

Risk management – DB differences across the Atlantic

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Emma Watkins, director of business development at MetLife Assurance Limited, examines research comparing defined benefit schemes in the US and UK

The current economic environment is increasing the focus on pension risk management in both the UK and the US, whilst at the same time making it more challenging. MetLife commissions annual research* in both countries to assess the current state of defined benefit (DB) pension risk management. The second annual comparison** of the results of these studies highlights how approaches toward pension scheme risk management have changed year-on-year. It also calls attention to areas for action.

Whilst respondents on both sides of the Atlantic are very worried about managing the critical risks which have the potential to threaten the viability of their schemes, there are some interesting differences in their prioritisation and management of these risks.

Attitude toward risk

Contrary to last year, where respondents ascribed nearly equal importance to all of the risk factors highlighted, the 2011 results show that respondents in both countries are focusing on a narrowed set of key risks.

Chief among the concerns are liability-related risks specifically dealing with scheme funding, driven in large part by ongoing market volatility. Notably:

- The risk that respondents ranked first in terms of importance in both the UK and the US related specifically to under-funding of pension scheme liabilities.
- The risk of a mismatch between assets and liabilities ranked second in the US and third in the UK.

These results are particularly noteworthy in the US, where until recently, assets rather than liabilities have been the main concentration of pension scheme management. The UK has been slightly ahead of the US in the trend of having a liability-centric focus.

On taking a closer look at the data, there is an important distinction in how the two countries approach management of their liabilities:

- In the UK respondents appear to be focusing on securing contributions to their scheme, with respondents (especially trustees) appreciating the importance of and examining the viability of their sponsor in recognition of its role as ultimate guarantor of the scheme (i.e. the employer covenant).
- In contrast, US respondents appear to be more concerned with seeking excess returns from their assets to meet their liabilities. This is no doubt influenced by the fact that the company acts as both the sponsor and the fiduciary.

Success in managing risk

Respondents in both countries continue to report that they are successfully managing many of the risks facing their schemes. However, a number of the risks identified as highly important were reported to be not as successfully managed as others, whilst some risks fell in to the low importance– high success categories. There may be an opportunity for schemes to shift some of the attention away from well managed risks with a lower priority in order to focus on the ones that immediately pose the greatest challenges.

Call to action

The findings demonstrate that no DB scheme is immune from the impact of financial market volatility. In the UK specifically, while sponsors and trustees appear to be moving toward a more coordinated approach to pension risk prioritisation, there must be concerted action to ensure risk mitigation activity is similarly coordinated. Frequent and ongoing communication between sponsors and trustees is critical for developing an agreed plan to manage and mitigate risk.

* MetLife in the US and MetLife Assurance Limited in the UK commissioned the 2011 US Pension Risk Behaviour Index and 2011 UK Pension Risk Behaviour Index. These studies surveyed respondents on 18 investment, liability and business risks to which their schemes are exposed. Respondents in the US were comprised of sponsoring employers; in the UK, both sponsoring employers and trustees were surveyed.

** For the full report please go to www.metlife.co.uk/metlifeassurance