pension solutions

Pension liability approaches ensure that businesses will increasingly view their pension and inflation liabilities in an overall balance sheet management context.

contact us

Dublin
tel: +353 1 790 0040

London
tel: +44 207 560 8680

Stamford, US
tel: +1 203 391 5555

Thomas Farrell
Actuarial Product Specialist

With the adoption of new accounting standards many companies have their Defined Benefit pension plan surplus or deficit reflected on their balance sheet for the first time. In many cases the deficit shown on the balance sheet has had a significant impact on the company reserves and hence has a knock-on impact on the operation of the company. For example, in some cases the cost of borrowing has been negatively impacted.

Consider the position of a company reporting year-end results. In recent years, figures have been calculated using FRS17* but were only included as a note to the accounts, and therefore, had no actual impact on the operation of the company. However, when comparing the figures shown in these notes over a number of years the volatility of these disclosures becomes clear. In particular, it is noted that falling bond yields can cause the liabilities to increase at a faster rate than the assets, despite the asset performance over the given period.

The additional volatility introduced onto a balance sheet due to the pension plan may not be something that a company is happy with. A solution can involve the company pension plan trustees and relevant advisors examining each of the risk factors, deciding on the level of risk they are willing to adopt, and investing the assets in an efficient a manner as possible with reference to these risk factors. Some of the elements included in the solution are as follows:

- A series of interest rate and inflation swaps designed to remove much of the inherent pension plan exposure to these factors.
- The use of some alternative investments in the hedging strategy due to the explicit risk parameters adopted and the suitability of these investments to generate the required returns for the interest rate and inflation swaps.
- The continued exposure of the pension plan to some equity investment in order to allow for potential positive experience of this asset class.

The particular strategies used can vary and can be extended to many pension plans. We can help companies who are now experiencing volatility due to the current pensions, regulatory and accounting environment to explore different solutions.

* Financial Reporting Standard 17 -
covers pension plan disclosures in company accounts.