A guide to running off mature schemes

John McAleer sets out four areas where a change in approach to managing mature pension funds could lead to better outcomes for members, trustees and sponsors

AT A GLANCE

✤ Mature schemes may face very different challenges to immature schemes
✤ Trustee boards should be reviewed to ensure they have the right set up and skills for effective run-off
✤ A full run-off plan would be clear about the long-term target and what should happen once it is reached

Since the 2015 pension freedoms were introduced, the number of deferred members transferring out of UK defined benefit (DB) pension schemes has increased dramatically. Combined with recent reductions to life expectancy estimates, this means many schemes have found themselves further on in their maturity journey than anticipated.

In its 2018 *Annual Funding Statement*, The Pensions Regulator (TPR) advised trustees that it expects them to "take into account risks that arise from scheme maturity". It is important that sponsors, trustees and advisers understand these risks and, in particular, what can be done to manage them.

It is well-timed that the Institute and Faculty of Actuaries' (IFoA's) Running Off Mature Schemes Working Party recently published helpful research into mature schemes. Our paper *Mature pension schemes – onwards and forwards* is a really helpful reference point for scheme stakeholders looking to run off pension schemes in an effective manner.

Why does scheme maturity matter?

Mature schemes can face very different challenges from immature schemes. As a result, it is crucial that trustees, sponsors and advisers are aware of the various issues that scheme maturity brings.

- Mature schemes tend to have a shorter time horizon to get things right.
- From the trustees' perspective, the mind-set can change. They could take the view that they are the cohort of trustees to lock down the risks, where appropriate, and then steer the scheme to its long-term target.
- Defining the long-term target becomes much more important. The long-term target for many schemes will be securing benefits with an insurance company over, say, a 15-year period. Alternative targets would include running the scheme to the last benefit payment or bulk transfer to a commercial consolidation vehicle.

There are various ways to measure scheme maturity. We opted for 'duration' for our measure. Duration measures how sensitive a scheme's liabilities are relative to changes in the discount rate assumption. Normally it is readily available and provides a fuller picture than focusing on alternative measures like average age or percentage of pensioners. We categorised schemes with durations of less than 16 years as being mature, and such schemes were the focus of our research.

Comparing against our expectations

We considered twelve key areas for mature schemes. For each area we set out what we would expect to observe by way of industry practice and compared it with actual industry practice. An overview is set out in the below table:

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How industry practice compares with IFoA expectations

Consistent with expectations	Semi-consistent with expectations	Inconsistent with expectations
Liability management	Pace of funding	Locking down the benefits
Cashflow matching	Covenant	Expense management
Outsourcing	Contingent assets	Employer relationship and governance
Bulk annuities	Asset allocation	Journey plans

While for most areas the industry approach is consistent (or semi-consistent) with our expectations, we did identify four areas where we believe change is required to improve outcomes for mature schemes.

1. Locking down the benefits

We would encourage data and benefit due diligence to be carried out sooner rather than later.

There has been a concerted effort to comply with TPR's common and scheme specific data standards. However, time is often only devoted to carry out more detailed data and benefit due diligence as part of a de-risking project (such as a bulk annuity purchase).

Waiting for such a trigger is unnecessary – it can significantly increase the costs associated with correcting any issues as well as derailing plans to meet the scheme's objectives. Locking down data and benefit risk should be a crucial milestone in any plan to effectively run-off a pension scheme.

2. Expense management

Holding a reserve for future expenses should be the norm for mature schemes, not the exception.

An expense reserve would help spread the lumpiness of projects for the sponsor and provide the trustees with more flexibility in their run-off approach. Once a reserve is established for future costs it then, at least to some extent, becomes a question as to *when* to carry out particular projects rather than a question of *if* you should carry out the projects. Some actions should therefore be brought forward, leading to a more effective run-off.

Although disclosing worsened headline funding positions may not be welcome, the running costs are genuine liabilities and recognising their quantum would result in clearer trustee management actions.

Ensuring trustee boards have the required skills for run-off is essential to improving outcomes for mature schemes

3. Employer relationship and governance

Trustee boards should be reviewed to ensure they have the right set up and skills for effective run-off.

There can be significant benefits from reviewing mature scheme trustee boards and how they operate. This should include consideration of whether a professional trustee would add value to the run-off strategy and decision-making process.

Also, while member-nominated trustees (MNTs) often add a very valuable and different perspective, we believe that the challenges in finding willing and able MNTs will only continue as schemes continue to mature.

4. Journey plans

Schemes should formulate full run-off plans.

At present many journey plans focus primarily on funding and investment. We believe schemes should formulate full run-off plans that are used as working documents. A full run-off plan would be clear about the long-term target and what should happen once it is reached. It would also include other important aspects associated with running off such as scheme governance and reducing uncertainty associated with the data and benefits.

We would encourage trustees, sponsors and advisers to discuss scheme maturity and how well placed schemes are to run off effectively

We believe such an approach would assist schemes in becoming a lot more deliberate in how they run off and access products and solutions. The run-off plan can then be used as part of a framework to drive forward various activities leading to better member outcomes. With a transfer to a commercial consolidation vehicle now also becoming a potential target, formulating a run-off plan becomes even more important.

Understanding how well positioned your scheme is

We would encourage trustees, sponsors and advisers to discuss scheme maturity and how well placed schemes are to run off effectively. To assist with these discussions, the following list of questions could be used as a useful starting point:

- How mature is your scheme?
- How fast is it expected to mature in the future?
- How well-articulated are your scheme's objectives?
- Do you have a strategy in place to reach your objectives?
- Are you aware of the funding and investment challenges maturing schemes face?
- Is your current approach for expense management well thought through?
- What steps have been taken to reduce the risks associated with the data and benefits?
- Has your governance structure evolved as the scheme has matured?

We hope our work continues to focus attention on the issues maturing schemes face and helps to lead to improved outcomes. Our full research paper can be found here: www.actuaries.org.uk/documents/running-mature-schemes

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