# Mature pension schemes – onwards and forwards

Running Off Mature Schemes Working Party
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Life Conference 2017, 23 November 2017

## What we'll cover

1. Brief background about UK corporate defined benefit pension schemes
2. The huge opportunity as a consequence of the £1 trillion of funds that will leave those schemes over the next 20 years
3. Some of the underlying themes that will generate that £1 trillion of spend and the types of services and products required as a result
4. How the development of full journey plans by scheme trustees will make scheme run-offs more deliberate, and the consequences
5. Big ticket item that may change the landscape

## Working party's deliverables

- A paper, that is easily accessible for all stakeholders across the pensions industry
- An easy reference manual, for future development
- A strategic framework for the management of mature schemes
- Identify areas for future focus and recommendations

**Running Off Mature Schemes Working Party members**

- Costas Yiasoumi (Chair), Legal & General Assurance Society
- Graham Wardle, Legal & General Investment Mgt.
- John McAleer, Aon Hewitt
- Mike Walsh, Just
- Nick Sparks, BMO Global Asset Mgt.
- Nigel Jones, 2020 Trustees and Mitchell Consulting

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## Setting the scene – the UK defined benefit pension environment

| Number of members | Number of schemes | Average liabilities £m | Total liabilities £bn |
|---|---|---|---|
| Less than 100 | 2,056 | 10.4 | 21.3 |
| 100 to 999 | 2,563 | 74.8 | 191.7 |
| 1,000 to 4,999 | 783 | 439.0 | 343.7 |
| 5,000 to 9,999 | 184 | 1,385.3 | 254.9 |
| Over 10,000 | 208 | 6,297.1 | 1309.8 |
| **Total** | **5,794** | **N/A** | **2,121.3** |

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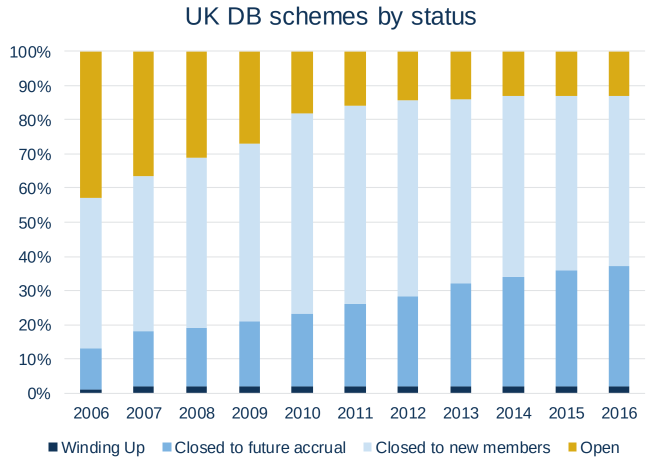
Table source: PPF Purple Book 2016. Liabilities shown are based on the cost of securing all accrued liabilities with bulk annuities

# Mature schemes are becoming the norm in the UK



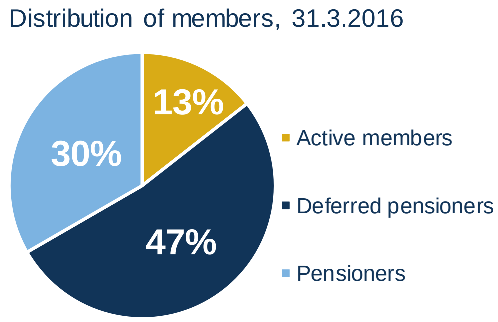




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Chart sources: PPF Purple Book 2016

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# Your typical pension scheme

- Employer is a specialist light engineering manufacturer
- Based in the Midlands. Listed, but outside FTSE350. Currently has 500 employees
- Relatively successful. Business growing steadily year on year
- The pension scheme was established in 1976. It closed to new entrants in 1998 and to new accrual in 2005
- Since the in-house pension manager retired in 2006, all services/DB expertise is outsourced
- Within the corporate the CFO is responsible for DB scheme management
- There is a professional trustee appointed to the trustee board
- Pension finances are a factor in corporate decision making but not a serious business impediment

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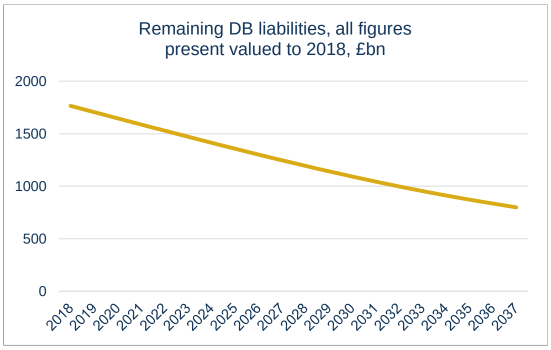
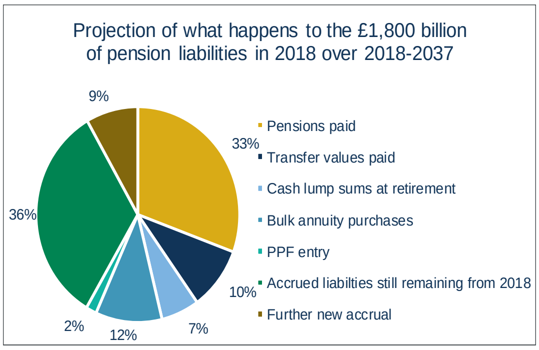
## Key behavioural characteristics driving management of a mature scheme

1. There is a real end point
2. Benefit cashflows are known
3. Plausible time horizon to which to work towards
4. Key financial and operational risks could be locked down within a decade
5. Cashflow becomes king
6. Scheme becomes irrelevant to employer



## The shape of the UK defined benefit pension market will change significantly over the next 20 years




**A huge opportunity for service and product providers**



Projections produced by the Working Party, using simplified assumptions. Liabilities are a proxy for best estimate and hence lower than bulk annuity cost shown in earlier slide

## The Working Party assessed 12 different areas of pension practice

1. Pace of funding
2. Covenant (incl. separation)
3. Contingent assets
4. Liability management
5. Cashflow matching (incl. hedging)
6. Asset allocation
7. Outsourcing
8. Locking down the benefit liabilities
9. Bulk annuities
10. Journey plans
11. Employer relationship/governance
12. Expense management

**Let's take a look at some of these**

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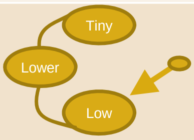
## Asset allocation

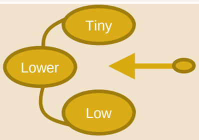
**Dashboard – what we'd expect**

**Relatively mature**



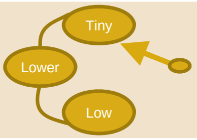

Return seeking is the smallest asset class but still nevertheless sufficiently large to make a material impact to expected returns

**Mature**




Return seeking allocation significantly lower. Funding triggers to reduce further common.

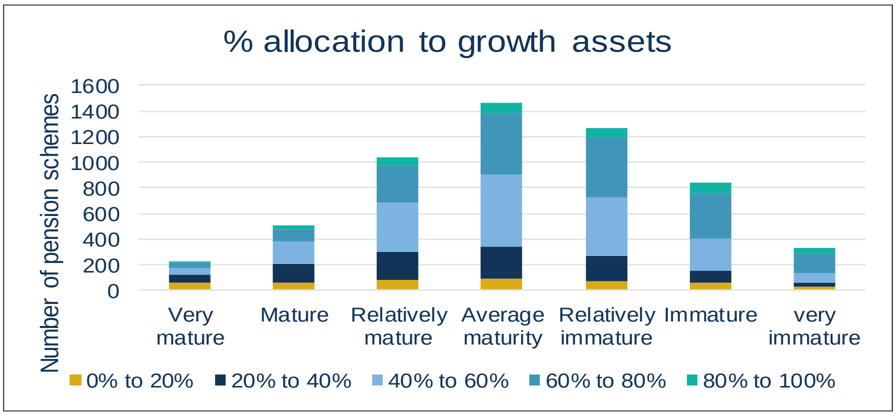
**Very mature**




Return seeking either nil or very small with a definite plan in place to reduce to nil.

- **What we found:** Mature schemes have lower allocations to return seeking assets – but not much lower (40/60 vs 60/40)
- **In future:**
  – Increased focus on short recovery horizon
  – Increased focus on cashflow matching
  – Increased focus on synthetic solutions and liquidity management

## Averages hide a lot of variation




Of the 700+ schemes with duration 14 years or less, 200 have over > 60% in growth seeking assets.

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Chart source: TPR Annual funding statement analysis, Tranche 11


## Liability management

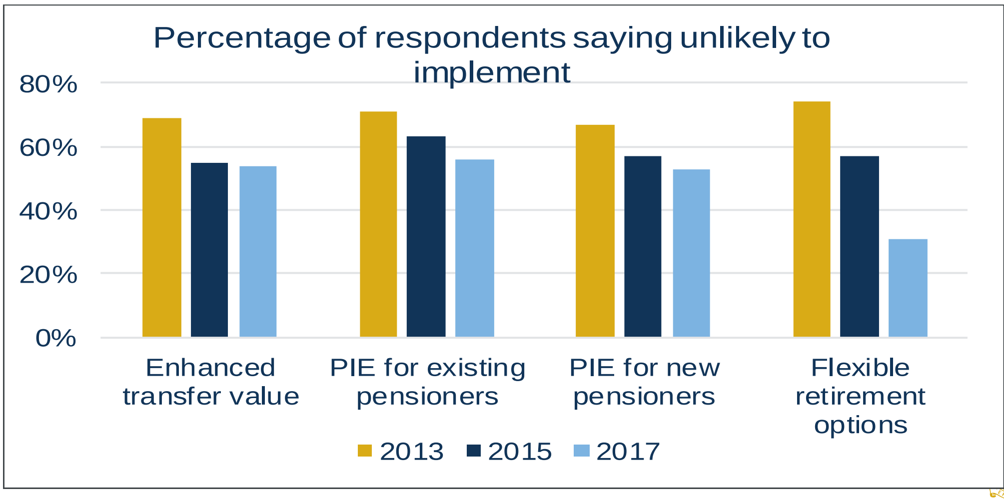


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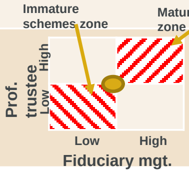
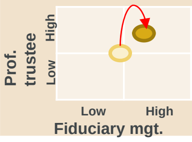
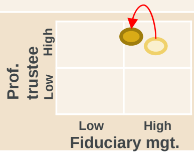
Chart source: AON Global Pension Risk Survey 2017

# Outsourcing

**Dashboard – what we'd expect (professional trustees and fiduciary mgt.)**

| Relatively mature | Mature | Very mature |
|---|---|---|
|   Not uncommon to see prof. trustees, but many still only company and MNTs. Fiduciary mgt. getting traction |   Prof. trustees more common. Increased prevalence of sole prof. trustees. Fiduciary management peaks |   Trustee boards typically made up of prof. trustees / sole trustee. Reduced usage of fiduciary mgt. as strategies less active, more "set and maintain" |

- **What we found:** Increasing take-up of fiduciary management (460 schemes with "full" version) and c20% of schemes now with professional trustees
- **In future:**
  - Member experience philosophy shifts from "excellent service" to "sufficient service"
  - Professional trustee or sole trustee the norm
  - Outsourcing of non-exec operations continues eg fiduciary mgt.

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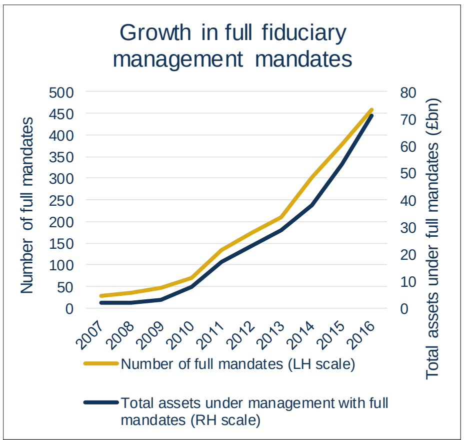
# Outsourcing – dramatic pace of change



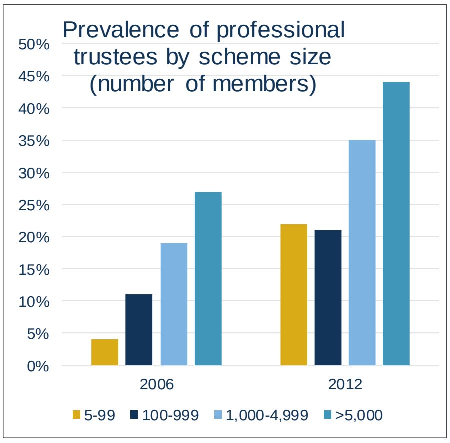




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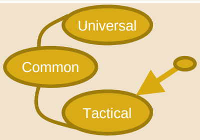
Chart sources: KPMG 2016 Fiduciary Management Survey, TPR Occupational Pension Scheme Governance Survey September 2006, TPR Defined Benefit (DB) Scheme Running Cost Research April 2014

# Bulk annuities

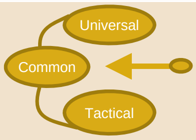
**Dashboard – what we'd expect**

**Relatively mature**



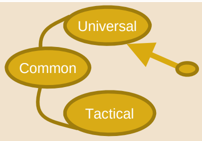

Bulk annuities not uncommon. Generally purchased as seen as offering good value vs alternative asset opportunities

**Mature**




Bulk annuities common as part of a deliberate strategy to de-risk with scheme termination in say 10 years being targeted

**Very mature**




Trapped surplus issues greater. Longevity highly uncertain except for large schemes. Bulk annuity usage universal – most trustees have an objective to wind up via a buy-out

- **What we found:** No data linking maturity with bulk annuity purchase. Anecdotal evidence is that buyout prevalence not strongly linked to maturity
- **In future:**
  - Lack of economies of scale will encourage all smaller schemes to aim for buyout or for DB master trusts or other non-insured consolidation vehicles
  - Continued use of bulk annuities and longevity insurance to manage risks



# Bulk annuities – underlying exponential growth

Business written (excluding largest 3 deals each year)

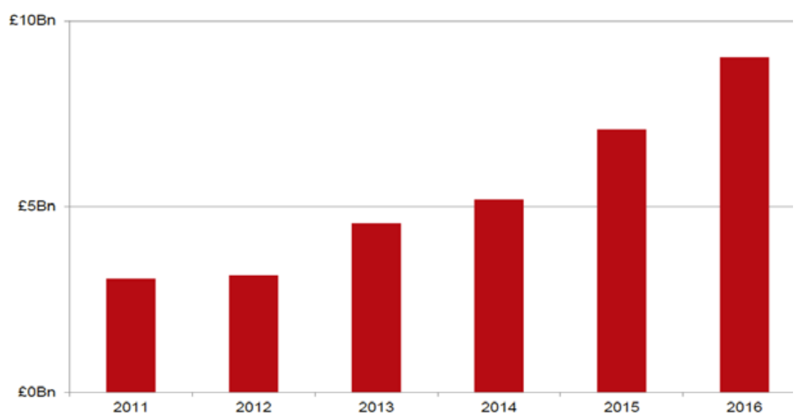



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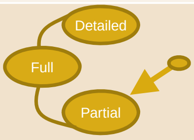
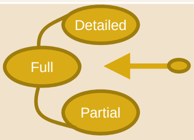
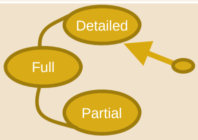
Chart source – Presented by John Baines, to the Bulk Annuities and Longevity Swaps Member Interest Group of the Institute and Faculty of Actuaries on 28 March 2017

# Journey plans

| Dashboard – what we'd expect | | |
|---|---|---|
| **Relatively mature** | **Mature** | **Very mature** |
|  The focus is primarily around managing funding and the path for de-risking assets as maturity and funding increase |  Journey plans now also cover operational aspects relevant to run-off and with end game targets now being definite rather than aspirational |  Detailed plans that cover in depth the timing and process for run-off and termination |

- **What we found:** An increasing prevalence of long term planning but generally focusing on funding / assets rather than true journey planning
- **In future:**
  - Clearer articulation of de-risking philosophy
  - More thoughtful choices of target dates
  - Improved understanding of "what will it be like when we arrive?"

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# Journey plans – much clearer end points

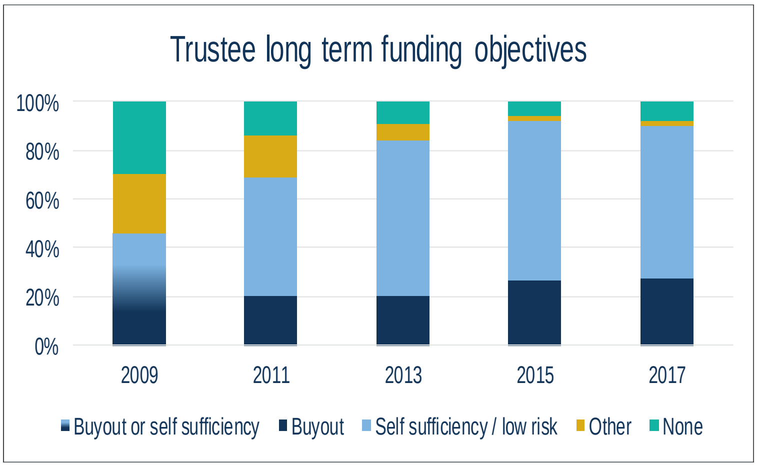


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Chart source: AON Global Pension Risk Surveys 2015 and 2017

# A framework for mature scheme run-offs

## VISION

**Meet member benefit expectations as far as possible whilst avoiding a disproportionate impact on the sponsoring employer(s) business**

## STRATEGY

1. The run-off plan
2. Creating and maintaining a shared understanding
3. Taking opportunities

## IMPLEMENTATION

1. Pace of funding
2. Covenant (incl. separation)
3. Contingent assets
4. Liability management
5. Cashflow matching (incl. hedging)
6. Asset allocation
7. Outsourcing
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# Implementation of journey plans leads to more deliberate run-offs

| Implementation theme | Current state | Next state | Change target | Comment |
|---|---|---|---|---|
| 1. Pace of funding | Immature | Mature | 2030 | 2030 is end of recovery plan. Technical provisions assumptions means they become increasingly closer to bulk annuity pricing at each actuarial valuation to 2030. |
| 2. Covenant (incl. separation) | Mature | - | - | Direct TopCo covenant in place. |
| 3. Contingent assets | Immature | Mature | 2030 | Target to add contingent security for gap between funding and bulk annuity cost. |
| 4. Liability management | Mature | - | - | Scheme wide exercise with high take-up completed in 2014. Target 2nd exercise in 2019 |
| 5. Cashflow matching (incl. hedging) | Relatively mature | Mature | 2027/2030 | Good level of cashflow matching already in place. Target 2027/2030 for fully matched status |
| 6. Asset allocation | Immature | Mature | 2027 | 60% return seeking. Target nil by 2027 driven by de-risk triggers and employer funding |
| 7. Outsourcing | Mature | - | 2034 | Bundled low cost service providers already in place. Viable down to 100 members |
| 8. Locking down the benefit liabilities | Immature | Relatively mature | 2020 | Carry out data and benefits audit within next three years. Defer codification of discretions and GMP equalisation approach until close to buyout |
| 9. Bulk annuities | Immature | Mature | 2030/2035 | Seek to have secured remaining exposures with bulk annuities by th end of this period |
| 10. Journey plans | Relatively mature | Mature | 2020 | Financial plan with triggers adopted in 2015. By 2018 prepare a comprehensive plan listing detailed actions grouped into and managed via consecutive 3 year buckets |
| 11. Employer relationship/governance | Mature | - | - | Independent trustee in place. Single legal sponsor with assets in UK |
| 12. Expense management | Immature | Relatively mature | 2020 | Employer PAYG arrangement at present. Introduce wind up expense reserve by 2020, full reserve by 2030. Higher PAYG budget to 2020 to fund selected journey plan areas |

## Potential game changer on the horizon – upcoming White Paper

1. Separation of schemes from stressed employers
2. Consolidation – including "superfunds"
3. Indexation – RPI to CPI
4. Governance
5. Pension benefit simplification
6. …

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## Superfunds – more detail

Four models of consolidation

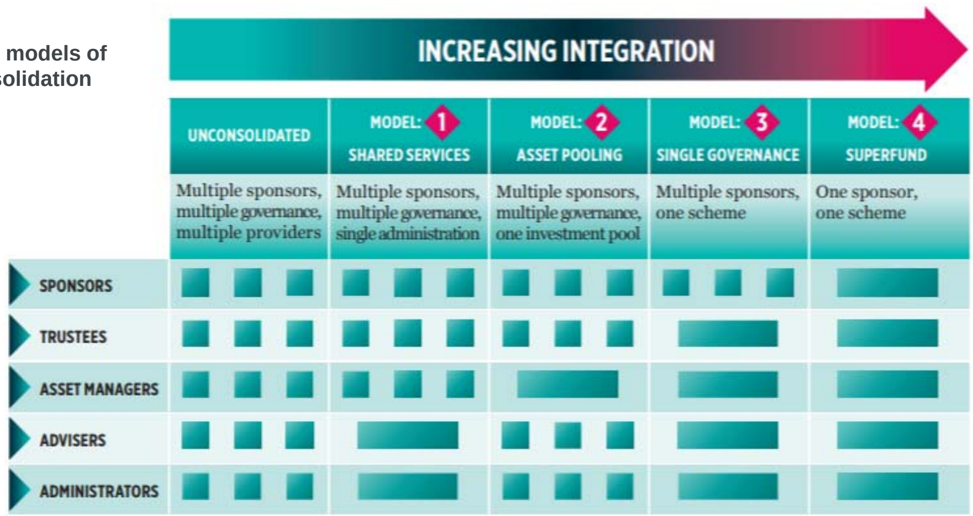


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Chart source, PLSA paper "The case for consolidation"

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**Questions** **Comments**

The Working Party is aiming to publish its analysis in 1Q 2018

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