

Considerations for Stabilizing Pension Plan Outcomes

by Kyle Rubovits

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Pension liabilities are long-duration obligations whose economic value is directly determined by interest rates. If left unhedged, changes in interest rates can be material and, at times, can represent a significant driver of changes to a plan's funded status regardless of asset performance¹. In this context, a pension portfolio that does not protect against interest rate risk is taking a macroeconomic position, effectively speculating on interest rate movements with the retirement security of its beneficiaries.

Fixed income assets, particularly long-duration securities, may provide a direct means of hedging against this risk. The defining characteristic of these assets is their sensitivity to changes in interest rates, closely paralleled by pension liabilities. By constructing a portfolio with duration characteristics aligned to those of the plan's liability stream, the impact of interest rate movements on the plan's funded status can be materially reduced. This helps shift the primary source of funded status volatility toward intentional return-seeking decisions, rather than from structural misalignments between assets and liabilities.

Stabilizing Outcomes Through Interest Rate Hedging

This alignment is often described through the concept of the "interest rate hedge ratio" (or simply "hedge ratio" for short), which denotes the proportion of a plan's liability interest rate sensitivity that is offset by its assets. Each plan's appropriate level of hedging is distinct, based on the plan sponsor's financial strength and long-term objectives. Plan sponsors should consider these factors when determining the appropriate hedge ratio for their portfolio at each given level of funded status.

The stability of the plan's funded status has tangible implications for plan sponsors. Volatility in funded status translates directly into variability in contribution requirements. Notably, periods of declining interest rates and rising liabilities often occur at the same time when sponsors may be least able to increase their contributions due to these added financial pressures². Hedging liabilities against this sensitivity to interest rate movements is designed to allow a liability-driven investment program to support more predictable plan management by improving funded status stability.

¹ Mercer, *Chasing Liability Growth Rates*, July 2026.

² IMF, *The Fiscal and Financial Risks of A High-Debt, Slow-Growth World*, March 28, 2024.

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For plans with a defined end goal, such as termination or significant risk reduction, glidepaths can be an impactful method to assist with derisking. They link funded status improvements to incremental increases in hedging, effectively reducing risk as funded status gains are achieved. As funded status improves, the plan reallocates return-seeking assets toward liability-hedging assets, reducing the plan's exposure to both market risk and interest rate risk. This approach helps to ease the emotional decision of derisking by introducing a disciplined, rules-based structure to decisions that might otherwise be discretionary, helping to ensure that progress toward the plan's objective is preserved.

Balancing Stability and Growth in LDI Strategy

We regularly evaluate these metrics for our clients in order to maintain the target risk control levels in each portfolio. We model the funded status for our clients using the plan's projected benefit stream and the portfolio's current asset allocation mix to determine whether adjustments to the liability driven investment (LDI) target allocation or the asset duration are warranted as the funded status shifts over time. In this way, we seek to control a pension's hedge ratio through changes in the plan's LDI allocation and asset durations. This serves to provide plan sponsors with greater certainty of potential outcomes resulting from interest rate volatility or market declines while stabilizing contribution requirements.

Despite the benefits of interest rate hedging, it is not without tradeoffs. Increasing the hedge ratio typically requires reallocating capital from higher expected-return assets like equities to lower-returning fixed income, which may reduce the portfolio's long-term return potential. For underfunded plans or those with aggressive return targets, this consideration is particularly relevant. Higher LDI allocations serve to help stabilize funded status, but this stability may not be desirable if a plan's current funded status is too low to meet the plan sponsor's long-term goals. Moreover, during increasing interest rate environments, hedged portfolios may not fully realize the improvement in funded status that unhedged plans experience as liability values decline. The decision of how greatly to hedge, therefore, reflects a balance between the desire for stability and the need for growth.

Applying Hedging Strategies Across Plan Types

The applicability and design of hedging strategies vary across plan types. Corporate plans, particularly those that are closed or frozen, often prioritize funded status stability and may pursue higher hedge ratios in conjunction with glidepaths. Public plans, by contrast, typically maintain lower hedge ratios, reflecting a greater reliance on return generation and in recognition of a more flexible liability and contribution framework³. In all cases, however, the underlying principle remains consistent: the interaction between asset behavior and liability behavior is a central determinant of plan outcomes.

Bringing the Investment Framework Together

³ Commodity Futures Trading Commission, [Public Pension Duration Risk, Interest Rate Swap Usage, and Transparency](#), August 2024.

To explore further considerations, Partner, Senior Consultant, Chris Rowlin touches on the impact of asset allocation in shaping expected returns, funded status volatility, and contribution requirements for plans of all types in his article [*Public Pensions and OPEB Plans: Core Elements and the Role of Asset Allocation*](#).

Additionally, Partner, Defined Benefit Practice Leader and Senior Consultant, Kate Pizzi, CFA, ASA explores the downsides to having unfunded liabilities in her article [*Demystifying Pension Liabilities*](#). These articles highlight how interest rate hedging, when implemented within a coherent investment framework, allows pension plans to more effectively align assets with liabilities. By using LDI assets to hedge against interest rate risk, plans improve the predictability of future obligations and create a more stable foundation upon which to pursue their broader investment objectives.

Ultimately, we believe effective pension plan management requires a clear understanding of how assets and liabilities interact. Interest rate hedging, LDI allocations and disciplined glidepaths can help sponsors reduce funded status volatility, create greater contribution stability and preserve progress toward long-term objectives. While the appropriate strategy will vary by plan type, funded status and sponsor goals, incorporating liability awareness into the broader investment framework can support more informed, resilient decision-making.

For additional support with pension plan management, please reach out to any of the professionals on Fiducient Advisors' Defined Benefit Team.

About the Author



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As a Consulting Analyst, Kyle is responsible for the analysis of defined benefit, endowment, foundation and other nonprofit client investment portfolios. He began his career in financial services in 2023, participating in Fiducient Advisors' internship program where he supported and contributed to the firm's research efforts. He earned a Bachelor of Science degree in Finance with a Minor in Philosophy from Trinity University. In his free time, Kyle enjoys visiting art galleries, attending jazz concerts and playing poker.