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## Papers

# Pension risk, governance and CFO liability

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**Abstract** Properly identifying, measuring and mitigating pension risks continues to be a critical element of fiduciary governance. The complexity and ongoing nature of the risk management process is sometimes overlooked as less important than realising a particular rate of return. Recent market volatility, large funding deficits and pressures from creditors, shareholders, rating agencies and plan participants make it harder for pension plan fiduciaries to avoid the adoption of some type of pro-active risk control strategy that effectively integrates asset and liability economics. At a time of great uncertainty, chief financial officers (CFOs) are increasingly being asked to shoulder the burden of making pension-related funding decisions that have the potential to materially and adversely affect plan participants, shareholders and creditors. As a result, the CFO is exposed to fiduciary liability, career risk and the economic consequences of an outcome with enterprise impact.

**KEYWORDS:** *asset-liability management, defined benefit, defined contribution, de-risking, ERISA, fiduciary, hedging, liability, pension governance, pension risk*

## INTRODUCTION

### Big money and headaches for treasury professionals

The last few years have not been kind to corporate defined benefit (DB) pension plans. With no immediate relief

in sight, chief financial officers (CFOs) are bracing themselves for the worst. An onslaught of ERISA lawsuits (many of which are class actions), regulatory enforcements, pension accounting reform, capital market turbulence, longer life spans and significant scrutiny

of employee benefit plan finances are a few of the challenges that have C-suite executives in a tailspin. Unless sponsors take control by properly identifying, measuring and mitigating risks, underfunding and poor governance spell trouble for participants, shareholders and creditors. Big money is at stake, so getting it wrong will be expensive.

According to a 2011 report, pension assets at year-end 2010 exceeded US\$31trn, up 8 per cent from 2009 and led by the USA with roughly 63 per cent of the total.<sup>1</sup> UK, Canada, Japan, the Netherlands and Australia comprised another 33 per cent. Asset growth tells a small part of the story. During the last few years, liabilities and related funding gaps have risen dramatically, far outpacing inflows from investment portfolios. The Pension Protection Fund reports that UK schemes lost roughly £80bn in September 2011 alone.<sup>2</sup> The story is the same in the USA, with a jumbo aggregate deficit in the neighborhood of US\$400bn for S&P 500 companies alone.<sup>3</sup> CFOs who planned to allocate cash to positive Net Present Value (NPV) projects find themselves instead spending money to top off underfunded pension schemes due to low interest rates, anaemic equity returns and longevity-related costs. In its look at pension contributions after 2008, the Society of Actuaries predicts that US companies will average required contributions of US\$90bn per year until 2020, 'peaking at about US\$140 billion in 2016.'<sup>4</sup> In context, US\$90bn is roughly 16 per cent of the US\$553bn in monies spent for US M&A deals done in 2010.<sup>5</sup> Notwithstanding tax benefits associated with pension plan

contributions, free cash that is used to fund employee IOUs is otherwise not available to grow the business. Therein lies the rub that has the issue of employee benefit economics landing squarely on the desk of CFOs everywhere, forcing them to balance legal obligations owed to retirees with performance expectations on the part of shareholders and lenders.

## **ENTERPRISE RISK MANAGEMENT, EMPLOYEE BENEFIT PLANS AND THE ROLE OF THE CFO**

Enlightened senior decision-makers understand the enterprise concept and are moving ahead to pro-actively mitigate some or all of the economic and operational risks associated with offering a traditional pension plan. For reluctant sponsors, the inevitable inaction is costing them plenty. Pessimists predict that further accounting and funding reforms will force the hand of latecomers to the pension risk management party. Already there is an emerging sentiment that a failure to consider even minimally some type of hedging programme could result in an allegation of fiduciary breach if construed as an extension of the fiduciary duty to diversify. Applied to corporations, one case affirmed culpability for not having hedged commodity price risk, despite the recommendation of outside advisers.<sup>6</sup> It is important for corporate pension plan fiduciaries to understand how prevailing employee benefits law compares and contrasts with the business judgment rule and related laws that apply to corporate officers and directors.<sup>7,8</sup> Regulators continue to emphasise the

need for a prudent process with respect to the use of derivatives. In a letter dated 21st March, 1996, to the then Comptroller of the Currency, a US Department of Labor official laid out detailed guidelines about information gathering, analysis and determination of an 'appropriate methodology used to evaluate market risk'.<sup>9</sup> Stress tests, regular monitoring and a vetting of operational risks were a few of the referenced action steps. In its letter of 3rd October, 2006, to a senior attorney with Reed Smith LLP about the use of a risk management strategy to better link 'the risks of a plan's investment portfolio assets with the risks associated with its benefit liabilities', the US Department of Labor responded that: 'The general standards of fiduciary conduct contained in sections 404(a)(1) apply to any investment by a plan covered by Title I, including investments made pursuant to the described risk management investment strategy'.<sup>10</sup> This means that a CFO with responsibilities for managing the company's pension plan(s) must 'act with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims'.<sup>11</sup>

Aside from the statutory obligations to put plan participants ahead of competing interests (and hopefully a company's desire to attract and retain productive workers by offering an attractive benefit mix), a holistic approach to pension risk management reflects the reality that share values can drop when a pension plan is ill-managed.<sup>12</sup> According to an interview

with a senior UK investment consultant in *Finance Director Europe*, pension plan management has only recently become the purview of CFOs as 'the pension fund is more integral'.<sup>13</sup> This is no surprise since, as already mentioned, underfunding can diminish liquidity, increase cost of capital, impede mergers or acquisitions and/or lead to lawsuits.

## **CONFLICTS OF INTEREST AND PENSION PLAN MANAGEMENT**

As momentum builds for finance executives to engage more actively in pension plan stewardship, critics caution that conflicts of interest should limit their involvement so as to avoid being seen as prioritising the needs of shareholders before participants (or in fact actually prioritising inappropriately). Specifically, if a pension de-risking or hedging strategy reduces reported expenses and deficit volatility for shareholders but participants do not gain, there could be serious questions about whether fiduciary obligations have been met. Authors of a special report on ERISA fiduciary liability suggest that the use of an independent trustee could make sense in lieu of having the CFO or another corporate insider serve as trustee.<sup>14</sup> UK companies are not immune to the conflict of interest dilemma. A 2008 White Paper on this topic reminds readers that a 'senior officer who acts in breach of any duty owed to the company and/or the scheme would remain personally liable for the breach' and could be 'in breach of a duty to the scheme if he does not disclose to the trustee board any material information that he knows'.<sup>15</sup> For those countries with no code of conduct for pension plan governance in place, participants

must hope that those in charge voluntarily invoke best practices to avoid conflicts of interest. As OECD researchers point out, fail-safe rules are still emerging in some corners of the world and can vary by plan size and knowledge of trustees, consultants and other types of adviser.<sup>16</sup> The proper legal interpretation is left to jurists but suffice it to say, it makes sense that a financially healthy sponsor and a well-funded defined benefit plan will often mean less risk for participants.<sup>17</sup> Neither shareholders nor plan participants want the *status quo*, if it means mounting losses that impede long-term growth or threaten a firm's ability to maintain itself as an ongoing concern that can pay what it owes.

Just as properly managing the risks of the defined benefit plan has the potential to improve the financial health of the sponsor, the converse can be true. An otherwise well-funded defined benefit scheme may lose its financial cushion if trustees invest in company securities such as stock or bonds and the sponsor files for bankruptcy or liquidation of its assets. According to the authors Smith, Williams and Kelson, a traditional ERISA pension plan can have up to 10 per cent of its assets invested in company stock.<sup>18</sup> Sometimes this allocation requires a prohibited transaction exemption from the US Department of Labor.

Questions about conflict of interest and valuation may entail the services of an appraiser, as well as an independent fiduciary, before the stock purchase can be made.<sup>19</sup> Based on results of a 2010 study conducted by Towers Watson, a severe recession and related funding deficits have tempted some sponsors to make up the shortfall by contributing

company stock. Between 2006 and 2009, the percentage of Fortune 1000 sponsors that held company stock in the defined benefit plan fell from 15.6 per cent to 13.3 per cent with approximately 4.25 per cent of plan assets taking the form of company stock in 2009. Said differently, while the numbers dropped slightly in the last few years, one out of every seven Fortune 1000 sponsors has some stock in its defined benefit plan.<sup>20</sup>

### **RISK MANAGEMENT PRINCIPLES APPLY TO DEFINED CONTRIBUTION PLANS TOO**

Good risk management principles apply to both defined benefit and defined contribution plans. There is no hiding place for sponsors these days. Creating and following a sound risk mitigation process can mean the difference between explaining bad decisions in court or keeping benefit programmes in place to attract and retain productive employees, who in turn are expected to add to the bottom line. The notion that risk management is complicated and expensive is a myth. It completely ignores the personal and professional liability to which many fiduciaries are exposed when a plan(s) is left untended with respect to assessing, measuring and controlling economic, operational and legal risks.<sup>21</sup>

Since Enron, company stock in a 401(k) plan illustrates the importance of effective risk management for defined contribution plans. Then, employees of this energy trading business helplessly watched as their 401(k) accounts were ravaged as Enron common stock fell from US\$80 per share in January 2001 to less than a dollar, one year later.<sup>22</sup> While some sponsors have since shied

away from offering company stock as an investment choice, those organisations facing mammoth lawsuits alleging fiduciary breach probably wish they could turn back the clocks and remove company securities from the menu of choices. Besides keeping US federal jurists extremely busy in the last decade, having stock in the 401(k) plan has put some CFOs in a thorny situation. Some ERISA attorneys urge all finance directors to implement a risk management approach that is rigorous and objective, perhaps including the use of a 'volatility index' that approximates the market value of a plan sponsor issued stock on the basis of 'fundamental economic health'.<sup>23</sup>

Even if a case is settled, a company can incur millions of dollars in legal fees and/or damages.<sup>24,25</sup> In late 2010, the court approved a US\$15m settlement in a class-action lawsuit involving General Dynamics.<sup>26</sup> A few months earlier, Caterpillar, Inc agreed to pay US\$16.5m to settle a 401(k) class action lawsuit.<sup>27</sup> In March 2011, a US federal judge approved an US\$18.5 settlement in the matter of *Kanawai vs Bechtel Corp.*<sup>28</sup> Besides a monetary payment, some defendants have agreed to institute 401(k) plan reforms to include competitive bidding and enhanced disclosure.

## **MERGERS, ACQUISITIONS AND SPINOFFS**

Unchecked pension problems are increasingly wreaking havoc with merger, acquisition or spin-off deals. According to a study of UK firms for the period from 2001–2007, those companies with large pension liabilities acquired fewer companies and made for 'less attractive takeover targets'.<sup>29</sup> This makes sense as pension deficits are often

thought of as a form of debt. Large corporate encumbrances directly impede free cash flow that could otherwise be used for positive NPV projects instead of making a retirement plan whole, as mandated by law. In the USA, certain types of corporate finance transaction trigger what is known as successor liability. When this occurs, the acquirer could end up with a nasty surprise in the form of a multi-million dollar bill to top up the defined benefit pension plan(s) or make a matching contribution to an existing 401(k) plan. Compliance with reporting rules, knowing how to freeze a traditional plan properly, merging the seller's plan(s) into the buyer's plan(s), or creating a new cash balance plan are a handful of possible items on a long list of 'must do' tasks when corporate ownership changes.<sup>30</sup>

Vendor contracts are another factor. According to a 2010 account of the US\$16bn purchase of Imperial Chemical Industries by Akzo Nobel NV, the investment selection and money manager harmonisation for the combined US\$330 million in stable value assets took almost 24 months, or about six times the time it took to complete the acquisition.<sup>31</sup> An acquirer of a company with a union work force must take into account the obligations associated with collective bargaining agreements or risk a strike and/or lawsuit that alleges inappropriate withdrawals.<sup>32</sup> Even single employer pension plans can create headaches. After Kraft Foods acquired UK confectionery company Cadbury, it could not terminate an existing plan without paying a fee of several hundred million dollars. For each of the next nine years, Kraft will pay £30m to remedy a shortfall.<sup>33</sup>

For those firms that cannot raise money in the public capital markets, a 2007 opinion from the Pension Benefit Guaranty Corporation (PBGC) sounds the alarm that a private equity fund may be on the hook to make a pension plan whole under certain conditions. By applying a 'control group liability' to general partners for underfunded plans included in its portfolio, the PBGC essentially upped the ante, making it harder to exit a position, especially now, with fewer IPOs and generally stalled capital markets. As a result, some experts offer that private equity fund managers must be vigilant about investigating the nature of pension IOUs reflected in the investment pool and possibly 'consider the use of parallel funds and alternative investment vehicles'.<sup>34</sup> Private equity investors may charge more to portfolio companies if they fear there is a chance that a pension liability will cost them later on.<sup>35,36</sup> The price tag associated with inferior pension risk management is no bargain if general partners and limited partners alike end up with big losses due to untended pension deficits.

### **HAVING A GOOD PROCESS IS CRITICAL**

Unlike a defined contribution plan, wherein participants bear some of the risks, a company sponsor is fully responsible for identifying, measuring, managing and monitoring the plethora of economic, operational, legal and fiduciary risks associated with a defined benefit plan.<sup>37</sup> The challenge for DB plan decision-makers is to properly access what risks are worth managing in-house versus those that are better left in the hands of professionals. A corporate treasury team that regularly

hedges its local short-term borrowings or foreign currency receivables (payables) may be comfortable using derivatives to manage the price risk of its asset portfolio but shy away from addressing higher DB plan costs due to expected longer life spans. An overburdened staff and limited access to technology tracking tools could encourage another plan sponsor to outsource the risk management decision making via a pension buy-in or buy-out. A plan sponsor with expertise in allocating to alternatives may forego a liability focus altogether and instead emphasise a selection of hedge funds, real estate, commodities, private equity and venture capital to try to enhance returns.

Each strategy that falls along the continuum of available techniques and providers has a unique risk-return profile, associated cost and financial statement impact. Some choices preserve greater latitude on the part of the employer to use benefits to attract and retain workers. Some strategies entail exit costs that could make it prohibitively expensive to replace one approach with another one if subsequent changes are desired. Some strategies may better comport with a sponsor's tolerance for uncertainty or be easier to explain to board members who are asked to sign off. Yet other choices might be deemed unacceptably imprecise if there are questions about the underlying cash flow projections, or the likelihood of being able to achieve a certain performance level without assuming excessive risk.

While each plan sponsor is urged to meet with its counsel for a proper interpretation, the concept of procedural prudence is linked to the need for those

in charge to demonstrate that informed and objective decisions are made on the basis of gathering requisite data and conducting a thorough analysis of all salient risks and expected advantages. Even if a particular set of fiduciary duties does not formally apply, a DB plan investment committee and related parties should establish a structurally sound governance framework that encourages rational and thoughtful decision making.

While the list of governance ‘must haves’ is long and can vary by plan design, regulatory regime and financial exigencies, Table 1 offers a small sampling of the numerous factors and

action steps that every fiduciary, especially the CFO, should consider. In some cases, the asset class allocation will determine additional governance-orientated action steps. For example, regarding funds with complex instrument positions, liquidity restrictions and model risk are especially important to vet: ‘Fiduciaries should conduct the appropriate due diligence regarding valuation methodology and performance calculation processes and business and operational risk management systems employed by a private pool, including the extent of independent audit evaluation of such processes and systems’.<sup>38</sup>

**Table 1:** Investment risk governance best practices — partial list

| ACTION  | SOURCE  |
|---|---|
| ‘Where it lacks sufficient expertise to make fully informed decisions and fulfil its responsibilities the governing body could be required to seek expert advice or appoint professionals to carry out certain functions.’  | ‘Guidelines for Pension Fund Governance,’ OECD Secretariat, July 2002 <sup>39</sup>   |
| ‘Develop a document that would take a ‘top down’ approach to addressing investment risk. In other words, the document should identify the broadest and most significant risk first and then identify subordinate risks in order of decreasing magnitude until there was a consensus that some level of immateriality had been reached or that the risk was too specific and, therefore, not applicable...’  | ‘Statements of Key Investment Risks and Common Practices to address Those Risks,’ National Council on Teacher Retirement <i>et al</i> , July 2000 <sup>40</sup>                           |
| Consider a compliance audit as part of carrying out fiduciary duties, ‘ensure that candidates’ qualifications are consistent with duties’ and ‘provide training to fiduciary candidates.’   | ‘The Expanding Web of ERISA Fiduciary Liability,’ Diller, N.A. <i>et al.</i> , Morgan, Lewis & Bockius LLP <sup>41</sup>  |
| ‘One of the first steps is to understand your scheme in terms of the risks faced and their concentrations, the objectives of the different stakeholders, the level of funding of the scheme and what, if any, extra funding is available. Once this is understood it should be possible to outline the aims of the derisking in the context of any financial and other constraints, to ensure that the de-risking will deliver the outcome sought.’ | <i>Bulk Insured Pensions: A Good Practice Guide</i> , Association of British Insurers and The National Association of Pension Funds, September 2011 <sup>42</sup>                         |
| ‘To be effective, internal controls must include an organisational chart (showing who is empowered to sign for the fund and who is empowered to approve decisions etc), and a written manual (describing the division of tasks, responsibilities, powers). The risk management system should be documented and communicated to all relevant staff members.’   | ‘Pension Funds’ Risk-Management Framework: Regulation and Supervisory Oversight,’ Working Papers on Insurance and Private Pensions No. 40, Stewart, F., OECD, February 2010 <sup>43</sup> |
| ‘If a plan has no risk management process in place, now is the time to move forward. For those organisations with an established process, a review and possible revision are in order. Regardless of where fund trustees currently stand with respect to risk control, detailed documentation and justification are crucial.’   | ‘Pension Risk Management: The Importance of Oversight,’ Mangiero, S. <i>Global Association of Risk Professionals</i> , March/April 2005 <sup>44</sup>                                     |

## GETTING STARTED

Just as important as good process is having an endgame in mind before information gathering and analysis begins. Consider a driver without a known destination: travelling around in circles may offer an enjoyable way to pass time but expends precious resources and does not accomplish much. For some companies, a chance to reduce funding level volatility may be a welcome outcome. A de-risking approach that outsources DB investment management to actuarially savvy vendors may be a perfect fit for sponsors with fiduciary fatigue or an inability to develop independently a complex model of future expected asset and liability-related cash flows. A goal of freezing the DB plan(s) and concurrently augmenting a defined contribution plan(s) could favour the use of a financial supermarket that provides both DB and DC products and services.

The facts and circumstances for each company can vary and must be considered. Identifying a realistic goal is the cornerstone of getting started on the pension risk management road. Zig Ziglar, a popular motivational speaker, observed that 'If you aim at nothing, you will hit it every time.' For some sponsors, the stated goal is to earn enough on its investment portfolio and thereby avoid having to make a cash contribution to the defined benefit pension plan. Others may identify the mitigation of funding ratio volatility as the primary purpose of a pension risk management programme. Other objectives might include (a) the avoidance of fiduciary litigation; (b) ensuring that fees paid to third parties are reasonable; (c) having the ability to liquidate a certain slice of the portfolio;

or (d) controlling spiralling costs due to longer life spans of plan participants. Importantly, the asset-liability management strategy that makes the most sense for any particular sponsor will depend on a variety of factors such as plan design, participant demographics, available cash, financial health of the plan, company credit ratings and much more. There is no 'one-size-fits-all' solution.

## SO MANY RISKS AND SO LITTLE TIME

Effective pension risk management entails a comprehensive assessment of relevant factors that keep fiduciaries up at night. A partial collection is presented in Table 2. Not every risk driver ranks

**Table 2:** Some DB plan risks to consider

|                                  |
|----------------------------------|
| Accounting risk                  |
| Actuarial risk                   |
| Asset Allocation risk            |
| Collateral risk                  |
| Complexity risk                  |
| Compliance risk                  |
| Concentration risk               |
| Contagion risk                   |
| Correlation risk                 |
| Credit risk                      |
| D&O fiduciary liability risk     |
| Downgrade risk                   |
| ERISA fiduciary liability risk   |
| Human capital risk               |
| Key-person risk                  |
| Litigation risk                  |
| Longevity risk                   |
| Model risk                       |
| Mortality risk                   |
| Plan design risk                 |
| Political risk                   |
| Price risk                       |
| Processing risk                  |
| Redemption risk                  |
| Regulatory risk                  |
| Reputation risk                  |
| Systems risk                     |
| Tax risk                         |
| Trading limit risk               |
| Transaction risk (M&A, spin-off) |



equal with others. Material and high-probability trouble spots merit particular focus. A plan sponsor with borderline credit ratings may want to address DB plan funding problems if, by doing so, there is an opportunity to improve its scores and thereby raise new capital at a lower cost. Active users of derivative instruments might worry that a particular mitigation strategy unduly exposes the DB plan to unacceptable credit risk with existing counterparties. A business in the throes of an acquisition is right to focus on due diligence of employee benefit plans currently being offered by the target. Minimising liquidity risk could be critical for a DB plan that needs cash in the near term.

If history is a teacher, recent years have shed light on several harsh realities. First, the uncertainty of market prices can end up taking a back seat to damage caused by other risks that, in some cases, are hard to measure. Operational problems associated with settlement, collateral monitoring or service provider internal controls have cost investors plenty when left undetected. Secondly, adverse events are seldom self-contained and can spill over into other areas, exacerbating already difficult circumstances. A flight to quality in 2008 and 2009 made it hard for some pension funds to liquidate investment positions, especially those holdings that were already deemed 'hard to value' and/or resulting from high leverage. Fast-changing correlations led to unexpected asset allocations, having been derived from traditional mean-variance simulations that depend on pair-wise association numbers. As a result, more than a few DB plans ran aground of pre-established sector limits and/or incurred large redemption

penalties.

Key-person risk is always critical to vet and perhaps more so if a service provider is not known to have a risk culture that rewards care and diligence. DB plan sponsors should dig deep when talking to third parties. Action steps can include a meeting with a vendor's chief risk officer and dissecting the SAS 70 report(s). A de-risking industry provider can differentiate itself on the basis of attributes such as a strong balance sheet, experience in modelling complex financial arrangements and a successful track record in managing its own risks.

## **BENCHMARKING SUCCESS**

What constitutes a successful pension risk management program depends in part on the specificity of pre-established objectives and the likelihood that goals can be met. It has to be possible to measure an outcome accurately as well as understand the limitations of competing metrics, if applicable. For example, there are several ways to measure leverage just as there are alternative approaches to assessing volatility or variance around a mean. Data characteristics and calendar time intervals are other factors that can influence the integrity of a DB plan-related 'success' measure.

The extent to which a plan is being risk managed as part of the overall corporate enterprise will likewise influence how to gauge effectiveness of an adopted strategy. Inputs such as the cost of cash — and related accounting and tax treatments — used to replenish a DB plan are integral to deriving a meaningful performance indicator. Value at Risk or similar evaluation tools applied to DB plan features such as funding level may not adequately

capture the long-term nature of a traditional pension plan. Whether assets and liabilities are properly valued is another imperative.

Largely unaddressed but vital in today's world where DB plan economics can and should be considered as contributing to enterprise value is the question of how corporate officers who wear the second hat of pension fiduciary are compensated. Specifically, how should a corporation judge its leadership team members to make decisions that help participants but are likely to affect shareholders too? For example, could someone improperly avoid de-risking if doing so requires a large upfront cash settlement or contribution that in parallel worsens the short-term scorecard that is used to determine bonuses and stock options? Correctly aligning interests is a hallmark of good corporate and pension governance.

The financial strategy itself is a determinant of incremental risks to which a pension plan is exposed and therefore something that must be considered when quantifying the outcome. When derivatives are used for traditional hedging purposes or risk is transferred via a liability driven investing (LDI) or dynamic asset allocation (DAA) strategy, buy-in or buy-out, fiduciaries will have their hands full in assessing a host of factors, not the least of which is whether the expected benefits are likely to outweigh the costs. No investment committee should affirm a decision without doing its homework at the outset and planning for a robust infrastructure to monitor progress regularly thereafter, allowing for changes if needed. While a detailed comparison of possible paths to pursue is outside the scope of this paper, Table 3

**Table 3:** Pension risk management strategy selection

| QUESTION  |
|---|
| Is it important to minimise reported earnings volatility?                                     |
| How much free cash is available for a contribution?   |
| Will a change in plan design make it difficult to retain new talent or lose existing workers? |
| Is liquidity important?   |
| Will waiting cost the company more in the long run?   |
| How will a plan freeze influence the choice of pension risk management strategy?              |
| Who will benchmark and monitor the efficacy of the risk management strategy?                  |
| Are derivatives-related strategies understood and accepted by the sponsor?                    |
| What are the regulatory constraints?  |
| Is a ratings downgrade a possibility if no pension risk management strategy is adopted?       |
| Is a lump sum option a consideration for retired plan participants?                           |

outlines some of the many questions that defined benefit plan fiduciaries should ask and have answered before committing resources. Creating a list of starter questions for DB (and DC) fiduciaries is straightforward and necessary as pension risk management is mission-critical for all types of plans.

## CONCLUSION

The good news is that there are numerous ways to manage DB plan risks. Outsourcing to a fiduciary manager, implementing LDI, transferring part or all of a defined benefit plan risk to a well-capitalised financial institution via a buy-in or buy-out, or traditional hedging of price risk via derivatives offer the CFO a wide array of choices to consider. The bad news is that semi-permanent or permanent decisions require a careful comparison of a multiplicity of risks. This takes time at the outset and regularly thereafter. Moving forward

begins with the creation of reasonable and measurable goals that embed constraints and plan-specific facts and circumstances. Risk tolerance, available cash, intention to keep a DB plan open or closed, corporate credit ratings, availability of knowledgeable and experienced treasury staff, transaction cost and comfort level with a particular service provider are a few of the many reflection points for a pension fiduciary to address.

One thing is certain: change is on its way. The days of tucking the traditional pension plan aside and hoping for a surplus to boost corporate earnings are long gone for most firms. Pre-emptive pension risk management is being discussed in corporate corridors around the world.

#### Author's Disclaimer

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#### Editor's Note

Henry Stewart Publications will debut a series of video lectures on the topic of pension risk management in late spring 2012. Financial and legal experts will offer an in-depth discussion of pension governance, along with a detailed description of various pension risk management tools and techniques.

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