Pensions Age de-risking roundtable, October 2019

In association with

De-risking roundtable

CHAIR

Chair for the day: Bob Hymas, Trustee Executive, BESTrustees

Bob has worked with pension schemes for nearly 20 years and is an experienced trustee. He has several scheme appointments with BESTrustees ranging in size from ones with assets of less than £100 million to one with assets of nearly £3 billion. Through these appointments, Bob is the chairman of schemes and committees as well as a co-trustee. Some of the committees he has chaired have been focused on specific de-risking transactions such as buyouts. He also has experience of chairing industry-wide groups.

PANEL

Guy Freeman, Business Development, Rothesay Life

Guy's career has spanned over 30 years in the pension fund industry, moving from scheme actuarial to investment consulting and then onto investment banking at J.P. Morgan and Goldman Sachs. Since 2007, Guy has worked in business development at Rothesay Life, playing a leading role in most of the insurer's transactions with pension funds, including those at Rank, RSA, BA, Uniq, GM, MNOPF, Lehman, CAA, Toshiba, and the Post Office amongst many others. He is a Chartered Financial Analyst and a Fellow of the Institute and Faculty of Actuaries.

Karen Gainsford, Principal Consultant, Aon

Karen is a principal consultant within Aon's risk settlement group. She spends all of her time working with clients on de-risking projects and is authorised to provide advice on insurance transactions. Karen has advised on risk settlement projects from £4 million to £2.7 billion, and in 2018 alone advised on transactions totalling £3 billion. Earlier this year, Karen worked closely with Behave London to develop Aon's Behavioural Insights into risk settlement guide, and is keen to help trustees and companies navigate through the decisions needed to de-risk.

Tom Ground, Managing Director, Defined Benefit Solutions, Aviva

Tom Ground joined Aviva in August 2017. He has 20 years of financial services experience across insurance, fixed income and strategy consulting as both principal and adviser. Prior to joining Aviva, Tom headed up L&G's bulk annuity and longevity insurance business, where he managed the execution of bulk annuities and the end operations once they were sold. Tom led the successful execution of transactions of all sizes including the largest buy-in and largest buyouts. Prior to Legal & General Tom spent 10 years with Accenture.

Mark Hedges, CIO, Nationwide Pension Fund

Mark has responsibility for the performance and implementation of the asset allocation strategies agreed with the trustees and fund investment advisers. Mark is responsible for a c£6.3 billion asset portfolio; with investment manager selection across liquid assets (equities, liability hedging, credit) and illiquid investment (infrastructure, real estate, private debt, opportunistic and buyout equity funds). Previously Mark led the establishment of Nationwide's Covered Bond programme and its Silverstone RMBS Master Trust funding vehicle.

Rob Mechem, Head of Business Development, Just

Rob joined the DB solutions team in 2014. He cares about what's right for schemes of all sizes when they're preparing to buy-in or buyout. His team supports trustees and their administration partners from enquiry, through transaction and onwards to transition. He's a qualified life insurance actuary, which helps ensure the right questions get asked to focus the expertise within the team and maximise value for trustees. Before joining Just, he spent 12 years at Aviva eventually leading the pricing of bulk annuities for six and half years.

Akash Rooprai, Head of Client Management, ITM

Akash is head of client management at ITM for de-risking activities, working with large pension schemes and insurers to improve the data in the context of buy-ins and buyouts. He has over two decades of experience in actuarial work all in the area of pensions. He has worked as a bulk annuity specialist for over 10 years and has been responsible for some high profile transactions, including the first £1 billion plus buyout, the first public sector bulk annuity and advised trustees on the first captive bulk annuity in the UK.

Matthew Swynnerton, Partner, DLA Piper

Matthew is a partner at global law firm DLA Piper and heads the London pensions team. He advises on all aspects of pensions law, including corporate and bulk annuity transactions, reorganisations, 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.

In association with

De-risking roundtable

De-mystifying the de-risking process

Our de-risking panel asks what pension schemes need to know when it comes to de-risking in today's world

Chair: De-risking can mean different things to different people – what do we think it means to pension funds?

Rooprai: De-risking means removing uncertainty in the wider sense. There's a lot of uncertainty in pension schemes and that can be in relation to investment returns, market movements, data, documentation, benefits; and removing uncertainty is removing risk.

Hedges: Ultimately, as a pension fund, your objective is to provide certainty around meeting the benefits of your members. So, you need to go on a journey that proceeds to keep removing risk and uncertainty to those payments, and that's the process that we go through as a pension fund. Typically, we start off with things that seem to give us the biggest risk and, as we start to remove those, we uncover other levels of risk that, whilst they may have seemed immaterial, become commensurately more significant because your overall risk is steadily reducing.

Mechem: That's right, and that way you are making it a higher and higher probability that you will pay out the right benefits now and in the future and that's what it's all about, securing the best outcomes for members.

Gainsford: There are a number of different aspects to this. One is having certainty over the benefits that are payable, so being sure on your data, having clear benefit specifications and so on. Then you've got the asset side – making sure that you have enough assets to meet those benefits, and making sure that you're getting the right risk and reward balance from those assets.

Swynnerton: Also, we shouldn't forget the security of the employer, looking at things like parent company guarantees, escrow, letters of credit – that kind of thing can obviously help de-risk a pension scheme.

Chair: Is de-risking on the agenda of all schemes?

Rooprai: Most trustees think it's on their agenda. I'm sure that there is a good portion though who don't actively do anything much about it.

Gainsford: Many schemes want to be doing something, but some feel they are constrained by the position of the company or the funding level of the scheme. There are quite a few with aspirations, but feel that they can't take action at this moment in time.

Rooprai: There's often a misunderstanding of what de-risking means, and I'm glad we started by defining it. Some schemes feel they're constrained because they think they haven't got the money to do something significant when, actually, they could be doing something. They could be looking at their data, they could be looking at their documentation and these things don't need to involve a settlement transaction or spending huge amounts of money – they involve spending money of course but spending less money.

Hedges: Whatever circumstance they're in, schemes should have an objective in mind of where they want to get to and, over time, that should lead them to decisions that enable them to do de-risking, whether it's de-risking of assets, whether it's understanding the data behind their membership and making sure that's in a better state and so on. There's a whole host of things in that risk spectrum for them to think about, but they should all have a clear objective of where they want to move towards,

In association with

De-risking roundtable

and they have to take into account, quite rightly, the financial covenant of the sponsor.

That will shape some of the risks they have to take in the interim, but they've got to continue to try and evolve that and move it forward. That's really the purpose of trying to ensure they're going to meet that ultimate objective of paying out the benefits to their members.

Regulation

Chair: Is everyone happy with the regulator's guidance and narrative on de-risking?

Freeman: I do think it would help trustees if there was some clarity about the sponsor's long-term aim, be it buyout or self-sufficiency. I think they're a little bit caught at the moment with companies who don't want to put more money in but have an objective of buyout in the long term. The sponsor can't be open about it because the moment they say, "we want to buyout", that might trigger additional funding. If they were forced to come off the fence about that point, it would help the trustees know where they are ultimately going, perhaps.

Hedges: That's a challenge because it depends on the maturity of the scheme, where it currently sits, where its sponsor sits in terms of financial strength, and its willingness and ability to support the scheme. We've had these discussions. We've thought about the long term, whether buyout is an objective for our fund. It isn't, at the moment. It may become so. Over time, your objectives will change, so you need to go on a journey. Ask yourselves, what's the first thing that you need to look at?

The first thing, maybe, is that you need to get well funded. You need to get your technical provisions funded, and then you perhaps move towards your next target, which is possibly self-sufficiency. Over that journey, there may be opportunities where you can take further risk off the table in terms of buy-ins, perhaps, and you might get to a point you are reasonably well-funded, where the costs to the sponsor of a buyout might become more reasonable, but you won't know that now.

So, to set an objective of buyout might be something the sponsor's not going to sign up to, because it just sees a big cheque at this point in time. But if you have a longer-term strategy that recognises it will evolve, then maybe you'll have a discussion in 10 or 15 years about buyout. All of this is very dependent on the maturity and the profile of each individual fund.

Gainsford: I agree. We see that often, in that schemes are aiming for self-sufficiency, and then some sort of corporate event happens or funding is better than expected and buyout becomes feasible far earlier than the scheme expected. The key point, from my perspective, would be to keep your options open. If you are aiming for self-sufficiency at the moment, don't close your eyes to the option of opportunistic buy-ins that can potentially move you towards a buyout in the future, because it could very easily fit within your self-sufficiency goal in the meantime.

Rooprai: In that context, it's important for a scheme to understand whether it will ever contemplate buyout or not, and there are some schemes that will never contemplate buyout – perhaps not very many, but there are some. If you are thinking you are going to aim for self-sufficiency over 10 years, but you're not closed off to buyout, then if there's an opportunity to do a buy-in, for example, you can take some risk off the table because perhaps something good has happened.

I do wonder if there's a need for regulatory clarity here because trustees and companies, in particular, perhaps feel constrained about signing up in some way to a buyout target, because there might be funding implications; there might be implications around having to pay higher transfer values and less flexibility. There should be some regulatory clarification here that says, if it's a separate long-term target, it doesn't trigger all sorts of other things that you need to do.

Hedges: I agree that the regulation is not very clear here and it's one of the concerns, clearly, that our sponsor has. The way we recognise it is that the journey to self-sufficiency means inevitably your technical provisions' discount rates are going to reduce over time. But how do you do that in a way that the sponsor can get comfortable with? It feels to them like they are almost writing a free cheque.

Freeman: My issue with this kind

itm Solution delivered...
JUST. RETHINK RETIREMENT
Rothesay life
In association with

of framework is it's quite driven by the question of 'what returns do we need to make it affordable?' From a trustee perspective, that's the wrong way around. It ought to be about how much risk you can take based on the covenant strength. And secondly does the sponsor actually want you to take those risks? If so, perhaps you should. Other than that, there isn't much in it for the membership. What do the members get out of taking risks? Not very much – all the upside of risk-taking normally goes to the sponsor's shareholder. So from a trustee perspective, de-risking should be about how much risk you can afford to take and how you can get to the right position for the pension fund. The company may not like that if it triggers additional funding, of course but the risk position is after all a trustee decision.

Mechem: It's also about the 'what-ifs?' Everybody is on a de-risking journey, but what happens if the sponsor becomes insolvent? What's the new de-risking journey and plan to get there if that occurs? I don't think the regulator focuses on adverse scenarios that may happen, unlike the PRA who regulate the insurance regime, where you've got lots of 'what-ifs'. That needs focus, but I agree it's about how much risk you are prepared to take to get to your end game in different scenarios.

Chair: So, is there a change in approach needed from the regulator or is there a change needed in regulation? Or do the trustees need to change their way of thinking?

Rooprai: I'm not in favour of overregulating, but there probably isn't enough from the regulator on this. I agree that you need to start by asking what risk you have in the pension scheme. Then measure that risk in some way (there are lots of different ways to do that), monitor it, and that then drives everything else you do. But there is the need for some regulatory impetus here.

Freeman: There has been quite a bit of impetus recently with the regulator focusing more on weaker schemes, highlighting the strength of the covenant as the key input to that decision about risk-taking, and that's heading in the right direction. It's whether trustees react to it and follow it, or ignore it like some of them seemed to have done in the past.

Swynnerton: I agree. There is quite a lot of material from the regulator on encouraging trustees to focus on their sponsor covenant and security, have appropriate emergency plans in place to deal with insolvency scenarios, and what Brexit might mean. Perhaps some trustees just aren't doing these things.

Also, the regulator has come under heavy criticism for some of the high-profile corporate failures that have resulted in schemes going into the PPF. Hopefully this will be addressed as part of the regulator's new powers. That will, I think, be the regulatory change that will drive thinking on this. The regulator will have new powers, which will force corporates to think differently about their restructuring and their transactions. Beyond that, it's hard to think what additional regulation should be brought it.

Chair: It sounds like the regulator's approach probably isn't too far off where it needs to be, but perhaps trustees need to respond or react to it slightly differently.

Swynnerton: And they need to drive employer engagement more – there isn't perhaps enough cooperation or discussion between trustees and employers about their appetite for risk.

Freeman: And clarity about the sponsor's long-term aims for the pension fund.

Supply and demand

Chair: We mentioned earlier the opportunities for buy-in and buyout. The presumption is that there is a supply, and trustees can engage and have successful transactions. But what is the capacity in the buy-in, buyout market and more widely what will the market look like in the future?

Ground: Overall, the de-risking marketplace/insurance capacity is growing by 20 per cent a year on average, and has been for the past six or seven years. There are probably two things limiting growth – the availability of assets and the availability of capital. We've got lots of new sources of capital coming in, so there are new re-insurers that effectively are putting capital in, and there are new people wanting to put capital in different ways either in debt or equity.

Then there are all sorts of new structures that are available that basically mean that you should have quite a lot of confidence that the market will be able to carry on growing. Whether it can grow as fast as the demand is growing is another question, but you'd have thought you'd be confident that you could support at least 20 per cent.

Chair: Can you talk more about these new structures?

Ground: There's more availability in terms of new ways of getting reinsurance into the market, so there's longevity

In association with

De-risking roundtable

reinsurance and then there are other reinsurance structures that allow capital to come through, which are being pushed very hard by banks and by other insurance providers. All of that gives more capacity to the market.

Chair: Is that the view on the supply side, that there is sufficient supply?

Freeman: The market looks like it's going to be something like £40 billion this year from pension fund transactions alone, and last year that was £24 billion, up by more than 50 per cent having already doubled over the previous year, 2017. If you look at the eight insurers that transacted with pension funds, they actually completed something like £40 billion in total last year too when you include back-book transactions with other insurers that are exiting the annuity market.

What is different about the market this year is that there are more very large deals, of £1 billion-plus, and there are more buyouts in the market. This has a couple of immediate impacts.

First of all, the larger transactions get a lot of focus and that means it's harder for the small and medium size deals to get as much attention as before.

Secondly, buyouts take a lot more time than pensioner-only buy-ins, both from the advisory side and on the insurance side.

Overall what I think we won't see is much of an increase in the number of transactions that take place from 160 in 2018. The average transaction was £150 million last year. This year, it might be well over £200 million. We're seeing that average size go up and that could mean it's getting harder for the smaller pension funds to access the market.

Mechem: That does depend. The smaller schemes need to come to the market much more prepared than they've ever been before. With accurate data and benefits ready for insurers to price against, understanding where they want to get to and with a plan in place. They probably need to be more open and honest with the insurers on what the target is, because we're all in a position to select which schemes we'd like to go for, and the smaller schemes have got to be prepared to share more information than they've ever done before.

Freeman: I agree. For smaller schemes trustees have to set their target price, they have to have a quick process, a simple process, and be willing to offer exclusivity fairly early on to an insurer that's prepared to give them the price that they want. But there's a difficulty there too – how do advisers get a client comfortable with a setting a price target?

Gainsford: Within Aon, we try to set decision-making frameworks very early on with our clients so that it's clear whether a potential transaction will meet their metrics or not. When we receive insurer quotations, we will judge the quotations against those metrics. If one or more of those quotations meets all of the metrics, we'd make sure that the trustee and company have governance in place to be able to then act quickly if required by the insurer who's provided the most compelling offer.

Also there's a greater need to be flexible. You can go into transactions setting out a one-stage, two-stage process but you need to be flexible in terms of both timing and whether you do run one round or two rounds or even just defer based on what quotations come back from insurers. So, flexibility and timing are key.

I agree with Rob [*Mechem*] that, as a consultant talking to insurers, I need a very clear message when I'm talking to the insurers to get them to quote on a particular case. So, schemes need to be well prepared – they need to have complete, clean data as far as possible and very clear benefits, benefits that have been specified and reviewed by the lawyers. Also, a price target that we think is achievable in the current market is very important. We will not take a scheme to the market with speculative pricing.

Freeman: The days of insurers being willing to do much work on what is probably a feasibility test have gone, and that means the advisers that are needed are ones that know where the market price is so they can do the best feasibility analysis.

Ground: The market is very much open for schemes of all sizes. There are several insurers that are focusing on schemes of all sizes. If you're a trustee of a small-sized scheme, you don't need to be afraid of the market not being available to you.

Gainsford: Yes, and they remain an important source of business for a number of insurers. What we've found is that we will still get interest in almost every transaction that we want to take to the market. Saying that, what we find is that we're not getting quite the numbers of insurers that we might have done in the past, but this isn't impacting the end results for schemes.

Ground: Insurers know which schemes they like and which ones they are likely to be able to be competitive on. We and other insurers

In association with

can look through the specification and decide pretty quickly whether it's something worth doing the work on. So, having fewer insurers quoting isn't a bad thing. In fact, it can mean a simpler and quicker process.

Chair: You mentioned small schemes. What do you mean by small schemes?

Ground: We did schemes as low as £100,000 last year, so small can mean very small – the whole market should be covered.

Also, it could be that you've got a scheme with which you can do a buy-in and you want to make sure that you're able to do a top-up buy-in when you can afford it. So it's very important that the market continues to address schemes of all sizes and definitely Aviva have been very focused on making sure that's possible.

Mechem: I agree. It's about getting engaged insurers rather than getting the whole market involved. Two or three engaged insurers that are actively going to target the transaction is better than having four, five, six insurers when only one or two are prepared to do it. That's where the dynamic is changing. The DB universe is polarised between a few large schemes and many smaller ones – which was the original impetus behind the recommendations made by the DB taskforce. It's natural that mega deals get the focus of attention now but it's smaller schemes and smaller transactions where some insurers have always focused.

Chair: As a trustee, how do I make a scheme more attractive to an insurer, especially at the smaller end?

Ground: Two things are important. Firstly, making sure that the data and benefit specifications are in a state ready to transact; we and other insurers will prioritise a scheme that's well-prepared. Secondly: it's about understanding that the scheme is ready to transact and has clear targets set.

A good adviser needs to be in a position to make sure the scheme is ready. It's about the commitment that the scheme has shown in order to execute a transaction. It doesn't matter whether it's a big scheme or a small scheme.

Hedges: Is there also a dynamic around the assets that you've used in the scheme?

Ground: The pension scheme needs to be able to disinvest from their existing assets. There were a few examples of schemes that have come to the market with illiquid assets, private equity or property that can't be readily disposed of. These are harder for an insurer to take as part payment for a transaction.

Freeman: That's an interesting area because if the investment consultants are doing their job properly, they're encouraging trustees to think more about how they can invest. A current theme is to have more illiquid assets. If you're in a pension fund that you think is going to be running for decades because the sponsor is large and strong then illiquid assets are a sensible area to explore. But if the sponsor suddenly says it wants to buyout, then the illiquid assets can make completing a bulk annuity transaction difficult. Insurers will usually want to receive a premium in the form of liquid assets as anything else can make a transaction expensive or complex to negotiate.

So, setting investment policies can be tricky for trustees where they don't have certainty over the fund's medium-term future.

Ground: It's the same with data – you need to make sure that data cleansing exercises that have been kicked off are completed. Before a buyout, we've got to make sure that the data's in a fit state to transact, and that the legal specification has been concluded properly.

Freeman: That's something that doesn't matter too much if you're focusing on pension buy-ins – you just need the demographic inputs such as experience data, post codes and marital status. But for a full buyout, everyone wants to know exactly what the cost is going to be for the company. You have to nail everything down. You can't have any uncertainties about what the benefits might cost. There are often gaps in areas such as contingent spouses pension amounts, pending cases from suspected or recent deaths, GMP population reconciliation etc without which you don't have certainty on total costs. So there's lots of work to do there to make sure you get to that point.

Mechem: Most insurers know where they're going to be most competitive and that's where they're going to focus their resource. We can be influenced by the ratio between pensioners and deferred members, the number of members to be covered (which might make it possible to medically underwrite) and the weighted average age. I agree with Tom [*Ground*] that scheme assets should be liquid, the exception being investments in infrastructure or other long-dated illiquid assets like LTMs that an insurer might want to take-on in-specie. Having good quality up- to-date data is also a real bonus.

In association with

De-risking roundtable

Chair: It sounds as if it is a seller's market and the individual schemes have to be at a high level of preparedness. They have to have done their homework and be fully prepared.

Mechem: I think the days of pricing to establish feasibility are well gone.

Freeman: The change in market dynamics also potentially puts a question mark over the idea of starting with a pensioner-only transaction and then expecting to come back to the market with the rest of the liabilities within the medium term. This because the market's appetite for deferred-only blocks or blocks that are largely deferreds is not as good as it was, particularly when another insurer is already in place on the pensioners. When insurers are being more selective, these second tranches are now much harder transactions to place. So that just poses a question if you start with a pensioner-only transaction, are you going to get to where you want to go?

Mechem: You're right – it then comes down to what your de-risking journey plan is. Even if it's only three years to your end game, pensioner buy-ins make sense to help you de-risk. But when

you're close to full buyout, you need to think about the deferreds that remain after a pensioner buy-in, to ensure you'll have the assets to pay for cover or plan a journey where the majority of these deferreds have become pensioners.

Rooprai: Back to the broader supply/demand question, there are £2 trillion worth of pension liabilities in the UK. If only half of them are chasing an insurance solution at some point, then the latent demand is huge. Tom [*Ground*] was saying how there is good availability of capital and the insurers have been good at finding assets that can give decent pricing. I wonder, over the longer term, whether that's going to continue. It doesn't take much for that to change in terms of schemes coming to market for that to create an issue for the suppliers.

Chair: Do we see the market changing over the next five to 10 years, 20 years?

Freeman: It's hard to predict but at the moment, there's plenty of supply from insurers. Access to capital is good, for Rothesay Life at least and we've been busy hiring ahead of demand. So hopefully the market supply will keep moving in line with trustee demand, which is inevitably going to increase over time. If there's a mismatch, then prices may become a little bit more expensive in the short term, perhaps, until more capital is drawn in and prices re-balance.

Mechem: It's about getting it right, being prepared and having everything in place, as opposed to speeding things up and coming unprepared. And part of being prepared is making sure your administrator knows what they'll need to do after a derisking transaction. It's surprising how often the first they hear about this is after the transaction is signed and the insurer briefs them and the trustees. This can cause problems as administrators aren't resourced-up or contracted to take on this additional work; it pays dividends in the long run for the administrators to be involved early on and have a plan in place for what work is going to come their way.

Swynnerton: For schemes thinking about how they can best market themselves to an insurer, well-advised trustees will establish a joint working group with the employer. Benefit specs have also always been at the forefront of trustees' minds and we've always had a lot of input into those on the legal side.

I've yet to see, though, trustee boards creating joint working groups to look at a potential transaction and establishing terms of reference, or developing a benefit spec, in advance of the initial recommendation to look at a buy-in, except perhaps where trustees have previously executed one, so already have the framework in place from the initial deal. You'd be surprised how long even a joint working group's terms of reference can take to agree, particularly if you've got an employer perhaps with an overseas parent who wants to get involved in the process. Is there really any harm, assuming that buyout is the ultimate goal, in creating an accurate benefit spec now, so that if the market opportunities are right, they can move really quickly, given that it's certainly going to be needed at some point?

Freeman: Perhaps this is another area for regulatory intervention – to encourage trustees to spend some money on making sure that they have an accurate benefit spec. This would help ensure that any issues with the historical documentation have been addressed and to check whether it all matches up against the administration practices over the years. At the moment, companies don't want to think about doing this because it is highly likely that they'll be spending money to unearth some problems that

In association with

will cost even more to address. With some stronger guidance from The Pensions Regulator, trustees would be able to push on this point.

Swynnerton: One of the risks here is that, when you create your benefit spec, whether it's for an insurance transaction or in a sale context, that's when the skeletons come out of the closet.

Chair: There is that big risk attached to any such exercise.

Swynnerton: Indeed, and there will be a natural tension between the trustees wanting to resolve those kinds of issues quickly and the employer representative who perhaps thinks: "Well, I'll have retired in 10 years, that's somebody else's problem to deal with."

Rooprai: The fact is those issues exist already in the scheme – you're just crystallising them. Arguably, they're even crystallised already, you just don't know. They're the known unknowns.

And yes, there is a resistance to spending money now for a future benefit. A scheme that is looking to buyout in five years will argue against doing the data work and the documentation work now. But it is important to do it sooner rather than later because you're going to spend that money anyway; in five years' time you're going to be spending lots of money on your consultants and your advisers and ultimately paying the premium, so why not do some of that spend now? That way you can spread the cost over a number of years.

Gainsford: It's also important to make sure that whatever target you're aiming for is actually calculated correctly, because if there are underlying issues with pension increases or equalisation or any other skeletons that come out of the closet, then you're aiming for the wrong target and you could get too far down the line to then be able to re-risk to earn the money that you need to fill any potential holes.

Rooprai: Yes – that would mean everything you do with the pension scheme is targeting the wrong thing. Your funding's targeting the wrong thing. Your long-term plan's targeting the wrong thing. You may be in the wrong asset classes.

Swynnerton: Trustees' fundamental duty is to pay the right benefits out of the scheme – creating a benefit spec and digging the drains in that way will only help them achieve that fundamental duty.

Mechem: Absolutely, and why not remove the uncertainty? The risk is there – and by not doing the work, the risk's still there, so you might as well do that work upfront.

I agree also that regulatory input into this would be very helpful. If you are in a situation where you don't know what your benefit specification is, how can you do anything that the regulator wants you to do?

Swynnerton: Trustees don't want to make themselves unpopular with the employer, so that's why these things don't get suggested sooner. It would certainly remove that tension between the trustees and the sponsor if the regulator said this was something the trustees must do.

Hedges: If it's not regulation, just guidance, a classic response from a sponsor would be: "Why do we have to do it?" We haven't done any buyouts in our scheme and we're a long way, probably, from doing that, but we have still gone through a detailed assessment of the data. We've cleansed that. We want to put ourselves in a situation where, if opportunistically we're in a situation where it now makes sense, we could execute quickly. If a good opportunity comes up, we don't want to miss it.

We've had a monthly de-risking group with the society for six years now and that focus has initially been on

inflation and interest rate hedging but, since we've dealt with most of that, we are now talking about longevity. We have been having discussions about where do both sides see the ultimate long-term objectives. We think that's the right process.

Behavioural aspects of de-risking

Chair: Something that's very important in what you have described is the good relationship with the sponsor and the sponsor understanding what the trustees are trying to achieve. That feeds into the behavioural aspects of the trustee board. Trustee boards may get distracted in conversations about how the sponsor is going to react to something, especially when there is a price tag, rather than focussing on what they need to achieve.

Gainsford: One behavioural bias that comes through in de-risking, particular with buyouts or buy-ins, is the pain of paying – paying the money now rather than potentially having to pay in the future. Sponsors do see that as a big issue – it is something that weighs heavily on them and perhaps a CFO today might prefer to leave that cost for a future CFO

In association with

De-risking roundtable

to deal with.

The other behavioural bias that comes through quite strongly is regret aversion. If I pay money now for a transaction or if I pay money now for a benefit specification, could I actually pay less in the future? As humans, we don't want to make decisions that we are going to regret. The way around that is to take out any ambiguity from the decision, make sure it's really clear what is required, what the benefits are, what the risks are that you're reducing, and therefore trustees and companies make informed decisions that have no ambiguity attached to them, and they find it easier to do that.

Rooprai: That's a really good point. I always used to get asked, as a bulk annuity consultant, is it a good time to buy? Will I get a good price? I think these are the wrong questions. What you should be asking is, for the price that can get rid of the risk, is it worth getting rid of that risk?

Hedges: Exactly. I've been looking at our interest rate and inflation hedging, and it's taken a lot longer than it should have done, primarily because the sponsor has been saying that rates will go up, so it's not a good time to do it. We however argue that it's a risk we don't get paid for, so let's just remove the risk and move on. But it's been a slow process because there is always that regret risk. But the point you make is correct – you should be asking the question, is this a good price to take that risk off the table today? If it is, do the transaction because you're taking away the risk. That's the crucial thing.

Gainsford: It highlights the importance again of the de-risking framework that you set up and your decision-making framework, so that when you get quotations in or when you're faced with some sort of de-risking opportunity, you can evaluate everything on the facts, rather than have some sort of behavioural influence in the background.

Chair: What other barriers exist for a scheme looking to de-risk?

Gainsford: I would say time. There are quite a few different options that a scheme can look at – bulk annuities, longevity swaps and many more. How do schemes look at them all and how do they consider them in the round? Which order do they do them in? This is at a time when trustees are still going through investment strategy reviews and triannual valuations. So they need to make sure there's enough time and resource from the trustee point of view to actually move forward, and generally setting up subgroups for specific topics is a good way of getting around that, so that people can specialise in a particular area and then feed back to the main board on the process.

GDPR

Chair: The regulatory environment in which we operate is always changing. We've had GDPR during the course of last year – has that had much impact on the de-risking market?

Swynnerton: GDPR still seems to be quite a difficult issue that, as lawyers, almost a year and a half on, there are still issues to be resolved around disclosure of data. Obviously, any buy-in is going to involve disclosure of personal data, but often that will include sensitive personal data, because in order to make pricing to be attractive, insurers want as much information as possible, including data in relation to ill-health pensions. You can

In association with

pseudonymise that data and omit the ill-health data set, but it may be difficult to avoid disclosing postcode data or the fact that the pension is in payment at a time which means that it must be an ill-health pension, meaning that special category data is effectively disclosed.

So sensitive personal data remains a really knotty issue for trustees, on which they will require legal advice as to whether there is a legal basis for disclosure. Ultimately, they may need to get comfortable through reviewing their privacy notices and a combination of mitigating factors, such as the strength of the non-disclosure agreements in place with the insurers, pseudonymisation, and use of secure transmission methods. So there are still some complex legal issues in relation to GDPR out there for trustees.

Mechem: I don't think GDPR has slowed anything down in the bulk annuity market. Matthew [*Swynnerton*] has highlighted some of the things that trustees should consider, of course, but we medically underwrite members and, therefore, we are looking at sensitive personal information. We've seen no slowdown on anything that we do in that area, so I don't think it's had a big impact.

Swynnerton: There will be more clarity over time as we have a bit more experience of how the Information Commissioner will act in light of GDPR in a pensions context, but the main issue is that it has created a risk for trustees that wasn't quite as acute pre-GDPR around disclosure of data, particularly sensitive personal data. The trustees must get comfortable with that risk, primarily through legal advice, and then through whatever protection they can put in place through NDAs, secure transmission, limiting the data and transparency.

Concluding thoughts

Chair: Can I ask each of you to give your top tip to trustees around de-risking – what they should be doing and what they should be focusing on.

Mechem: I think being fully prepared, having a clear project plan, having a fully engaged sponsor throughout the de-risking process – these are all key things to ensure that a transaction occurs. And probably most importantly, talk to the insurer early to understand where they are in their business cycle. And last but not least, small schemes should feel confident to approach the market once they've done their preparation.

Swynnerton: I'd echo that, although it's important not just to focus on one specific aspect, but perhaps have a slightly broader scope than just buy-in and buyout transactions, through engagement with the employer and creating, if one doesn't already exist, a subcommittee or joint working group of trustees and employer representatives who can act quickly on a buy-in but can also look at the broader spectrum of de-risking options.

Gainsford: I'd encourage schemes to have clear objectives and a framework for evaluating the different options, so when they receive information back from the market or from other options, like member options, how are they going to decide which to do and when? So, clear objectives and a clear way of evaluating those options.

Ground: Be ready – appoint good advisors and make sure you get all of the governance sorted so that you can execute quickly. That's critical. It is a very busy market, so if you get things wrong then you might not get the best price and the best deal for your members.

Freeman: I would say engage experienced and expert advisers, definitely. That is key. But also, if you want to get insurer interest, trustees should go and meet the insurers face-to-face. Insurers have to weigh up the likelihood of a transaction and little counts as much as a direct conversation in making that judgment.

Hedges: Understand your risk, have a long-term plan, be open to the opportunities and be prepared so you can have the governance to execute quickly.

Rooprai: Have an aim in mind, have a plan and execute the plan, but get the basics right, sort your data and documentation out.

Chair: To add the trustees' perspective, the challenge that exists for trustees, especially with the smaller schemes, is having the budget and the resource to get the scheme into a position where it is ready to approach the market. The perception in the past has probably been that there's a healthy appetite from insurers and because of excess supply trustees could complete transactions by resolving issues during a period of negotiation. Those days are clearly well and truly over. The emphasis now needs to be on preparation, and also having early engagement with the sponsor so that all options have been considered and the sponsor is onside.

Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. FCA Firm Reference No. 466067. Registered in England No. 06127279