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Project de-risk: The DB journey planning summit

With over 5,000 DB schemes in the marketplace, it's no surprise that project de-risk is being treated as a mission in itself within the industry. At the inaugural Pensions Age DB journey planning summit, held in association with Just, speakers focused on how schemes can choose the right route for them, and get to the front of the pack

With 2019 already a record-breaking year for bulk annuities, it's no surprise that de-risking is high on the agenda for the industry. Just, in association with *Pensions Age*, held its inaugural DB de-risking summit, supporting attendees and their pension schemes to effectively manage their DB de-risking journey.

PTL managing director, Richard Butcher, and Just Group CEO, David Richardson, kicked off the conference by welcoming delegates and outlining the key themes that are high on the endgame agenda, from investment strategies to working relationships and, of course, data.

Getting to the 'heart' of the conference, Lane, Clark & Peacock partner, Myles Pink, talked through the key components of a de-risking journey, including having a clear target, defined but flexible timing, an appropriate investment strategy, and the benefits of a strong sponsor covenant. Pink highlighted that while the typical DB scheme is expected to approach maturity over the next 20 years, it's crucial for trustees to track their specific scheme maturity, adjusting targets and investment strategy in line with this.

Then taking delegates through developments in regulation was The Pensions Regulator's investment consultant, Neil Bull, outlining the regulator's plans for the principles of the DB funding code.

While Bull emphasised the importance of tailoring scheme investment strategies in line with scheme maturity, he agreed that sponsor affordability would also have to be at the front and centre of any funding guidance. Bull clarified that while money can't be pulled from thin air, the regulator is looking for improvements in terms of the testing, and evidencing, of the employer covenant, to prevent trustees ending up between a rock and a hard place in such cases of financial distress.

He added that while the statutory funding objectives (SFO), based on schemes' technical provisions, have been in place as a goal for the de-risking journey in the past, the regulator now hoped for these to become stages rather than the final destination. Instead, Bull said, the new long-term funding target (LTFT) represents a step above the historical approach of "just paying benefits".

However, Arc Pensions Law partner, Jane Kola, stressed that "paying the right benefits at the right time" can be a good start for schemes, especially with data issues to contend with. Kola explained that "scheme benefits are the scheme's target…if you don't know what your target is fully and properly, then you're not going to hit it."

Kola described the journey to calculating an accurate benefits target as "a team effort" between administrators and legal advisers, clarifying that while administrators are "fabulous with data" they shouldn't be expected to understand the legalese of scheme deeds and rules, especially when faced with poor drafting.

Acknowledging that some risk cannot be controlled, Kola urged trustees to face potential data and poor drafting issues early on in order to mitigate the risk of these causing problems further down the de-risking journey. She stated that while "one can understand why trustees may not grasp this nettle when in financial trouble, it's much harder to justify not grasping it when actually you're getting closer to the end". She stressed that this can cause mistakes in data or calculations to be revealed too late for trustees to take action and emphasised that even a mistake revealing a surplus is "never good news for an employer".

Pi Pension Trustees director, John Oldland, agreed, and highlighted that it is key to create the right atmosphere between the scheme and employer. He urged both sides to avoid 'playing the blame game' when historical issues or mistakes are found, adding that while it's important for trustees to be empathetic, "empathy does not mean surrender".

The trustee panel, chaired by Mercer partner, leader risk transfer and DB journey planning, Andrew Ward, echoed this sentiment, with BESTrustees president, Alan Pickering, urging trustees to stand up to employers when needed. Pickering highlighted the need for good working relationships, acknowledging that trustees may need to go back to the sponsoring employer for capital to bridge any funding gaps. Equally, Dalriada senior trustee representative, Hugh Nolan, urged trustees to "educate the board" to ensure strong sponsor support and understanding.

Following the morning's discussions around the overcrowding of the market, 2020 Trustees trustee director, Duncan Willsher, warned schemes not to try to be ahead of the pack on the de-risking journey, but rather "just make sure you are at the front of it". He clarified that while there is a generally accepted approach to de-risking, there are marginal gains that schemes can use to differentiate themselves from the competition. Willsher used the example of data, explaining that all schemes approaching a bulk annuity need good data, so "make yours excellent".

Pickering however warned trustees not to "fall into the herd mentality", stressing the importance of keeping the de-risking journey "scheme specific".

The importance of scheme-specific approaches was reiterated as we entered our second panel session, focusing on the provider view and chaired by Aon's head of bulk annuities, John Baines. Just director of DB solutions, Tim Coulson, noted that this is especially important in terms of transaction pricing, stating that "we normally assume we're in competition, so the quality of the tender process is very important. Nuances in pricing are driven by the shape of the benefits and membership, so having accurate and complete data takes out uncertainty".

Coulson continued, stressing the need for greater transparency from trustees around transaction criteria, especially considering the number of quotes an insurer could be handling at one time. He clarified that "the insurer only gets paid upon completion of the transaction. If you look through that lens, that then helps you understand what makes your scheme attractive to an insurer". Therefore "being open about your criteria and transaction requirements, for instance by providing a target price, is really important".

Coulson agreed with previous speakers that there are a variety of components on a journey to buyout, such as good data, which can make a scheme more attractive to insurers. However, he underlined the importance of considering how those components are actually used by the insurer. He cited member postcodes and spousal information as examples of data that, while not crucial to a pension scheme, can have a significant impact on both the affordability and attractiveness of a scheme.

Clara Pensions actuary, Ashu Bhargava, highlighted that even a well-funded scheme with a strong de-risking plan could come into difficulty if the sponsoring company unexpectedly becomes insolvent. As this would result in benefits being crystallised through the PPF, members would likely be left with reduced benefits. Bhargava added that removing this risk of an insolvent sponsor makes consolidation vehicles, such as Clara, even more attractive to both schemes and employers who need capital to 'bridge the gap' in order to protect member outcomes sooner than a bulk annuity path might.

Looking to the future of consolidation, TPT's head of strategy and business development, Paul Murphy, warned that the current DB market of over 5,000 schemes was unsustainable. He predicted that the consolidation market will continue to grow at an accelerated pace, much like has been seen in the banking sector.

Of course, there's no avoiding what

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Pensions Administration Standards Association president, Margaret Snowdon, described at the PLSA conference as "the big elephant in the room" …data.

While much of the morning's conversation had focused on other key elements of the de-risking journey, the backlog of bad data had gotten away with being mostly unmentioned. Many of the day's delegates may have hoped for the appearance of a magical data scrubbing brush, the key message from speakers however was that there are no easy solutions to data problems.

Premier head of trustee secretarial services, Jay Solanki, emphasised the impact poor data can have, stating that poor administration could cost a scheme between 2-4 per cent of its total liabilities. Solanki urged trustees to prioritise their administration and data quality, explaining that "people get quite fixated on assets and funding levels, but it's important to keep proper administration up on the agenda", adding that data exercises should be viewed as an investment.

Next up for the day was an even closer look at data, specifically longevity data, and the trends that have been emerging. Just expert longevity consultant, Richard Willets, clarified that while life expectancy is still rising, it has continued to rise at a far slower rate than previously expected. Despite this slowdown, Willets emphasised the potential for scheme liabilities to continue to rise and therefore the need for schemes to keep their de-risking plan flexible, in order to adjust to shifts in their scheme's maturity profile.

Indeed, many of the issues and predictions made by the morning's speakers were proven in practice, with ITS client director, Nita Tinn, highlighting the positive effect that marginal gains can make, using the example of incorporating medical underwriting to help make an endgame transaction more affordable for a scheme.

Hymans Robertson partner and head of risk transfer solutions, James Mullins, also highlighted how the de-risking market is still evolving to meet new needs, talking delegates through the deferred premium buyout solution, which was an innovative solution used by one scheme to differentiate itself from competitors. The solution enabled the scheme trustees to lock in keen insurer pricing, remove major risks, and wind-up the scheme a year ahead of schedule. This same solution gave the employer a predictable commitment in terms of contributions, and allowed them to meet their corporate aims of selling a subset of the company.

Another practical example reiterated just how crucial the relationship between a scheme and its sponsoring employer is to a de-risking journey. Quilter Cheviot Retirement Benefits Scheme chair of trustees, Jane Roskill, stressed the need to educate the employer, especially as the journey to buyout has "a steep learning curve" with a "lot of moving parts".

Lincoln Pensions senior adviser, Francis Fernandes, agreed, underscoring the technical side of this relationship and the role of the sponsor covenant, an issue that both the regulator and providers had previously brought attention to. He added that this needn't only be a source of risk though, explaining that "there are lots of opportunities for trustees when corporate transactions take place", as was the case for Quilter who had undergone six changes in ownership. He also acknowledged that trustees "need to think about the impact on covenant" in times of change too.

PPF panel manager, Helen Beckinsale, echoed this message, urging trustees to involve the PPF as early as possible when concerned about the strength of a sponsor covenant, turning this into an opportunity for the PPF to work alongside trustees to try to stabilise a scheme.

She also emphasised the need for greater contingency planning, even when approaching the endgame, with many trustees not contingent planning despite knowing that a sponsoring employer is in financial distress. Beckinsale cited examples of a scheme with no trustees, and another whose in-house payroll structure left members scrambling for their benefits just before Christmas.

Butcher closed the day by echoing the key message that schemes should "never assume that their sponsor is permanent".

From investment strategy and sponsor covenant issues to longevity and working relationships, there are a number of components for the industry to consider and the key for trustees when navigating these issues will be in prioritising early on.

Written by Sophie Smith