Independent Trustees

GOWLING WLG

Are UK pension schemes de-risking? 2016 survey


sponsors
certainty
liability
approach
pension
trustees
timescale
joint
insurance
schemes
results
investment
strategy
respondents
derisking
best
agreed
management
strategies
sponsor
funding
survey
exercises
members
years
engagement

Contents

PSIT Independent Trustees

GOWLING WLG

Summary

De-risking is a top priority over the next three years for pension trustees and scheme sponsors alike.

Given the recent volatility in the value of sterling and ongoing political uncertainty over Brexit, it's perhaps no surprise our joint Gowling WLG/PSIT research project found that de-risking is on the agenda for 91% of respondents between now and 2020.

68 trustees, pension managers, sponsors and professionals involved in schemes ranging in size from less than 100 to more than 10,000 members (with values ranging from less than £100m to £1bn+) told us about their approach to de-risking. The results challenged some preconceptions on sponsor funding and what de-risking actually looks like for schemes of all sizes.

The three key themes emerging from the survey are:

- engagement between trustees and sponsors to develop a strategy is vital to de-risking successfully;
- de-risking is no longer just about insurance, with liability management exercises and investment strategies at the heart of a new joined up approach to de-risking; and
- sponsor funding is often not the main impediment to de-risking.

> Considering de-risking sooner rather than later means fewer regrets down the road, and the range of options available means de-risking should be within reach for schemes of all shapes and sizes.

Agreeing the de-risking strategy

70% believe de-risking is developed jointly by the sponsor and trustees - but 54% do not have an agreed strategy in place

Most respondents agreed a close working relationship between trustee and sponsor is important. However, with fewer than half of respondents saying they have an agreed strategy in place, schemes are clearly still working through this process.

We anticipate a growing appetite from trustees and sponsors to engage on strategic planning in the coming months and years. Joint strategy days, improved information sharing and increased sponsor engagement on investments are among the tools available to help turn the good intentions revealed in the survey into practical results in the form of an agreed de-risking strategy.

More than just insurance

55% are not targeting insurance of pensions – and over 52% do not expect to be ready to transact within 10 years

Buying the scheme out with a willing insurer isn't currently suitable or achievable for all schemes. This means actual de-risking strategies are wider than just preparing for an insurance trade.

Schemes are increasingly looking at liability management exercises that make sense in today's market. These include flexible retirement option exercises to allow members to take full advantage of the new defined contribution (DC) flexibilities or pension increase exchanges (PIEs) to manage the cost of indexation.

Investment strategies are also evolving to complement the de-risking model, whether through currency hedging, liability driven investment or growth asset allocation. A tailored investment strategy can help de-risk a scheme without the need for the sponsor to put up additional cash – a good result for the trustees with minimal impact on the sponsor's bottom line.

Overcoming the impediments

Less than 25% say the sponsor is unable to finance a de-risking project

The preconception that de-risking is completely dependent on sponsors being willing and able to make a substantial cash injection is not supported by our survey's results.

Whatever the ultimate goal for the scheme, whether it is self-sufficiency or an insured solution, the best approach for success is to agree the objective, consider the timescales and come up with a joint plan to direct investment strategy, liability management projects and contributions towards that goal.

Final thoughts

32% of respondents regret not de-risking sooner

All schemes, regardless of size, should consider the best options open to them to reduce pension scheme risk and improve sustainability. Often de-risking is in the best interests of trustees, members and sponsors alike, helping to manage contribution levels while improving certainty that benefits will be delivered in full.

Whether it's lack of knowledge and understanding of fairly complex de-risking products, or risk-averse instincts preventing the adoption of more innovative options, there are still plenty of impediments to successful de-risking. However, most of these can be overcome with improved communication.

In our view, taking comprehensive professional advice and ensuring active engagement between sponsor and trustee are the cornerstones to successful pensions risk management. Considering de-risking sooner rather than later means fewer regrets down the road, and the range of options available means de-risking should be within reach for schemes of all shapes and sizes.

About you and your scheme

Respondents to our survey represented a broad cross section of schemes - from those with less than 100 members and less than £100 million in assets to those exceeding 10,000 members and with over £1 billion in assets.

Responses were received from trustees, pension managers and representatives of scheme sponsors. The majority were trustees, but there was a higher proportion of:

- scheme sponsors for small schemes of less than £100m (24% compared to 10%)
- pension managers for very large schemes of >£1bn (67% compared to 25%

In total we received 68 responses.

Q1: In what capacity are you answering this survey?

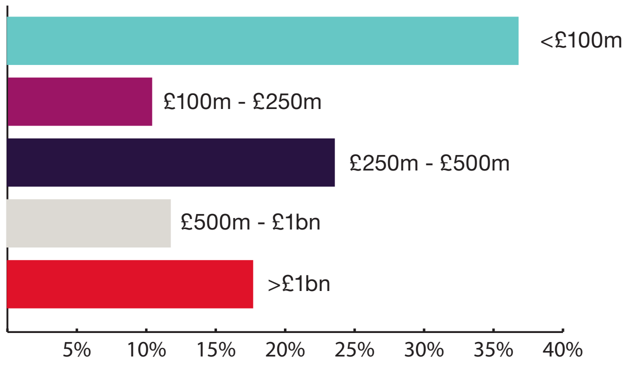
- Trustee – 55.88%
- Scheme sponsor – 10.29%
- Pension manager – 25.0%
- Other – 8.82%

Just under 56% of respondents to our survey were pension trustees. A further 25% were pension managers and just over 10% represented scheme sponsors.

Those who selected 'Other' included:

- actuary or scheme actuary
- pension adviser
- consultant
- company senior manager - Group HR Manager
- pensions manager & trustee

Q2: Approximately what size is your pension scheme?

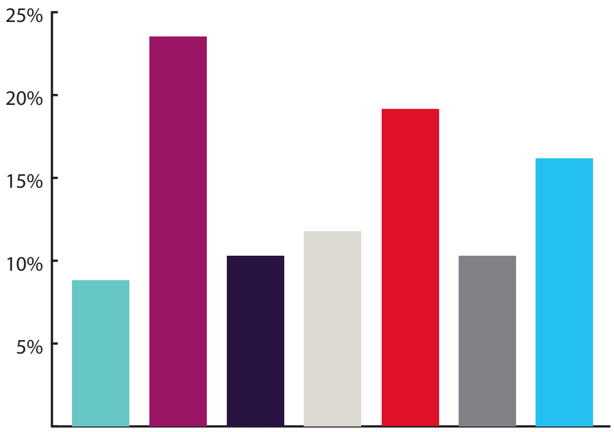


- <£100m – 36.76%
- £100m - £250m – 10.29%
- £250m - £500m – 23.53%
- £500m - £1bn – 11.76%
- >£1bn – 17.65%

Respondents to our survey represented a wide spread of pension schemes, from the very small to the very large.

Over one-third were from schemes with assets of less than £100m. Almost one quarter had assets in the range £250m - £500m and nearly 18% had assets in excess of £1billion.

Q3: How many members does your scheme have in total?



- <100m – 8.82%
- 100 - 500 – 23.53%
- 500 - 1,000 – 10.29%
- 1,000 - 2,500 – 11.76%
- 2,500 - 5,000 – 19.12%
- 5,000 - 10,000 – 10.29%
- >10,000 – 16.18%

As you may expect given the result of the previous question, our survey respondents also represented a good range of schemes by size of membership. The figures include all active, deferred and pensioner members.

Achieving this range was important, as it gave us the opportunity to see if there were any disct-inct differences in the results for large and small schemes.

PSIT Independent Trustees
GOWLING WLG

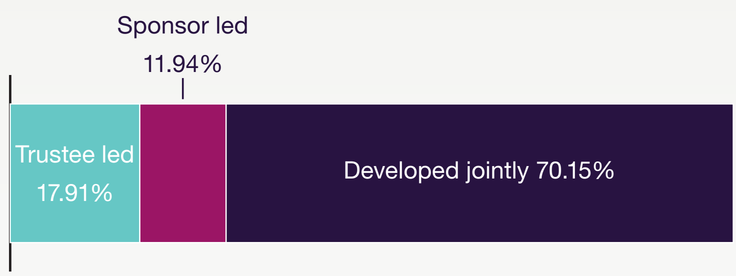
De-risking: where are you now?

Overall, 70% of respondents believe pension scheme **de-risking should be developed jointly** between the trustees and sponsor, which is something the Pensions Regulator is keen to encourage. There were some small variations in the results when we looked closer at the underlying segments:

- small schemes of <£100m are more likely to see de-risking as trustee led (21% compared to 18% overall)
- only 8% of very large schemes (>£1bn) think it is trustee led, with 75% saying developed jointly

There is a high level of understanding of each other's goals and objectives - rated 4 out of 5 on average. Despite this, and the fact lots of de-risking activity has already taken place, **54% do not have an agreed de-risking strategy**.

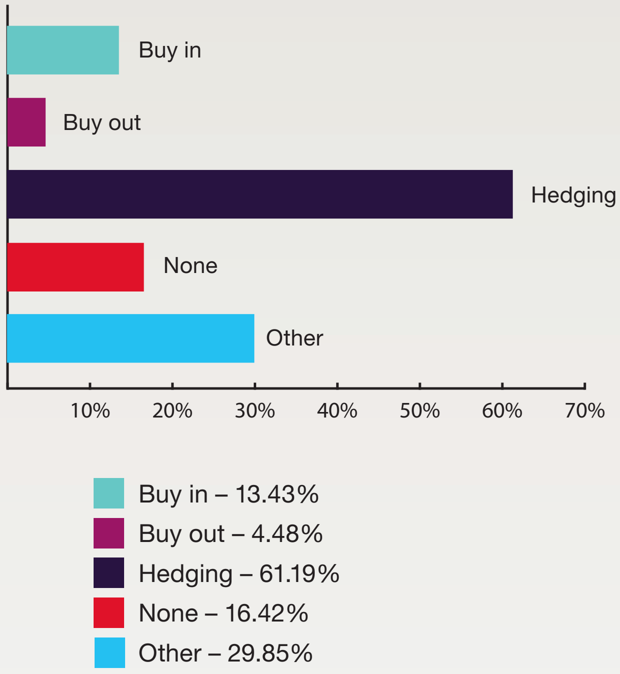
Q4: Do you see pension scheme de-risking as:



Q5: What level of understanding does each party have of the other's goals and objectives?

PSIT Independent Trustees GOWLING WLG

Q6: What de-risking have you carried out in the last 3 years?



A great deal of de-risking activity has already happened - mainly hedging (61% of schemes) but also some buy outs or buy ins (18%). Again, there are some variations between schemes of different sizes.

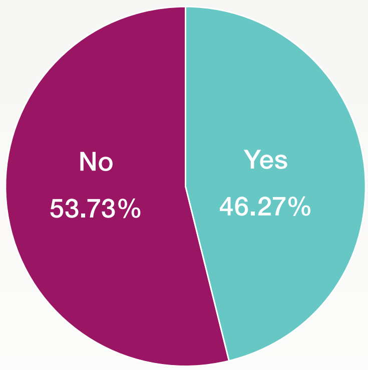
Very small schemes of <£100m are more likely to have done nothing (37% compared to 16%).

Very large schemes of <£1bn are more likely to have hedged (75% compared to 61%) activity.

'Other' includes:

- investment strategy changes - eg less risky and more diverse asset allocation, refocused equity portfolio, use of diversified growth funds (DGFs) and liability driven investment (LDI)
- enhanced transfer values (ETV) & transfer value awareness
- flexibility at retirement, pension increase exchange (PIE) and trivial commutation exercises
- closure of defined benefit (DB) scheme to future accrual.

Q7: Have the trustees and sponsor agreed a de-risking strategy?



Overall, 46% of schemes said they have a de-risking strategy agreed between the trustees and sponsor, and this fits with our experience of the general market.

However, the proportion switches at the large end, with 58% of very large schemes of >£1bn saying they have agreed a strategy.

Respondents who answered 'Yes' were asked to continue the survey at question 8. Those who answered 'No' went on to question 13.

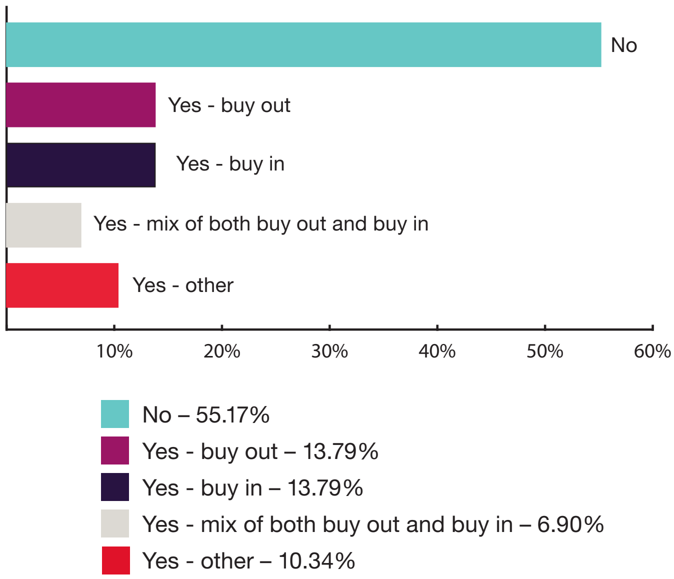
About your de-risking strategy

This section was completed by respondents who told us in question 7 that they had a de-risking strategy agreed between the trustees and the sponsor.

Although many people believe pension de-risking goes hand in hand with buy ins and buy outs, in reality these are only a small part of the picture - 55% are not targeting insurance of pensions. This result could tie in with the fact the majority (52%) of schemes believe it will be over 10 years before they are ready to transact.

We found it surprising that a high proportion of respondents felt they had clean data (69%) and an agreed benefit specification (64%) but were a long way from buy out. "What is clean data?" is a question all pension trustees need to consider carefully. Focusing on what proper data is and what the insurers are really using that data for is key.

Q8: Are you targeting insurance of pensions?



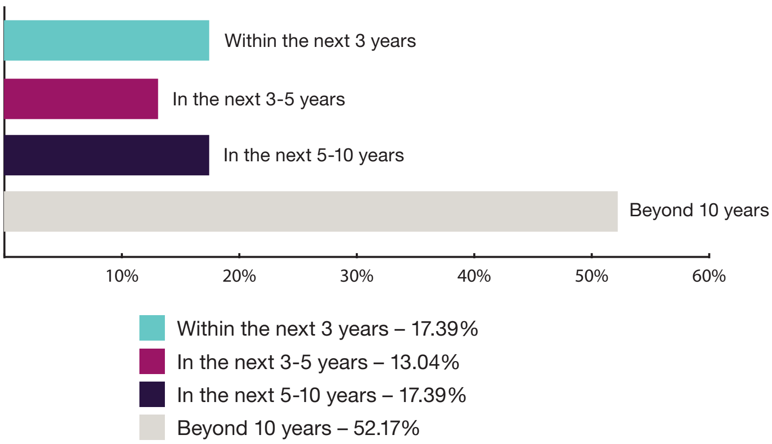
'Yes - other' included:

- long term yes to reach a sustainable amount allowing for buy in
- we have already bought in a substantial chunk of pensioner liabilities and continue to actively review further options
- but not at this time and detail to be agreed

PSIT Independent Trustees

GOWLING WLG

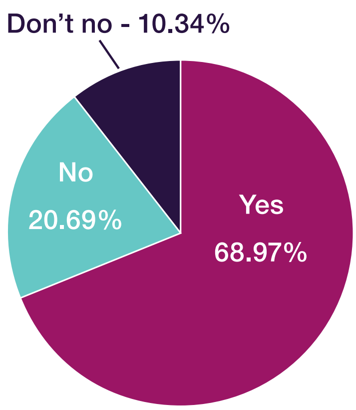
Q9: When do you expect to be ready to transact?



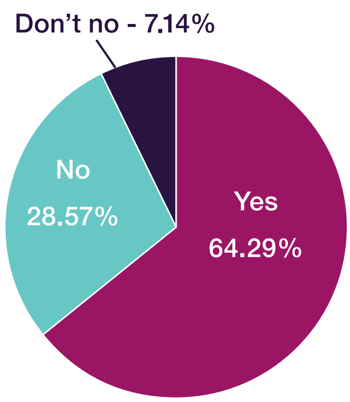
Half of pension schemes do not expect to be ready to transact for at least 10 years. The spread across earlier time periods is relatively balanced.

Schemes with an independent trustee in place are slightly more likely to be ready to transact in the next 3 years (21% v 17%).

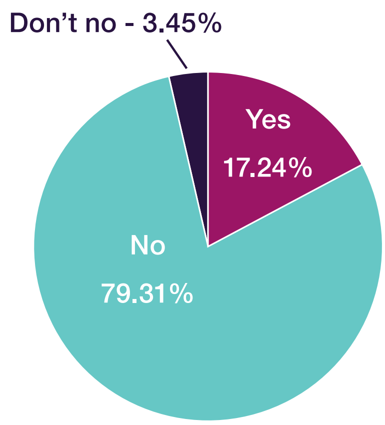
Scheme size seems to make a big difference - 100% of very large schemes of >£1bn are ready to transact in the next 3 years (comapred to 17% overall).



Q10: Is your scheme data clean?



Q11: Do you have a checked & agreed benefit specification?



Q12: Has the Brexit decision affected your strategy?

The results were even higher where an independent trustee is in place - 78% said they had clean data and 75% an agreed benefit specification.

For de-risking projects, data cleanliness needs to be taken in parallel with the benefit specification. Figuring out whether benefits have been administered in the way they should have been can sometimes be a challenge to getting things tidied up.

The respondents who felt Brexit had affected their strategy can be broken down as:

- yes - delayed it - 13.79%
- yes - accelerated it - 3.45%

PSIT Independent Trustees GOWLING WLG

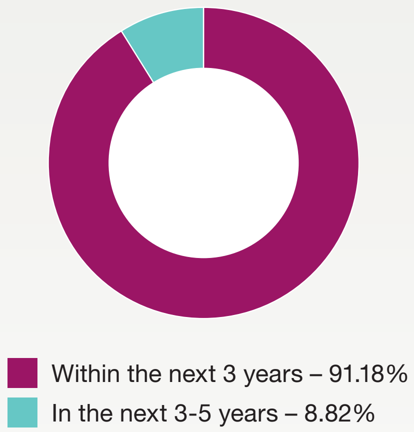
Your plans to de-risk

This section was completed by respondents who told us in question 7 that the trustees and sponsor had not yet agreed a de-risking strategy.

De-risking clearly is a hot topic - with 91% saying it will be on the trustees' agenda within the next 3 years. No-one felt it could wait more than 5 years.

As for the previous section, the Brexit decision has had very little impact on de-risking plans.

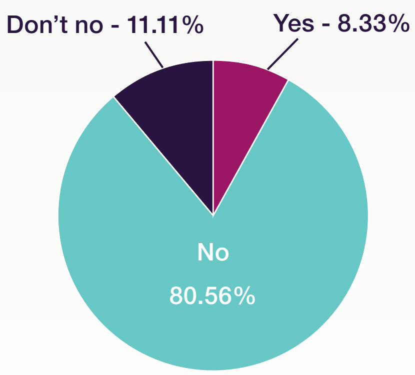
Q13: When do you expect de-risking will be on your agenda?



No respondents selected either of the other two options:

- in the next 5-10 years
- beyond 10 years

Q14: Has the Brexit decision delayed your forming or implementing a de-risking strategy?



PSIT Independent Trustees

GOWLING WLG

Successful de-risking

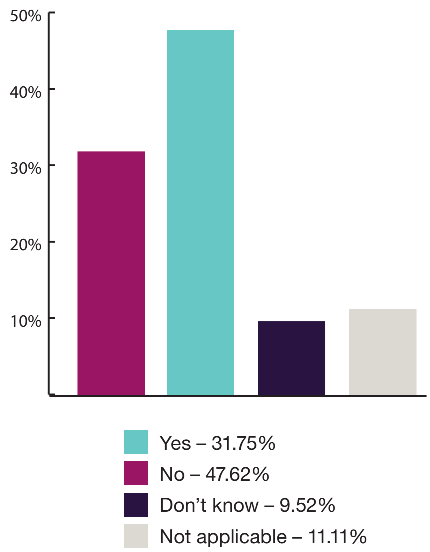
Almost one-third of respondents regret not having de-risked sooner.

For many, the main impediment may appear to be cost and, if you see de-risking primarily in terms of buy out, that's understandable. Our survey showed, although many sponsors are unwilling (35%) or unable (24%) to provide a cash injection, there are many other impediments. It is sensible to remember also that not all de-risking requires a cash injection from the sponsor.

A lack of knowledge around the often complex financial instruments involved with de-risking is another issue. Cost effective professional advice is required by trustees but not always readily available, particularly at the small end of the market. Other business issues are also a significant impediment for many.

Q15: What level of engagement has there been between the trustees and sponsor on the de-risking strategy?

Q16: Do you regret not having de-risked sooner?



PSIT Independent Trustees
GOWLING WLG

Q17: What do you see as the main impediments to successful de-risking of your scheme? Select up to 3 responses.

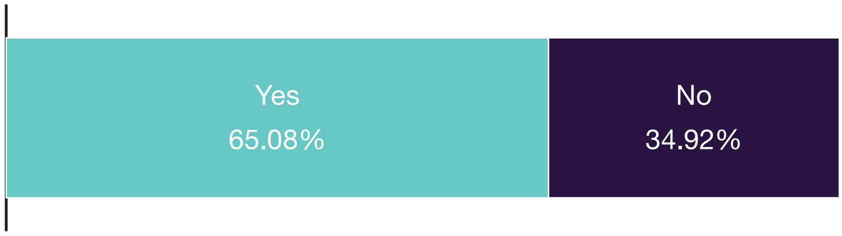
- **35%** sponsor unwilling to provide finance
- **24%** sponsor unable to provide finance
- **25%** negotiation between trustees & sponsor is difficult
- **9.5%** poor data quality
- **17%** agreeing benefit specification
- **33%** other more pressing issues for scheme/ sponsor

Other more pressing issues included:

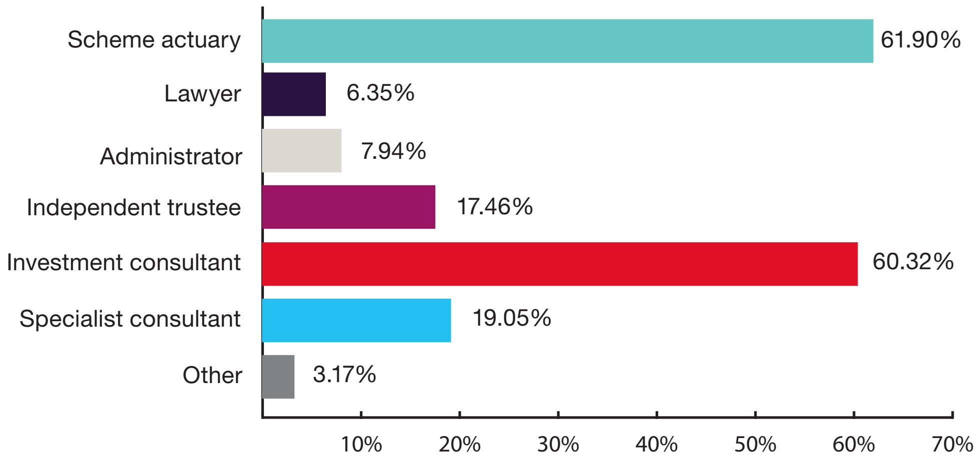
- sponsor believes it is the wrong time to de-risk & is expecting the bond bubble to burst
- other business issues, M&A's, sponsor being acquired, de-mergers etc
- need to strike a balance between finance required, benefit achieved & effect on sponsor's other investment options
- wide number of factors affecting timing, including financial/market considerations
- educating trustees to understand how de-risking works, eg introducing LDI & hedging, what implications are and them being comfortable
- balancing de-risking with the need to maintain growth for active & deferred members
- current funding level, market conditions, interest rates
- other pension projects ahead in the queue, eg shift of DC scheme into a Mastertrust
- current pricing and convexity position to play out

Q18: What is the level of engagement on integrated risk management between the trustees and sponsor?

Q19: Does your scheme have an independent trustee?



Q20: Which of the following parties do you consider likely to offer the most help in successfully de-risking your scheme? Please select up to 2 responses.



'Other' included:

- US parent of sponsor
- in house expertise

PSIT Independent Trustees

PSIT is a leading independent pension trustee company and professional trustee secretarial services business. We offer clients high quality service, innovative thinking and true expertise, delivered with a personal approach and a clear commitment to professional standards.

Email: info@psitl.com

Web: www.psitl.com

Phone: 0845 313 0024

GOWLING WLG

Gowling WLG is an international law firm built on the belief that the best way to serve you is to be in tune with your world, aligned with your opportunity and ambitious for your success.

Email: ben.goldby@gowlingwlg.com

Web: www.gowlingwlg.com

Phone: 0370 904 1099

> Taking comprehensive professional advice and ensuring active engagement between sponsor and trustee are the cornerstones to successful pensions risk management