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CLEAR PATH ANALYSIS

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PRE-INTERVIEW IN ASSOCIATION WITH THE PENSION PLAN DE-RISKING, NORTH AMERICA 2020 REPORT

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ABOUT CONNING

Conning (www.conning.com) is a leading investment management firm with a long history of serving the insurance industry. Conning supports institutional investors, including pension plans, with investment solutions and asset management offerings, risk modeling software, and industry research. Founded in 1912, Conning has investment centers in Asia, Europe and North America.

The cornerstone of Conning's LDI philosophy is disciplined pension risk management. We believe that a robust LDI strategy should be designed to minimize the downside risk associated with a plan's funded status. Every plan should have a clear understanding of its risk appetite in order to develop a risk budget that reflects the considerations of the plan's various stakeholders, anticipated contribution amounts and where the plan may be in its de-risking glidepath. As a result, we believe each plan requires a customized solution that addresses its unique needs.

ABOUT CLEAR PATH ANALYSIS

Clear Path Analysis delivers dedicated market insight and intelligence to institutional finance professionals in the UK, Europe, North America and APAC.

Through research-led Summits and Seminars, industry-focussed Reports and trade news websites, we offer exclusive expert opinion and analysis.

An exclusive interview with Conning

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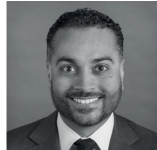

Sean Kurian,
Managing Director and Head of Institutional Solutions, **Conning**

With markets completely upended by the COVID-19 fallout, how have sponsor concerns changed?

The current environment has helped plan sponsors to better appreciate the impact of market volatility on plans and demonstrated that the various investment risk premia are no free lunch.

Unfortunately, this renewed appreciation may have arrived a little late for sponsors who hadn't sufficiently diversified their growth portfolio investment-risk-premia exposures, or paid enough attention to the interest rate risks embedded in their liabilities via a suitable liability-driven investment (LDI) journey plan.

If we separate sponsors into those who have a robust growth portfolio investment process and LDI journey plan (with respect to their defined benefit [DB] pension plans) and those who don't, the former should be in much better shape following recent market events, while the latter are probably hoping that the worst is over.

Conning would encourage sponsors within the latter camp to consider creating a robust growth portfolio investment process and an LDI plan that includes implementation terms (i.e., a strategy for what types of trades to make and when to make them) for when market conditions are relatively more stable.

Are you concerned that sponsors will overreact to current conditions?

Not really. Those sponsors with a robust growth portfolio investment process and LDI focus are already pursuing a journey plan designed to weather market volatility. I fear that many in the latter camp who are not planning a revamped investment process and journey plan with associated implementation criteria are probably hoping for things to quickly recover so they can simply maintain their status quo.

Will sponsors remain open to equity strategies in the near and long term? Are there particular strategies that you think will resonate with them?

In the near term, and for those with the temerity to follow through, this could be a major short-term tactical buying opportunity. However, I do feel those with a good strategic foundation and the necessary risk management tools already in place (including a journey plan) will be best positioned to take advantage of this potential opportunity.

In the longer term, things are less clear. For plans in deficit with sponsors unwilling to make the contributions necessary to address their plan funding deficit, investment returns are the only tool available to close the gap. Such sponsors may be forced to retain higher growth portfolio allocations (i.e., equity investments) in order to pay all pension obligations as they fall due. Some sponsors are perpetual equity bulls and, regardless of investment paradigm, will always see equity as the safest investment in the longer term regardless of the nature of the DB pension plan liabilities.

I hope a solid majority, however, will improve their risk management approach to be able to fully see the risks they are taking by investing in equities and scale their allocation so that it is consistent with their fiduciary risk appetite. The most robust way of doing this is by constructing an investment journey plan that is outcome-orientated and ultimately leads to attaining a given sponsor's objectives for their plan in the context of their overall core business.

With interest rates back to record lows, do you think bond markets are up to the challenge of helping sponsors earn the yields they need?

It depends on the part of the bond market you are looking at.

In terms of Treasury yields, yes, they are low, but looking at other developed markets (with negative yields), there's no guarantee that they won't go even lower.

In terms of bond spreads over Treasury yields, a crisis (subject to liquidity) is when bonds are usually at their highest spreads. Assuming things don't get any worse, particularly in relation to defaults (and downgrades to a lesser extent), it's sub-AA investment grade (IG) credit that should be DB pension plan investors' first port of call in order to get both risk management benefits against liabilities and also to outperform those liabilities (kind of like having your cake and eating it too). Going further down the spectrum, such as into high yield and more esoteric and structured credit, may reveal additional opportunities but with less of the risk management benefits relative to liabilities.

Conning is also working with clients to take advantage of tactical opportunities in the market in the most efficient way possible. For example, clients looking to add to their IG credit allocations, but who fear a rise in Treasury yields when spreads come back in, are being advised to hedge the risk of an underperformance in Treasury yields by selling Treasury futures of the appropriate term and size. These futures are very liquid and can be removed over time as yields revert to more normal levels. Alternatively, they can be quickly and cheaply removed if there are fears that yields will fall instead of rise.

Post-crisis, what type of market indicators will you be watching?

Pension plan sponsors today should take a step back and garner as much perspective as possible. Even for seasoned investors, it's all too easy to get caught up in the moment and allow behavioral or other biases to lead to sub-optimal decision-making. It is an even greater risk for pension plans, where critical plan attributes are dependent on a number of hard-to-predict variables.

A pension plan is shaped by the interaction between liability and asset valuations. Long-term bond yields directly influence the former, while a combination of equity/growth valuation parameters and bond yields affect the latter. The nexus between the two is the funding level, and most pension plan funding levels have deteriorated sharply in recent weeks.

Conning will therefore be keeping a keen eye on these key plan variables. However, equally important are the economic and demographic variables that will be determining factors under the present COVID-19 crisis. A sample of these would include:

- Government stimulus arrangements and utilization levels
- GDP projections and estimates
- Producer production indicators
- Corporate earnings estimates and warnings
- Unemployment rates and jobless-claims levels
- Inflation levels and indicators (including break-even levels from different markets)
- Regional curfews and socialization prohibition
- Regional rates of infection and mortality
- Treatment options, production rates and requirements.

At the end of the day, we should remember that pension plans are long-term investors and there will always be obstacles and challenges to overcome along the way. For this reason Conning believes that journey plans are a great way to help pension plan sponsors maintain discipline and focus, especially in times of significant market dislocation.

Sean Kurian, FSA, CAIA, FIA, FRM, is a Managing Director and Head of Institutional Solutions at Conning, responsible for a team providing strategic investment advice and broader investment solutions across the main institutional investor types. Mr. Kurian serves on the FTSE Bond Index Committee, responsible for the FTSE/Citi bond index range, and has been a frequent media commentator on financial risk management and institutional investment issues. He has over 20 years of industry experience, working on both sides of the Atlantic in portfolio management and consulting roles. Prior to joining Conning in 2016, Mr. Kurian was a lead structuring specialist and derivatives portfolio manager at J.P. Morgan Asset Management, and previously led Towers Watson's Structured Solutions group. Mr. Kurian earned a Master's degree from the University of Oxford.

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