LOOK TO U.K. INNOVATION FOR DB DE-RISKING

U.K. plan sponsors have been on the de-risking journey for many years, with the majority of U.K. DB plans having now completed, or at least considered, some form of de-risking. Along the way, many creative solutions have emerged, prices and features have changed and lots of lessons have been learned – and these innovations may be of interest to Canadian plan sponsors who are trying to identify opportunities while avoiding pitfalls.

Many U.K. DB plans are now closed and the U.K. pension market has changed dramatically over the past five years. According to the 2011 Purple Book, published by the Pension Protection Fund, closed plans have increased from 56% of all DB plans to 82% and 10-year government bond yields have fallen from 4.4% to 2.0%.

Liability-driven investment (LDI) solutions are increasingly popular and, according to the National Association of Pension Funds Annual Survey of UK Pension Funds, U.K. plans have reduced their average equity allocation from 70% to 42% since 1999. In addition, the U.K. risk transfer market has grown from just £1 billion in 2006 to over £11 billion in 2011, according to Lane Clark & Peacock LLP.

New challenges lead to innovation and DB plans in the U.K. are increasingly implementing new solutions, such as the use of contingent assets to meet funding requirements and the use of annuity buy-ins and longevity insurance to hedge interest rate and inflation risk.

Several catalysts propelled U.K. DB plans down the road of de-risking and many of these factors now affect Canadian plan sponsors, including:

- market volatility;
- changes in financial reporting standards; and
- increases in life expectancy.

Sun Life Financial

DB SOLUTIONS InSights

Canadian DB plan sponsors are starting on their own de-risking journeys and LDI solutions and annuities are becoming more popular – with a Canadian risk transfer market[1] of almost $1.4 billion in 2011, according to LIMRA.

Like Canada, the de-risking markets in other countries have lagged behind the U.K., and are just starting to take off. Even in the U.S., where DB pension liabilities are estimated to be more than $2.0 trillion USD, the risk transfer market was only $1.7 billion USD in 2011, according to LIMRA.

So what five key lessons can Canadian plan sponsors learn from the U.K.'s experience?

1. Don't believe everything you hear regarding cost, capacity and complexity. Solutions are becoming increasingly affordable, the market is growing quickly to meet new demand and many de-risking solutions are simple to document and execute.
2. Demand for de-risking solutions can affect prices, so it pays to be prepared to act.
3. Act early to benefit from a first mover advantage before demand outstrips supply.
4. Annuity buy-ins may eventually be more popular than annuity buy-outs because they provide flexibility for plan sponsors.
5. New solutions will emerge to meet new demands –longevity insurance is a recent example in Canada that is an attractive option for some plans.

And what four actions can Canadian plan sponsors take now to prepare for future success?

1. Educate senior decision makers about de-risking now.
2. Evaluate de-risking solutions by discussing them with your retirement and investment consultants and by asking insurers for illustrative quotations.
3. Pick the solutions that work for you and prepare a plan that allows quick action when market opportunities arise.
4. Keep in touch with key players in Canadian de-risking for insights, market conditions and access to unique opportunities.

There is no single solution or quick fix to de-risking Canadian DB plans. While the road to lower risk can be a long one, it's important to start the journey and take advantage of the risk transfer opportunities that are now available – before market volatility or regulatory changes create new cost uncertainties.

ABOUT THE AUTHOR

Heather Wolfe joined Sun Life Financial in 2011 and brings over 15 years of experience as a consultant, and plan sponsor, giving her the perspective needed to develop and implement customized de-risking solutions.

For more information about Sun Life Financial's de-risking solutions for defined benefit pension plans, please contact:

Brent Simmons
Senior Managing Director, Defined Benefit Solutions
416-408-8935 | brent.simmons@sunlife.com

Heather Wolfe
Assistant Vice-President, Defined Benefit Solutions
416-408-7834 | heather.wolfe@sunlife.com

[1] 'Risk transfer market' refers to transactions that transfer risk from a pension plan sponsor to another company, and includes annuity buy-outs, annuity buy-ins and longevity insurance.