

What is the end game?

John Herbert discusses different views on what the 'DB end game' could look like and whether it is much closer than many people think

Traditionally most people have considered the 'DB end game' to be a full settlement of the liabilities with an insurance company through a buyout. This removes all liabilities from the balance sheet and transfers the pension risk to a third party through a single transaction.

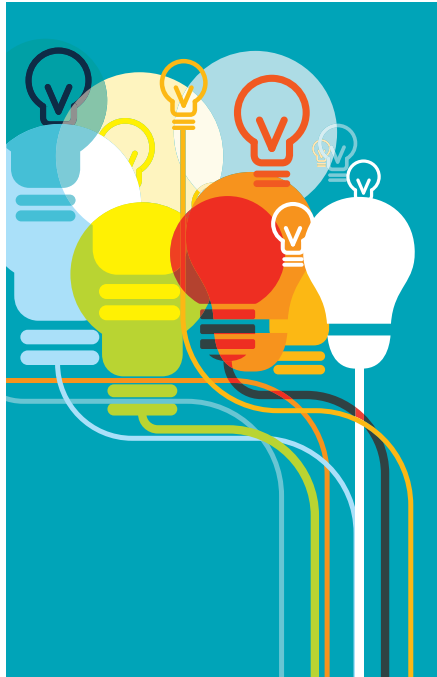
However, the discussion and debate around DB consolidation has resulted in the emergence of further options such as 'superfunds' and 'DB master trusts', which may provide alternative strategies to a full buyout. More recently The Pensions Regulator has asked trustees to consider a long-term funding target, which could lead to a sustainable, low risk, pension strategy much sooner and without the additional cost of a buyout.

So the DB end game could become a low-risk solution within the existing governance structure. Therefore, the desire (or objective) to fully settle the liabilities through a buyout may become less important and fall away from the agenda. The costs of achieving this alternative target are likely to be significantly lower and consequently the timescales for achieving this are likely to be much shorter.

The long-term funding target could become a much more important funding objective than achieving buyout once a pension plan has achieved full funding against its Technical Provisions.

Lower funding cost, shorter time scales and less administrative work (at least in the short term) are all key advantages and it would not prevent a buyout at some point in the future.

In practice this is already happening where pension plans are fully funded against their Technical Provisions, as



trustees have turned their focus towards risk management in order to protect the funding position, rather than retain existing levels of risk in order to achieve a buyout as soon as possible.

Often this involves increasing the allocation to matching assets and increasing the level of protection against changes to market conditions.

The road to a sustainable low risk solution is just a natural development once Technical Provisions have been met. In fact, it may be a natural course in any event because many pension plans (particularly with a strong covenant) target a higher investment return before retirement and a lower investment return after retirement. Consequently, as more members retire and the proportion of pensioners increases, the target investment return in the funding plan

will naturally decrease. Once there are only pensioners, there will probably be a low-risk funding and investment strategy in place. Over the medium term (as benefits are paid and liabilities run down) there is likely to be convergence towards the buyout position.

Perhaps the most pressing immediate question for trustees is to reach a consensus view on the long-term funding target. This is also likely to include a journey path and timescale to achieve this objective.

Whether this represents the DB end game or not will probably depend on the economic position at the time, the remaining levels of risk and the overall objectives for each pension scheme.

It is likely that larger pension schemes will have the resources and skills to continue to operate efficiently and meet the governance requirements over the long term but smaller pension schemes may look to reduce operational costs and governance risks through consolidation in order to achieve economies of scale. For smaller pension plans moving towards their long-term funding target, the availability of sufficient choice of suitable, accessible and affordable consolidation options from superfunds, DB master trusts or insurance companies is likely to have a significant impact on how the DB end game will play out.

Many pension plans may be able to achieve a low-risk solution within a few years with only modest amounts of additional funding. If they decide to run off the liabilities rather than pay the additional premium to achieve buyout they will be entering the DB end game much sooner than they expect. That said the DB end game will then take quite a long time to play out in full.



Written by John Herbert,
chief actuary, Premier

In association with

premier