

# Challenges and Reactions to the Financial Market Crisis

## Highlights from the 2009 Survey of Pension Risk

### **About the 6<sup>th</sup> Annual Survey**

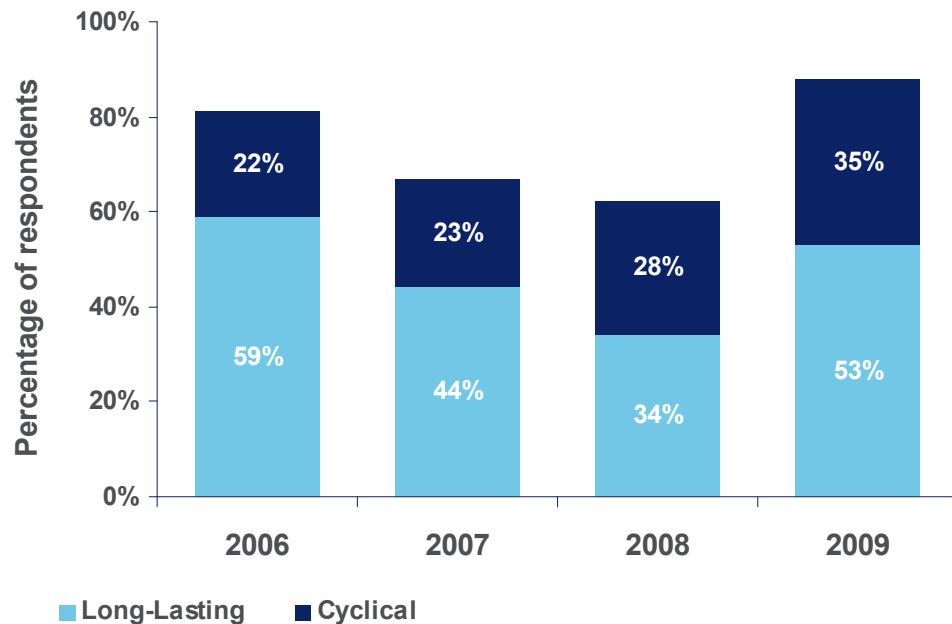
Stock markets fell drastically after the financial turmoil intensified in September 2008, translating into trillions of dollars of losses to investors around the world. This has had a profound impact on the private pension landscape. To better understand the effect of the financial crisis on Canadian pension plan sponsors, Watson Wyatt Worldwide conducted its sixth annual Survey of Pension Risk during February-March 2009. The survey asked senior executives, including chief financial officers and vice presidents of human resources, about their views on — and reactions to — the current challenges, as well as future threats to their defined benefit (DB) and defined contribution (DC) pension plans.

## Major Resurgence in Funding Crisis Facing DB Sponsors

Previous survey results indicated increasing optimism regarding the long-term outlook of DB pension plans in Canada. As shown in **Figure 1**, the percentage of respondents who see the DB funding crisis as a widespread problem continued to decline between 2006 and 2008; however, this picture has changed dramatically as a result of the financial crisis.

This year's survey reveals that the number of respondents who think there is a DB funding crisis in Canada has jumped markedly from last year's level. Close to 90 percent believe a crisis exists in 2009, surpassing the previous peak of 81 percent in 2006. A notable difference between this year's results and those for 2006 is that more respondents, especially HR vice presidents, view the current funding crisis as a cyclical problem. While over half of the respondents see this crisis as long-lasting, another 35 percent perceive the crisis as cyclical.

**Figure 1 |** Respondents Who Think There Is a Pension Funding Crisis



## Government Funding Relief Critical for DB Plan Sponsors and Canadian Economy

Many DB pension plans are facing sizable deficits caused primarily by the sharp decline in the stock market. Without funding relief from the various governments, the amount of solvency deficit payments that DB plan sponsors have to contribute is expected to be enormous over the next few years. This, in turn, would restrict their ability to make necessary investments to maintain and grow their business. Assuming no regulatory relief on DB funding, 30 percent of publicly-traded and private companies with non-bargained DB plans say they would reduce investment spending on capital to a large extent, whereas another 46 percent indicate a moderate reduction.

Different jurisdictions have proposed various forms of funding relief. As shown in Figure 2, when asked which relief is most desirable in funding their solvency deficits, a longer amortization period without conditions attached is by far the most helpful option, cited by close to 90 percent of respondents. Increasing the actuarial discount rate is viewed as a distant second (47 percent), followed by longer amortization with conditions (27 percent) and temporary suspension of additional solvency contributions (27 percent).

**Figure 2 | Preference on Government Funding Relief**

	Least Helpful	Somewhat Helpful	Most Helpful
Longer amortization period for solvency deficits (e.g., 10 years) without needing a letter of credit and/or member consent	2%	9%	88%
Increasing the actuarial discount rate for solvency valuations	24%	29%	47%
Longer amortization period for solvency deficits (e.g., 10 years) for plans that obtain a letter of credit and/or member consent	48%	25%	27%
Temporary suspension (e.g., 12 months) of the requirement to file valuations with the regulator	46%	27%	27%

## No Substantial Changes in DC Conversions and Investment Strategies

As cost and volatility reduction is considered the primary driving force in plan design decisions, one might suspect that more DB sponsors are considering DC conversions after the financial crisis. A perhaps surprising result is that the attitude toward DC conversions is very similar between 2008 and 2009. Forty-one percent of DB sponsors indicate they have no intention of converting their pension schemes to DC, compared with last year's 42 percent.

Further, there is no clear indication that DB sponsors are adopting more conservative strategies as a result of the financial crisis. While increasing bond weighting and lengthening bond duration are popular strategies to help contain future solvency deficits and to stabilize costs, some respondents continue to move to alternative asset classes and strategies in search of higher, uncorrelated returns.

## Insufficient Retirement Savings as Growing Threat to DC Plans

Insufficient savings to retire, due to low contributions and poor investment returns, continue to be the most serious threat to the long-term sustainability of DC plans. More important, the vast majority of respondents consider this threat to be more acute in light of the current financial crisis. Despite their awareness of the concerns, most DC sponsors do not believe it is their responsibility to establish and aim for a certain income replacement target for their plan members. The majority (78 percent) believe their responsibility is to maintain a certain contribution level regardless of changes in future expected investment returns. When asked about the current contribution rates, less than 5 percent are contributing 8 percent of pay or more.

One way to help DC members who have suffered deep investment losses to rebuild their retirement funds is to materially increase employer contributions. However, very few DC sponsors indicate that they have revised or are planning to revise their contribution rates as a result of the financial crisis. As shown in **Figure 3**, around 90 percent expect their contribution levels to be lower or remain unchanged in the next three years.

**Figure 3 |** Future Employer Contributions to DC Plans, as Percentage of Pay

Below or no change from current level	90%
1% higher than current level	2%
2% higher than current level	7%
At least 3% higher than current level	1%



## Conclusion

The severity of financial threats, particularly the cost and volatility of maintaining DB plans, has increased substantially in the current financial climate. This year's survey shows that close to 90 percent of respondents believe a widespread DB funding crisis exists in Canada, surpassing the previous peak of 81 percent in 2006.

Defined benefit plan sponsors are seeking government funding relief to avoid massive solvency deficit contributions over the next few years. A number of jurisdictions have proposed or implemented a range of solvency relief options, such as temporary extension of the solvency amortization period and suspension of additional solvency contributions. Among all the relief options, a longer amortization period without conditions attached is cited as the most desirable in funding solvency deficits.

Although cost and volatility are not a concern for DC plan sponsors, the vast majority indicate that the threat of insufficient savings to retire has become increasingly acute after the financial crisis. Defined contribution plan members are worried about their inability to retire due to deep investment losses. Yet, very few DC sponsors have revised or are planning to revise their contribution rates to help rebuild members' retirement funds. These members will need to save more and wait for a stock market rebound in order to recover their recent losses. Unless there is a speedy recovery, retirement may become unaffordable for those who are planning to retire in the next few years. Older employees unable to exit as planned can pose a significant challenge for DC sponsors that are trying to streamline their operations to survive the current recession.

## About the Survey

The 2009 survey was completed by 161 respondents from 156 organizations across Canada. Fifty-two percent of respondents were from Ontario, 20 percent were from Western Canada, 17 percent were from Quebec and 2 percent were from the Maritimes. Twenty-three percent of the organizations in the survey sponsor only DB plans, while 69 percent have pension arrangements that include DC assets, either alone or in combination with DB plans.

Of the 161 responses, 29 percent were completed by chief financial officers alone, 50 percent by vice presidents of HR alone and 8 percent jointly by both functions. The remaining 13 percent were completed by individuals in other functional areas.

**Figure 4 |** Survey Participants by Province/Territory

	Number of Organizations
Maritimes	3
Quebec	27
Ontario	81
Manitoba/Saskatchewan	9
Alberta	16
British Columbia	16
Others	4
Total	156



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- Advising pension plan sponsors and other institutions on optimal investment strategies
- Providing strategic and financial advice to insurance and financial services companies
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