Approaching the endgame: The future of Defined Benefit pension schemes in the UK

Launch write up

The Pensions Policy Institute (PPI) held a policy seminar on 29th October 2019 to launch ***Approaching the endgame: The future of Defined Benefit pension schemes in the UK***, sponsored by Aberdeen Standard Investments. The event was also hosted by Aberdeen Standard Investments.

Private sector Defined Benefit (DB) pension schemes have been in decline for a number of years, in terms of the number of schemes and members. The vast majority of schemes are either closed to new members or to new accrual, and most are cash-flow negative, payments to pensioners exceed contributions from members and the sponsoring employer. Against this background, many pension schemes are turning their attention to how they can ensure that they continue to provide the benefits to members while minimizing the costs and risks to the sponsor. Traditional approaches to this 'endgame' scenario have been insurance solutions, such as bulk annuity purchase. However, there is growing interest in the use of alternative consolidation mechanisms; either merging schemes or transferring liabilities to a third party.

Over 40 people representing a broad range of interests within Government, the investment industry, the pensions industry and the third sector attended the seminar.

Madeline Forrester, PPI Council Member, chaired the event.

Mark Baker, Senior Policy Researcher, PPI, presented the findings of the research, reflecting on the decline of both DB scheme number and membership in recent years, as well as the range of strategies available to schemes navigating towards their endgame, including strategies being used in combination with one another.

Douglas Hogg, Senior Solutions Specialist – Pensions, Aberdeen Standard Investments, gave a sponsor's response to the research: The research sheds light on the issues that DB pension schemes face and how these might evolve in the future. A different investment approach is needed for schemes navigating towards their endgame, with strategies less focused on growth and more about minimizing risk and maximizing the likelihood of meeting the scheme's ultimate endgame objective.

Panel responses to the research

David Fairs, Executive Director of Regulatory Policy, Analysis and Advice, The Pensions Regulator: There are some concerns about continuing deficits among schemes which are cashflow negative as a result of being closed to future accrual while still needing to pay benefits to pensioner members. All DB schemes are required to set clear funding objectives and a realistic plan for achieving them. Broadly speaking, these strategies should aim to reduce dependency on sponsors by improving funding levels and reducing risk.

Lynda Whitney, Partner, Aon: It is important to recognise the breadth of solutions and how these can combine to produce diverse trajectories for DB schemes navigating the endgame. However, one thing all of these solutions have in common is the need for effective administration and accurate data.

Jack Jones, Policy and Campaigns Support Officer, TUC: Is there scope to put more focus on how to preserve the DB schemes that remain, rather than just how to manage them down into their endgame? While dwarfed by the rapid growth in DC scheme membership, active membership of DB schemes has remained relatively stable over the last year, following years of decline. As the number of DB schemes has declined, members have been increasingly recognising the value of their DB entitlements, as we've seen with the cases of USS and Royal Mail.

Panel discussion and Q&A

The following points were raised during the panel discussion and Q&A, held under the Chatham House Rule. They do not necessarily reflect the views of the Pensions Policy Institute or all panelists.

The increasing complexity of the DB management

- The level of complexity associated with de-risking strategies may be a barrier to some, particularly smaller schemes.
- High levels of DB schemes with fiduciary managers in place illustrates an increasing recognition among trustees that they need to bring in appropriate expertise in order to navigate their endgame effectively.
- Ongoing dialogue between a scheme's sponsor and trustees is vital to ensuring that their objectives are aligned.

Consolidation and Superfunds

- Innovation of new pooled fund solutions can make endgame strategies available for smaller pension schemes.
- Moving members into a Superfund severs the link to the sponsor, so it is important to ensure that member rights are protected.
- Superfunds are a significant innovation in the DB landscape. The regulator and Government must consider carefully the benefits, but also the challenges.
- It is important to find a balance and to ensure that Superfunds don't just become a cheaper alternative to buyout.

- While Superfunds are not necessarily the right option for the majority of schemes, they could be the best option for some. Given the high levels of assets under management of many schemes, this could become a large market even if only a small number of schemes opt for this route.
- Why would Superfunds want to take on poorer funded schemes? It seems more likely that they will 'pick off' the better funded schemes, leaving behind schemes with the greatest need.

The importance of effective administration

- Reducing the amount spent on administration is one of the easiest ways to cut scheme costs but doing so can negatively impact member outcomes.
- Data cleansing exercises can reveal some shocking mismanagements, including underpayment of member benefits. Some underpayments result from the complexity of layering of different court cases over the years which have an impact on benefit amounts. However, it is important that these errors be avoided as much as possible.
- Will the dashboard help to act as a catalyst for better data, which will then aid consolidation further down the line?
- Schemes which have been through a number of take-overs can find it extremely difficult to ensure accurate data. There needs to be transparency if asking for member help in cleaning this up.

Transfers out of DB schemes

- There are significant numbers of members giving up their valuable DB entitlements in order to access the flexibility offered by pension freedoms. Should it be made more difficult for members of DB schemes to transfer out?
- High levels of DB transfers in the last year are correlated with the increase in transfer values over the same period, so it is unlikely that we will see stability in the number of transfers going forward.
- There may be an incentive for sponsors to encourage transfers out in order to improve their credit rating.

Evolving DB investment strategies

- What types of alternative assets are DB schemes using and how acceptable would these be to consolidators? Consolidators may be hesitant to advise on what types of assets these might be specifically as this potentially reduces the supply for their own investment strategy.
- Is there a potential supply issue which will manifest itself as DB schemes increasingly look to different asset classes?
- When allocating to illiquid assets, it is vital that trustees make sure that these fit with the scheme's objectives, whether they are looking towards an exit strategy or to keep the scheme running on an ongoing basis.