Building for success

Francesca Fabrizi meets Skanska Pension Fund trustee director and head of pensions, Mohsin Harhara; and chair of the trustee board and executive vice president, Harvey Francis, to discuss the pension fund's dynamic journey in recent years

Please give an introduction to the Skanska Pension Fund.
Harhara: In 2000, Skanska acquired Kvaerner Construction and Skanska UK was born. The Skanska Pension Fund was established in 2001 and shortly afterwards received a bulk transfer in respect of the members of the Kvaerner Pension Fund.

In 2005, the fund transitioned to being a career average scheme and then closed to future accrual from 2018. The assets stood at £581 million as at the end of the second quarter of 2023 compared to the 31 March 2021 valuation of £840 million – a significant decrease but more than sufficient to secure the benefits of the circa 7,300 members on a technical provisions (TP) basis.

The decrease is mainly due to the movement in the fund's liability-driven investment (LDI) assets which are sensitive to factors that affect the liabilities such as gilt yields and interest rates. The effect of the Liz Truss/Kwasi Kwarteng mini-budget in September 2022 was a considerable factor driving the drop in the value of assets and liabilities, but the diversified investment strategy in place and swift reactionary action by the trustees ensured our hedge was maintained and the funding position on the TP basis remained comfortably in surplus at circa £45 million.

The trustee moved a number of the fund's investments into a wrapper from Q2 2022. We couldn't include all investments – for example, there were illiquid and certain equity assets that were not feasible, so sit outside the wrapper. This afforded the benefits of a streamlined governance structure with effective reporting and administration

From 2017, a longevity swap was transacted to hedge against the key risk of the then-pensioners living longer than expected.

Given the challenging global conditions, what are the main objectives of the fund going forwards?
Harhara: The fund has proven resilient despite challenging conditions, which is testament to the investment strategy the trustee put in place, the de-risking programme and a close working relationship with our advisers.

The prior year and first half of 2023 were somewhat of a rollercoaster for investment markets, with the impact of the war in the Ukraine, followed by the turmoil of the UK's mini-budget in the autumn. High inflation and correspondingly high interest rates will likely feature for longer than initially thought. This raises the risk that some of the major developed economies will edge into some form of recession at some point over the next year or so. The mini-budget was extremely volatile for both gilt yields and prices and the value of almost all other asset classes – notably equities. Despite these headwinds, we have been able to ride out the storm and remain in good shape.

The trustee, our UK CFO and our actuarial and investment advisers convened a strategy day in Q1 of this year during which we took stock of where we were in terms of funding and investments, reviewed our current strategy and formed a collective view as to how our future journey plan might look.

We had previously adopted a long-term funding target (LTFT) which was a culmination of discussions at our last strategy day held in 2018 and subsequent agreement of the fund's 2019 valuation at a time when a material deficit prevailed on the TP basis. The backdrop to this year's strategy day was dramatically different with the fund in surplus on the TP basis and very close to being in surplus on the LTFT basis. This time the group unanimously agreed on an aspiration to target buyout, whilst accepting it might still be a number of years until full funding on the solvency basis is reached.

Other intents include greater focus on managing the impact of the fund on the balance sheet, consideration of ESG issues, and collaboration between the trustee and the company. Significant market shocks hindering the funding plan and a deterioration in insurer pricing for bulk annuities are seen as main concerns in terms of our agreed journey. Whilst partial buy-ins were acknowledged as a stepping stone towards a full buyout, as used by other schemes, the consensus is this would not be an appropriate strategy for the fund at this time. Such a strategy would lead to the balance of the investment portfolio becoming highly illiquid in nature, and likely lead to issues due to the increased collateral requirements following the gilts/LDI crisis last autumn.

A high-level journey plan has been developed for the required workstreams, which will inform the trustee's business

planning over the next few years as we strive towards making the fund as buyout ready as possible. This work is progressing apace, with our data now cleansed and GMP equalisation due to finalise in 2024.

What have been your biggest successes?
Francis: The funding position on all bases has improved markedly over recent years. At the March 2016 triennial actuarial valuation, the fund recorded a deficit on the TP basis of c£110 million dropping further to c£175 million by August 2016 due to a drop in bond yields and unhedged interest rate risks.

Since then, the funding position has significantly improved to a steady and comfortable surplus position but there were bumps along the way, perhaps most notably a slight deterioration in 2020 attributable to the effects of the Covid-19 pandemic. This recovery can be credited to a combination of deficit recovery contributions and a successful investment strategy.

Similarly, the estimated buyout basis position has improved from a shortfall of c£445 million in 2016 to c£55 million in 2023. The trustee has adopted an LDI strategy since 2013, which has contributed to the significant funding improvements in the years since, and the effective matching of the fund's liabilities.

In 2013, the fund purchased Skanska Infrastructure Development's interest in three schools and two street lighting projects, and a stake in Barts Hospital in 2015, which provided the pension scheme with valuable assets in the form of a stable, long-term cashflow.

In 2019, it was decided to sell these assets with the process commencing in 2020. The disposals were successfully completed in early 2021 much to the benefit of the fund.

In 2014, the trustee purchased a mixed-use office, warehouse, and industrial facility in Bentley from Skanska. The property was sold including a 20-year lease with Skanska UK as tenant providing a secure income stream until 2034. The trustee also managed to secure a parent company guarantee to cover rent payments should a forced sale event occur due to an unforeseen change in legislation which should maintain the value of the property/lease in such a circumstance.

What challenges have you overcome?
Francis: Until recently, the scheme was in considerable deficit, which reached over £100 million in February 2020, exacerbated by the pandemic and as such significant deficit recovery contributions (DRCs) were required to be made by the company. Driven by the knowledge that, by 2021, the funding position had since materially improved and to get a better sense of when the company could likely cease DRCs, the trustee brought the date of the 2022 triennial actuarial valuation forward by one year. The results of this funding assessment prompted a decision to cease DRCs from May 2022 in association with the implementation of a tap-on/tap-off funding level trigger-based mechanism to automatically restart DRCs if certain conditions play out. Our assets include a proportion of illiquid assets, which include some property with varying terms to maturity, the longest being the Bentley property, which will run-off in 2034.

Our LDI fund has been successfully matching the fund's assets to its liabilities since it was introduced. However, the mini-budget created a major challenge as it meant we were forced to sell investments to recollateralise the LDI fund at short notice and bring the leverage back to target levels. The trustee showed its agility with the board getting together at very short notice to discuss the issue and implement the agreed immediate action that was needed. In response to the crisis, we have put in place a collateral waterfall framework and reduced our leverage.

What is the trustee's stance on ESG?
Harhara: The trustee has set and communicated to the fund managers to consider in their ongoing stewardship and engagement activities with investee companies three stewardship priorities – climate change; diversity, equity and inclusion; and human rights. The engagement with the fund managers and monitoring of what they are doing in terms of these priorities is delegated to the fund's investment adviser. The trustee takes ultimate ownership of the fund's stewardship, and the investment sub-committee keeps these activities under observation with managers challenged where their activity has not been in line with expectations. The exercise of voting rights attaching to investments and engagement with investee companies has been delegated to the fund manager.

The investment adviser builds its assessment of the nature and effectiveness of fund managers' approaches to voting and engagement into its advice on the selection of the fund managers and their ongoing review. The stewardship priorities were selected because, in the trustee's view, they rank as the most important global risks, and they also align with the values of Skanska.

Written by Francesca Fabrizi