

Briefing

Planning for your DB pension endgame

RISK | PENSIONS | INVESTMENT | INSURANCE

The Pensions Regulator has recently increased its focus on the endgame (sometimes called journey plan or long-term funding target) of UK defined benefit (DB) pension schemes and is actively asking trustees how their schemes are approaching this.

At the same time the Regulator is also scrutinising the relationship between dividends and deficit contributions paid by sponsors of DB plans. Companies paying dividends that are higher than the deficit contributions should expect more focus and challenge on this from their trustees and the Regulator.

18% of FTSE 350 companies are expected to be able to buy-out their benefits in the next five years if they continue their current contributions

22% of the FTSE350 companies no longer paying deficit contributions will need to restart these to reach buy-out funding

13% of FTSE 350 companies will not reach buy-out funding within 15 years if they continue current contribution levels (and some of them may not get there at all)

96% of FTSE 350 companies pay dividends that are higher than the contributions to their DB pension scheme

Regardless of the regulatory aspect, we believe that a focus on endgame has other benefits for the sponsors and trustees of DB pension schemes:

- members' benefits are fully settled and off the sponsor's balance sheet within appropriate time, cost and risk constraints
- provides a meaningful framework to make strategic investment decisions
- provides a strong rationale to consider the governance of the scheme and whether the existing decision-making framework is optimal
- triennial valuations become less combative and more a routine check on progress against the endgame strategy

We believe that endgame is an area that scheme sponsors should be taking the initiative on; having a robust, stress-tested endgame plan, agreed between the sponsor and trustees, will enable the sponsor to defend any dividend policy and corporate activity when the Regulator asks.

What is an endgame?

We believe that an endgame consists of the elements below.

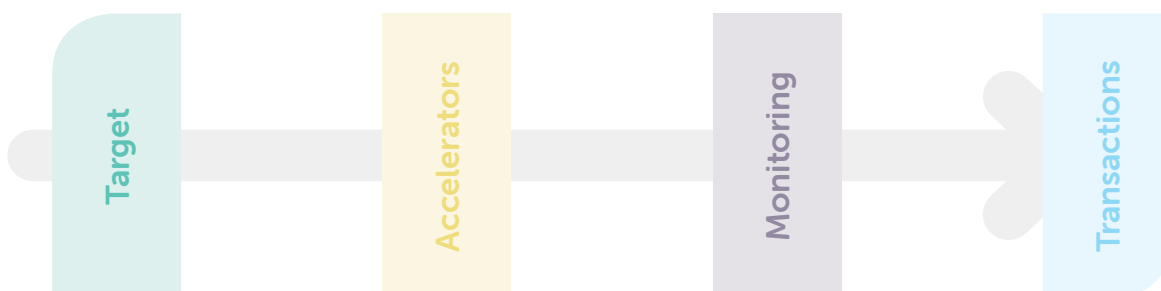
- An achievable target for securing members' benefits given the strength of the covenant of the sponsor. This will generally be one of:
 - buying immediate and deferred annuities from an insurance company
 - transferring members' liabilities to a consolidator
 - achieving a self-sufficient funding level so that the scheme is expected to be able to run-off and pay members' benefits in full without any further support from the company
 - a run-off and payment of members' benefits within some other risk and cost parameters
- A plan for taking advantage of beneficial market conditions to settle benefits for some or all of the members before the final endgame is reached. This may involve:
 - transfer exercises (and embedded "at retirement" transfer options) for non-pensioner members
 - trivial commutation exercises
 - pension increase exchange exercises
 - buying immediate annuities for pensioner members (or a subset of them)
- An associated contribution and investment strategy that enables the endgame to be reached within an appropriate timeframe and acceptable cost and risk constraints given the strength of the sponsor's covenant
- A real-time monitoring process that enables progress against the endgame to be measured and for the strategy to be reviewed and potentially adjusted according to actual experience

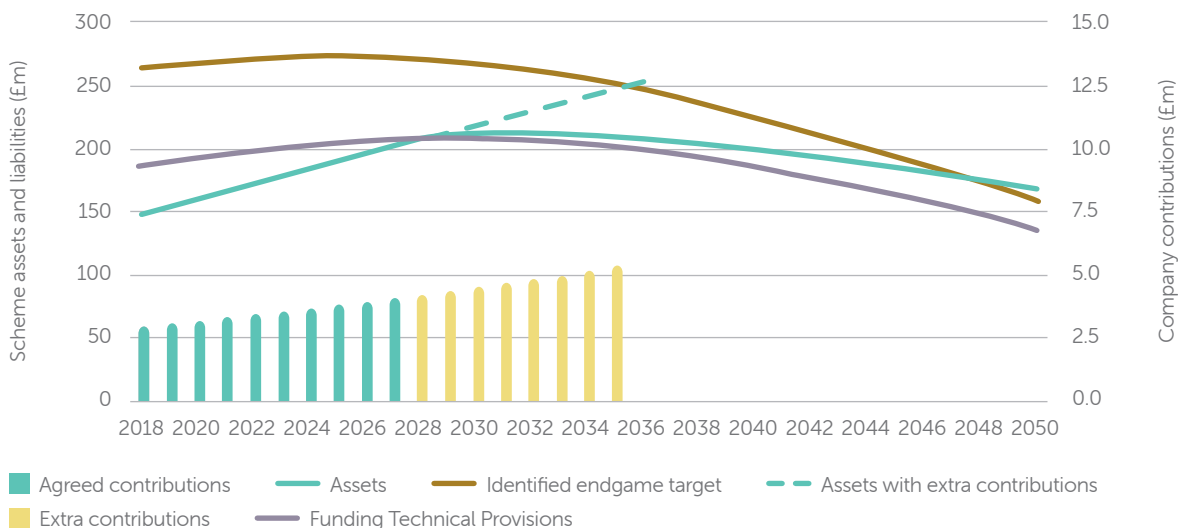
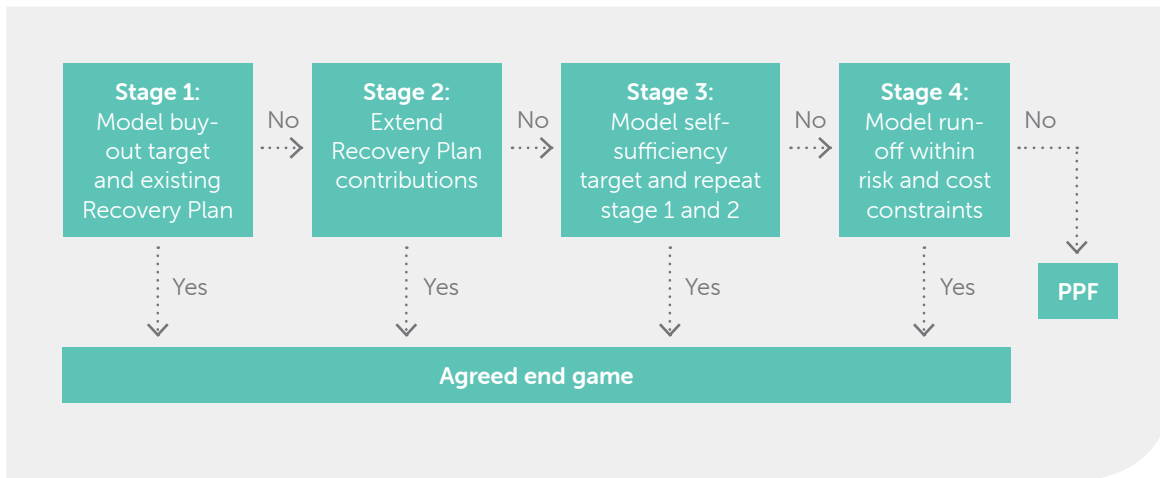
Setting an endgame

Devising an endgame is a balancing act between many variable different aspects. Our framework for setting an appropriate endgame is designed to simplify this balancing process and provide a robust, justifiable strategy that can be agreed by the sponsor, trustees and Regulator.

Identifying the target

1. Calculate current timeframe to reach full buy-out funding based on current contribution and investment strategy – is this acceptable?
2. If not, repeat assuming current deficit contributions continue after the end of the agreed recovery plan – does this bring reaching buy-out into a reasonable timeframe?
3. If not, repeat steps 1 and 2 for a self-sufficiency target (and in time, once the terms are better understood, consolidator entry pricing). Does this give an acceptable outcome?
4. If not, then look at running-off the scheme within acceptable cost and risk boundaries.
5. If step 4 does not produce an acceptable outcome then the scheme and sponsor could be viewed in a distressed situation and PPF considerations might come into play.





Refining the journey

Once the ultimate target has been identified the next steps are to consider ways to shorten the journey or reduce the risk associated with it. This includes considering the impact of:

- different contribution levels (subject to affordability, business investment and shareholder returns)
- different investment strategies (de- and re-risking, profit taking etc.)
- liability management / member choice exercises (transfers, annuity transactions etc.)
- setting soft trigger points at which certain actions are discussed with a view to being undertaken (asset strategy changes, bulk annuity transactions etc.). These triggers can be related to the funding level of the scheme and / or general market conditions and developments

- contingency plans for reacting to adverse experience or taking advantage of beneficial experience

We believe that liability management exercises and embedded "business as usual" options are a key part of an endgame strategy as they enable benefits to be settled cost-effectively with a resulting shortening in the period until the endgame target is reached. Implemented well, they can provide members with valuable choice and options as well as being beneficial to the scheme.

Monitoring progress

Progress against the endgame target can be monitored using our Illuminate online tool. The tool can also track progress against any pre-agreed soft trigger levels for certain actions to be discussed so that these changes can be implemented effectively and with pre-planning.



Preparing for implementing the endgame strategy

Once the endgame target has been identified, the next stage is to carry out preparatory work to ensure that the transactions expected under the strategy can be implemented efficiently to ensure that opportunities are not missed.



DATA

Make sure the membership data is clean and up-to-date, including addresses and dependants' details and contingent pension amounts.



BENEFITS

Carry out a benefit audit to ensure that the scheme's administration practices are in line with the rules. Prepare a detailed benefit specification.



DECISION MAKING

Put in place a governance structure to enable decisions and transactions to be agreed and completed quickly when triggers are met.



MEMBER CHOICES

Set up member choice exercise frameworks to enable members to investigate their options for taking their benefits.

Summary

Endgame will become increasingly important for all UK DB pension schemes as the Regulator shifts its focus. It is vital that scheme sponsors and trustees set a robust and achievable endgame strategy that balances members' benefit security with corporate interests. The ability to review and potentially transact quickly when conditions are right will be key to a successful strategy.

Barnett Waddingham can support you through all stages of the process, from helping you set the target to implementation and transaction.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch with one of our experts:

✉ simon.taylor@barnett-waddingham.co.uk

☎ 020 7776 3830

✉ liam.mayne@barnett-waddingham.co.uk

☎ 020 7776 3815

✉ jane.ralph@barnett-waddingham.co.uk

☎ 015 2730 0030

www.barnett-waddingham.co.uk

Barnett Waddingham LLP is a body corporate with members to whom we refer as "partners". A list of members can be inspected at the registered office. Barnett Waddingham LLP (OC307678), BW SIPP LLP (OC322417), and Barnett Waddingham Actuaries and Consultants Limited (06498431) are registered in England and Wales with their registered office at 2 London Wall Place, London, EC2Y 5AU. Barnett Waddingham LLP is authorised and regulated by the Financial Conduct Authority and is licensed by the Institute and Faculty of Actuaries for a range of investment business activities. BW SIPP LLP is authorised and regulated by the Financial Conduct Authority. Barnett Waddingham Actuaries and Consultants Limited is licensed by the Institute and Faculty of Actuaries in respect of a range of investment business activities.