Knowing yourself

Pensions Age talks to Aon principal consultant, Karen Gainsford, about the importance of understanding behavioural traits when implementing a de-risking solution

Why did Aon decide to look at the behavioural trends of trustees making de-risking decisions? And why now? For instance are there any past examples of illogical client behaviour you've come across during this process?

Good question…were we just jumping on the fashionable behavioural bias bandwagon? Not at all. Trustees have been aware of how behavioural biases can affect their decision making for some time. Aon's *2017 Trustee Checklist* for decision making was really well received, and I often find myself in meetings where trustees call themselves out for 'anchoring' or 'regret aversion' affecting their decisions. I think it's a topic that is of interest to trustees as decision making is a key part of their role, and anything that helps them make well-informed decisions must be a good thing.

Among schemes that have taken action to reduce investment risks, the key remaining risk in the scheme is often longevity risk – the risk that members live for longer than currently expected. With bulk annuity and longevity swap transactions expected to cover over £40 billion of trust-based pension scheme liabilities in 2019, many schemes are taking action. However, many schemes have not yet taken action. We wanted to find out why.

We wanted to really delve into the behavioural biases that could impact longevity de-risking decisions as more and more UK pension schemes are getting towards the point at which removing or reducing longevity risk is a reality – a decision that they could be asked to make in the next one to five years. When the time comes for that decision, it can be a really big and important decision. It's important to get it right. In the case of a buyout, the trustees would be handing over the scheme assets and responsibility to pay the members' pensions to the chosen insurer. It's critical that trustees feel able to make that decision and are comfortable and confident in the choices that face them.

We occasionally see clients where de-risking is the logical next step on their journey but they are resistant to the idea. Where this resistance is because they don't fully understand the de-risking process and are reluctant to engage in training or strategy sessions, it can be frustrating. Hopefully our de-risking guide will help here so that trustees can get up to speed with what is involved in their own time and be open to de-risking when the time is right for their scheme.

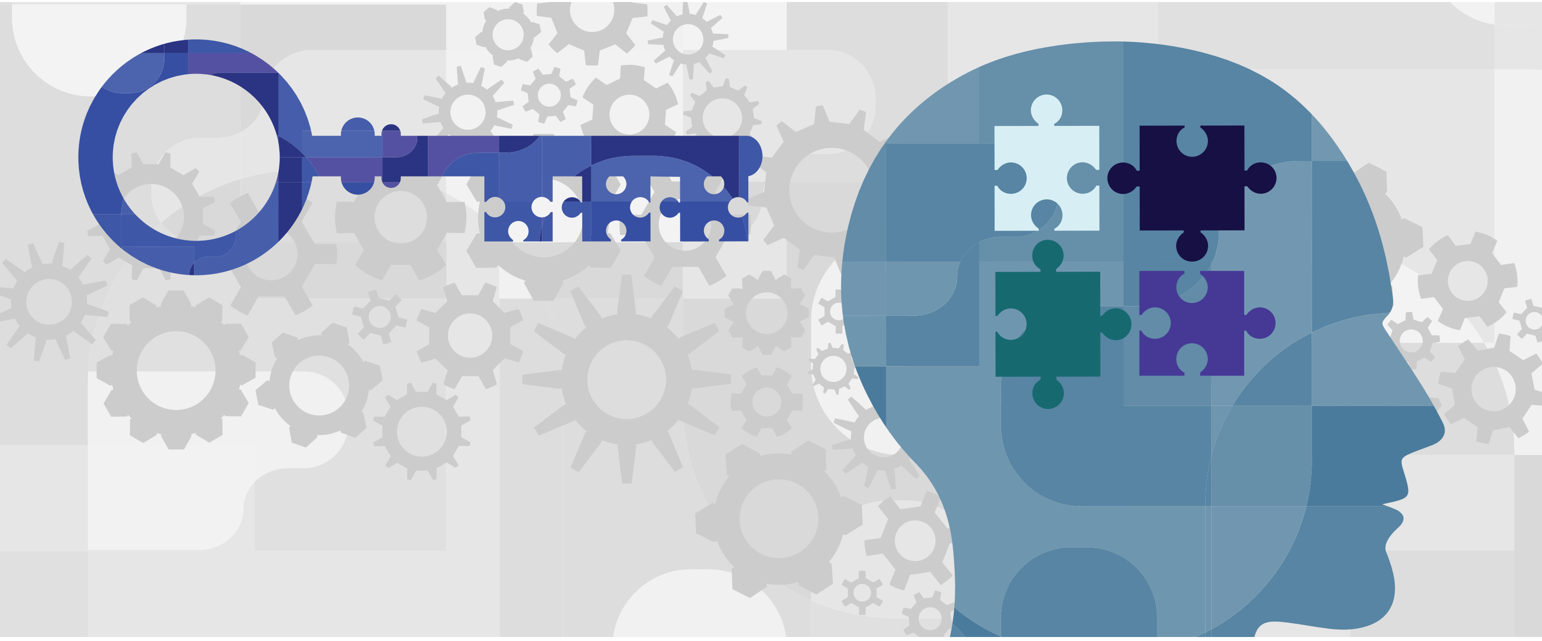
How important would you say it is for trustees to have this knowledge of behavioural insights? How much of a difference can it make?

Of course I'm going to say it's really important, but I genuinely believe it is! The de-risking market will continue to get busier as schemes mature and reach the point at which buyout is affordable. Efficient decision making is very important in capturing the best pricing and terms available. Firstly, by making the decision to take action sooner rather than later so that your scheme is towards the front of the queue. And secondly, by being clear on the decisions that will need to be made once you start your de-risking journey, and the timing of those decisions. Add in some awareness of the behavioural biases that could come into play in making decisions and trustees will be well placed to capture those pricing opportunities when they arise.

If I think of a couple of the transactions I have advised on this year, one required the trustee to make a swift decision to lock into an attractive offer. Assessing the offer against the trustee's objective framework meant that the trustee could efficiently reach a decision that they were comfortable with.

Another required the trustee to be disciplined and to enter a monitoring phase while waiting for a proposal that met all of their framework criteria. Some trustees may have been desperate to transact earlier due to the time and effort invested in the process to date (sunk cost bias), but the trustee board I worked with held firm and achieved their threshold price after a four-week monitoring period.

In terms of how much difference this can make – this really depends on the size of the transaction – but often leads to savings of millions of pounds.



Are there concerns that even when trustees are aware of these behavioural insights, they can't ever be truly mitigated as it is just human nature?
I'm sure that's true, and it may not be right to completely mitigate them. For instance, placing a value on brand names – known as the familiarity heuristic – could potentially come into play when choosing between a shortlist of insurers at the end of the quotation process. It's important to be aware if you are going to pay more, or accept worse terms, from a provider just because they are a known brand name rather than one that your members may not have heard of. However, that does not mean that the decision to pay more for a brand name is wrong. Your members will not have had training to remove their behavioural biases, and they may be far more comfortable with a household name paying their pension. That said, if brand name is going to be a factor in your final decision, it would be better to identify this at an early stage and only request quotations from providers who you would be willing to transact with.

Having conducted this research, what advice would you like trustees to take away from it when considering undertaking a de-risking exercise?
I think there are two key takeaways from my perspective. First is to make sure you fully understand what de-risking exercises involve and what decisions you will need to make along the way. Have a training session and fully explore the topic now, even if you think it may not be right for you at this stage. Once you start your de-risking journey, if at any point you don't understand why you are being asked to make a decision or the impact of a decision: stop, and get your advisers to explain things more.

Our guide to de-risking is good background reading, but there is no substitute for getting a risk settlement adviser in the room and having the opportunity to fire questions at them as you go through training or your decision making later in the process. If you aren't clear in your decisions, you won't feel comfortable making decisions. This could mean you either delay a decision, make the wrong decision, or feel uncomfortable with the decision you have made – avoid this at all costs.

Secondly, status quo bias or wider regret aversion will almost likely play on your mind when making decisions. The key here is making sure that you are clear on what you are trying to achieve by de-risking. First and foremost you are trying to remove risk to increase the certainty of members receiving the benefits that they expect. Agree a framework upfront for determining what pricing and terms would be needed for a transaction to be attractive so that you can objectively assess quotations provided by insurers. Test this to make sure that all parties are comfortable with the parameters so that you do not get sucked into 'is now a good time to transact?' discussions once insurer quotations are received. If insurer offers meet your framework, then the default should be to go ahead and de-risk.

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