

# Waiting for Impact— Are Plan Sponsors Ready?



EDITORIAL

A few years ago, I saw a bad movie about a giant asteroid hurtling through space on a collision course with Earth. The plot went something like this – American kid spots asteroid through telescope and notifies authorities. Attempts are made to obliterate the mass using large missiles and complicated math. Nothing works. The rest of the movie is about waiting for the inevitable impact. Of course, the meteor hits. Life on Earth changes radically, but people survive and adapt to the new landscape, nonetheless.

The challenges facing sponsors of Canadian defined benefit plans in 2002 remind me of this scenario. Spring is around the corner and the economy is starting to show signs of life. But while things are looking up for investors in 2002, sponsors of Canada's defined benefit plans are bracing themselves to receive the full, negative impact of the 2001 bear markets – a meteor that has been moving toward pension fund balance sheets for some time.

According to a white paper on pension financing released by Towers Perrin, sponsors of defined benefit pension plans should expect higher costs arising from negative equity returns in 2001. This situation will be made even worse by higher-than-expected pension liabilities. The combined impact of lower pension fund assets and higher liabilities has yet to hit many plan sponsors – and when it does, it will definitely hurt.

During the last two decades, Canada's pension funds earned an average return of 11 per cent from capital markets, or nine per cent over inflation. Last year put an end to that and, according to Towers Perrin, things could

get worse. The fallout from the poor equity market performance in 2001 will start to hit pension plan costs in 2002 – and beyond. For many plan sponsors, this means that funding holidays are now a thing of the past and pension costs for this year will have a dramatic impact on corporate earnings. This could lead employers to raise future pension contributions to make up for the shortfall.

Eric D'Amours, a consultant at Towers Perrin, believes that while the impact can't be avoided, it can be deferred. He suggests that plan sponsors explore some "funding levers" to soften the blow. For example, the timing of the next actuarial valuation can be deferred. Or, a smoothing technique can be used in the plan's solvency test. But these options require quick and immediate action. Plan sponsors will need to act fast and review their financial policies.

Of course, these deferral techniques depend on the hope that markets will continue to improve and interest rates will start to rise again this year. And there's no guarantee of either. But D'Amours points out, there's no harm in trying. "If things don't get any better, [plan sponsors] will have to pay anyway."

If you believe that single-digit equity market returns and low interest rates are here to stay, is there any point in postponing the inevitable? We are on a collision course and the landscape is being transformed – now is the time to adapt and change. ■

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