

Setting your corporate DB endgame strategy

Optimising your endgame strategy

If we take a look at the defined benefit schemes over the last 10 years that have successfully implemented their endgame strategies, they all share some common features, irrespective of their specific strategies or ultimate objectives.

So, what are those common features?

- ✓ A clearly articulated endgame strategy, that all stakeholders buy into;
- ✓ An effective monitoring and governance framework that looks at the whole picture and “joins the dots” between different technical areas; and
- ✓ A proactive and prompt mindset to correct when things go off track or grab opportunities to get ahead of plan.

Put another way, these schemes are clear where they want to go, keep a close eye on their progress, and look at individual decisions in the context of the overall strategy.

To bring this to life, we’ve created this short guide which includes our top tips and a case study that shows a great example of how this can be done in practice.

Three tips to improve your endgame management

1 Ensure everyone is pulling in the same direction

One of the most frequent reasons endgame strategies go off track is that there is a lack of clarity between the trustees and the company on endgame objectives. Discussions and agreements have been too high level and vague. This leaves room for genuine misunderstanding and lack of a common framework for monitoring and taking short-term tactical decisions.

Most DB schemes are now in a place where it is essential to be precise about the endgame strategy and ensure all stakeholders are on board with that strategy.

2 The early bird catches the worm

Whether responding to changes in the economic outlook, emerging legislation or provider solutions, identifying the issue or opportunity quickly and taking prompt action has time and again proven to be critical to the success of schemes’ endgame strategies.

In practice this means being able to make tactical investment changes without lengthy decision making, being in a position to move on good insurer pricing in the risk transfer market when it emerges at short notice or switching between cash and non-cash solutions in a timely fashion.

This all comes down to getting the trustees and company governance framework aligned and fit for purpose. ▶

Three tips to improve your endgame management (continued)

3 Success is made up of lots of individual actions being taken in an intelligent way and seeing the inter-relationships

In our recent webinar we looked at investment, risk transfer and member option considerations. Individually these are all key areas to any endgame strategy, but consider:

- ✓ An investment discussion on what the journey to an endgame portfolio looks like.
- ✓ A discussion about introducing a PIE option, that will reduce inflation related pension increases.
- ✓ Insurers' views on:
 - a. What type of pension increases are least attractive to insure and will therefore adversely impact insurer pricing.
 - b. How current economic conditions are impacting insurer pricing more generally.

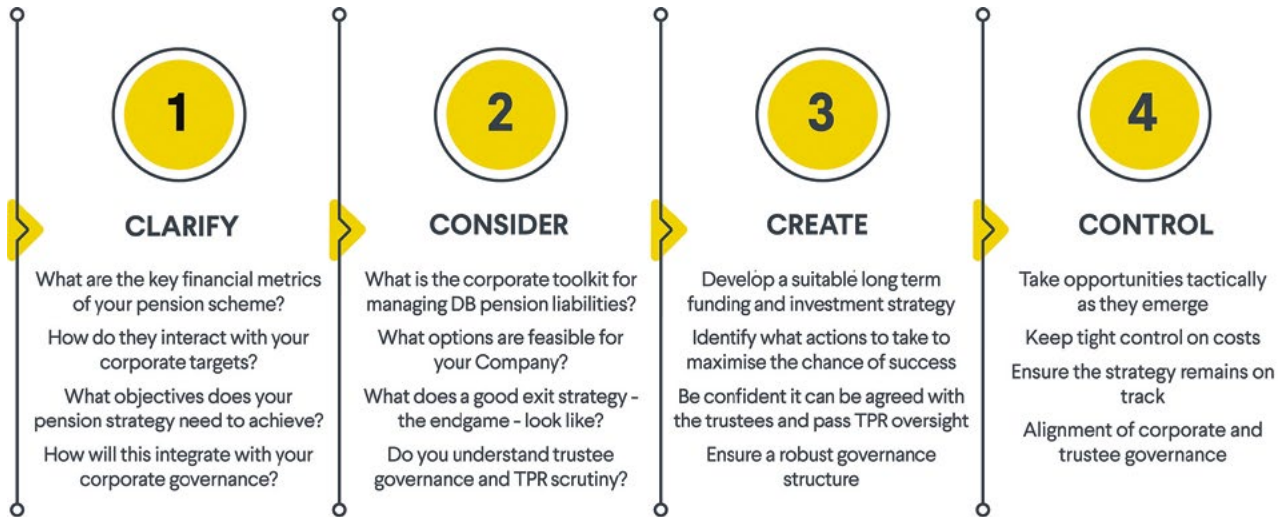
These three topics can be explored as standalone areas, but the real power of an effective endgame strategy is to see the relationship between these areas and how to join up the decision-making to maximise the value to the scheme's journey.

What else are we seeing in practice?

RISK TRANSFER	MEMBER OPTIONS	INVESTMENT	GOVERNANCE
<ul style="list-style-type: none"> • Increased use of traditional partial buy-ins along the journey. • Some schemes have moved much closer to the actual "endgame" sooner than expected. • Companies are responding to recent regulatory developments by looking more closely at risk transfer solutions. 	<ul style="list-style-type: none"> • Longer term support being explored, through partnering with an IFA on at retirement options and in-scheme options (i.e. bridging pensions and pension increase exchange). • High retail advice fees and lower market capacity means facilitating financial advice is even more important to supporting member outcomes. • Companies not assessing the impact of GMP equalisation and dual records on future member options, or leveraging the work undertaken to offset GMPe costs through supporting member options. 	<ul style="list-style-type: none"> • Trustees and company aligned on long term objectives and the interaction of funding and investment strategy. • Greater analysis on the journey to reaching the endgame and what the endgame portfolio will look like (i.e. prior to any final transaction). • Liquidity of assets for any risk transfer solution remaining a key concern. • More regular testing against the scheme's long term objectives. 	<ul style="list-style-type: none"> • Joint working parties being introduced to allow the company and trustees to work together to control the endgame strategy. • Reviews of internal company monitoring and decision making on pensions.

Putting it into action – case study

As a reminder, our **four 'C's process** (*Clarify, Consider, Create and Control*) helps to ensure that nothing gets missed, meaning the company can have confidence that the right solutions have been considered and developed relative to its specific objectives.



Clarify

Company A had an open to accrual defined benefit pension scheme with just under £2bn of liabilities. In 2011, it had a technical provisions deficit of c£325m and a deficit on a gilts flat basis of c£450m, with deficit reduction contributions in excess of £20m p.a. required each year. In the context of the weak company covenant, the scheme was a material strain on the company.

The funding level had suffered significant volatility over a number of years, resulting in minimal funding improvements despite the company's past contributions and the scheme was exposed to a 95% 1 year VaR of c£175m on its technical provisions basis.

The company objectives and beliefs needed to be considered at the outset to ensure any endgame strategy was appropriately aligned.

Working with the company management, we identified that:

- ✔ The company was not able to commit further contributions into the pension scheme annually beyond those already agreed.
- ✔ The direct company had a weak covenant and certain covenant enhancing mitigations had already been agreed (including a negative pledge on dividends, information sharing protocols, etc.)
- ✔ The company's long-term goal was for the scheme to be self-sufficient so that it was not reliant on it for any further funding, and to achieve this within the next 15-20 years.
- ✔ The provisions of the scheme included a power for the trustees to utilise any surplus to increase benefits and limiting the trustees' ability to exercise this power (making self-sufficiency harder to achieve) was a key objective for the company. ▶

Putting it into action – case study (continued)

Consider and Create

We put forward a number of proposals, noting the impact against their key objectives and criteria. After discussion with the company, and subsequent negotiations with the trustees, it was agreed to:

- ✔ Reduce funding volatility by materially reducing the investment risk. The trustees were previously seeking to generate surplus funds to award non-guaranteed pension increases.
- ✔ Address funding risk by considering risk transfer opportunities, including longevity swaps and buy-ins.
- ✔ Enter into a longer-term commitment to maintain annual pension contributions until the self-sufficiency funding target had been achieved.
- ✔ Limit exposure to future accrual by capping the level of pensionable pay, therefore focusing on the security of accrued past service liabilities.
- ✔ In conjunction with an appointed IFA, engage with deferred members on reaching age 55 on their early retirement options.
- ✔ Utilise an escrow arrangement as the scheme approaches full self-sufficiency funding avoiding creating a surplus that the trustee's might feel obligated to distribute to members (this escrow arrangement has since been put into force).

Control

The strategic aspects were regularly controlled through joint trustee and company meetings and through an open dialogue, resulting in a collaborative approach that best met the interests of all parties, including members. Over the years, this process was embedded into the company governance process and, with the trustees, the company has been able to:

- ✔ Move the scheme into surplus on its technical provisions and self-sufficiency, thereby stopping all deficit contributions into the scheme (and to the escrow).
- ✔ Regularly monitor risk transfer opportunities, which has resulted in two opportune pensioner buy-ins.
- ✔ Collaborate with the trustees on what the endgame asset portfolio looks like and the journey to reaching that portfolio (for instance identifying any issues such as illiquid mandates).
- ✔ Manage risk effectively for themselves and the trustee on that journey, by de-risking from a gilts + 3% annual expected return to gilts + 1% over a period of 10 years. This also included agreement to a longevity swap covering around 40–45% of members in the scheme. As a result of all of these actions, the 95% 1 year VaR has now reduced to c£50m.

Our process is tried and tested, and the above case study shows how it can work in practice.

Key takeaways

- ✔ Companies on the “front foot” with their endgame planning will find there is clear economic value in being proactive.
- ✔ These strategies will deliver the best outcomes if the company and the trustees also **Commit** (the fifth ‘C’) to working closely together to see the strategy through, by using a robust governance structure.
- ✔ Timely and efficient decision-making can lead to a number of smaller actions that add up to a big impact, which can make or break the success of your endgame strategy.

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