(UBS Pensions series 23) Sponsoring Company Finance and Investment and Defined Benefit Pension Scheme Deficits

Author

Listed:
- David C Webb

Registered:
- David Webb

Abstract

This paper presents a model of the interaction of a company's financial and real investment decisions with the financing of its defined benefit pension plan. The pension plan deficit is a debt of the company, with explicit funding requirements and priority in the event of company insolvency. Pension plan deficits and options on future deficits and surpluses affect investment incentives as does the size and composition of company debt. We illustrate the incentives for the firm to pay dividends rather than fund the pension plan and the general incentives to overfund the pension plan. We also illustrate the impact of pension benefit insurance and minimum funding requirements.

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