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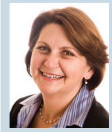
De-risking roundtable

CHAIR

Mike Smaje, Trustee Executive, BESTrustees
Mike joined BESTrustees early in 2020. He has over 28 years' pensions experience, as a scheme actuary and investment consultant on corporate and trustee assignments. He currently represents BESTrustees on seven schemes, including two as chair. Mike was an investment partner at Aon for two years and prior to that spent 19 years with Willis Towers Watson. He also spent two years working for a global investment manager, helping them to build an innovative LDI proposition. He is a fully accredited member of the Association of Professional Pension Trustees (APPT).

PANEL

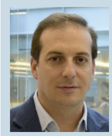
Sammy Cooper-Smith, Head of Business Development, Rothesay
Sammy joined Rothesay in 2011 and is responsible for new business origination and marketing to DB and insurance companies. At Rothesay, Sammy has played a lead role in transactions with the pension funds of National Grid, telent, Asda and Allied Domecq among others as well as the reinsurance of the Prudential, Zurich Assurance and Aegon annuity portfolios. Prior to joining Rothesay, Sammy was at Paternoster which Rothesay acquired in 2011. He started his career at Prudential.



Melanie Cusack, Client Director, PTL
Melanie brings a wealth of experience from across the pensions industry addressing both statutory and non-statutory actuarial and non-actuarial aspects of UK pension provision. As a qualified actuary, she worked for consulting firms including Towers Perrin (now Willis Towers Watson) before becoming a professional trustee. Melanie's project management skills, pragmatic "can do" attitude and technical appreciation of the actuarial science enable her to support fellow trustees and their sponsors in arriving at well-constructed, collaborative funding solutions.

Tom Lord, Senior Actuary, Capita Pension Solutions
With over 15 years' pensions experience, Tom is a senior actuary at Capita within the DB pension scheme de-risking and risk settlement team. Tom specialises in bulk annuities, journey planning and liability management. He has wide industry experience at leading consultancies and an insurer and has advised trustees and corporates of all sizes on their pensions issues in a variety of sectors. Tom is currently a member of the DB committee for the SPP and a member of the Institute and Faculty of Actuaries working party group on end-states for DB pension schemes.

Rob Mechem, Director of Business Development – DB, Just
Rob joined the DB solutions team in 2014. He cares about finding the right solutions when trustees are preparing to buy-in or buyout. His team supports trustees and their administration partners from enquiry, through transaction and onwards to transition. He is a qualified life insurance actuary which helps ensure the right questions get asked to maximise value for trustees. Before joining Just, he spent 12 years at Aviva. He is a regular contributor to the pensions press.



Francisco Sebastian, ALM & Regulatory Capital Strategist, Wellington Management
As an asset liability and regulatory capital analyst, Francisco focuses on meeting insurance and pension investment management needs. He develops actuarial and financial models on ex-ante return and risk, scenario analysis, cashflow generation and return simulation for strategic and asset allocation, ALM and capital management. Prior to joining Wellington Management in 2019, Francisco held different positions at Pimco in the UK and US. Before that, he was a member of the European Commission's financial crisis taskforce.

Matthew Swynnerton, Partner, DLA Piper
Matthew advises on all aspects of pensions law, including corporate and bulk annuity transactions, re-organisations, benefit redesign and liability management projects, reviewing and updating scheme documentation and advising trustees and employers on their legislative and trust law duties. Matthew drafted key legal sections of the Combatting Pension Scams Code of Practice, which received widespread praise from The Pensions Regulator, the Pensions Ombudsman and the Pensions Minister. Matthew heads the London pensions team.

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De-risking roundtable

Debating the world of pensions de-risking

Our panel of experts reflect on the current state of play in the pensions de-risking space, discuss exciting trends and debate what we are likely to see in the future

Chair: In the past 18 months, we went through the worst of the Covid-19 pandemic and experienced plunging markets; but we've since seen a strong recovery. What has this all meant for pension schemes and the clients you've been working with from a de-risking perspective?

Lord: There have been significant challenges: negative impacts on some sponsors, impacts on sponsor covenants, and we also saw, during the earlier part of the pandemic, a worsening of funding deficits in some cases for those schemes that weren't well hedged. So, it's been a challenging time for trustees especially with The Pensions Regulator's (TPR) focus on schemes having long-term funding objectives going forward.

The pandemic has also meant that managing cashflow has become a key focus for sponsors. This has in turn put more focus on the pension scheme funding risk and has opened up discussions with sponsors around risk management options. And, because there are those cash constraints, it's made it really important when trustees are presenting to the sponsor any de-risking strategy that they're clearly articulating the risks, the costs, and the benefits.

What we also saw during this period was a lot of focus, not necessarily on risk settlement right away, but schemes looking to get themselves to a position so that, when the economy recovers, they are able to transact – they're going to be transaction-ready, ready for an insurer to take on the risk as things improve.

Finally, there's been a lot of corporate restructuring on hold through the pandemic. Now that things are recovering, we're seeing a lot of corporate activity, which in turn places more focus on pension scheme risk and how to potentially settle that risk. So, we are seeing a lot more interest from the sponsor side.

Cusack: The first year there was a feeling of panic – sponsors making sure they were set up to continue functioning, and in some instances they were cutting costs and so on. This year, by contrast, I'm seeing some of those sponsors that haven't made acquisitions they would have made, or haven't needed to invest in their businesses, having cash available, and they are keen to do something.

They're asking, for example, about buy-ins, or just generally they are wanting to manage their longevity risk, even when they hadn't been focused on the pension scheme before. This is a welcome change in focus.

Also, across my schemes, where they had significant hedging in place, they are generally fine. If they hadn't fully committed to hedging, they are now more prepared to talk about it because

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De-risking roundtable

they didn't like the exposure they had.

So, we are in a much better place than we were pre-pandemic. There's definitely more engagement from sponsors, distressed or not, which is really good news.

I have also noticed a naivety about what's involved with some de-risking strategies. Quite often, for example, it is thought a buyout can be done in a matter of months with no understanding that there is a lot of planning and other parts of the equation that need to be fulfilled, such as GMP equalisation and so on.

So it's busy and it's also exciting because there's this dialogue now that wasn't there 18 months/two years ago.

Chair: I've seen that too; the recovery in markets and the improvement in funding levels coupled with the regulatory overlay, as well as the new Pension Schemes Act has, for a lot of companies, caused them to consider whether they can manage the pension scheme off the books at some point.

Swynnerton: We are also seeing increased dialogue between trustees and sponsors. The pandemic seems to have brought all the risks inherent in defined benefit (DB) schemes into fairly sharp relief and that dialogue is healthy.

At sponsor level, the end of furlough will have also had a negative impact on some employers – our restructuring department is gearing up for there to be a lot of activity over the next 12 to 24 months, a lot more reorganisation within companies. But as that risk increases, so does the attractiveness of risk transfer, albeit there may not be the funds there to support it on the employer side.

Also, we shouldn't forget what's going on at member level because members have obviously been significantly affected by the pandemic. It's caused a lot of them to rethink their retirement plans and a lot of them are considering retiring later and phasing into retirement in a way that perhaps they weren't previously.

Sebastian: In terms of what has happened in the market, I would echo a lot of what has already been said. On the back of the Covid crisis, the combination of these hugely expansionary monetary and fiscal policies globally has fuelled risk assets. That has been a key driver of the financial position of pension schemes.

To give you an example, UK equity markets in the past 12 months are up 20 per cent. I can't remember the last time that happened. In global markets, they're up 30 per cent – that's more normal but still incredibly strong. In investment grade credit, spreads are very tight.

Something even more amazing has happened at the same time: interest rate curves have moved higher and steeper, which has a very strong impact on the valuations of pension scheme liabilities. Long-term rates have risen by around 60 basis points (bps). Altogether, this has resulted in an aggregate increase in the value of assets, and decrease in the value of liabilities, of about £100 billion. That's around 6 per cent of the total valuation of DB pensions in the UK.

With that large increase in funding levels, the PPF 7800 index is posting the highest funding level in the past 10 years and, on a s179 basis, less than 50 per cent of pension schemes are underfunded. This is extraordinary, so it's not surprising that a lot of schemes or trustees are wondering what to do with all this additional value.

However, this is arguably a double-edged sword. Just because the schemes have the money now, they shouldn't simply overpay to de-risk. Rather, they should use it wisely.

Cooper-Smith: As has been mentioned, the funding level of schemes has improved quite dramatically. The number of incoming calls, and the number of schemes that are realising that their funding level has got better, has also gone up dramatically. That doesn't feed through to this year's pipeline, but it does into next year's and further out as people prepare.

The one quirk in the marketplace at the moment is that there is probably more supply from insurers in terms of capacity than there is demand from pension schemes for this specific year. So spreads have tightened. I'm not sure that has flowed through into bulk annuity pricing fully. So, the funding level has improved because spreads have tightened, their assets have increased in value; while bulk annuity pricing hasn't necessarily moved at the same pace. I would expect next year the pricing to ease up in the market, but that will see the supply and demand match each other, and the yield that insurers are passing on, and the assets that they're buying, will reflect the increased value in the assets that schemes actually own.

I also believe the higher inflation expectation is going to improve funding levels yet again. If schemes have inflation capped at 2.5 per cent, capped at 5 per cent, and they've got gilts backing it – although it all comes down to how well hedged they are – there is the potential that some of their assets are going to grow in value more than the liabilities do if short-term inflation nudges above 5 per cent.

So there's a whole range of things that are conducive and supportive to what

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schemes are now going to try and achieve over the next year or so.

Finally, as demand from pension schemes increases, that will either filter through to less insurers being able to quote for everything that is out there, or pricing hardening a touch.

Mechem: On the pricing point, in the first half of the year there were around £7 billion of transactions. Insurers have a much larger capacity than what came to market. So, if schemes had been prepared and ready, they would probably have got very good pricing. And this won't necessarily be the case next year when demand is likely to increase and meet supply. It emphasises a potential benefit of schemes being well prepared, in the market and ready to move to a transaction. Indeed, we had one client who was monitoring pricing with Just for over six months and because they were ready to move once the objectives were met, transacted very quickly.

One of the trends we are seeing this year is a lot more tenders for pensioner and deferred buyouts, compared to pensioner only buy-ins. That is probably one of the reasons it's been slower in the first half of the year. Schemes targeting a buyout have had to properly prepare their data and benefit specifications before coming to market. They've had to do their thinking about GMP equalisation even if they've not started the process. There's a lot more preparation involved and so it's taken them longer to get to market. That preparation has paid dividends for those schemes that put in the effort as they were able to secure the competitive pricing already mentioned. I call this being 'buyout ready' and it's a trend I think we'll see build into 2022 and beyond when it will become a necessity for schemes hoping to transact.

Commentators talk about the market potentially being £25 billion this year. If you've done £7 billion in the first half of the year, you can see what's coming through in the second half which has been incredibly busy and fuelled by those cases that have done their preparation. I think the last few months of the year will be dominated by buyouts, insurers will be keen to transact so we achieve our targets by the end of the year and some of that demand will flow through into next year when buyouts will dominate again.

Cooper-Smith: Volumes are lower this year for multiple reasons that have been touched on but some of it was to do with the gestation period of the transactions. The pipeline continued as it was from March last year but then the new stuff went on hold for six months and that new stuff, that six-month hold, is coming through the pipeline right now.

The other factor is, if you go back to 2019 when £40 billion was done, you had seven or eight multi-billion-pound transactions. Last year, there was only one of that size in the market, and the market eased off to £30 billion. This year, time will tell but you would need some quite substantial deals to get to £40 billion, and there's only so much human capacity in the market too.

If I look to next year, I see something in the order of £18 billion of multi-billion pound trades that are having conversations already. So that's dramatically different to where we are now.

Cusack: Going back to the point around the gestation period and the pipeline and also the work done in preparation before coming to market, do you think it's a good thing that people are doing things like getting the data checked, the benefit specifications done, etc, so that when they come to market, it's a shorter timeframe to the transaction, or do you think it's not really going to make any difference?

Mechem: I think the former. The more prepared the scheme is, the better i.e. if they've done the benefit specification review with their lawyers, the data is being checked, marital write-out is underway or near completion and GMP equalisation is being thought about if not under way or done. Those schemes will pass our triage process and go to the top of the queue to receive pricing because they'll have put the groundwork in place that makes the second half of the process, the data cleanse and true-up during the transition, much easier. There's only a certain amount of human capital to do quotations and transitions. So we'll focus on those schemes that have done the groundwork before they come to market, that are 'buyout ready' and that makes the initial pricing and subsequent transition smoother so we can handle more schemes.

Lord: I agree, it's definitely an advantage to have done that work upfront – it's going to push you up the list. But it's interesting the split between small and large schemes. There's a lot to make up this year for insurers having a quiet H1, and when you've only got so much bandwidth, as insurers, it's going to mean a focus on the larger schemes.

So, when advising trustees at the smaller end, we do whatever we can to push them up that list; and being transaction ready and having signed-off benefit specification and having their data and GMP equalisation sorted out all helps. Nevertheless, it's still challenging for smaller schemes to secure a bulk

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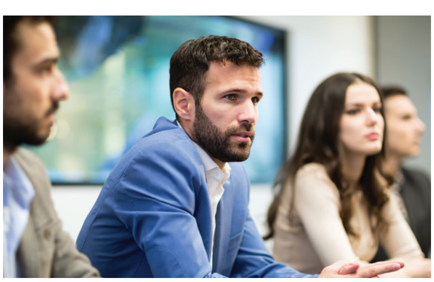
De-risking roundtable

annuity with an insurer.

You just have to accept that's the way the market is at the moment and we need to spend time with the smaller schemes to get them transaction ready and get them to a position whereby they can transact at short notice as and when slots become available with insurers. So, we spend a lot of time preparing our clients in order to do that.

Sebastian: The operational aspect of transacting requires time, but there is also the question of whether or not transacting makes sense. We have looked at the past 20 years of funding positions in the UK and found that, post the great financial crisis, there have been only very small windows when these same conditions were present, with funding levels this high. At the same time though, the price of de-risking was very high too, as it is today. This can make de-risking not economical to implement.

As I said earlier, the decision to de-risk can be a double-edged sword. On the one hand, many pension schemes are funded well enough to proceed. On the other, when they go into the marketplace and ask for insurance, it's expensive. In this situation, it is very important for schemes to take actions that prepare them for de-risking – for when conditions become more favourable – and also make sure they retain the flexibility to do so. That could take just a few months in some cases or several years in others. What is most important is that pension schemes become prepared



to properly commit to a longer-term solution so that, when the cost of the solution becomes palatable, the schemes can execute promptly.

We are advising our UK pension clients, based on their particular circumstances, to protect their funding positions so they can keep that dry powder for when it's needed. It may be 2022 or later, but it's very important to get the scheme ready for when the time – and the pricing – is right for de-risking.

Cooper-Smith: Rothesay doesn't operate at the smaller end of the market and never has. But if I was to try and operate in that part of the market, what would it require for things to become efficient? I think for the sub £50 million market to be able to get focus, smaller schemes are going to have to be transaction ready but to a level even beyond what people talk about today – literally to the point where everything is done as much as it possibly can be.

When I first started in the marketplace, small schemes would come with the data in a format on which they wanted policies to be issued. There would be no data cleanse – everything was already done. If small schemes reverted to this, then I think they would get more traction in the marketplace.

Mechem: I'd echo that point. At Just, we work with transactions in the small and mid-sectors of the market where schemes that had already done their data cleansing and all the other things necessary would go right to the top of the queue. We would effectively lock it in, load it into our system and away you'd go – I'd be a strong advocate of that. Added to that, at Just, we can provide feasibility quotes off much reduced data to inform whether or not trustees are there or thereabouts, before they go and do all of that work.

We're discovering that feasibility quotes are very popular with professional trustees who are keen to enter into dialogue with us. Securing indicative pricing early in the planning process tells them whether they can already afford a buyout, which is something we're seeing more regularly, or it lets them approach their sponsor knowing what contribution is required to close a funding gap to full buyout or for their next pensioner buy-in. Once the indicative pricing is done, then the idea that Sammy *[Cooper-Smith]* has about completing as much as possible on the data/ben spec is a powerful one.

Lord: I agree, and I understand from the insurer's point of view having the data in a finalised format is obviously going to be preferable. Trustees of course need to balance that with the position they're in. But, in an ideal world of course everything would be finalised.

What's really helpful for trustees also is having regular price monitoring from insurers, for example like Just provides.

Mechem: Yes, which is why we've developed it and are able to run multiple schemes through that process on a monthly basis.

But for small schemes to get traction and for us to be able to price them at scale, they'd need to have done all of that data cleanse, all of the GMP equalisation, and so on. Once that happens, I don't think there'll be as much of a capacity issue for schemes under £50 million.

While they don't do it, you are picking and choosing between pricing a £10 million case here, a £20 million case there or a £100 million case and the latter will probably come first if they're as well prepared and there's a target to close. So for small schemes, there is a fundamental change that's needed.

Chair: To what extent do the resource requirements for post transaction data cleanse activities impact on insurers'

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resource constraints for new business?

Cooper-Smith: In my mind, the work you would have to do as a trustee to wind up your pension scheme is not dictated by the size of the scheme particularly. So, whether it's GMP equalisation or cleansing the data and checking spouses pensions, all the work is the same, regardless of scheme size. We have worked on schemes across the spectrum. The ones which are easiest tend to be – in terms of winding them up – the large ones, because if you are a £4 billion pension scheme and winding up, you tend to have a sponsor or budget commensurate with the size of the scheme.

Spending a six or seven figure sum on the data cleanse and getting all the work done and getting everyone involved to get everything lined up is nothing in the grand scheme of things. If you are a £100 million scheme, the budget isn't there to do all this work.

That filters through to our thinking of just what kind of resourcing level is required post-deal. Not pre-deal, not pricing the data as it comes through from the consultants, whoever it comes through from. It's more about once the initial buzz of getting a transaction done is over and actually you now need to wind the scheme up, that's when more of the issues arise.

Lord: I've worked both on the insurer side and consulting side, and I'm pretty confident there is a resource constraint for most within the post-transaction transitions team. Having worked for a number of years on the leadership team of a bulk annuity provider, what I've sometimes seen happen is that when trustees do a transaction, there is a specialist de-risking manager assigned to that transaction at both insurer and consultant side and everyone is focused on the transaction. The trustees transact and there is a sigh of relief. Afterwards, then, these de-risking specialists may then step away.

Then it's left for the insurer post transaction team to liaise with the administrators of the pension scheme, without the support of those de-risking specialists which can slow down the post-transaction process and add to the resource intensity.

We use a different model. You have all your de-risking specialists leading up to transaction and they remain post-transaction, remaining in dialogue with the insurer to get all of the data cleansing activities completed. Acknowledging that's a resource intensive process helps with the smaller schemes in terms of working with insurers to build up credibility with them to say, "if you're going to transact with Capita, we're going to remain engaged with you, the insurer, post-transaction. You're going to have your same key contact with the de-risking specialist to get this concluded in the most efficient manner possible".

What I'm saying in summary is it's disjointed, and everyone needs to join up, understand what's required. Pre-transaction there's a lot of work to be done but, to some extent, post transaction is when the real work starts.

Cusack: We mentioned earlier human capital and resources and I am struggling with administrators having the ability to do the day job of administering the scheme but also consider all the other tasks to get you into the position of thinking about going to the market, let alone actually going to the market. For example, when can we do the data verification, when can we make sure the GMPs have been rectified and equalised? We're just not getting the traction because there doesn't seem to be the manpower available to do this work on top of all the other escalated interest that we are seeing.

There appears to be more members thinking about their pension options and wanting information about the pension scheme because they've experienced this furlough arrangement and had time to plan. So, while the trustees might be keen, and the sponsor might be keen, there's just not the administrative capability. You have to be sympathetic towards that, but it does create some frustration as well.

Sebastian: I would go back to the question of why demand has been slow. I hear other panellists talk about the operational side of things and how things take time, but I firmly believe that there is some degree of rationality among UK pension schemes. When someone can get gilts plus 20 bps or 30 bps (at most) from a buyout strategy, or manage it internally and achieve no less than gilts plus 60 bps or 70 bps, it seems to me not a very wise decision to go for the former rather than the latter.

We estimate that, for a £1 billion scheme, the cost of going into the buy-in/buyout decision at the moment is between £50 million and £150 million, which is huge. So, while the operational side of de-risking is important, we should not forget that committing to a long-term buy-in/buyout strategy is very expensive these days. This is probably why, to some extent, demand for that type of de-risking solution has been slower in 2021 to date.

In the next 12 months, we might see UK insurers taking a cut on their margins

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to provide a better, more compelling business proposition for pension schemes. We may also see fixed income markets improve from the current ultra-tight spread levels. There are reasons to be constructive but, for the time being, I think the first half of 2021 has been difficult for insurers offering buy-in/buyout solutions because they're selling a very expensive product.

Cooper-Smith: People come to us because they want to purchase a buy-in or a buyout and they do their own value for money test. But there are a few things that perhaps you're missing in your analysis and that is the downside i.e. if you could afford to buy out but you choose to run on, in the event that your sponsor runs into difficulty at any point in the future, that triggers a test as to whether or not the members continue to get full benefits, or they go into the PPF, or they get somewhere in between.

So, if you could have afforded to and then something happens to the sponsor and that test happens and at that point in time you now can't afford it, the members pay for that. So, it's very rare in my mind that trustees who find out they can afford to buyout would turn that down because the downside there is carried by the members.

In your analysis, the implication is you will deliver that return, nothing else will come up along the journey. The funding level of the scheme will continue to be as it is but, who is carrying the risk? So, ignoring the company running into difficulty along the journey, the upside is for the members potentially, the downside is for the sponsor. The trustees also at some point do want to get a discharge of their liability.

That's not me advocating everyone should buyout, some people want to, some people don't, but I think there's more to it than just your assessment of value.

Chair: Melanie *[Cusack]*, as a trustee, have you ever had the situation where a scheme has been in the zone of probably being able to afford to buyout but there's been resistance from the sponsor?

Cusack: With one of my schemes, we were doing everything right, we set up a project plan to go to buyout because we found ourselves suddenly in a position where it was well within cheque writing distance – so, we were doing everything to get our house in order. Then I asked the working group to confirm than the parent company was happy with the P&L impact, and it all fell apart at that point.

Another sponsor said: "Why bother? Why not just carry on in a self-sufficient framework? We don't need to move it anywhere else, we're quite happy with that, the trustees are managing it, we are not going to go to buyout at any point", and that's been their view for years. The scheme has remained fully funded on a self-sufficient basis for years. So there are some who do not view buyout as the be all and end all.

But the conversation is more live than it has ever been for me for my schemes, but then the funding levels have improved considerably as well.

Chair: I have seen similar things – particularly with parents overseas, some have been reluctant to do buyout; they'd rather run it off with a pretty big surplus on a self-sufficiency position.

Swynnerton: On the employer side, I've seen the same thing – overseas sponsors not really understanding the upfront costs and the time involved in doing the transaction. It doesn't seem such a well-trodden path for some parents. Risk will inevitably remain a key driver though for sponsors who do understand the landscape and are pursuing de-risking; and those factors are only heightened by the successive layers of legislation – most recently, the Pension Schemes Act 2021 and the criminal sanctions that the regulator can potentially issue. That should be waking up shareholders too. So, I suspect changes under the Pension Schemes Act will drive more schemes or more sponsors and trustees to look at risk transfer.

On the trustee side, it would be a very unusual situation for the trustees of a scheme that could afford to buyout to take the decision to pursue runoff and I question how they would rationalise that decision given their duties to act in the members' best interests.

For most schemes, of course, there'll need to be a sponsor engagement piece and possibly a parent company engagement piece which can be tricky.

But it does seem in most cases that a risk transfer can provide that higher level of security because members just aren't exposed to the same degree of covenant risk, of investment risk, of demographic risk. Those are factors that the pandemic has really brought into sharp relief at every level.

Chair: Does anyone have any thoughts on current pricing and how that might evolve over the next year?

Sebastian: There are some very important things ahead of us. Some variables in the UK or the global, such as credit spreads, risk assets or interest rates, are beyond the pension schemes' or the insurers' control. But others are within the control of the insurers. For example, in the next couple of years the Solvency

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II reform is expected to be implemented, which will hopefully provide extra room for insurers to price more efficiently. They might decide to retain the profit, or they might share it with the schemes, we don't know yet. But that is a reason to be optimistic.

The second thing has to do with IFRS 17 for insurers. The change in accounting rules might encourage them to do more business in the next few months, because they want their financial statements to look great when IFRS 17 kicks in. Again, this is another hopeful situation for the pension schemes.
I would say those two variables are within the control of the insurers, in terms of pricing their offerings more appropriately. The other items are spreads and yields, which are out of insurers' and everyone's control and is more a question of pension schemes being prepared to seize the opportunity as it arises.

GMP considerations

Chair: Are some schemes looking to buyout likely to find conversion more attractive than others?

Mechem: If you'd asked two years ago, there would have definitely been a preferred methodology for conversion – the D2 methodology. The fact that HMRC is still not giving clarity on what the tax issues might be for members means it's difficult for trustees to go down that route. But our preference still remains for conversion. We can now cope with dual records and in some case triple records that covers the B and the C2 methodologies, depending on the administrator that is looking at it – so it's no longer a barrier but dual records will require more data to be collected as part of the data cleanse.

Whether it works for a particular scheme or not, I'm probably the wrong person to ask, it's probably for the actuarial and the legal advisers to say whether conversion or dual records are their preference. Conversion is clearly the easiest way to administer, whilst dual records are more complicated, but there are complications even with conversion.

Swynnerton: From a legal perspective, I would have thought, in a nutshell, conversion is going to appeal more to smaller schemes. But there's a range of factors that will dictate whether conversion is attractive, from the complexity of the scheme's benefit structure to the member demographics in the scheme. But maintaining year-for-year administration is inevitably going to be easier for the larger schemes compared to smaller schemes, and smaller schemes that are looking to buyout I would have thought would favour conversion. It seems a lot more straightforward.

Cooper-Smith: For trustees, there are two considerations. One is the cost of equalising, so let's assume that's the same between D2 and C2; and then there's the cost of administering that equalisation method of which, from our perspective, it's pretty much zero at D2 and a cost for dual records. That's the first consideration.

The second consideration is: can the trustees receive legal advice which says D2 is appropriate; that is at the smaller end, because at the larger end I think most of the time the schemes push to include the cost of doing C2. But we are quite keen that people don't do C2, and they do B2 because it's actually easier to administer, easier for the members to understand, and less likely to get it wrong in the future. In our mind the cost is the same between B2 and C2. So it's really changed. A couple of years ago, the market was saying conversion; then it said C2; and now we're saying B2, and others are saying the same.

But we are in a position to support all of them, the trustees turn to their legal advisers as to which is the right approach and what can they afford. But it's those two considerations. There are obviously the tax issues as well – we've got schemes who are doing conversion for nearly everyone but wanting to do C2 for six or seven people, which is a lot of work.

Lord: From Capita's point of view advising on GMP equalisation, for GMP conversion the role is simpler, easier for insurers to take on. What we are seeing is most insurance companies will administer the majority of methodologies. However, we're now also seeing more trustees considering the tax implications between the different methodologies.

But for schemes already entered into a bulk annuity contract, then the options are available to them from the insurers. For schemes not yet having entered into bulk annuity, it's probably something they want to consider, to ensure that they're applying the methodology that is best going to allow them to engage with insurers and get a buyout quote. But I do highlight the tax implications of conversion which is a real problem.

Superfunds

Chair: Is the continued delay in the first superfund transaction causing issues for schemes?

Sebastian: The environment is favourable to the insurers because of the

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Solvency II reform. This is an important driver. The superfunds might need to catch up with that very quickly because, while their regulatory advantage is not going to disappear, it is going to get a little bit smaller in the next couple of years.

Chair: I'm seeing very little conversation about superfunds amongst the schemes I work with.

Cusack: I've had a few conversations with other chairs of schemes, and we have struggled to come up with scenarios where the trustees would believe they're acting in the interests of the members to go to a superfund if the requirements are similar or not much more onerous to go to buyout. If they're your comparators, with buyout we've got the insurer with all the regulatory background, then we've got a superfund.

There must be scenarios where trustees could agree to transfer to a superfund, but it is quite challenging to say precisely what they are. At this point, it's not being explored on any of my schemes.

Chair: As we know there are very different models for some of the different providers.

Cusack: I imagine there are some overseas parents who might find a superfund quite attractive because it removes any UK issues they may have.

Swynnerton: I am seeing superfunds mentioned in a menu of risk transfer options, but I've not seen it pursued in earnest. For trustees, being the first to transact is obviously inherently quite off-putting and risky and the lack of an initial transaction makes that route pretty unappetising for a lot of schemes, even those that might benefit from the consolidated and increased leverage they'd get from being part of a collection of schemes. It seems like such a hurdle to get over, being the first to transact and that is a big problem for the superfunds.

Cooper-Smith: There are a range of schemes who are going to exit the PPF and usually they would be buying insurance. Now the question is, should they be buying insurance for X per cent of full benefits, or should they be trying to secure full benefits via a superfund? Going back to the original question of whether the delay is causing an issue, at some point I suspect trustees will have to make a decision.

There's the concept that potentially they could do full benefits with a superfund at a date in the future but how long do they carry on spending money, assessing things and having fees or when do they just pull the plug and say, "right, we have to secure benefits above PPF for our members". I suspect there's quite a few schemes in that position. They're the schemes I can think of that might have an issue with the delay, not meaning the issue is a negative, it's just something they really have to consider properly now. Who knows how that resolves itself in the next 6, 12, 18 months?

Cusack: It comes up as a question mark because you are duty bound to consider all the options, but it doesn't get much more than that because it's not really a viable option if you want to do something now.

ESG

Chair: How are ESG considerations developing in the de-risking space?

Cusack: ESG seems slow to come into the de-risking space, but I am hearing a lot more about the fact that, when you are considering an insurer, you need to look at what their ESG considerations are, or what their views on ESG are, otherwise you will be undermining any of the good work you may have done on the ESG side yourself. So it's recognising that the importance of ESG consideration doesn't stop just because you're going to buyout.

Chair: I agree. I do think that is becoming an increasingly high-profile criteria amongst all the other things, i.e. alongside quality of administration. ESG is, like it is everywhere, rising right up the agenda.

Lord: Yes, it's high on trustees' agenda and when we're working with trustees deciding on a bulk annuity deal, that's one aspect they need to consider because it's an investment like any other investment. The trustees will want to request copies of an insurer's ESG policies, and carefully scrutinise them together with their advisers. But saying that, what we are actually seeing is insurers are quite well advanced in this area and the ESG policies are acceptable to trustees. But, yes, it's definitely one of those criteria that the trustees are required to consider before entering into a bulk annuity.

Mechem: I also think we're seeing it from both new potential quotations and existing clients, so it is becoming a very important part of the due diligence that's done on the insurer now and beyond. But I'd echo what Tom *[Lord]* said, most insurers are very well advanced on this.

Cusack: But not all trustees have thought about it, have they? You're absolutely right. It should be part of the process but, historically, because trustees haven't had the ESG issues high on their agenda, they haven't included it in the transactions space. So it's about making sure that you are aware what your

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insurers are doing in this space. Also, it's about being transparent to members as well – showing them that we are not just washing our hands of our obligations by handing the scheme over to an insurer; our obligations are being considered in full, including considerations of ESG.

Looking ahead

Chair: Thinking about the next 12 to 24 months in terms of de-risking strategies, do you see anything on the horizon that could affect things going forward?

Cooper-Smith: The world is a volatile place at the moment, so there are endless things which could knock schemes off course, such as rates or inflation. Equity markets should have less impact, but credit is incredibly tight; yes, that could change, but equally if credit loosens, insurer pricing will get better. So there's a whole range of things which could knock it off but, based on where we are now, I expect this year to be somewhere between £24 billion and £27 billion and next year to easily be back above £30 billion again and that journey will continue.

There are more re-insurers coming into the market, there's more re-insurers offering deferred capacity. I don't know any schemes that aren't trying to improve their funding levels. So, whether or not buyout is what they're aiming for, as funding levels improve, it will become a more relevant conversation for trustees.

So the buyout market is going to build over time. It won't be right for everybody, of course. But we're going to see the market pick up again next year, based on what we see in the pipeline. But, again, there's a whole range of things which could knock all of that off course.

Sebastian: From a market perspective, I would argue that inflation is a very important topic when looking into the future and one that is definitely in the limelight today. Any reasonably sized UK pension scheme has, for many years, already implemented some sort of LDI strategy. They are huge buyers of linkers and inflation swaps. Well-managed pension schemes are very well hedged too. I'm therefore not sure what the incremental gain is for a pension scheme that has already hedged to move onto something else such as buy-in or buyout.

Then there's the question of scale too – hedging properly requires certain volume. For a small pension scheme, it's difficult to do; one needs at least several hundred million in assets to do it properly. So there might be a divide, where the better managed, larger schemes go for less expensive, in-house run-off solutions, and the smaller schemes that struggle to cope with the day-to-day opt for outsourcing in the form of buy-in or buyout, simply because they don't have the resources to manage risks properly.

Chair: What about from a regulatory perspective? Is there anything significant that could impact the de-risking landscape going forward?

Swynnerton: The obvious one on the immediate horizon is the Pension Schemes Act 2021. There's probably going to be two main impacts relevant to this discussion and one sidebar. We've got the long-term funding objective meaning schemes are going to have a plan to target a long-term funding objective and then meet that objective by the time they're substantially mature.

That inevitably is going to cause schemes to focus on long-term targets and journey planning and it's hard to see how that won't result in an increased focus on de-risking solutions/de-risking transfers.

The second aspect of the Pension Schemes Act is the regulator's new

powers. It's slightly less direct in that it's the perceived increased risk associated with DB schemes, and the regulator's ability to frustrate a wider range of corporate activity and its greater powers to issue bigger fines and potentially criminal sanctions, including imprisonment. That's probably going to sharpen focus at the corporate end in relation to the risks associated with DB schemes, and therefore cause them to look at other solutions, de-risking and risk transfer being the obvious ones.

Then the third impact is the bandwidth issues that it's going to cause. A lot of the changes, certainly the ones that will affect corporate transactions, aren't yet in force. The notifiable events regime change, which probably has the biggest potential to impact day-to-day corporate activity, moreso I'd say than the widening of the regulator's moral hazard powers, is not in force yet, but when it does come into force, it will inevitably distract trustees and the corporates and their advisers, and people will have less time to focus on de-risking.

So there's a couple of factors, some of which will result in more de-risking transaction solutions, and some of which might constrain capacity to do them.

Chair: It does feel like the sheer volume of stuff that's coming over us all seems to be ever growing and never seems to shrink. Bandwidth is a real issue in the industry actually across all of the service providers and is likely to continue to be so for a long while to come.