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Mature pension schemes – onwards and forwards

Preview of the "Running Off Mature Schemes" Working Party's analysis to date

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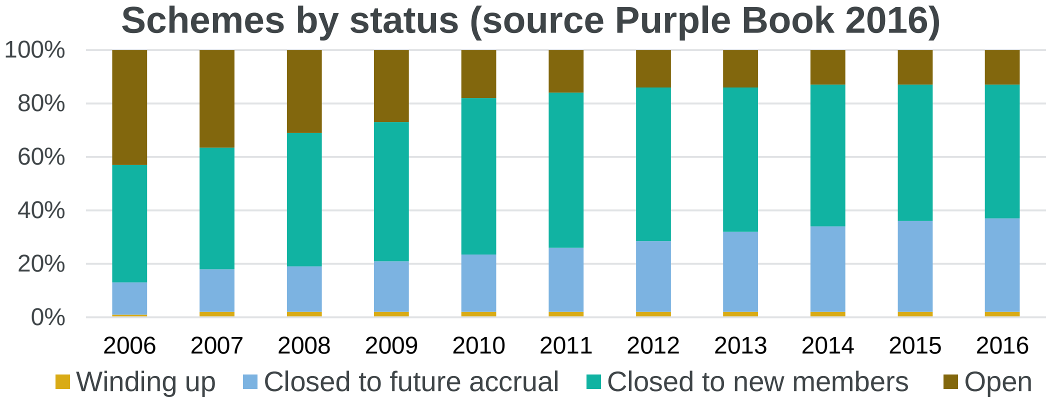
23 November 2017

Working party's deliverables

- A strategic framework for the management of mature schemes
- The start of an easy reference manual, for future development
- Identify areas for future focus and recommendations
- A paper, in the form of this slide book, that is easily accessible for all stakeholders across the pensions industry



Few of these schemes in scope

Many of these schemes are in scope today. Most will be in scope within the next 10 years

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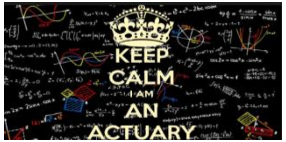
Why does it matter?



- **Members:** Millions of individuals. Maximising the likelihood that their benefits are delivered in full is key to meeting the retirement expectations they've worked towards
- **Employers:** Hundreds of billions of GBP of exposures. Sub-optimal management could impact business activities with a knock on impact in employment creation and the economy
- **Trustees:** Unenviable task of overseeing transition of schemes into increasingly mature schemes that, often, have lower margins for error. Require advice and services tailored to these new circumstances
- **Actuaries:** A situation in which schemes are on a relentless path to maturing introduces challenges and opportunities. Actuaries well placed to deliver successful outcomes to all stakeholders

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What is a mature scheme?

A scheme where the bulk of the liabilities have already accrued, and that is anticipated to run-off for a number of years.

Key behavioural characteristics driving scheme management

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**

How do we measure maturity?

- We all know a mature scheme when we see one … or do we?
- We can all agree how a super-mature scheme looks … or can we?
- There is no right approach, but an approach is better than no approach

New

Average maturity

Relatively mature

Mature

Very mature

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We selected duration as a measure for maturity

New — > 18 years duration classed as immature

Average maturity — Duration 16 to 18 years

Relatively mature — Duration 14 to 16 years

Mature — Duration 12 to 14 years

Very mature — Less than 12 years duration

Note: Maturity definitions as per TPR annual funding statement analysis, Tranche 11

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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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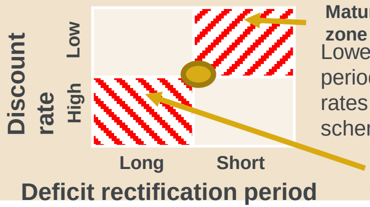
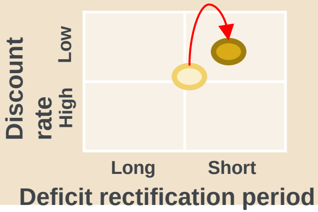
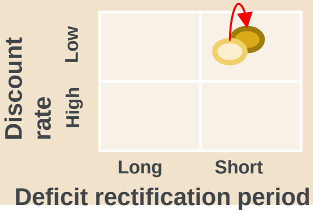
1. Pace of funding

Dashboard – what we'd expect

Relatively mature	Mature	Very mature
 Lower deficit rectification periods and discount rates than for immature schemes	 Deficit rectification periods and discount rates reduce by tangible amounts as schemes mature further	 Expect further but much smaller reductions in deficit rectification periods and discount rates as there is a limit to which these can reasonably reduce

- **What we found:** Data showed very little correlation between maturity and deficit rectification periods, but that discount rates do reduce
- **In future:**
  - A trend towards 'self-sufficiency' or "buyout" TPs
  - More attention to the non-discount rate aspects of the TP assumptions

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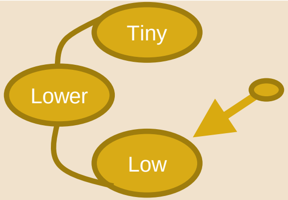
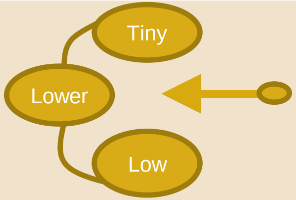
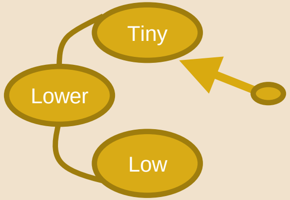
6. Asset allocation – introduction

Dashboard – what we'd expect

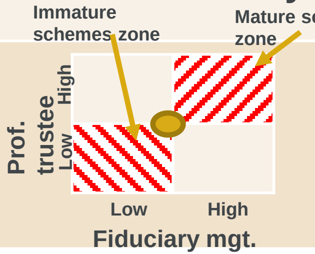
Relatively mature	Mature	Very mature
 Return seeking is the smallest asset class but still nevertheless sufficiently large to make a material impact to expected returns	 Return seeking allocation significantly lower. Funding triggers to reduce the allocation further are common.	 Return seeking either nil or very small with a definite plan in place to reduce to nil.

- **What we found:** More mature schemes have lower return seeking assets – but not a lot 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

7. Outsourcing

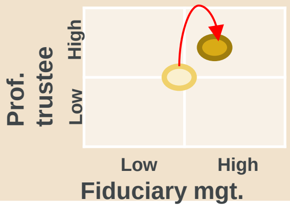
Dashboard – what we'd expect (professional trustees and fiduciary mgt.)

Relatively mature



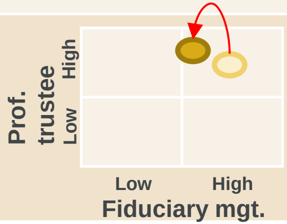
Not uncommon to see prof. trustees, but many still only company and MNTs. Fiduciary mgt. getting traction

Mature



Prof. trustees more common. Increased prevalence of sole prof. trustees. Fiduciary management peaks

Very mature



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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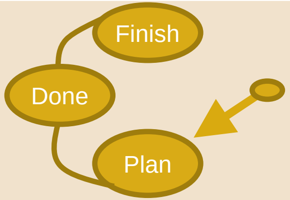
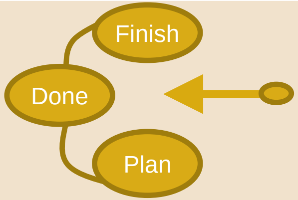
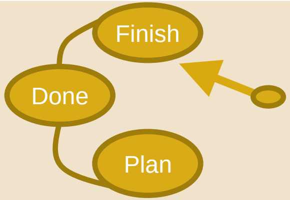
8. Locking down the benefits

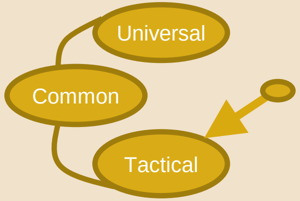
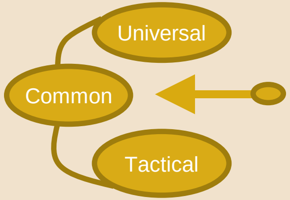
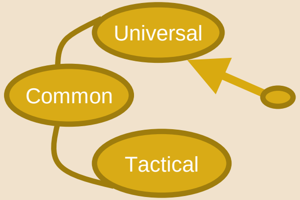
Dashboard – what we’d expect

Relatively mature	Mature	Very mature
 If data and benefits haven’t yet been validated / audited then it is within the scheme’s calendar of future activities	 Data and benefits have been validated and audited. However, proportionality will apply so scope may have been restricted	 Data and benefits fully validated including resolving how to deal with “known unknowns”

- **What we found:** No correlation found between maturity and data quality. But an apparent correlation between proximity to de-risking and data quality
- **In future:**
  - The norm for mature schemes to have locked down their full detailed benefit provisions and data as a matter of course
  - Industry standards for recording that information will be an ingredient for future “soft” or “hard” consolidation

9. Bulk annuities

Dashboard – what we'd expect

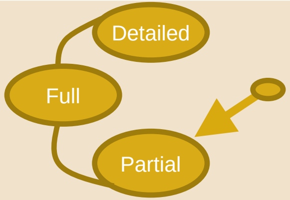
Relatively mature	Mature	Very mature
 Bulk annuities not uncommon. Generally purchased as seen as offering good value vs alternative asset opportunities	 Bulk annuities common as part of a deliberate strategy to de-risk with scheme termination in say 10 years being targeted	 Trapped surplus issues greater. 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

10. Journey plans

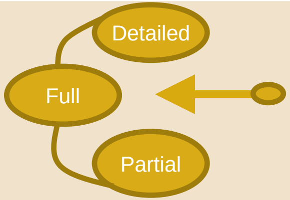
Dashboard – what we'd expect

Relatively mature



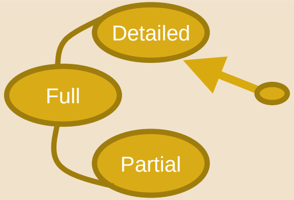
The focus is primarily around managing funding and the path for de-risking assets as maturity and funding increase

Mature



Journey plans now also cover operational aspects relevant to run-off and with end game targets now being definite rather than aspirational

Very mature



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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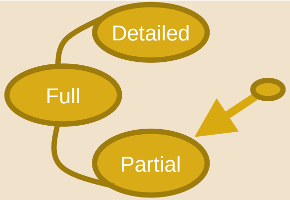
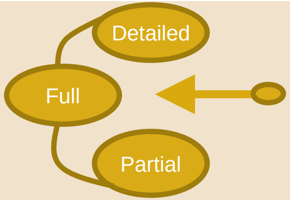
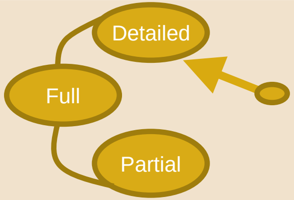
12. Expense management

Dashboard – what we'd expect

<table>
<tr><th>Relatively mature</th><th>Mature</th><th>Very mature</th></tr>
<tr>
<td>

Focus on expense control commences in conjunction with increased outsourcing of services. Too many future uncertainties for proper reserving</td>
<td>

Full analysis of future expense reserve undertaken. Aligned with scheme journey plan</td>
<td>

Detailed expense reserve including analysis of expense risk. Expense mgt. influences journey plan eg does a bulk annuity now make sense?</td>
</tr>
</table>

- **What we found:** Remains normal to exclude an expenses reserve in TPs. Yet expenses are c3% to c11% of TPs for schemes of 100 to 5,000 members
- **In future:**
  - Expenses reserving will become prevalent with increasing maturity
  - Schemes will also start looking at expenses risk eg plausible stress
  - Visibility of expenses will inform journey planning

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. Develop the journey plan
2. Create and maintain a shared understanding
3. Take opportunities

IMPLEMENTATION

1. Pace of funding
2. Covenant (incl. separation)
3. Contingent assets
4. Liability management
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The three strategy components

1. The journey plan

- A strategic vision for the scheme embracing all the implementation features
- Identify the most important steps
- The discussion may be more important than the written plan
- Keep up-to-date

2. Create and maintain a shared understanding

- Sponsor and trustees should debate and understand commonalities of interest and the continuing tensions
- Develop a broad timeline around when it would no longer be sensible to run the scheme in its current form
- Members should be told about what is likely to happen and when
- Communicate the plan to service providers

3. Take opportunities

- The smartest schemes have a clear sense of direction but the flexibility to adapt
- This means having the governance to react rapidly and strategically
- Be prepared to take big decisions

Example: Assessing + managing maturity
Matching behaviours to metrics

Operation area	Current state	Change target	Comment
1. Pace of funding	Immature	2030	End of recovery plan
2. Covenant (incl separation)	Mature	N/A	Direct topco covenant already in place
3. Contingent assets	Immature	2030	Security to buyout level to be added
4. Liability management	Mature	N/A	Exercise completed 2014. Ongoing program in place
5. Cashflow matching (incl hedging)	Rel. mature	2020-25	Derivative overlay covering 70% liabilities
6. Asset allocation	Immature	2020-25	Current 60% return seeking with de-risk triggers in place
7. Outsourcing	Mature	2034	TPA in place – viable down to 100 members
…	…	…	…
12. Expense management	Immature	2025	Target switch from employer PAYG to a funded reserve

Metric	Current	Maturity gate	Date at gate	Comment
Duration	18 yrs	14 yrs	2028	
Number of members	267	100	2034	No longer viable below 100 members
% deferred pensioners in TPs	51%	25%	2032	
Covenant	CG2	CG3	2023	Sponsor in long term decline
Benefit cashflow % liabilities	2.6%	5.0%	2027	

And finally, some other key observations

- Getting the governance right – essential to success
- Covenant – a critical, if not the most critical, factor in setting strategy
- Scheme separation – an inevitable outcome for many?
- Expense reserving will result in lots of management actions which would otherwise not have happened
- Consolidation will happen directly (bulk annuities, superfunds etc) or indirectly (fiduciary management, professional trustees, TPA rationalisation etc)

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Recommendations (1)

1. The industry should adopt a standard industry measure or measures of maturity to facilitate communication and analytics

2. Legislation/regulation should be adapted so as to more easily accommodate the needs of mature schemes

3. Schemes should develop comprehensive journey plans mapping out their intended run-off approach

4. It would be advantageous for there to be a framework for separation of schemes from sponsor employers, in some circumstances

5. Key industry bodies should identify what skills base and expertise are needed to efficiently service scheme run-offs

Recommendations (2)

6. Most mature schemes would benefit from having a professional trustee appointed

7. Industry standardised member data and benefit formats should be developed

8. Schemes should focus resources to lock down their benefits (iedata and benefit cleansing)

9. Reserving for future expenses should be a norm for mature schemes

10. Adoption of the practices highlighted in the slide book may spotlight the benefits of some consolidation and prompt activity, whether that is taking advantage of outsourcers for selected services, master trusts or bulk annuity buyouts

Questions

Comments

The Working Party is aiming to publish its analysis by end 2017

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
- Tim Keogh, independent

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