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Session 100: Pension De-Risking Through Glide Paths

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Triggered by the Pension Protection Act (2006), the global financial crisis of 2008, and the maturing of the U.S. pension system, the adoption of de-risking glide paths has become commonplace among corporate pension sponsors. Unlike a standard static asset allocation, the glide path is a systematic way to adjust asset allocation by reducing funded status risk as funded status improves.

At low funded status, the glide path recognizes that the sponsor may desire to take on investment risk to close the funding gap.

Conversely, when the plan is fully funded, the sponsor, realizing that there is little benefit to taking additional risk, would want to de-risk and invest primarily in a liability matching portfolio.

Table 1
Simple Illustrative Glide Path De-Risking Schedule

Funded Status Trigger	Return Seeking Allocation	Liability Matching Allocation
<80%	50%	50%
80% to 85%	45%	55%
85% to 90%	40%	60%
90% to 95%	35%	65%
95% to 100%	30%	70%
100% to 105%	25%	75%
>105%	20%	80%

After adopting a glide path, the plan sponsor then must decide on the details of implementation, including:

Governance structure—Whether to de-risk automatically at each trigger or to use the triggers as a chance for deliberation where the committee must approve each de-risking allocation change.

Monitoring frequency—The choice of daily, weekly, monthly, or quarterly creates a trade-off between increased precision and increased costs.

One way vs. two way—A decision whether to allow re-risking of the allocation when funded status declines.

Trading policies—The establishment of tactical ranges, use of derivatives, and the consideration of transaction costs.

Changes *within* the growth and liability-hedging allocations—For example, excluding illiquid growth assets and customizing the liability-matching portfolio as funded status increases.

Before adopting a glide path, the plan sponsor must consider many questions, including:

- Is it appropriate to take risk at all in their pension plan, especially uncompensated risks like interest rate risk?
- Is the time horizon of a glide path long enough for all asset classes to pay off?
- Is it advantageous to wait to buy long bonds and face a crowded marketplace?

- Do shareholders benefit when the sponsor takes equity risk in the pension plan, especially at low funded status and when the plan has high exposure to market downturns?
- Glide paths have become common with an increased regulatory environment, a focus of risk management and a maturing pension system. This can be seen in annual surveys or in the financial statements of a plan sponsor. We do expect the use of glide paths to continue but believe that sponsors need to adopt and implement them in a thoughtful way based on the specifics of their plan and their beliefs as an investor. ■

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