Managing Pension Risk

FEI Canada Conference: Victoria

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TOWERS WATSON

Today’s Topics

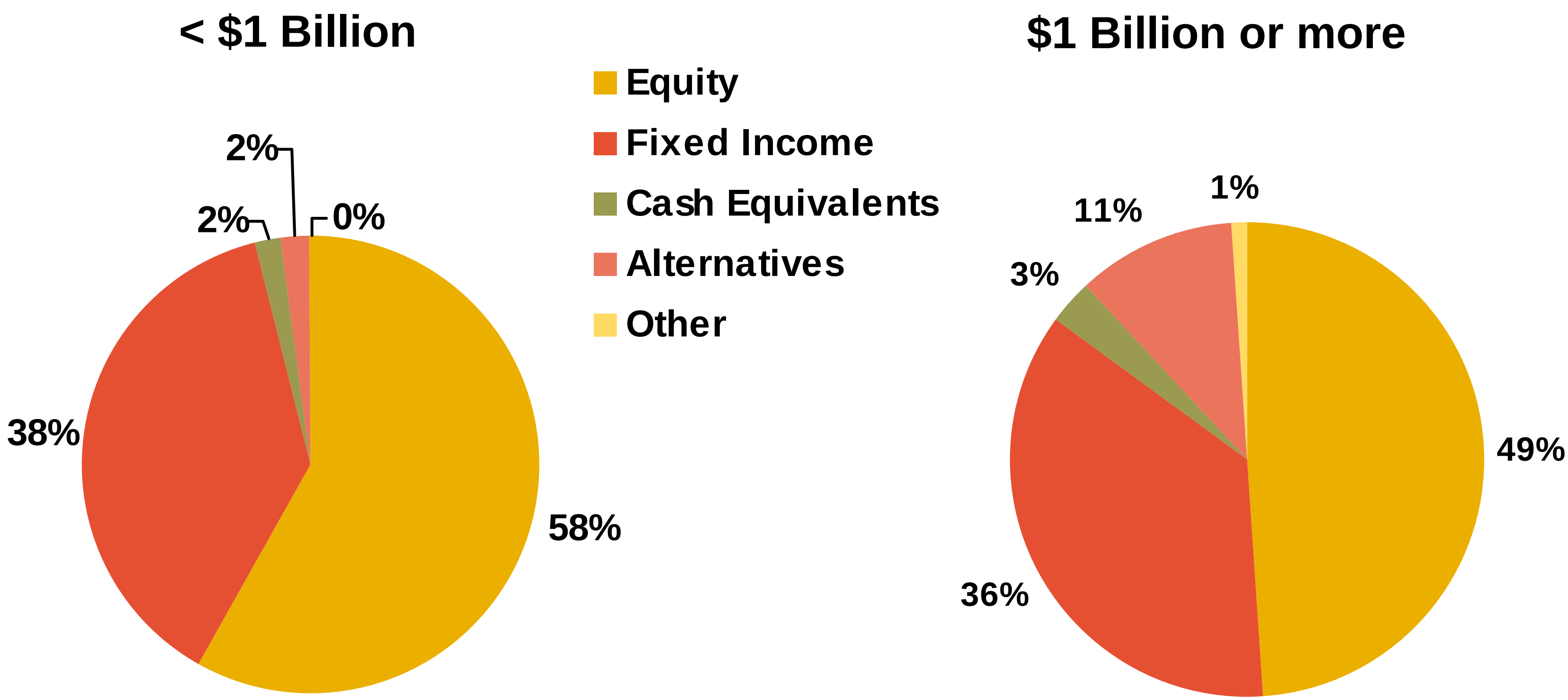
DB pension risk

DC pension risk

Some solutions

An Era of Change to Pension Plans

Current Target Asset Mix



Towers Watson survey: “Investment Strategies for Defined Benefit Pension Plans Post-Crisis” (November 2009)

Reasons for Changes in Investment Strategy

	Before Crisis	After Crisis
Mitigate financial risks of the pension plans	59%	58%
Stabilize pension plan costs	50%	↓ 45%
Search for higher returns	34%	↓ 21%
Immunize the plan from solvency deficits	25%	37% ↑
Tactical decision re. equity risk premium	13%	↓ 8%
Tactical decision re. the bond price	0%	3% ↑

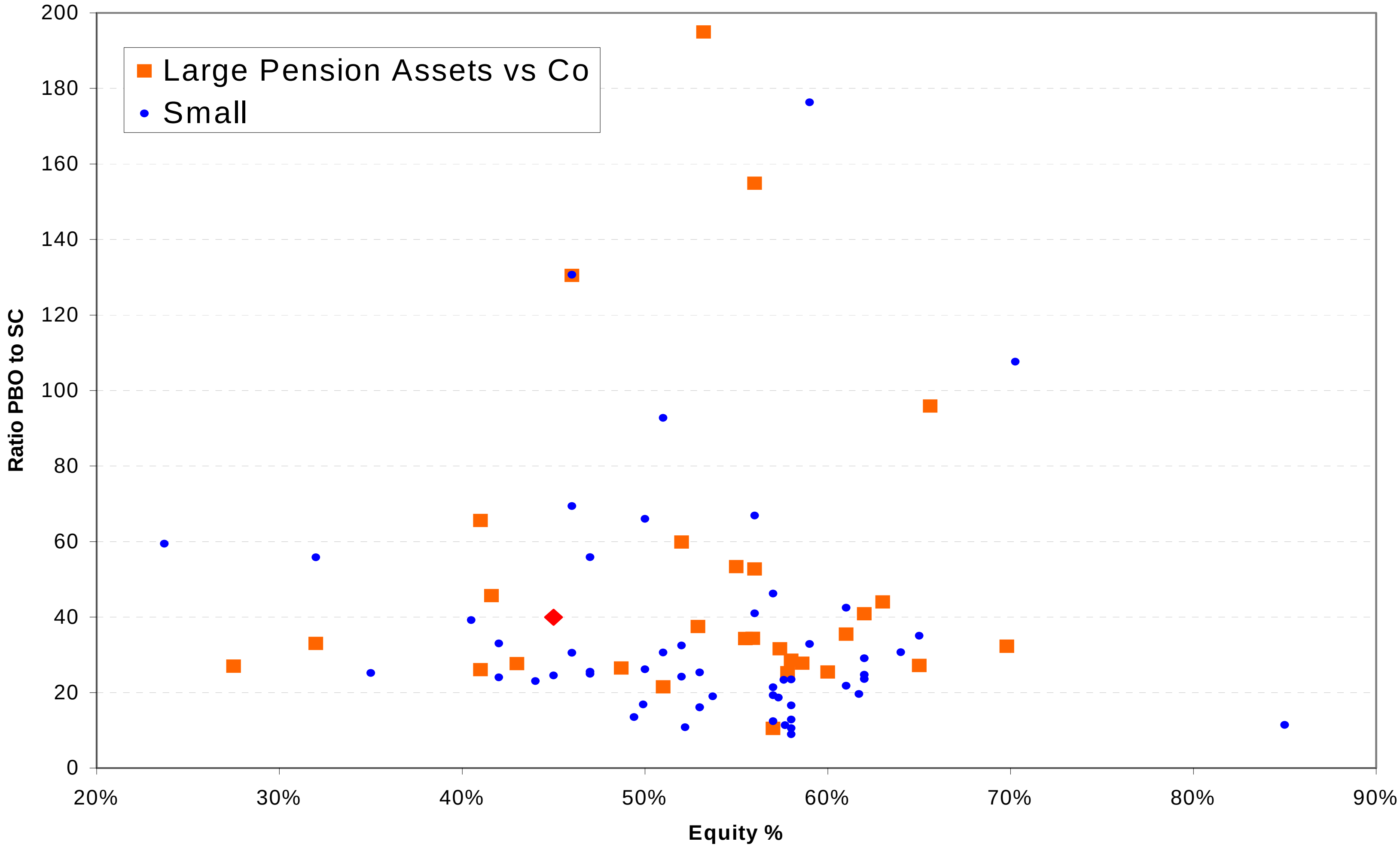
Towers Watson survey: "Investment Strategies for Defined Benefit Pension Plans Post-Crisis" (November 2009)

More Changes to Investment Policies Are Coming …

	Next 12 Months	Considering for the Future
Increasing fixed income weighting	7%	18%
Lengthening fixed income duration	9%	11%
Cashflow matching	6%	14%
Annuitize	2%	9%
Other liability driven strategies	14%	18%
Other investment strategies not related to risk mitigation	13%	10%

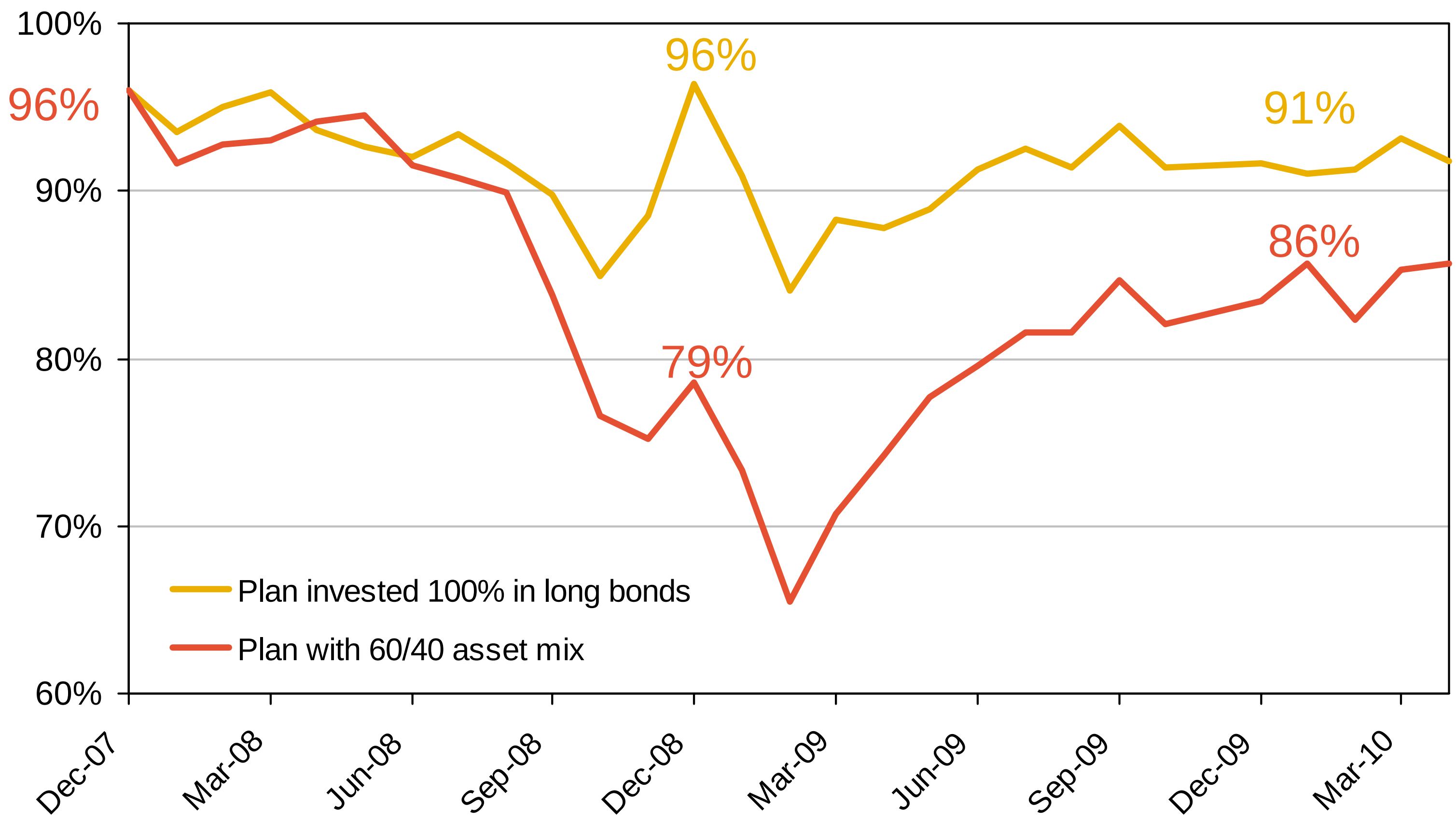
Towers Watson survey: “Investment Strategies for Defined Benefit Pension Plans Post-Crisis” (November 2009)

No Discernible Relationship between ‘Plan Maturity’ and Equity Allocation



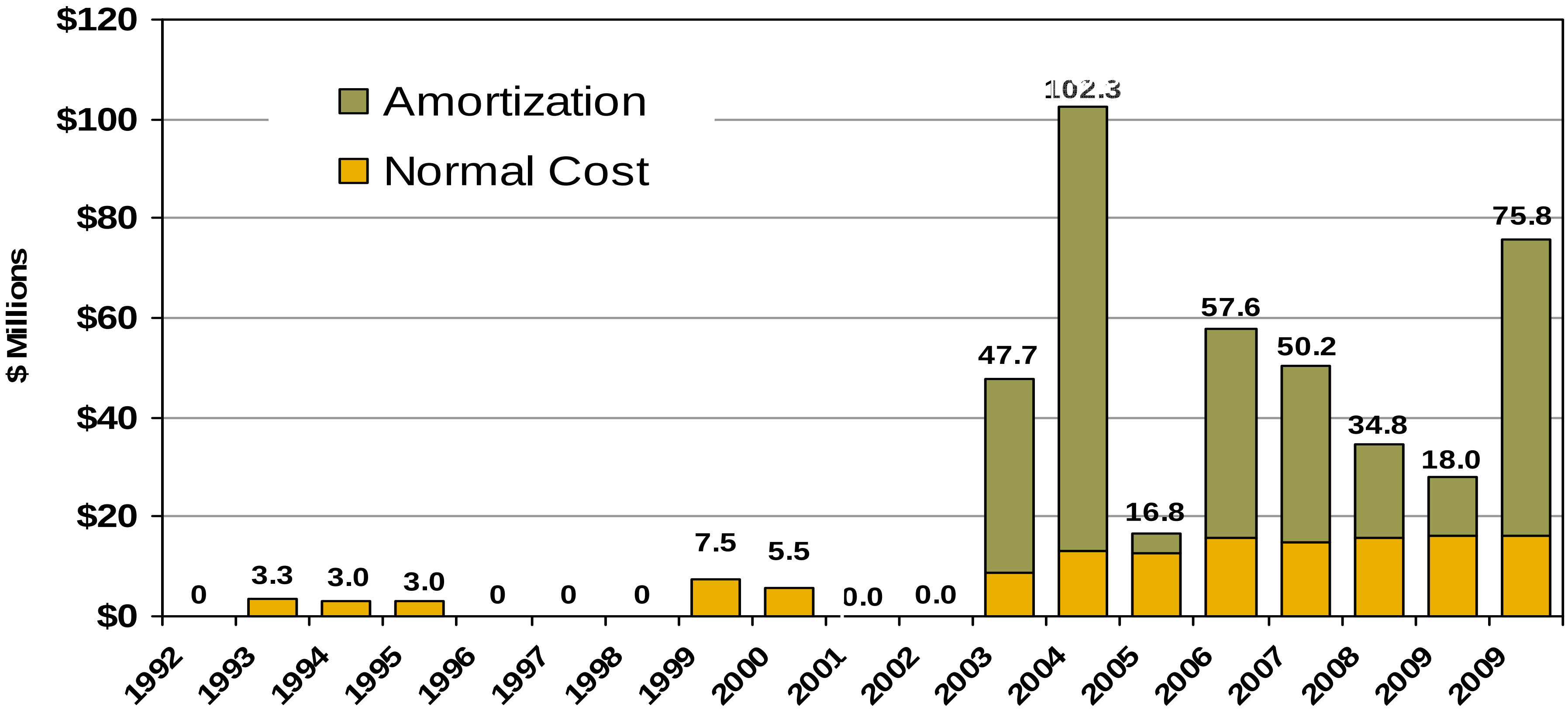
Note: “Large” is defined as pension assets > 10% of company assets

Solvency Position for a Typical DB Plan



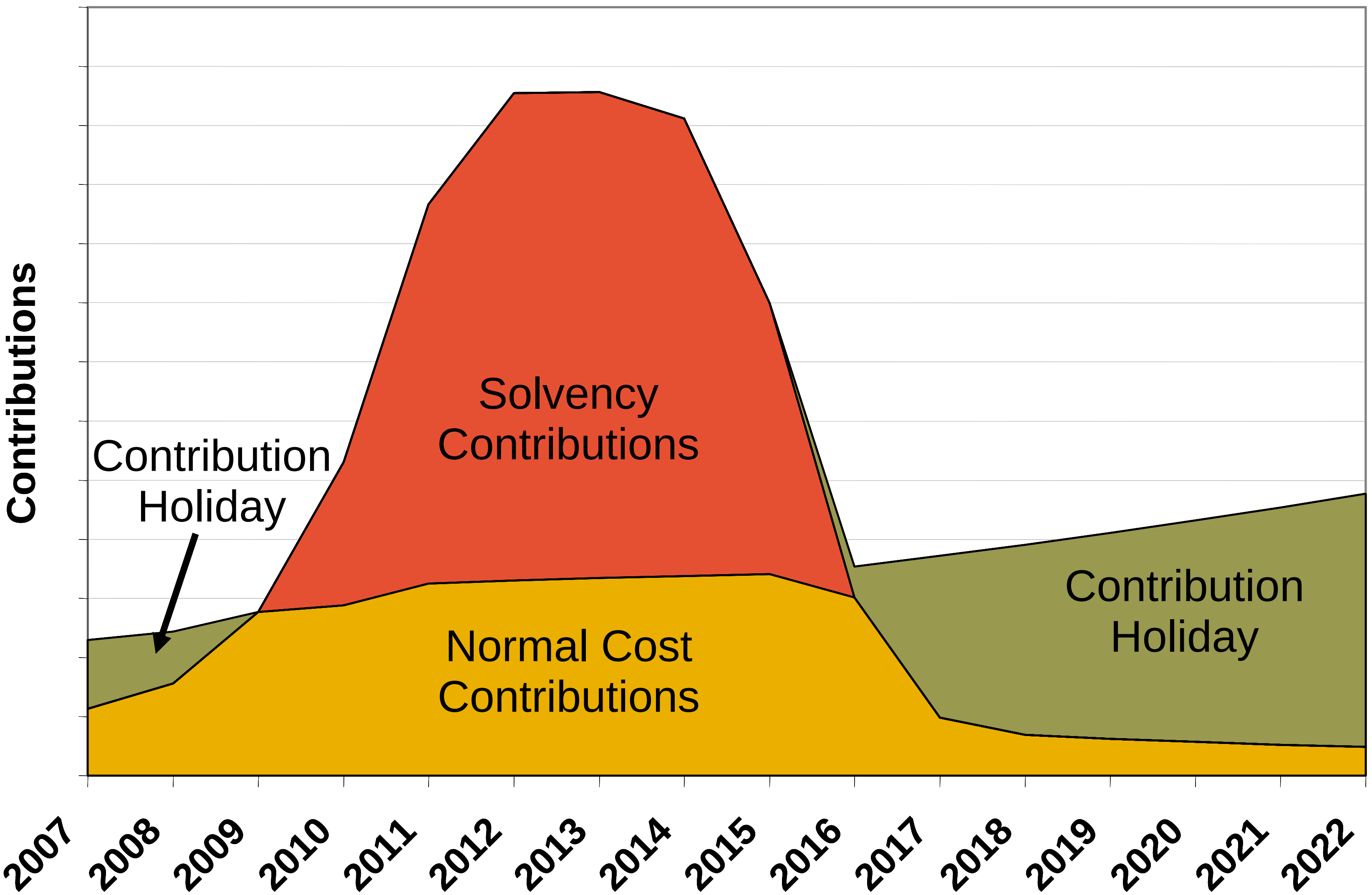
Watson Wyatt Pension Barometer

Company Contributions



Example: One plan's historical contributions

Current Funding Rules Can Lead to "Trapped Capital"



Risk Management Strategies

Accounting Policy

Meet evolving financial reporting requirements

Plan Design

Ensure design fits long term goals

Investment Policy

Ensure it is consistent with your risk profile

Funding Policy

Accelerate / decelerate contributions

Converting from DB to DC

4%

Last 12 months

6%

Next 12 months

13%

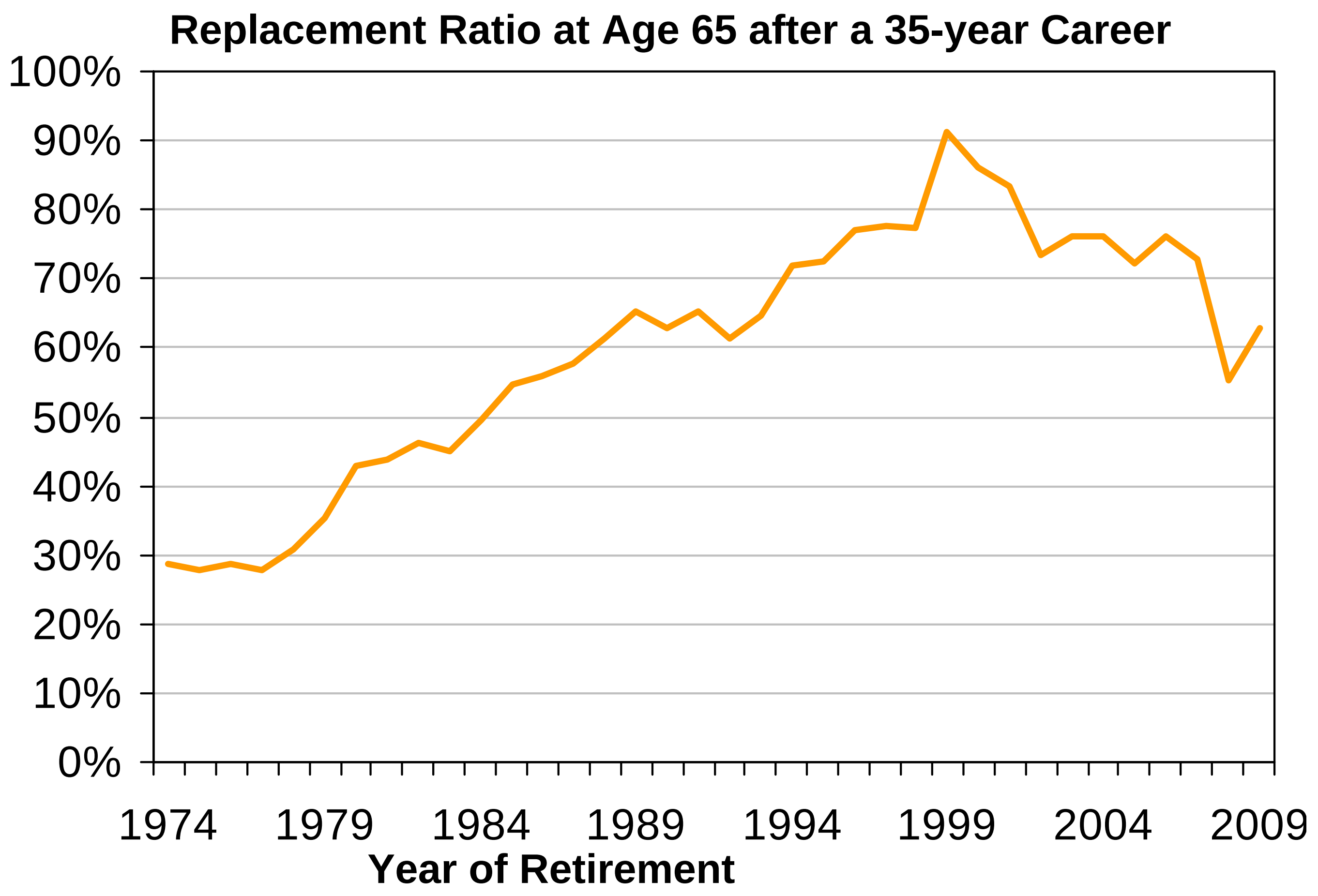
Considering for the future

Towers Watson survey of pension risk (2010)

Trend to DC Plans leaves Most Risks Borne by the Members

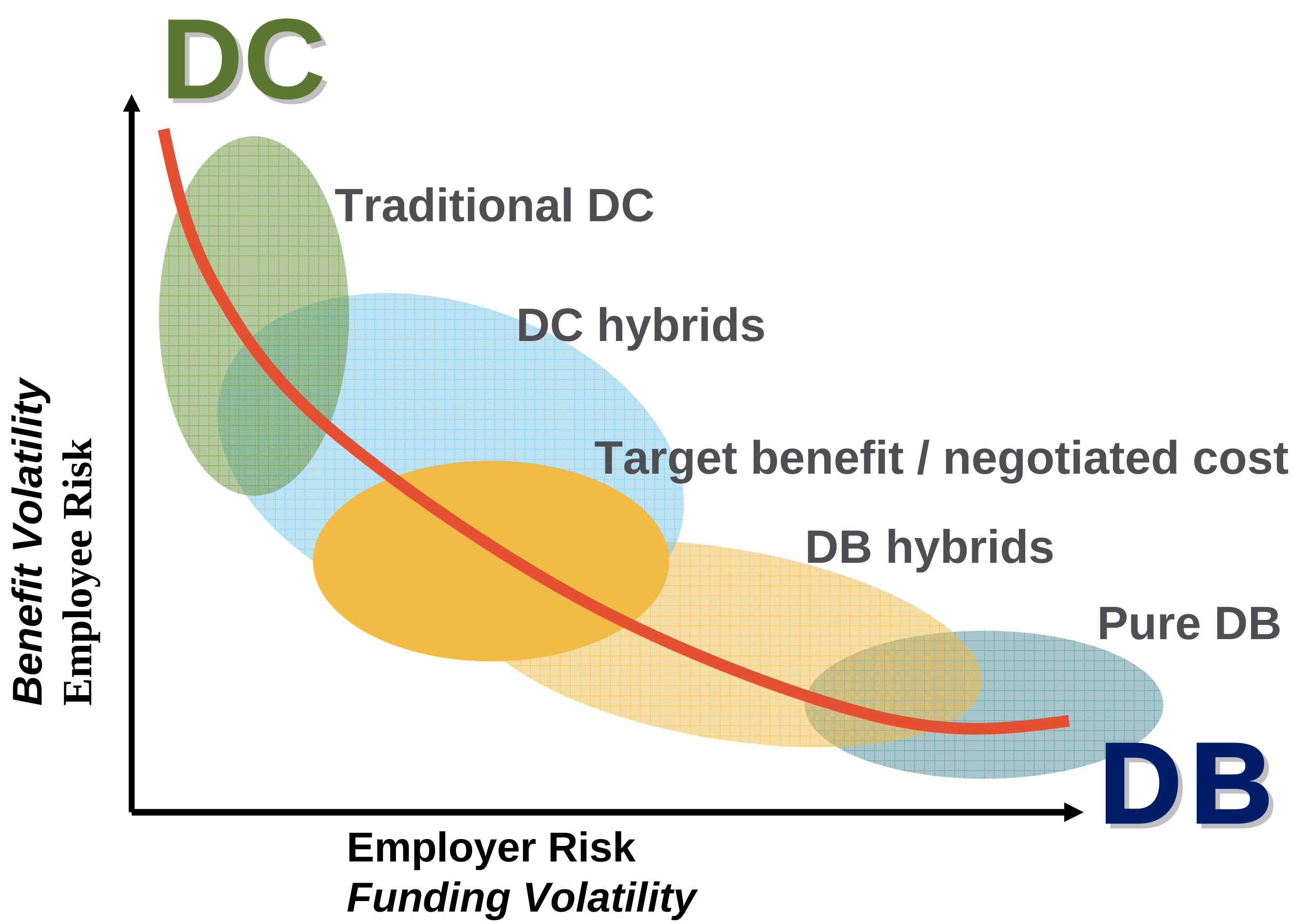
- Contribution decisions: sponsor and member
  - When and how much
- Retirement goals: when to retire and how much does one need?
- Longevity risk: outliving one’s income
- Investment risks (member decisions):
  - Education and disclosure issues
  - Perspective (personal risk assessment)
  - Flawed decision-making
- Investment risk: market cycles

What Retirement Income Will Your DC Plan Provide? Depends on When You Retire …



Employee works for 35 years and participated in a DC plan with 10% contribution for all years of employment. Employee retires at age 65 and purchases an annuity. This chart shows that the pension income (as a percentage of pre-retirement income) varies considerably depending on when he/she retires.

Plan Design Spectrum

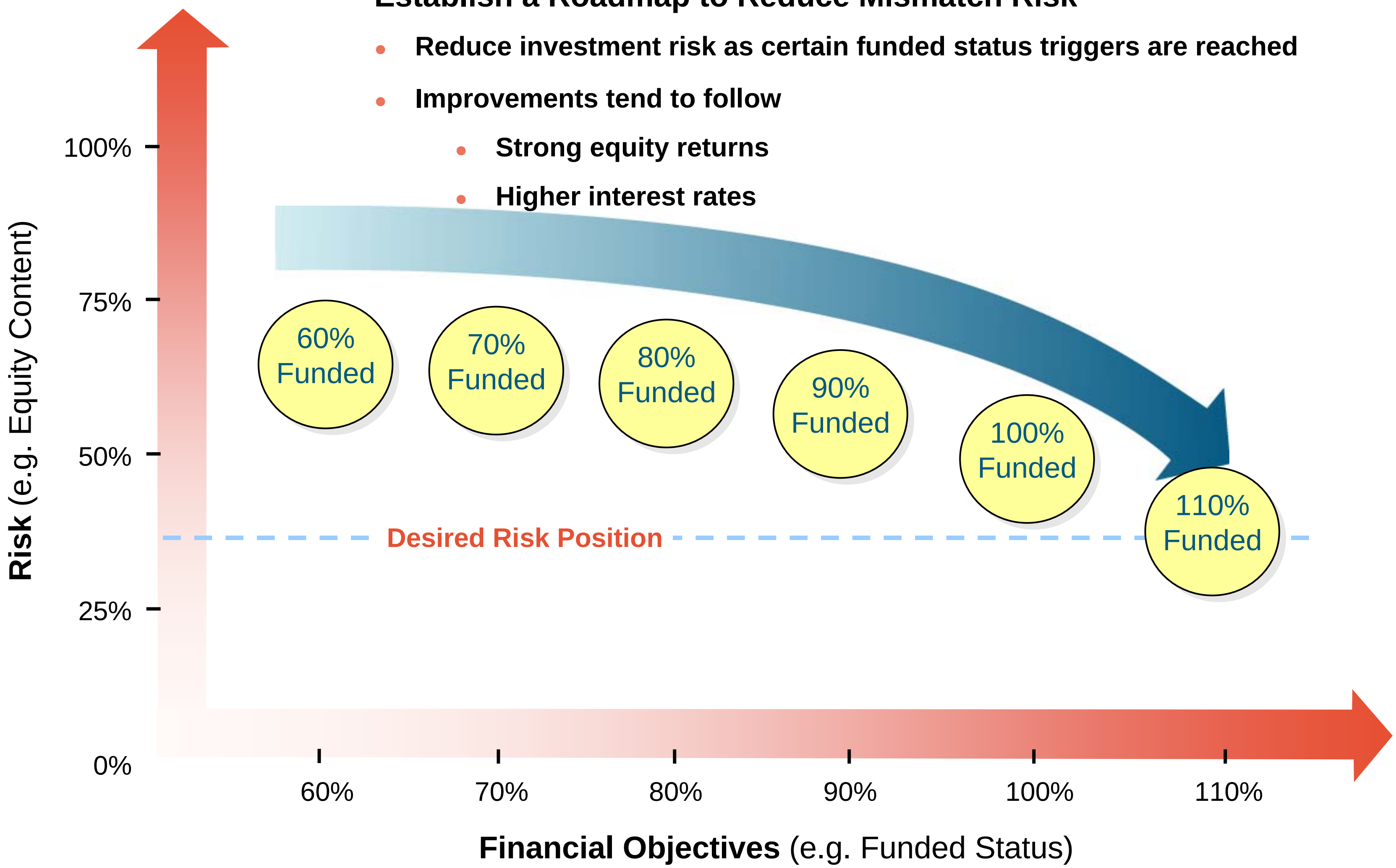


How to Navigate Through All This?

New Era: Dynamic Asset Allocation Strategy

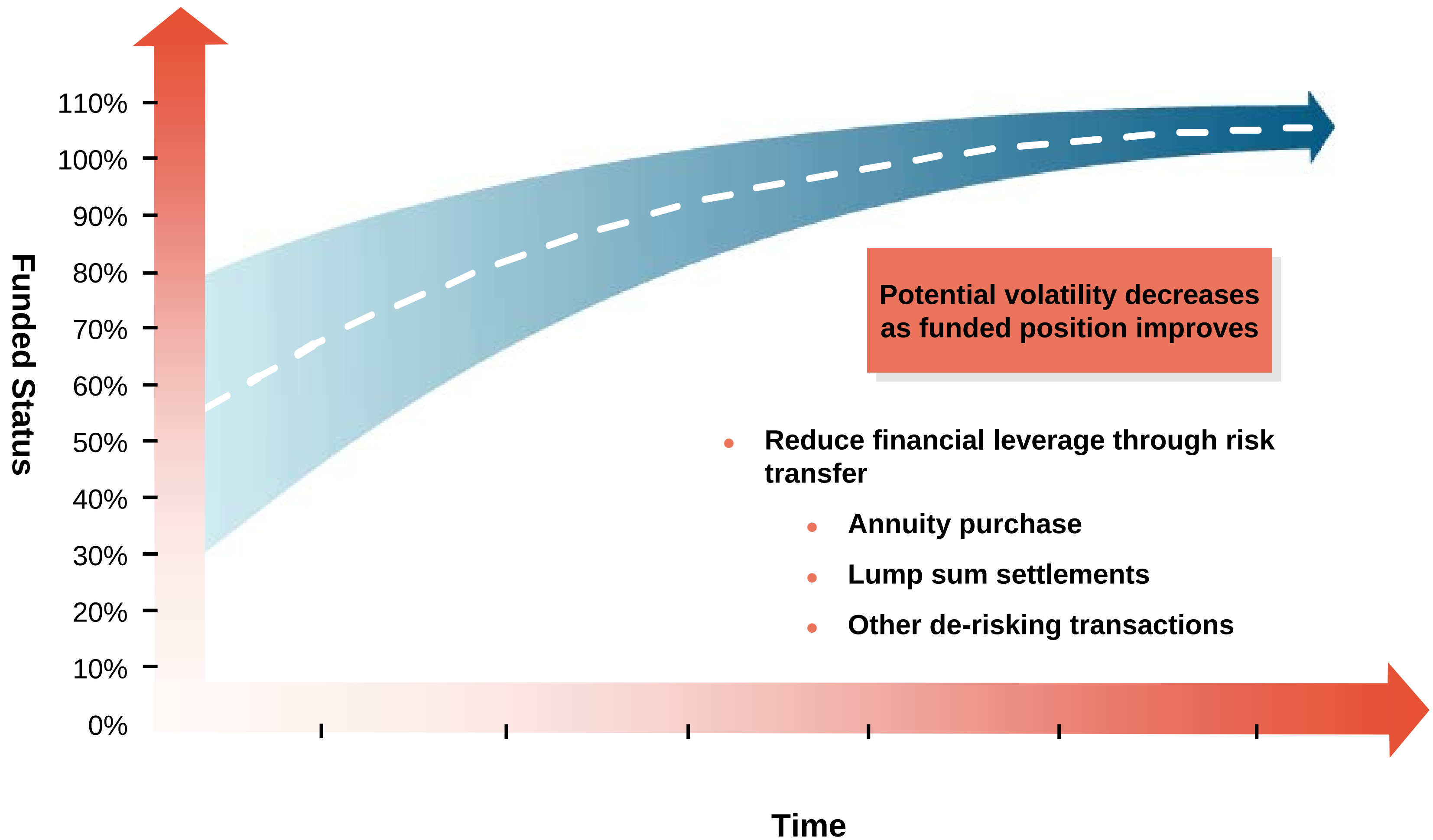
Establish a Roadmap to Reduce Mismatch Risk

- **Reduce investment risk as certain funded status triggers are reached**
- **Improvements tend to follow**
  - **Strong equity returns**
  - **Higher interest rates**



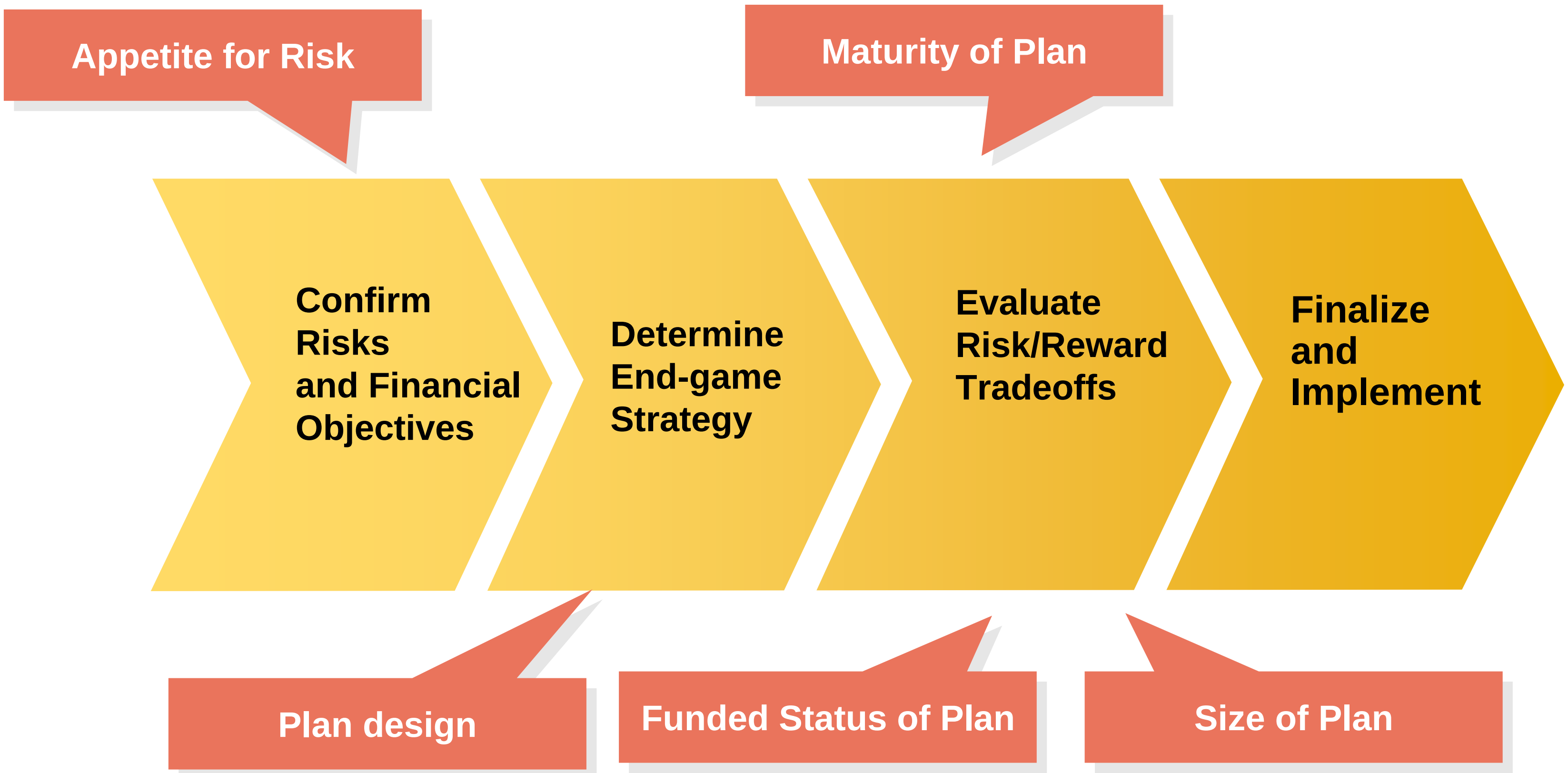
Expected Benefits of Dynamic Asset Allocation Strategy

Sample Desired Outcome



- **Reduce financial leverage through risk transfer**
  - **Annuity purchase**
  - **Lump sum settlements**
  - **Other de-risking transactions**

Dynamic Asset Allocation Process

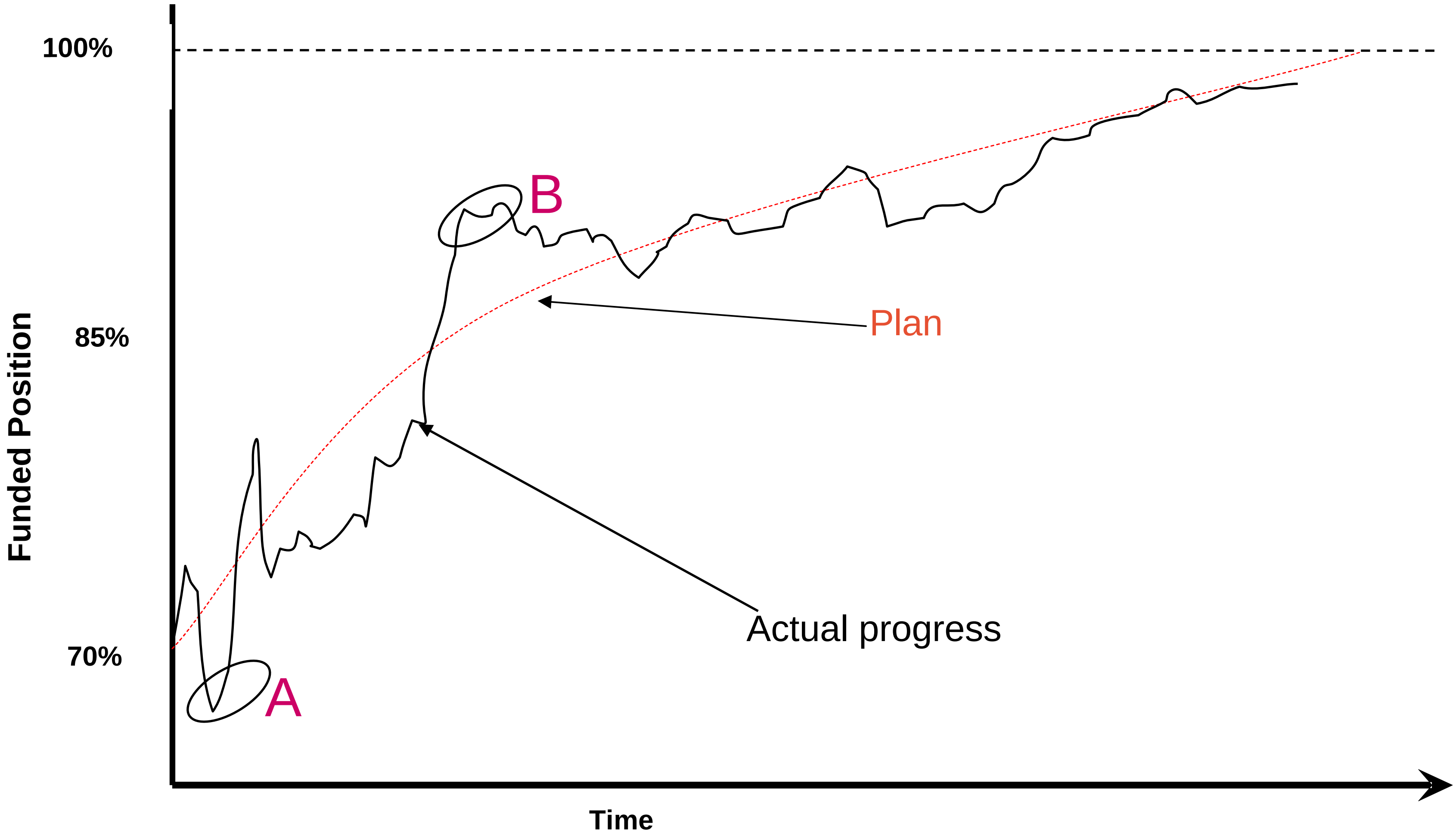


Example: A Client Who Wanted to “Get out of DB”

Started by setting goals / priorities:

Alternatives considered	
	A Imperative to get out as soon as possible.
	B Exit is desirable but the immediate priority is cash within the business.

Set a Plan ….
But Actual Progress will not Follow the Plan …



Journey Plan Example

3 Components:

Asset Strategy

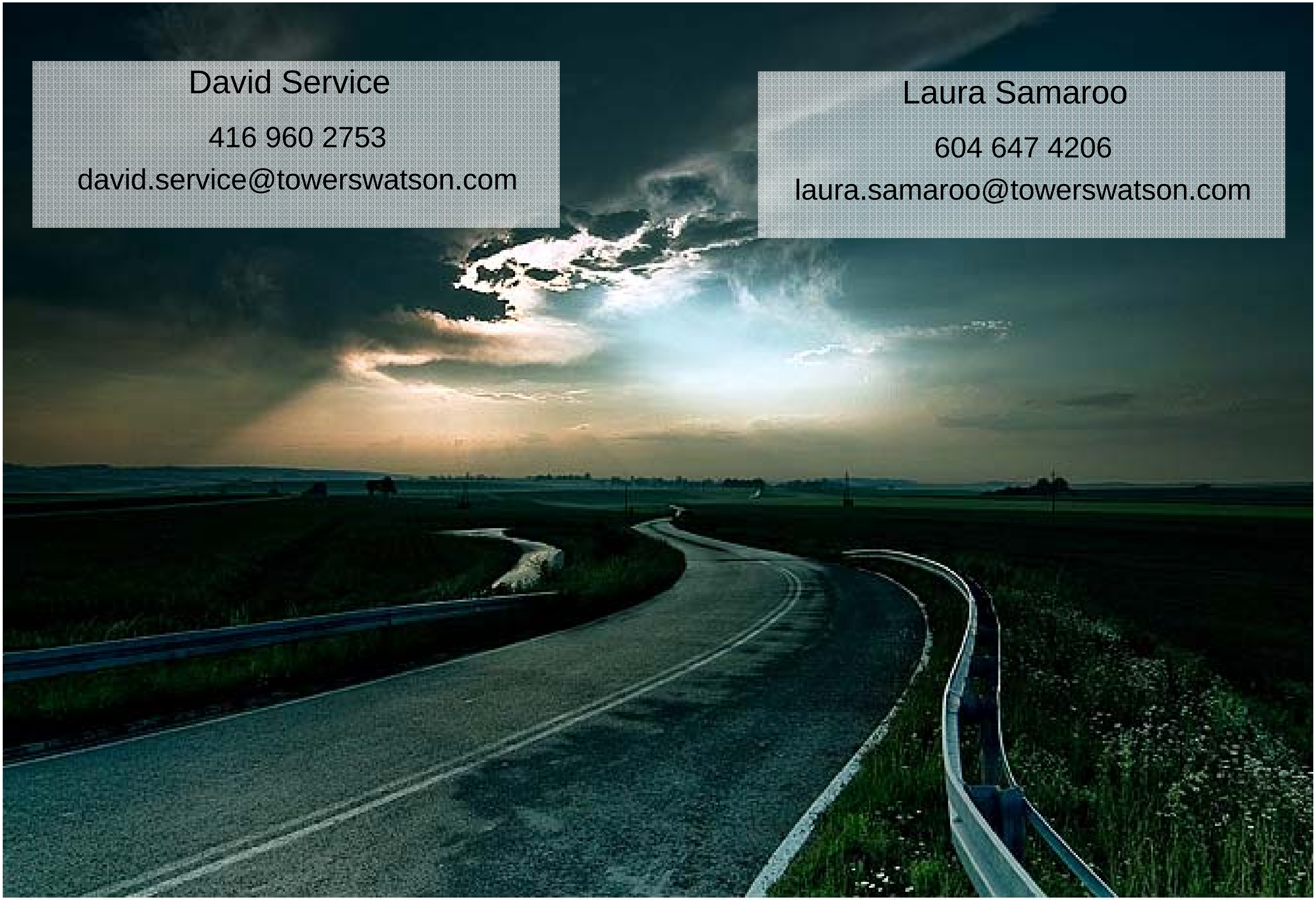
- Investment
- Funding

Liability Strategy

- Close DB plan
- Other plan design changes

Settlement Strategy

- Set / monitor “buy out trigger”
- Monitor market conditions
- Clean data


David Service
416 960 2753
david.service@towerswatson.com
Laura Samaroo
604 647 4206
laura.samaroo@towerswatson.com