Managing Global Pension Risk – USA and UK in focus

Despite best efforts in recent years to "close" DB plans around the world, many global corporates have seen their defined benefit (DB) pension plan liabilities increase significantly on their balance sheets. These plans continue to pose significant (and often increasing) financial, regulatory, and other risks to global businesses. Costs to fund, operate and govern these plans remain high. Terminating (or "buying out") plans remains challenging, resource-intensive and expensive around the world.

Managing DB plans effectively worldwide, in line with key business priorities and local context, remains a significant challenge as global businesses have transformed and shifted priorities through the pandemic. Balancing the right global influence with effective and proactive local management is critical. There is a significant opportunity to gain competitive advantage for organizations who get it right.

Below we illustrate some of these challenges and opportunities by comparing the current pensions landscape in two prominent global pensions markets – the UK and the US. We also share some key "calls to action" for senior leaders in global organizations with material pension risks.

Spotlight on UK vs US Pensions – Similar but Different

	UK	US
Size of private sector DB pension market*	£1.8 trillion	$3.5 trillion
Funding positions	Since the beginning of 2021, there has been a general increase in bond yields across the globe and a resurgence in equity markets. Both changes have been positive from the perspective of DB plan funding levels. At the end of October 2021, corporate bond yields were up by around 0.3% p.a. and 0.5% p.a. in the USA and UK respectively, with global equity markets around 16% higher than they were at the start of the year. In the UK, the general improvement in funding levels has been tempered somewhat by the impact of increasing inflation expectations on largely inflation-linked liabilities.	
	IAS19 funding levels over 10 months to 31 October 2021 ↑ **8%**	**IAS19 funding levels over 10 months to 31 October 2021** ↑ **8%**

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<td rowspan="2">Endgame tracking</td>
<td colspan="2">DB pension provision is increasingly seen as a legacy issue. The focus for most companies is to efficiently manage the DB plan on the route to termination, with a transfer to the insurance market generally seen as the ultimate goal. Monitoring insurance market pricing and the route to termination should be a key focus for corporates managing legacy DB pension plans.</td>
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<td>Our UK team are now publishing the "DB End Gauge" index, which provides an estimate of the average time for UK pension plans to reach full funding on a buyout basis. At the end of October, the index was 10.8 years, a reduction of 1.1 years since the end of December 2020.</td>
<td>Our USA team publishes a monthly Pension Buyout Index which provides an estimate of the cost of buying out retiree pension liabilities. At the end of October, the index suggested that retiree buyout cost as a percentage of the accounting liability was around 102.5% - a small increase relative to the 101.8% calculated at the end of December 2020.</td>
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<td>Hot topics</td>
<td>- Pension Schemes Act 2021: A number of new provisions came into force on 1 October 2021 and further requirements are due to be introduced in relation to corporate activity. Read more here.
- Covid-19 and longevity: Assessing the impact of Covid-19 on life expectancies is an important consideration for those managing DB plans. Read our latest thoughts here.
- DB transfers: Defining a strategy to support members with their benefit options should be a key priority for trustees and companies. Our latest overview of the UK transfer value market can be found here.
- Bulk annuity market: The UK bulk annuity market has seen a resurgence in activity during the second half of 2021 following a quiet start to the year. Read our team's latest insights into the UK bulk annuity market here.</td>
<td>- ARPA '21: The American Rescue Plan Act 2021 provides relief for DB plans by relaxing the funding rules. Read how this might affect plans to terminate or de-risk single employer plans here.
- Pension risk transfer (PRT) market: The pension risk transfer market was incredibly active in Q3, with three times the volume during the same period in 2020. Industry estimates show that $25.7bn was transacted in the nine months to 30 September 2021, which puts the prior annual record of $36bn set in 2012 well within reach given a typically active fourth quarter yet to come.
- PBGC Premiums: The Pension Benefit Guaranty Corporation insures private sector DB benefits for virtually all U.S. corporate plan sponsors. The premiums they charge sponsors typically represent the single largest plan expense. The rates for 2022 are $88 per participant and $48 per $1,000 of unfunded vested benefits, which is a 284% and 533% increase over the premium rates in 2007, respectively.</td>
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Despite the geographical distance and the distinct legislative landscapes, there are clear parallels between the DB pension plan markets in the USA and the UK. In both markets, companies are shifting their focus to the DB end-game, recognising that these plans are increasingly viewed as legacy arrangements. Even so, terminating plans remains costly and challenging in both markets. There remain very material DB obligations in both countries for companies to manage for many years. Financial market volatility, demographic shifts and continual regulatory change remain significant challenges around the world.

However, there are key differences between the US and UK markets to understand and navigate:

- The power and influence of UK trustees over key pension plan decisions - *managing this relationship effectively and proactively is critical. Similar structures exist in other large pension markets such as the Netherlands, Switzerland, Ireland and more*.
- More formulaic US funding rules vs "principles based" rules in the UK – *understanding how these principles work in concept and practice can be a huge challenge for those outside the UK.*
- Regulation is different and frequently changing in both markets – *applying strong corporate governance practices, appropriate to the local context, is important to ensure plans remain compliant and are managed in line with critical priorities*
- Whilst there is an active insurance market in the US and UK, the markets move in different ways and at different speeds – *staying on top of local trends and regulations, with appropriate global oversight, can help global organizations keep their pension risks under control*

Ask the fundamental question – do we want to continue offering DB plans or not?

There is plenty of received wisdom that all organizations should exit DB pension provision everywhere due to the risks and costs involved. In practice, of course, DB pension provision makes sense for some organizations – to support the employee value proposition and the ability to retain critical talent, or due to the size or nature of the organization.

The key point is that organizations should be clear on what purpose their DB plans serve, and whether the costs and risks of these plans are sustainable.

In short, "do we want to continue offering DB plans around the world?"

If the answer is yes, how do we proactively understand and manage our costs and risks over the near and longer term, e.g., through design, funding and investment strategy, administration etc.? And how do we put in place effective governance to ensure these costs and risks remain under control, and these plans continue to support the needs of our talent and business?

If the answer is no, what is the company's endgame objective for each DB plan in each market? For example, do we want to freeze and terminate / buy-out our DB plans? If so, what timescale is realistic given our funding position and tolerance to risk? Or should we manage these plans over the long term, in a sustainable low-risk way? In this case, how can this be achieved in the most efficient manner, with minimal cashflow and risk?

Call to Action - set a globally consistent strategy and execution plan for pensions

Our work with global organizations has highlighted the value of having a clear and globally consistent strategy and execution plan for managing DB pension obligations. Organizations that do this well achieve greater cost and risk control and avoid surprises. They proactively monitor plans globally and take advantage of market opportunities to achieve their goals more quickly and cost effectively. They also use precious internal resources and management time more effectively and give greater confidence to senior leaders that plans are well managed.

We recommend investing the time to be clear on your organizational objectives for DB pensions, starting with your most material plans – most commonly in the US and UK, but potentially other markets such as Germany, the Netherlands, Switzerland, Japan, Canada, etc. Strong planning and governance are also essential to ensure global organizations can make effective decisions quickly and execute them, to take advantage of market opportunities worldwide and support critical business priorities.

A trusted, independent global adviser can help develop a strategy that is fully aligned to your business priorities, and a well-structured plan to execute that strategy consistently and cost-effectively worldwide. This strategy should be developed using the right insights, involving the right stakeholders, and at the right time for your organization. Getting this right takes planning and effort but can deliver significant value to global businesses – at a time when such value is hard to come by. The time for action is now.

For more information, please contact John-Paul Augeri, Lewys Curteis or your local MBWL or Milliman consultant

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CONTACT

John-Paul Augeri FIA
johnpaul.augeri@milliman.com

Lewys Curteis FIA
Lewys.Curteis@Barnett-Waddingham.co.uk

End notes:
*UK: PPF 7800 Update October 2021 (total assets); USA: Investment Company Institute Release Quarterly Retirement Market Data Q2 2021 (total assets)