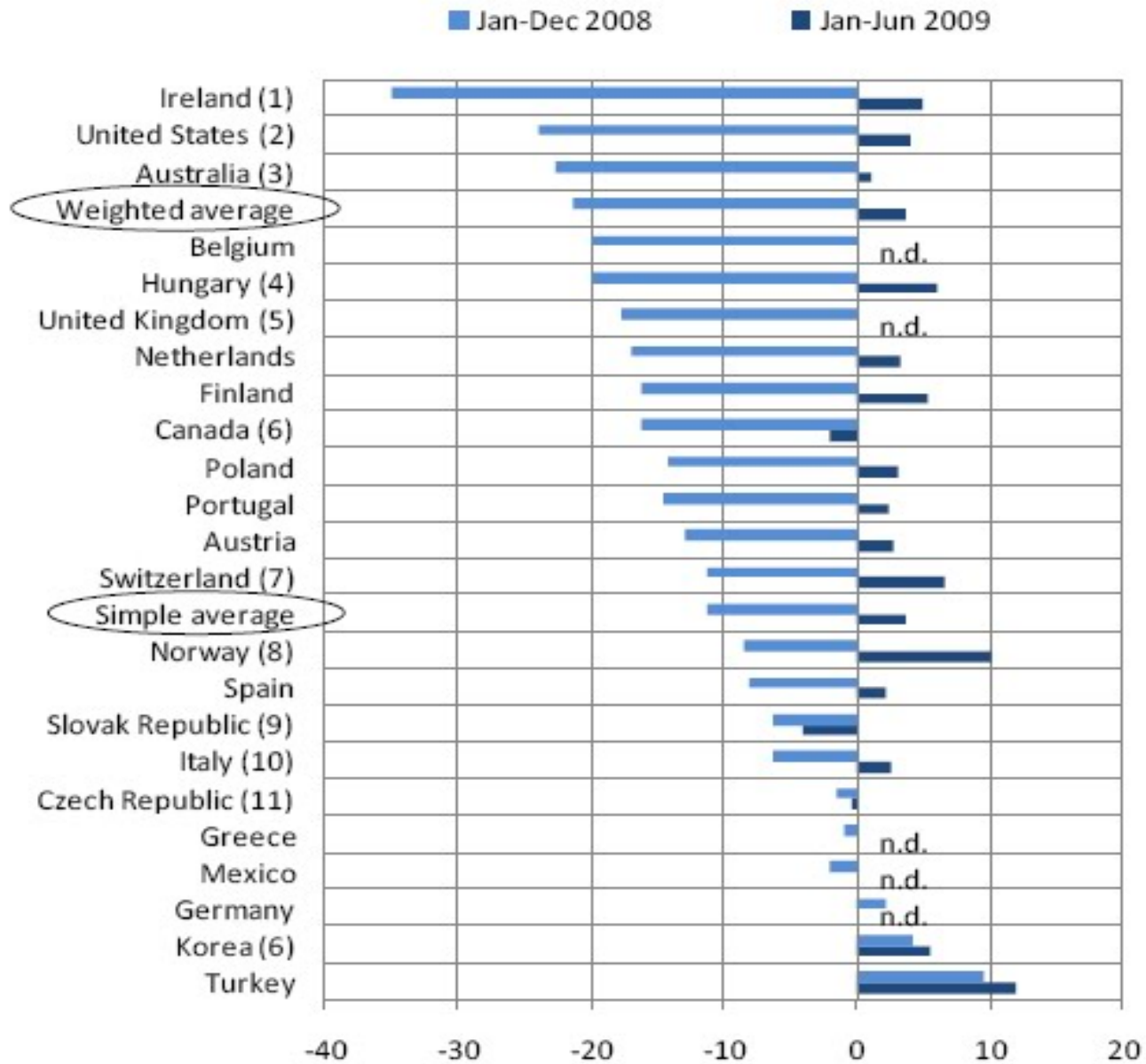
Hewitt

# Agenda

- Introduction
- What has happened?
- Global Risk Survey Results
- Managing Risk in Defined Benefit Schemes
- Managing Risk in Defined Contribution Schemes



Figure 1. Pension funds' nominal investment rate of return in selected OECD countries



Source: OECD Global Pension Statistics and OECD estimates.

## A Dark 6 Months

'Takeover of Fannie, Freddie  
to cost government billions'  
**Seattle Times 08/09/08**

'Six Central Banks cut  
interest rates 0.5%'  
**Financial Times 08/10/08**

'Lehman Collapse send  
shares diving'  
**Evening Standard 15/09/08**

'ISEQ Crashes to 12 year low as chill  
winds blow in from Iceland and Asia'  
**Irish Independent 25/10/08**

'Northern Rock is nationalised'  
**The Times 23/02/08**

'Three More Banks sign  
up for bailout scheme'  
**Irish Independent 28/10/08**

'Insolvency Fears lead Ireland  
to Nationalise Anglo Irish Bank'  
**Financial Times 16/01/09**

'ISEQ hits 14 year low'  
**Irish Independent  
24/2/09**

'EU Probe into €100m hole in  
Waterford Pensions'  
**Irish Independent 7/2/09**

'Bord na Mona tells workers it  
cannot pay their pensions'  
**Irish Times 2/4/09**

# What Has Happened?



**Accounting Assets**

**Accounting Liabilities**

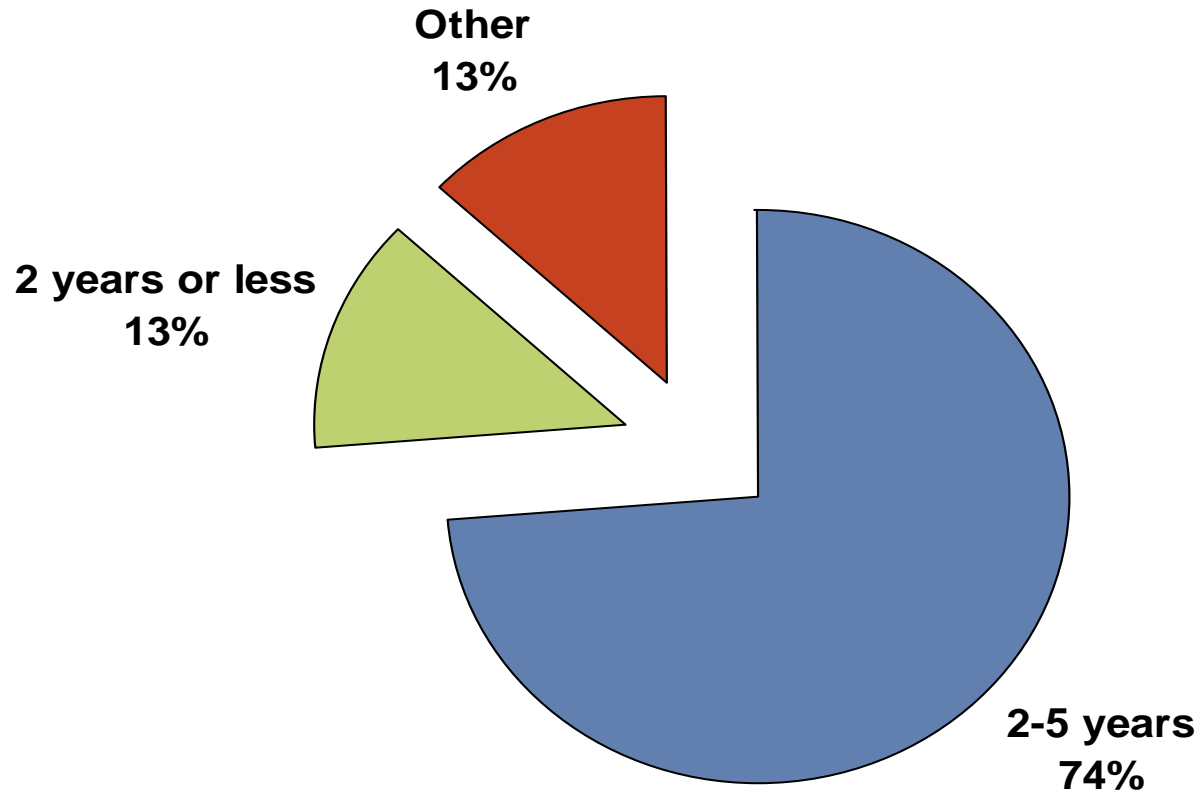
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# **The State of Play in Ireland**

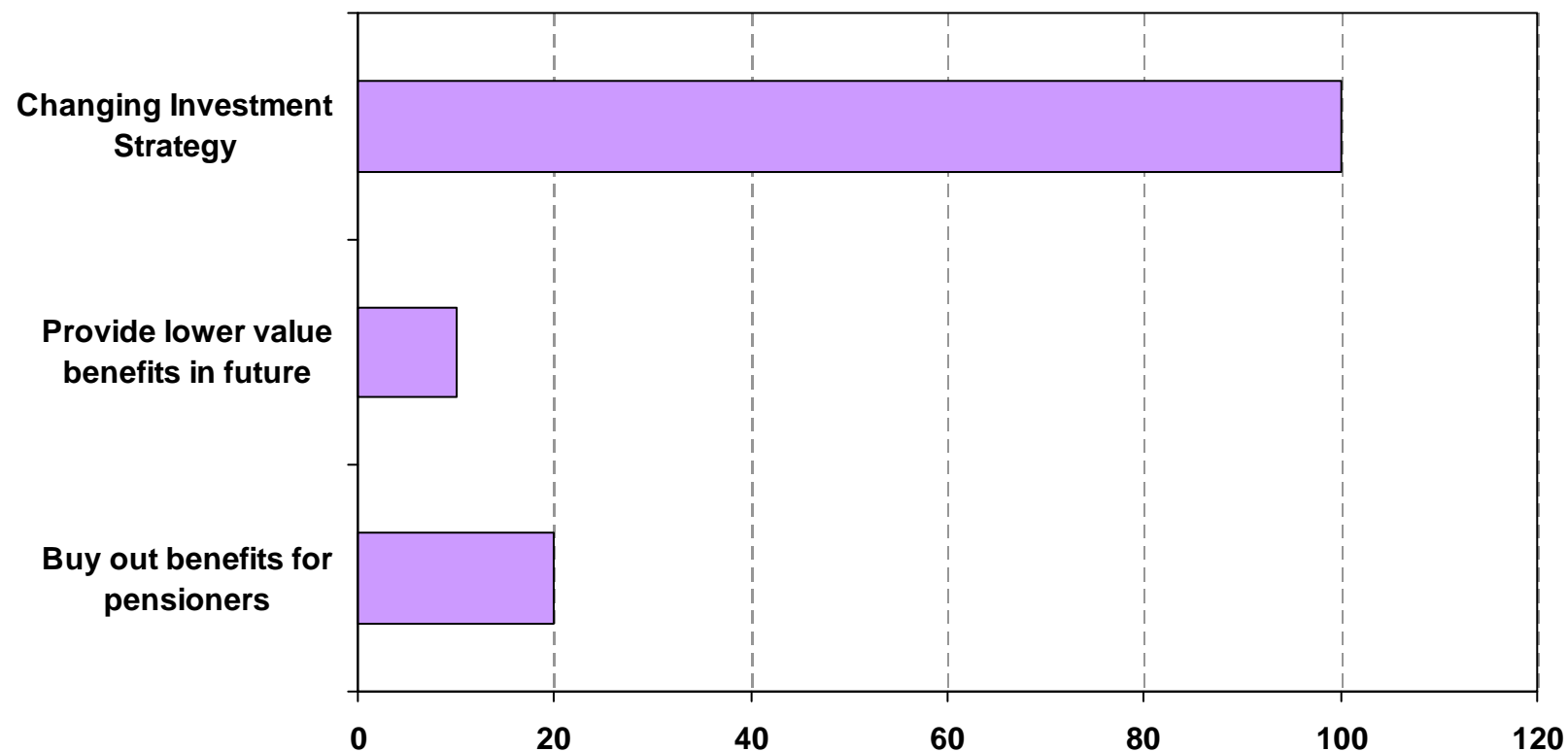
## **Global Risk Survey Results**



## Timescales to reach long term goals

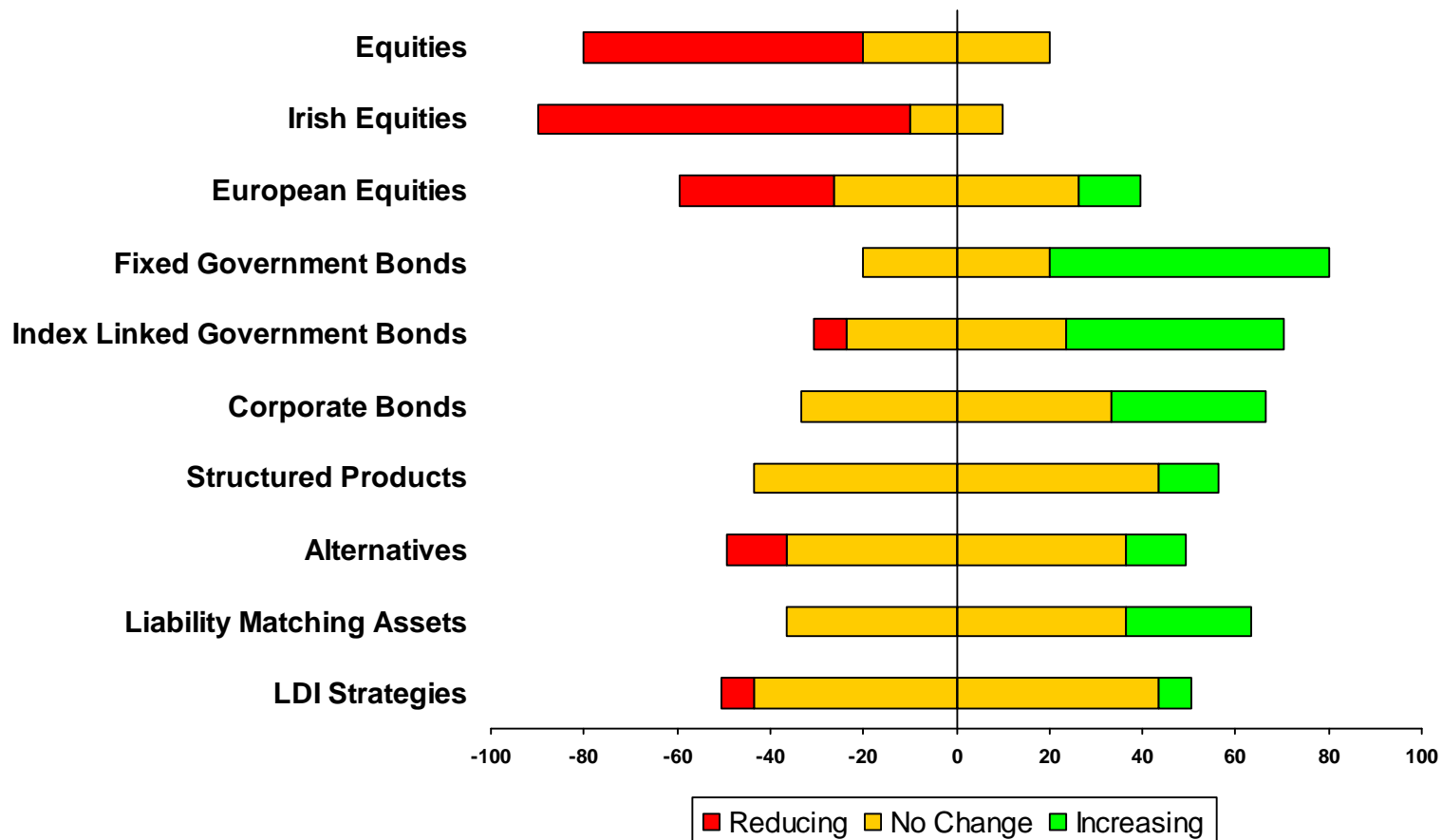


## Actions to meet long term goals

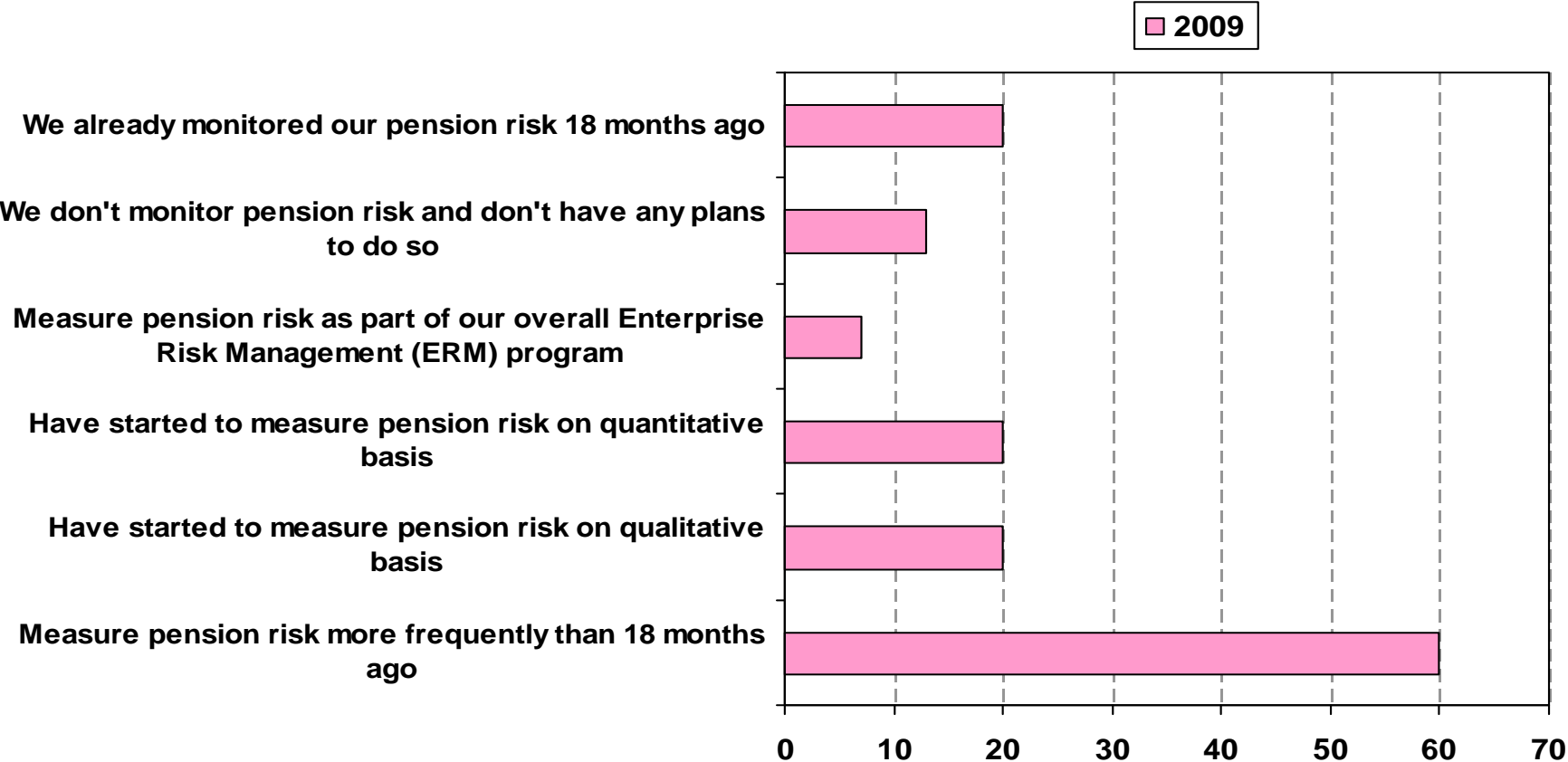




# Investment Policy Changes



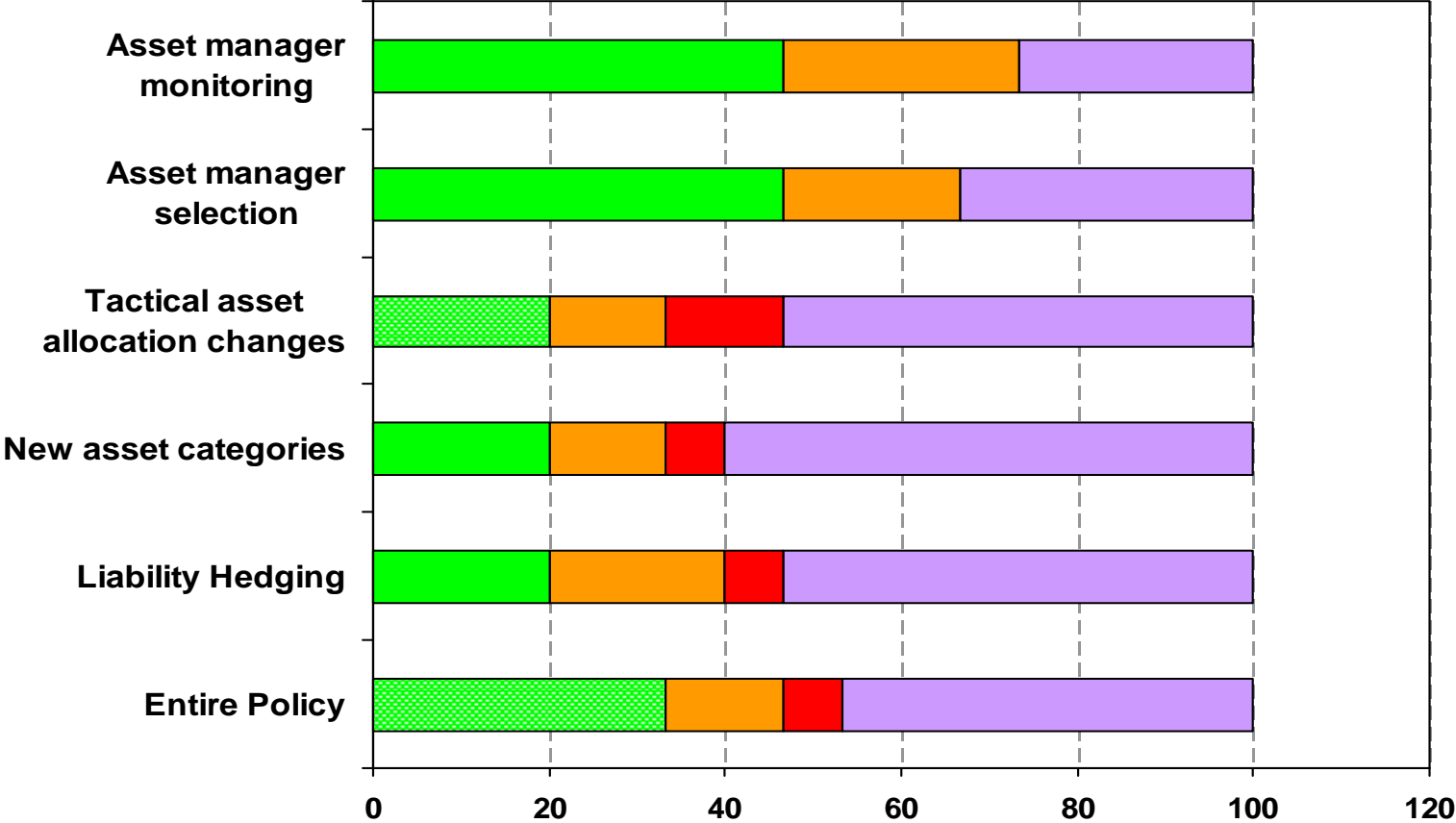
# Monitoring Pension Risks



# Financial Focus

	Less Influential	Broadly the same	More Influential
Accounting Measures	0%	40%	60%
Cash Requirements	0%	47%	53%
Risk Reduction	0%	13%	87%
Perception of analysts, rating agencies, etc	13%	53%	33%

# Delegation of Investment Decisions



## What were the causes?

- Credit Crunch
- High Equity Content
- One size fits all Investment strategies – Managed Funds
- Irish Equity Concentration
- Irish Property Concentration
- Governance!!

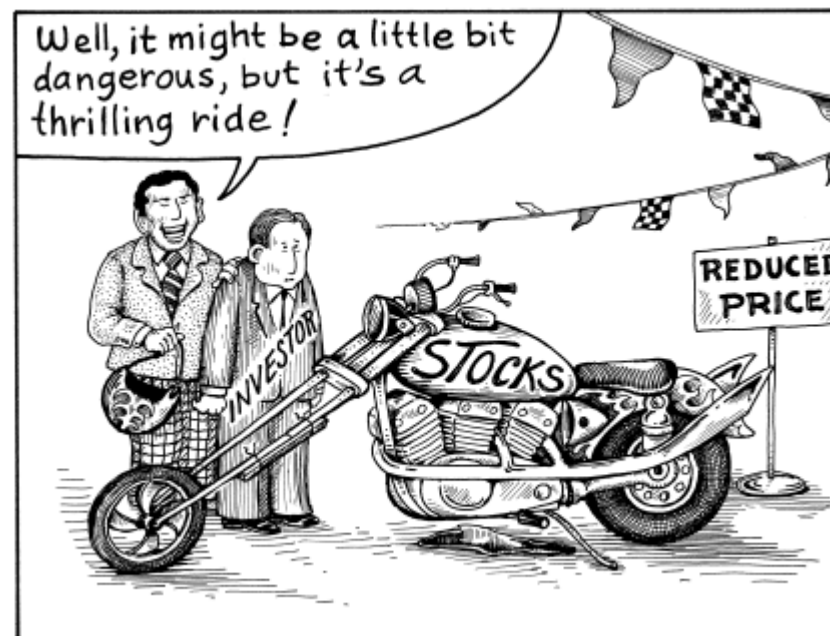


# Managing Risk in Defined Benefit Schemes

- Do solutions exist to the funding crisis?
- What is being done on the investment side?
- What actions can be taken? A Solutions Roadmap

## What is being done on the Investment Side?

- Increased Pro-activity
- Tailored Investment Strategies
- Strategic Plans – Flight-paths
- Increased Diversification
- Global Risk Benchmarking
- Alternative Consultant Engagement Models

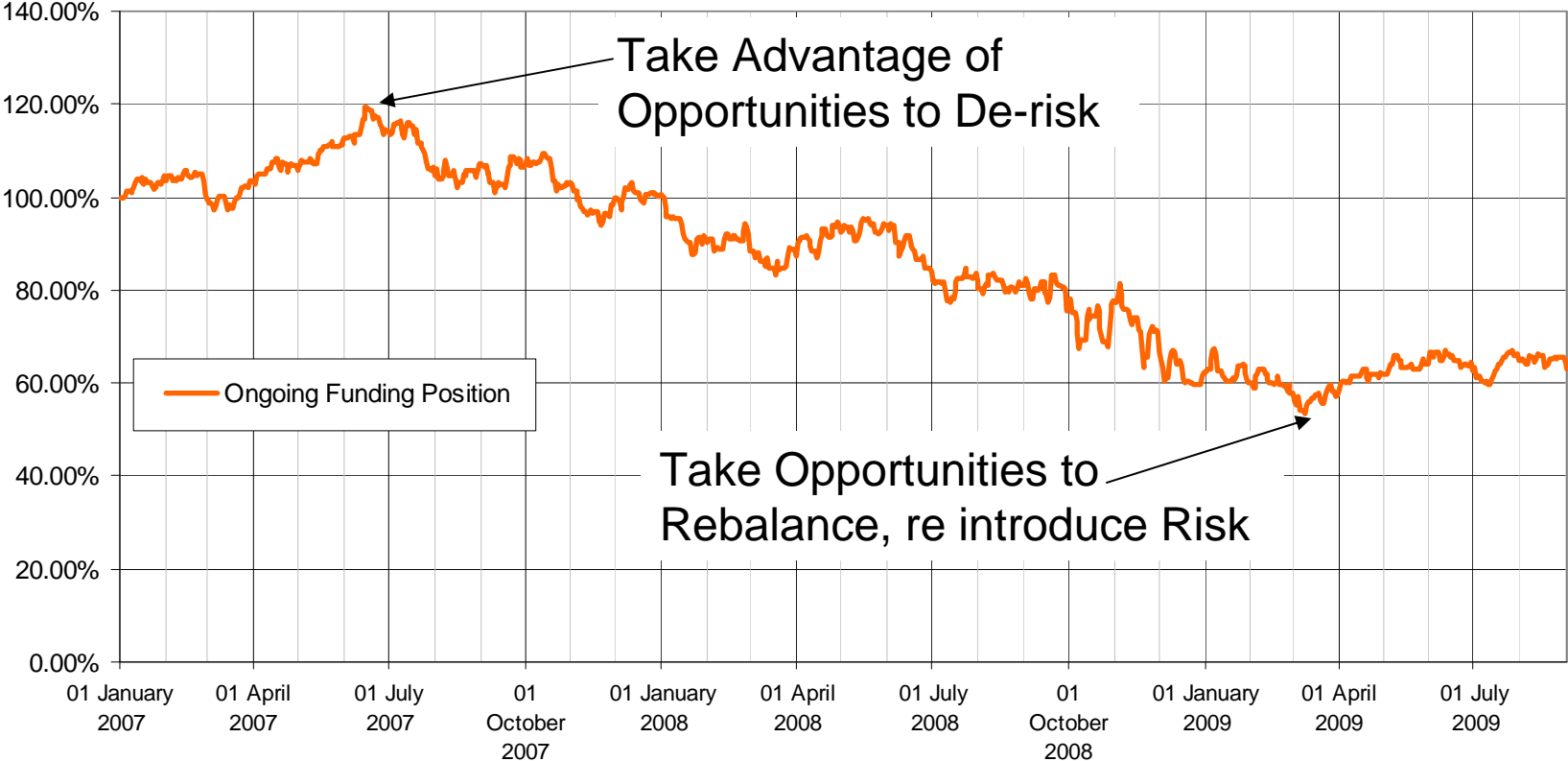


## More Pro-activity (i.e. Investment Switches)

- Timing is critical (as demonstrated by the recent movements in the assets and liabilities)
- For example, Hewitt's medium term views have included :
  - Irish Equities & Property were far too rich and too risky
  - A preference for more diversification (alternatives and corporate bonds)
  - Views on timing of lengthening duration of bond portfolios
  - Views on re-balancing
- The use of directive investment strategy and/or triggers (e.g. when a certain funding level is reached or a certain level of asset out-performance is achieved) should be considered

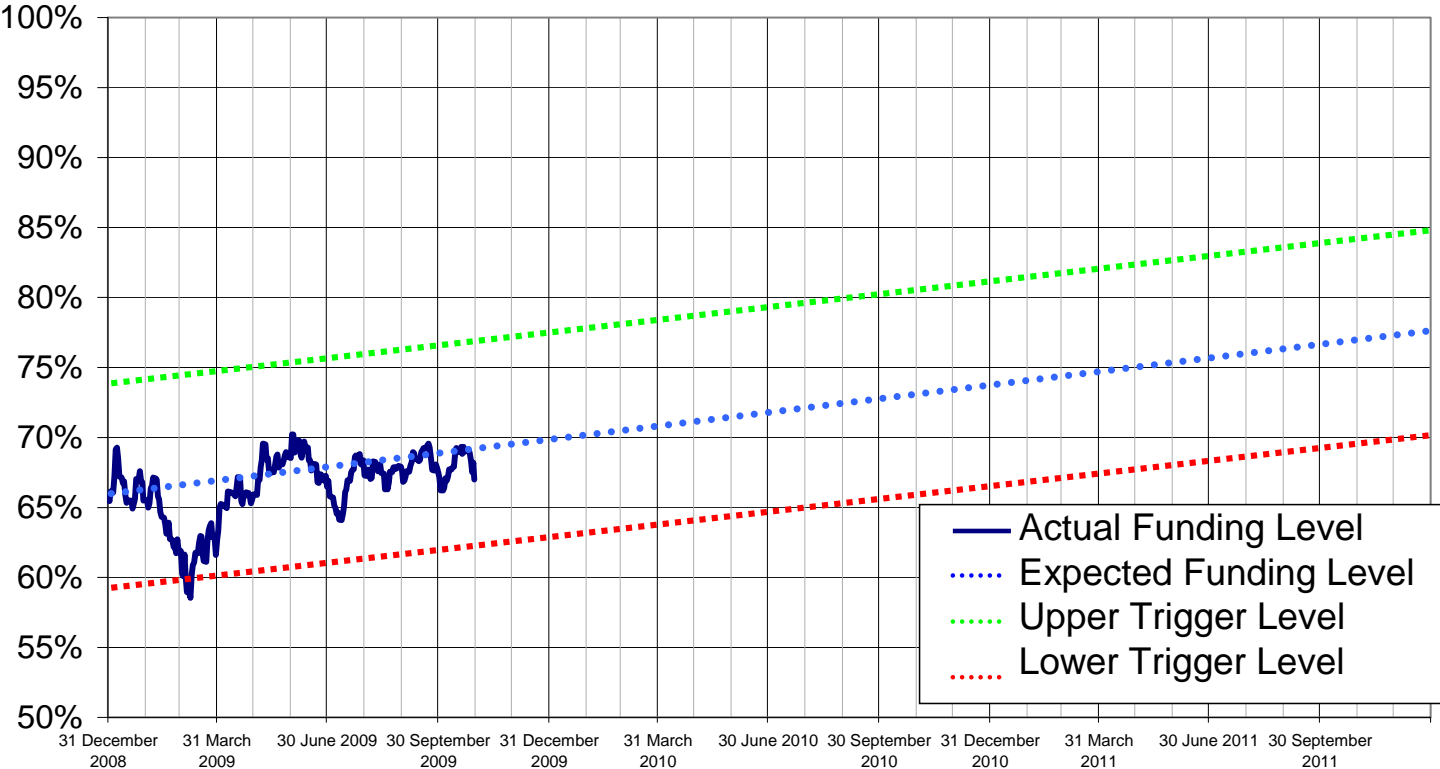


# Impact on Pension Funds



Note: The above graph is approximate, and becomes more approximate as the projection period lengthens. It reflects approximate stock market movements and interest rate changes (assuming these occur uniformly along the length of the yield curve), but not client-specific factors, such as material changes in membership numbers or profile or changes in benefit scales. It is designed to give a broad picture of the direction of funding changes since the last actuarial valuation but does not have the same level of reliability as, and therefore does not replace the need for, formal actuarial valuations.

# Flight Plan's – An example



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# Strategic Plan – A Flight-path Example

Overall reduction in equities and increase in bond allocation required.

Bonds a mix of corporate and index linked

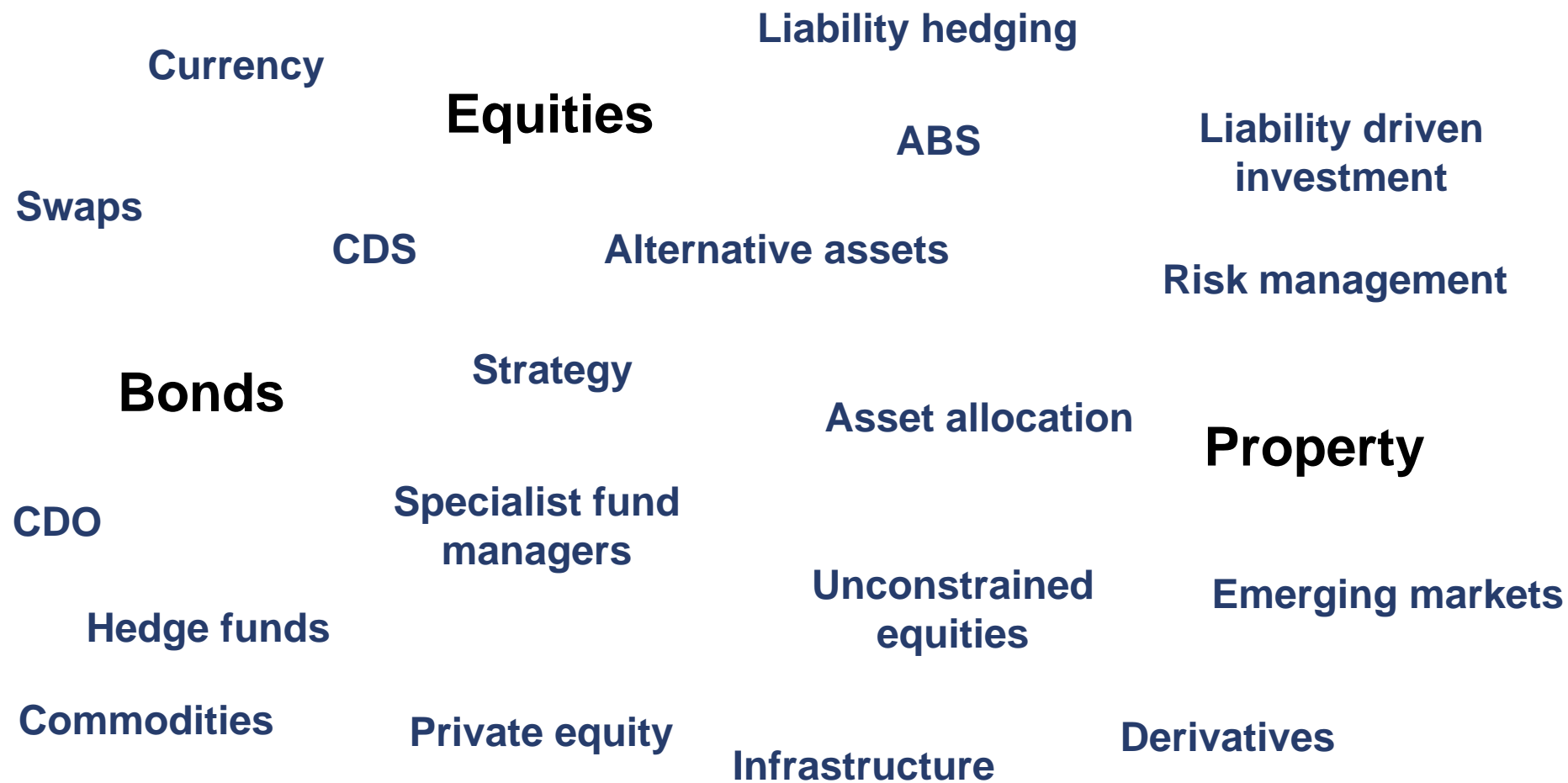
Equity allocation likely to be at least halved

Switch 10% current equities out and into corporate bonds immediately

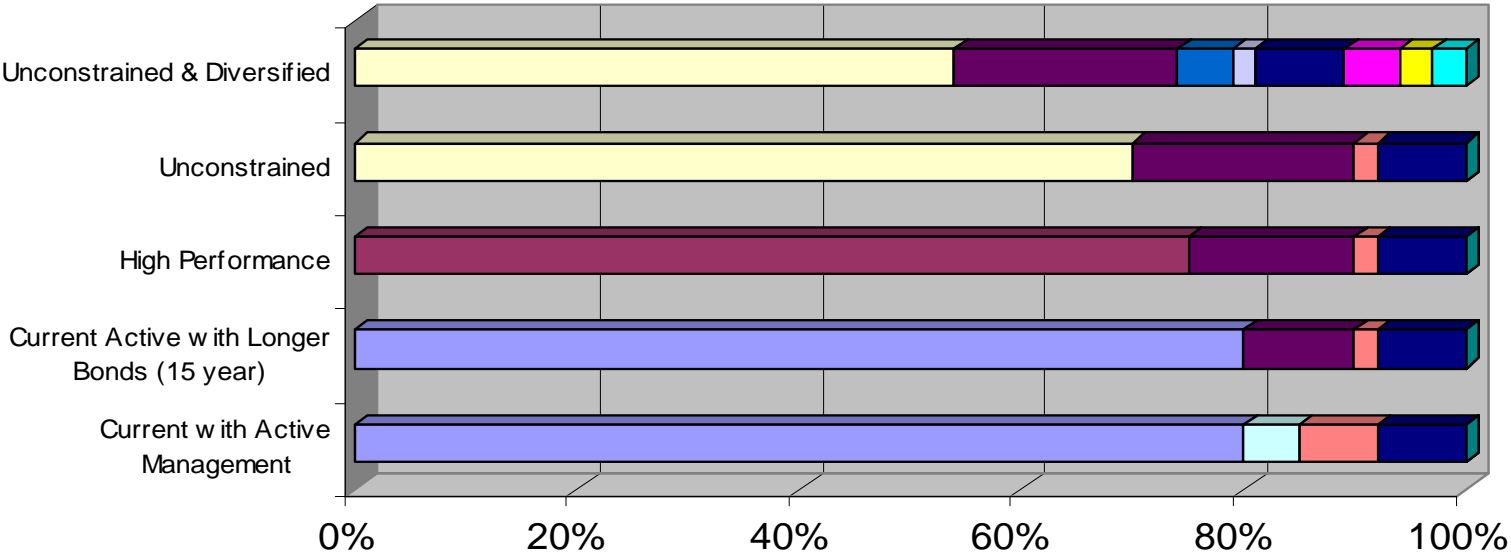
Allocation to Bonds	Funding Level					
Time	<60%	60-75%	75%-90%	90%-120%	120%-194%	>194%
During 2009	25%	35%	45%	55%	55%	100%
During 2010	35%	42%	50%	55%	65%	100%
During 2011	45%	48%	52%	55%	75%	100%
During 2012	55%	55%	55%	55%	75%	100%



# What is Diversification?



# Impact of Diversification



Return	Risk	VaR (mil)
3.3%	13.9%	€12.98
3.6%	15.2%	€14.10
3.5%	15.8%	€14.55
2.7%	16.0%	€14.66
2.7%	16.2%	€14.81

- Global Equities - Traditional Active
- Global Equities - High Performance
- Global Equities - Unconstrained
- Fixed Interest Gilts - Passive
- Index-Linked Gilts - Passive
- Cash - Passive
- Absolute Return - Hedge Funds
- Absolute Return - Active Currency
- Other Alternates - Property
- Other Alternates - Private Equity
- Other Alternates - Infrastructure
- Other Alternates - Commodities

# Alternative Engagement Models

Traditional Approach	Directive Approach	Delegated Consulting Service (DCS)
<p>Monitoring</p> <p>Long term Asset Allocation</p> <p>Manager Selection</p> <p>Reactive</p> <p>Slow to Implement</p>	<p>Work with Small Group</p> <p>Make proactive recommendations and revert for approval</p> <p>Management of Dynamic Investment Strategy</p> <p>Use of Tracker</p> <p>Shorter Term Asset Allocation</p> <p>Proactive</p>	<p>Full delegated management of Assets and Liabilities</p> <p>Final stage of Regulatory Approval</p> <p>Fee pegged to improvements in funding</p>



# Governance must be addressed!



# DB Solutions Roadmap

- ▣ Increased Pro-Activity
- ▣ Avail of tactical opportunities (corporate & index-linked bonds, unconstrained equities, emerging markets, commodities)
- ▣ Set investment objectives relative to liabilities
- ▣ Know where you want to get to and what to do when you get there!
- ▣ Manage and Measure progress accordingly
- ▣ Improve diversification
- ▣ Address the elephant in the room!



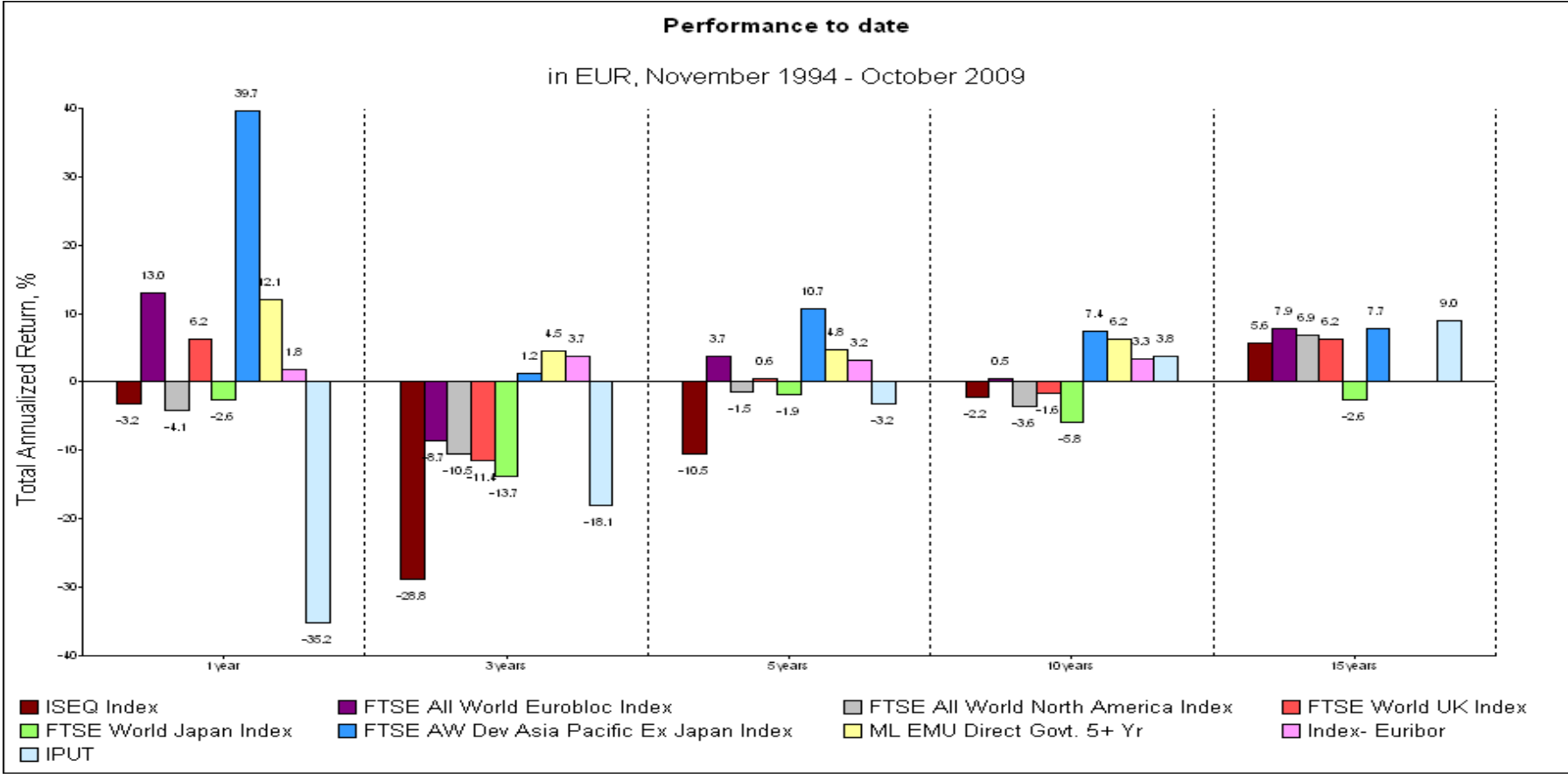
# Managing Risk in Defined Contribution Schemes

- Trustee Responsibility/Governance
- Current State of Play
- Issues Emerging
- Key Messages

# Trustee Responsibility

- Getting more onerous
- Real choice???
- Proper guidance? Adequate Information?
- Investment strategy and “Nature and Duration of Liabilities”
- Policies on member switches
- Governance!

# Major Index Returns to 30th October 2009



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## DC Issues Emerging

- Less than 15% to 20% actively manage their investment
- 80% to 85% use Default Option
- 90% of Default Options invest in Managed Fund (50% Stand Alone; 40% coupled with Lifecycling)
- Managed Fund has 50% to 80% in Equities
- Investment Managers no longer actively 'manage' asset mix in Managed Funds

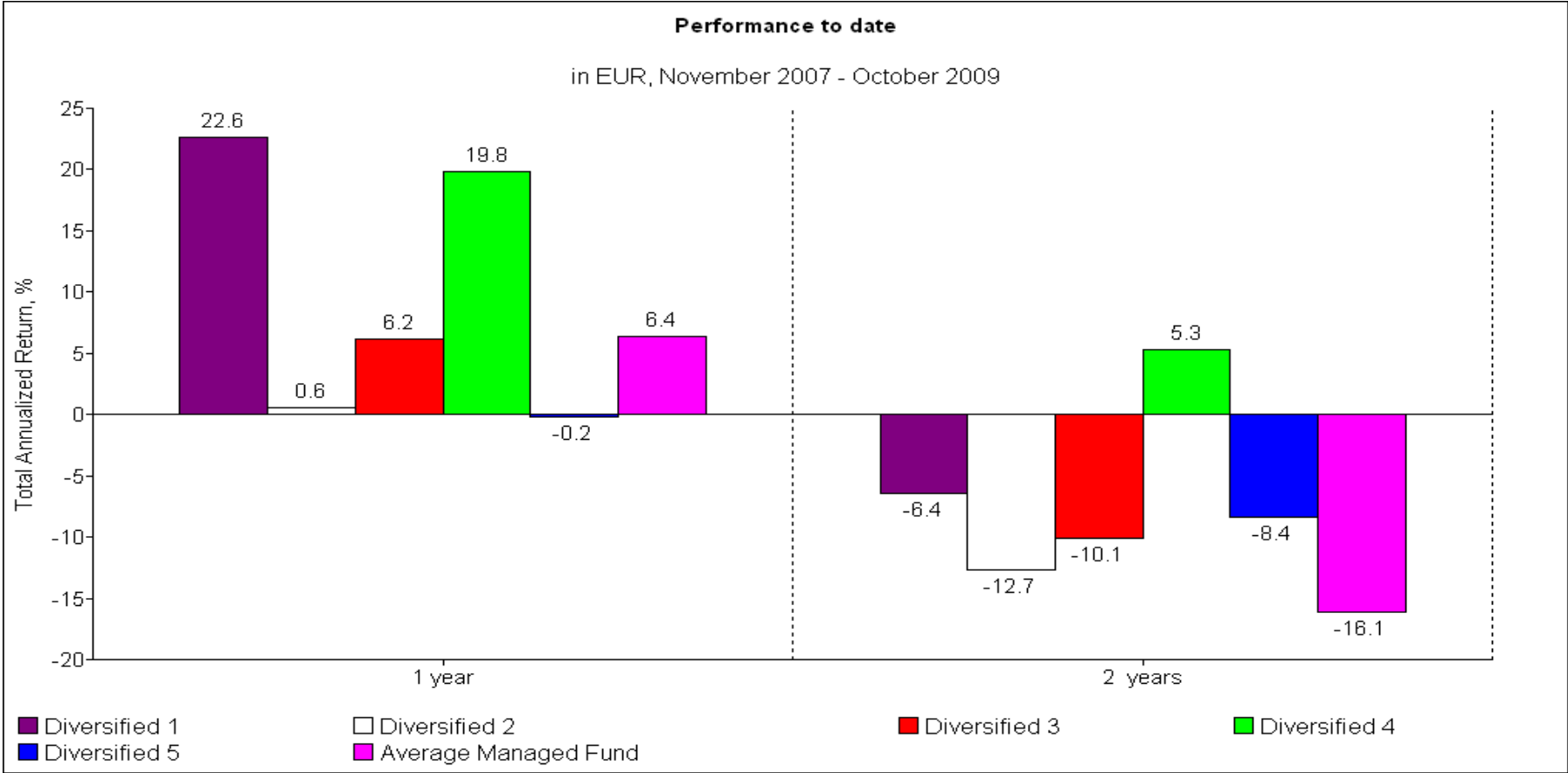
## Issues with Traditional Default – Consensus Fund

- High Equity Exposure
- Perceived as Low Risk
- Irish Exposure
  - Equity
  - Property
- Inefficient

## Majority of Current Default Options

- Take a long term rather than a short term view
- Focus on “real” long term returns rather than short term positive absolute returns
- Do not specifically strive to manage volatility
- Is it possible to have a Default Option to satisfy everybody?

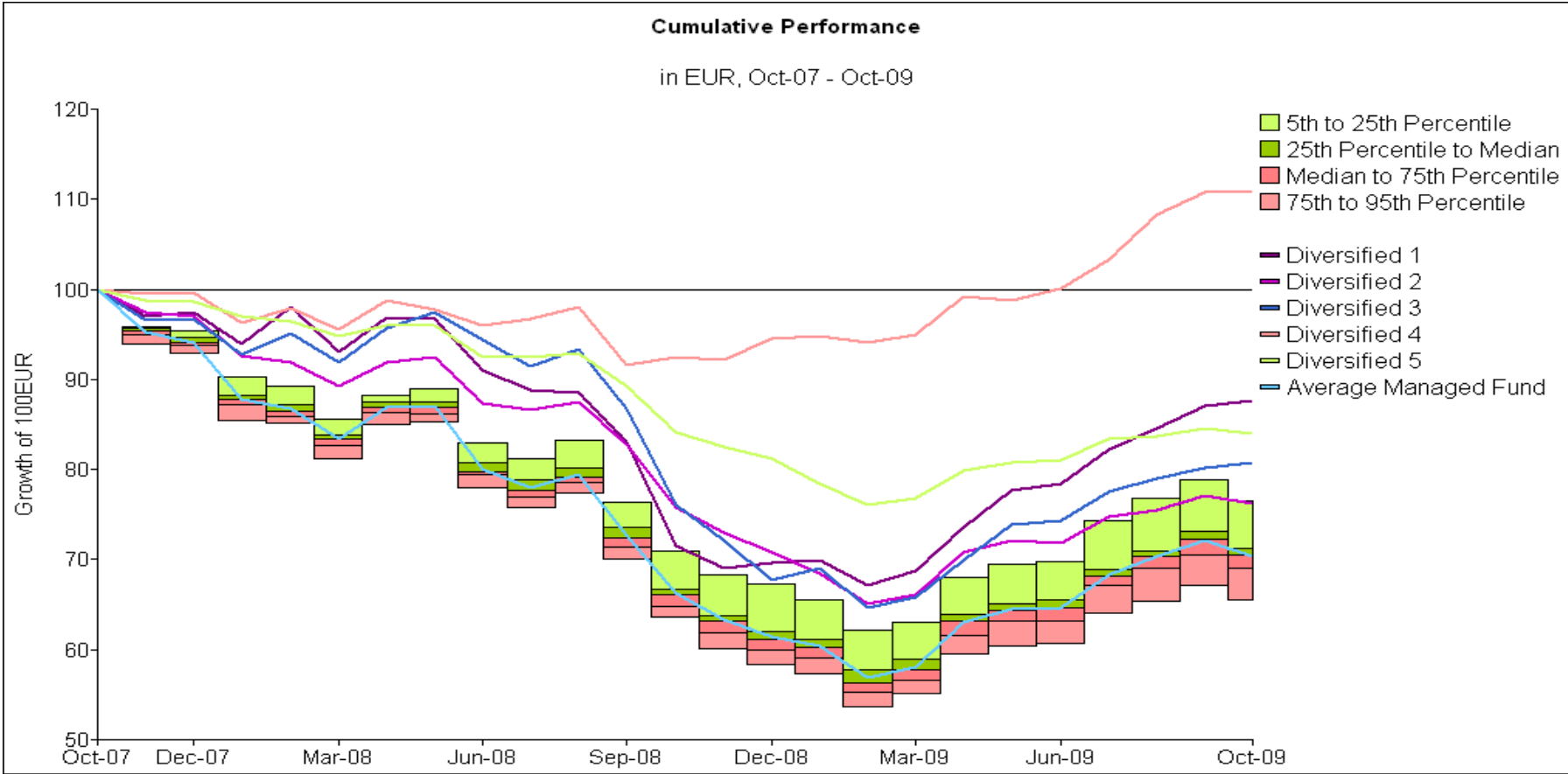
# Performance of Diversified Funds vs Average Managed Fund



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# Diversification lowers volatility

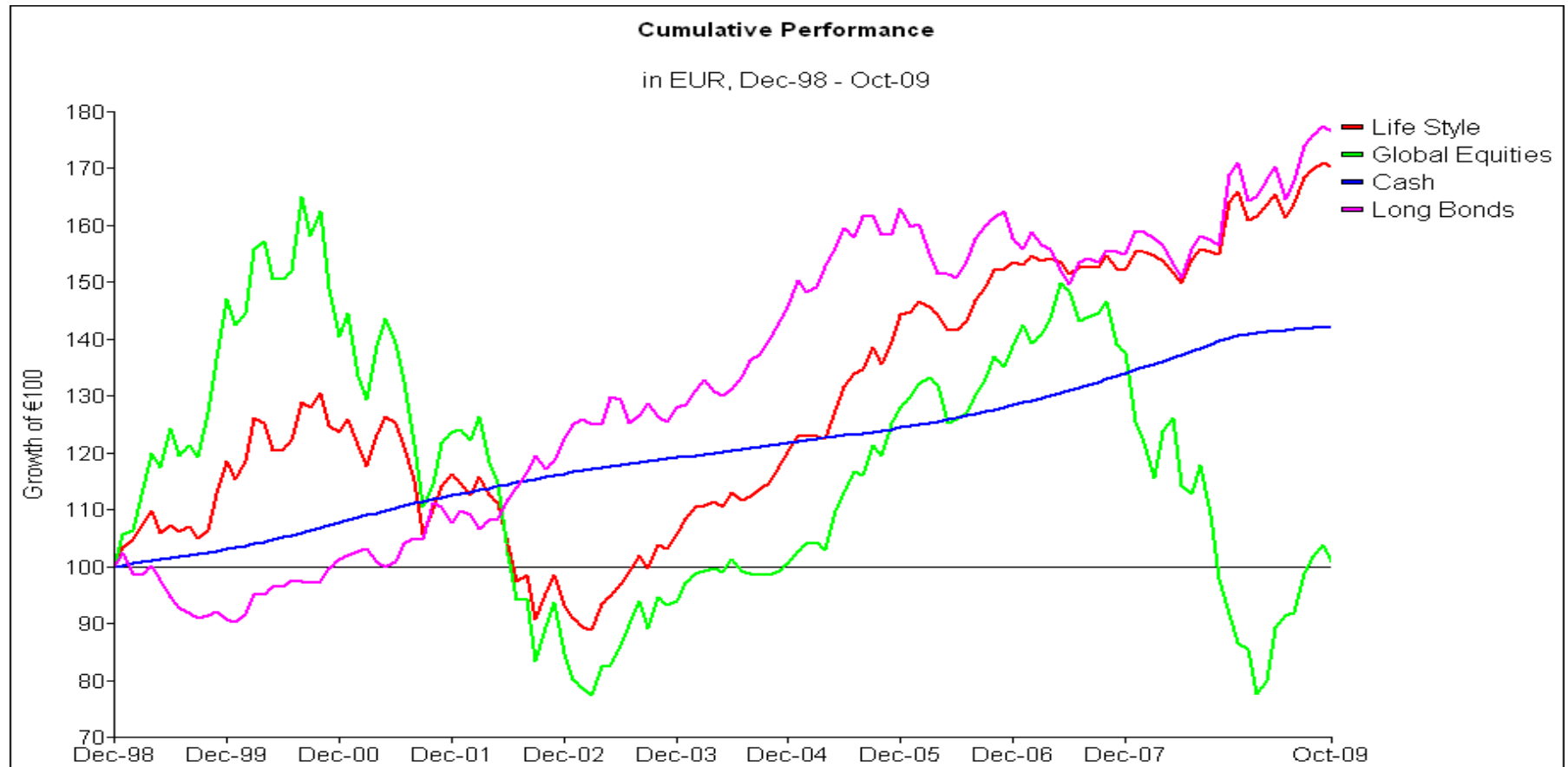


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# Lifestyle Works



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## Key DC Messages

- Regulators becoming more prescriptive about Trustee responsibility
- Need Real Choice
- Need to Increase Efficiency of Portfolios (Increase Diversification)
- Need to Protect Pensions closer to retirement (Lifestyle works!)
- Need to consider risk/return trade-off of various options





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