Attention, Deficit!

Managing small DB pension schemes

Knowledge Sharing Scotland
22 September 2016

Sharing knowledge on…

Typical small DB schemes

Scheme funding

Distressed schemes

Liability reduction exercises

TDC
DB50

A typical small DB scheme

Closed to future accrual

60% non-pensioners, 40% pensioners

A few members with big benefits

Low volume of member transactions

Sponsoring employer is fee sensitive

Who are the Trustees?

Small group of Trustees

Conflicts of interest

Limited resources and use of advisers

No professional trustee

Low levels of TKU

21st Century Trustees

Scheme funding

"Pension deficits threaten dividend cuts at UK companies"

FINANCIAL TIMES

"Smoothing approach is key for pension deficits"

"Noisy lobbyists are shouting that the pensions sky is falling"

Funding of small schemes

Paying the promised benefits as they fall due is the key objective for trustees.

The DB funding regime is designed to be sufficiently flexible to enable trustees and employers to agree funding strategies which meet the scheme's funding requirements without compromising the ability of the employer to invest in their business and support the scheme in the long term.

8% of schemes will struggle to pay the promised benefits.

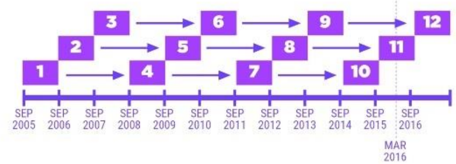
72% are merely looking to reach full funding over a medium to long time period.

20% are close to or in surplus and therefore considering a 2nd funding objective.

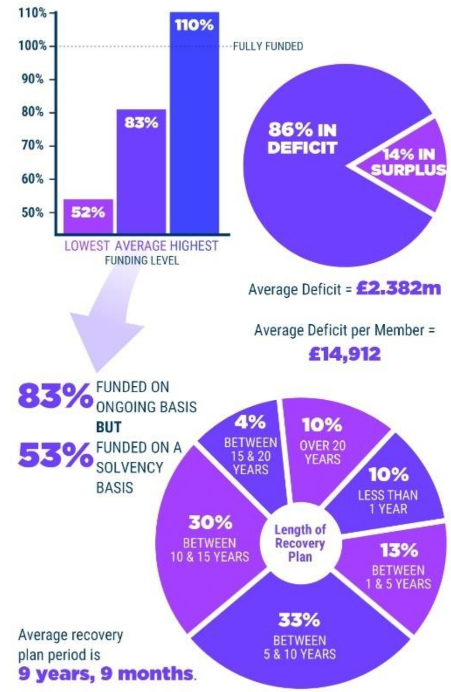
The Pensions Regulator annual funding statement, for Tranche 11 valuations, is expected in May 2016.

ATTENTION, DEFICIT!

Scheme specific funding valuations have been carried out for over 10 years and we are now working on Tranche 11 triennial valuations.

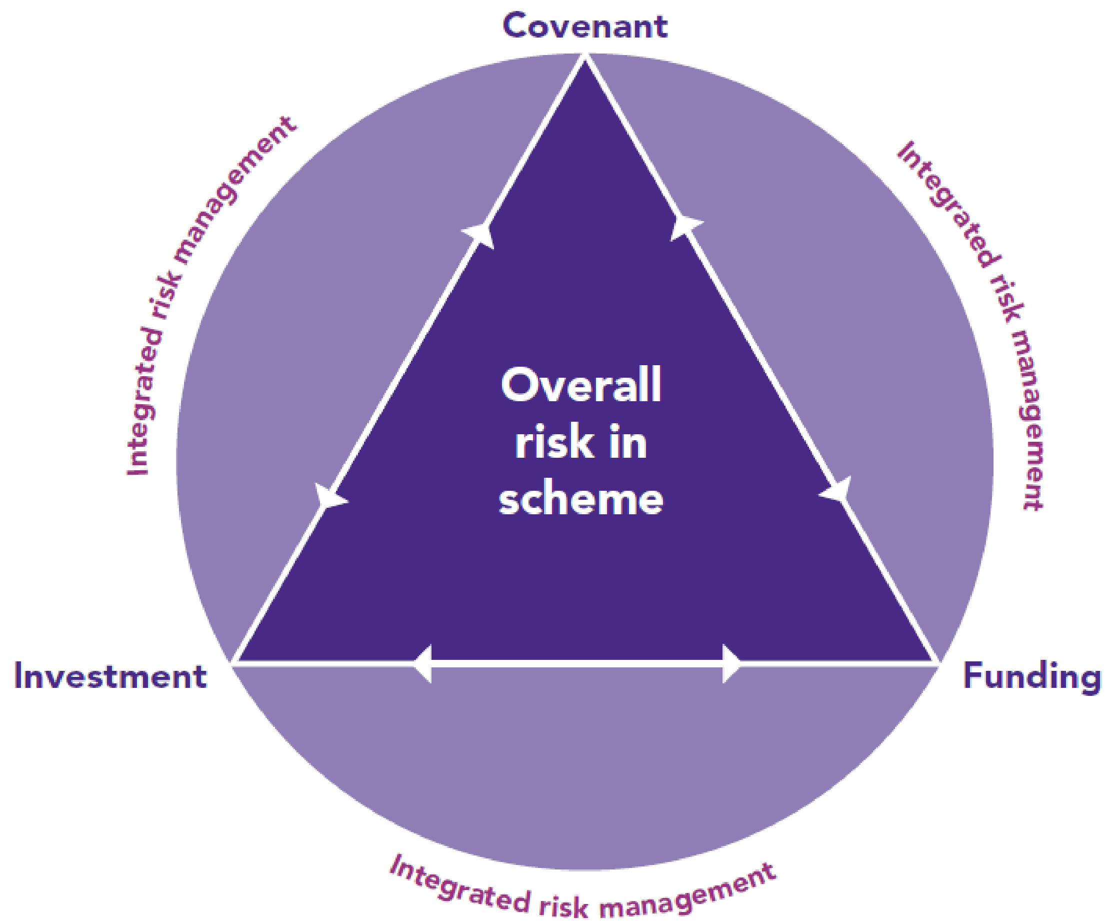


Statistics from the most recent triennial valuation (Tranches 8, 9, 10 combined)



Integrated Risk Management

The IRM method



Distressed schemes

Example 1

Current value of assets £2.8m

£3.9m deficit, Apr 2015 valuation

£200,000 pension payroll but £24,000 DRCs

Example 2

Dec 2014 valuation – assets of £7.7m, liabilities of £12.7m

Annual DRCs of £150,000 but expenses from Scheme funds

5% pa investment return results in 19 year recovery plan

Pensions Institute, Dec 2015

"600 employers are unlikely to ever pay off their pension scheme debts"

The first cut is the deepest!

“Conditional indexation” options to consider

Replace RPI with CPI inflation for pension increases

Remove pre ‘97 pension increases

Remove all pension increases

Use CPI for pre-retirement revaluation

….but still pay more than PPF compensation

A "Reduced Benefits Scheme"

- Employer applies to the Trustees to be classed as a "distressed employer"
- Scheme Actuary calculates extent of distressed funding, on prescribed basis?
- Employer covenant adviser verifies maximum DRCs
- If certain conditions met, eg recovery plan too long, scheme switches from "full benefits" to "reduced benefits", decided upon by Trustees
- Annual check of employer and scheme
- Conditions to apply during RBS status, in particular no dividends paid to shareholders

Liability reduction exercises

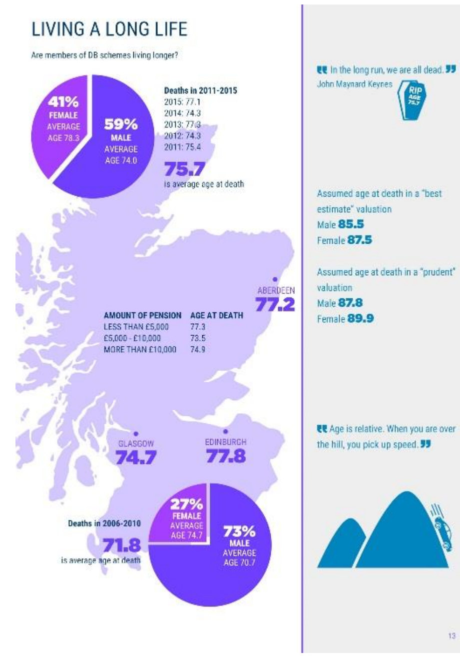
- Of interest to the sponsoring employers with better funded schemes
- Initial stage could be a Financial Education exercise, with analysis of members and liabilities
- Non-pensioners – enhanced transfer values
- Pensioners – medically underwritten bulk annuities

The Transfer Window

- More requests for transfer statements and higher CETVs
- CETVs up over 25% since start of 2016
- Review of recommendation from IFA?
- 5% of deferred members requesting transfer statement
- But very few transfers paid out
- Scheme and employer pay for enhancement to standard CETV?

Living a long life

- If not, lower cost of insuring the pensioner members
- Impact of 10% saving on employer's funding objectives?



DB50 stats

Average age at death in last 5 years is 75.7

4 years difference between males and females

3 years difference between Glasgow and Edinburgh

In conclusion….

- Majority of small schemes have sole objective of reaching prudent full funding over longer term
- More schemes are now willing to appoint professional trustee than in the past
- Member experience can have significant impact on scheme funding and cashflows
- More transfer values will be paid in future
- Genuinely distressed schemes should be able to pay reduced benefits