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Topic A. Investment Strategies and Risk Management

A Practitioner's Observations On Some Innovative Ideas For Pension Plan Investment

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Many defined benefit plans are in deficit. Proponents of financial economics would not be surprised. They would note that the investment policies of many plans, which involved extreme mismatches of assets and liabilities, were likely to lead to funding deficiencies at some point in time. Where should investment policy go from here? This paper examines a number of possible approaches and identifies practical limitations in their implementation, including:

- Securitizing the unfunded liability, full-funding of accrued liabilities, and investing in suitably matching investments as proposed by Jeremy Gold in "Never Again"
- Using dynamic asset allocation techniques with fixed income securities
- Continuing to invest with a mismatch strategy but hedging the risk using Margrabe options
- Continuing to invest with a mismatch strategy but incorporating more flexibility into the pension deal in order to share more risk with plan participants

Keywords: asset-liability mismatch, dynamic asset allocation, financial economics, hybrid defined, benefit pension plan, Margrabe options securitization