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Translating PRT from LDI

This month we argue the wisdom of high allocations to bonds in a potentially rising rate market.

Last month we wrote that Pension Risk Transfer (PRT) strategies mitigate interest rate risk and are an embedded hedge to rising rates. LDI bonds will drag recovery to fully funded status. MAP rates allow lower contributions but settlements are still based on PPA rates.

PRT as a Tactical Strategy

In LDI, bonds are positioned as a "buy and hold" asset even in a rising rate market. So we posit:

Why would you hold bonds at their highest prices ever if you expect prices to fall?

If sponsors are wedded to LDI and can afford to be fully funded for settlement, then maybe it's not an issue. But, isn't corporate cash better used elsewhere? If rates rise, bond prices fall.

Terminating plans should evaluate implementing defensively postured tactical PRT strategies. *Translation:* Selling bonds in a rising rate market means you tread water with liabilities. However, if you swap bonds for PRT, you acquire a hedge. If rates trend higher, swapping bonds into PRT could lower costs. If rates are certain to rise (translation: Ben raises rates and sells) then bonds can be sold to cash or swapped "in kind" for PRT.

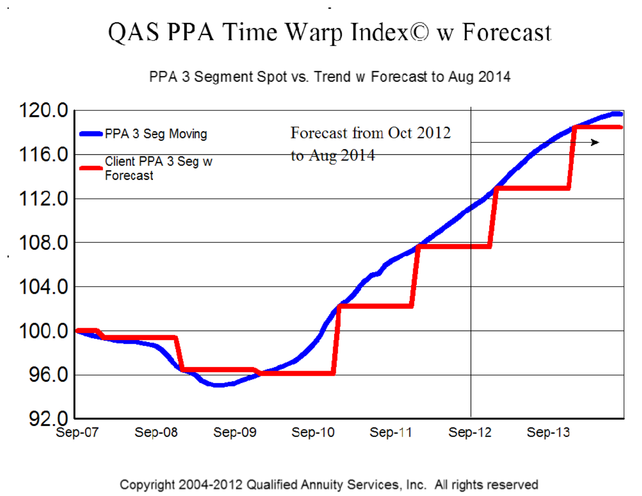
The Key Ingredient

PRT strategies can be positioned in advance of termination. PRT execution effectively fixes the takedown price. This can minimize the MAP GAP and potentially reduce overall exit costs.

How Do You Get There?

Tactical PRT means selling bonds at high prices and buying annuities into a rising rate market. The question to as is: *Is it better to trade when the price is right for me or at whatever price the market demands on some unknown future date?*

To illustrate the cost of this lag effect, we use the QAS Time Warp Index to highlight the impact of averaging of PPA rates.



Future 12-month cost using segment rates are higher even as we assume spot rates remain flat. Liability continues to increase due to averaging.

We believe risk appetite has returned. Translation: we see better annuity pricing relative to settlement going forward. It is time to de-risk DB plans.

Get Informed. Think Strategic. Act Tactical.

For information contact Don Cunningham (513-772-4488) or Joe Cleary (201-447-3900) or QAS.

Date	**Immediate Life Annuity**	**Deferred Life Annuity**
August 1, 2012	2.89%	3.34%
September 1, 2012	2.91%	3.24%
October 1, 2012	2.86%	3.33%