AON
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Executive summary

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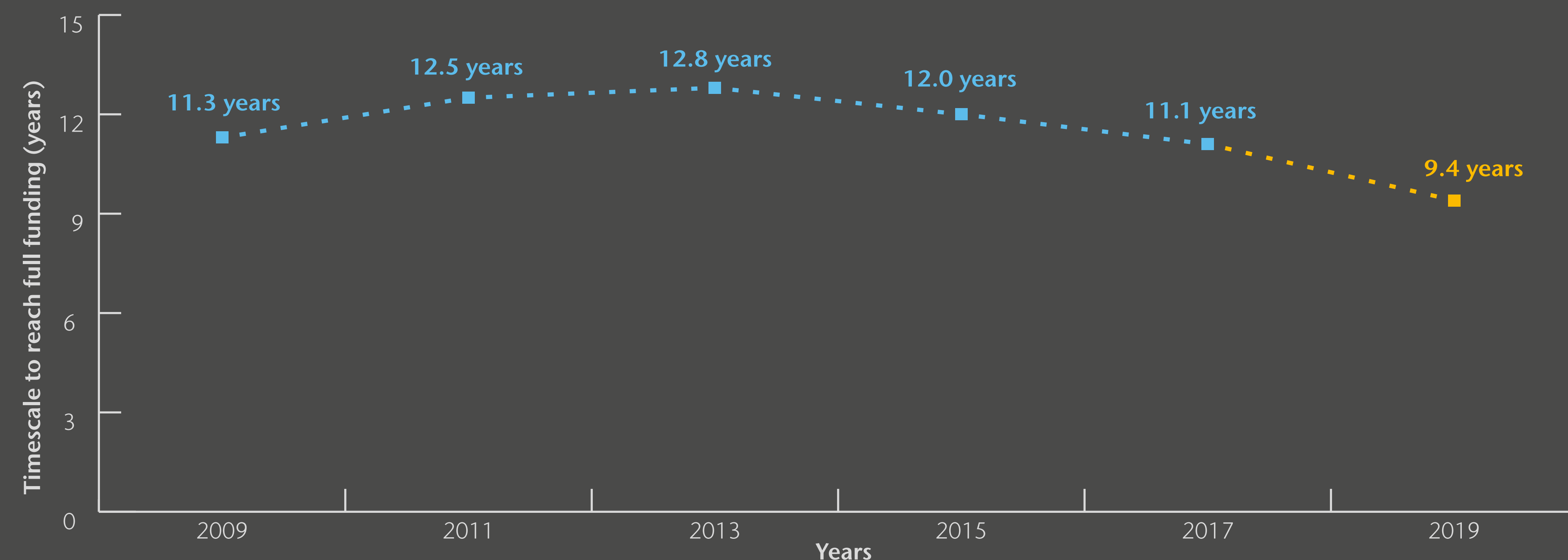
Welcome to our report on the UK findings of Aon's 2019 Global Pension Risk Survey into defined benefit (DB) pension schemes. We carry out the Global Pension Risk Survey every two years; looking back over the last decade we can see how the pensions landscape has developed.

Ten years ago, schemes were dealing with the fallout from the global financial crisis — we used the analogy of a donkey chasing a carrot tied on a stick to its head in the 2013 survey report to symbolise that schemes' long-term targets forever seemed just out of reach. However, in recent years, schemes' long-term targets have grown closer than they have ever been, as schemes mature. It seems the donkey is set to catch the carrot!

Maturity is a key theme of this survey, as it is of many of The Pensions Regulator (TPR)'s recent statements, including the 2019 Annual Funding Statement. As many schemes see significant amounts of liabilities transferring out, they are maturing rapidly, and some decisions around long-term targets and approaches to hedging longevity risk are coming more sharply into focus. Even open and less mature schemes will be affected by these changes as well as by the pressure from TPR to have a long-term target. There are also new issues for schemes to confront in 2019, including cyber risk and (finally) dealing with GMP equalisation after 2018's Lloyds Bank court case ruling.

Timescale to reach long-term target as reported in previous Global Pension Risk Surveys

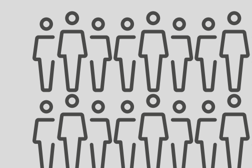


Unless otherwise indicated, all sources are the Global Pension Risk Survey 2019.

Survey demographics at a glance

170 UK respondents to the 2019 survey

15% of respondent schemes had fewer than **500 members**



28% of respondent schemes had over **10,000 members**

Wide range of asset sizes covered.
From sub-£100m to over £1bn of assets

Nearly 2/3 of responses came from trustees

Long-term targets

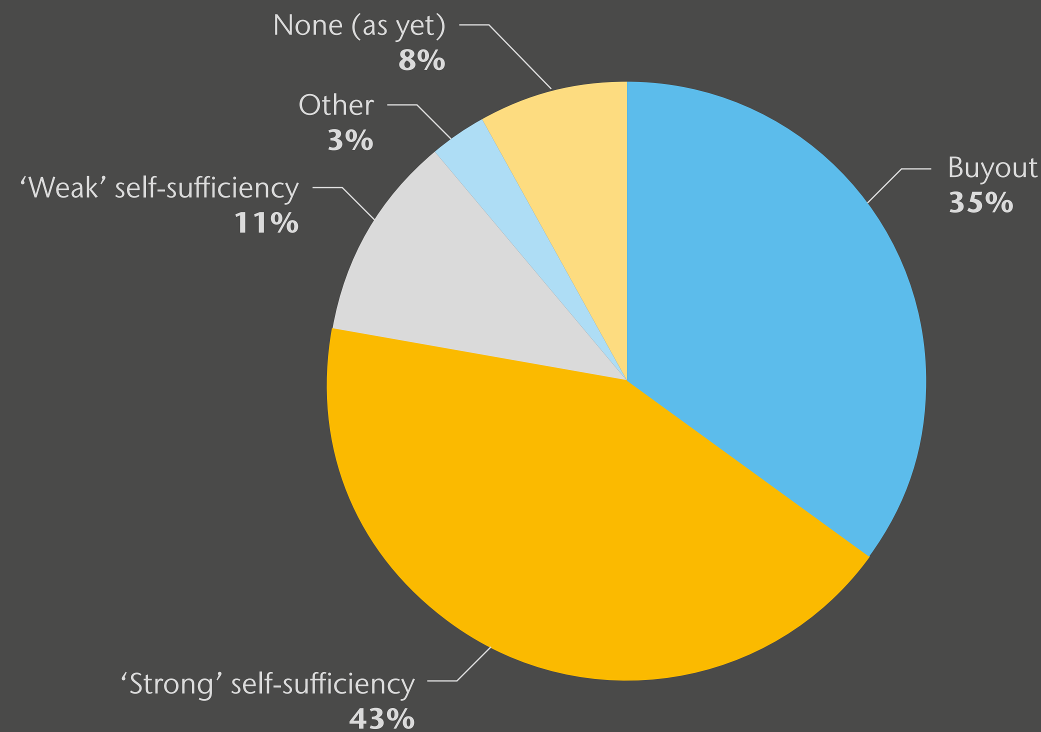
Long-term targets

We asked respondents what long-term targets their schemes had. By far the most common answers were 'strong' forms of self-sufficiency/minimal risk targets (43%) and buyout (35%) — together accounting for over three in four of all targets.

There has also been a material increase in the adoption of a buyout target since the 2017 survey (from 27% to 35%).

Risk settlement is discussed in more depth in the 'Managing DB Risk' chapter.

Long-term targets



As schemes have seen improvements in funding positions, lower risk targets such as buyout seem more achievable and we see more schemes willing to set it as a target.

The Department of Work and Pensions (DWP)'s 2018 White Paper and the 2019 Annual Funding Statement from TPR have both indicated the expectation that all schemes should have a long-term target, with a steer towards self-sufficiency or buyout targets, so we can expect these proportions to increase in future surveys.

No respondents indicated that they were targeting commercial consolidators, implying that these nascent solutions are perhaps seen as a fallback option rather than a destination to be aimed for.

For more information on broader consolidation options, you can read our paper, Defined benefit consolidation: what are the opportunities?

Key findings

Most common long-term targets

1. 'Strong' forms of self-sufficiency
2. Buyout

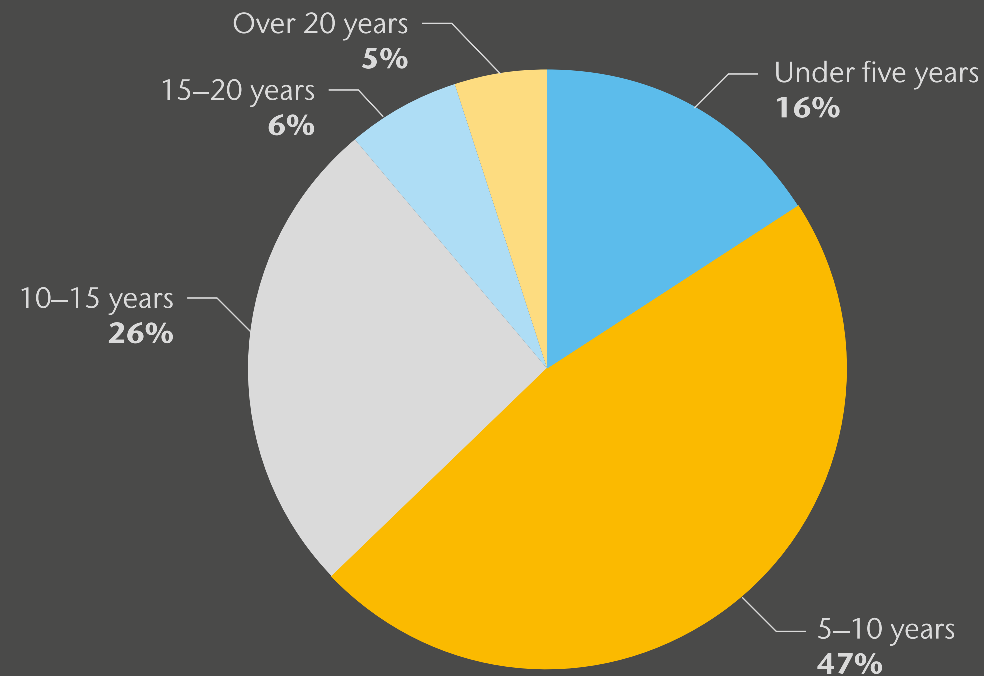
Almost 2/3 of schemes expect to reach long-term targets within 10 years

Average timescale fallen by **1.7 years** since 2017 — Timescale **9.4 years**

78% of schemes to rely on asset performance to reach targets

Distinct shift by schemes to more robust flightplans

Timescales to long-term target



We were curious as to how long respondents expected to take to reach their long-term target (however defined).

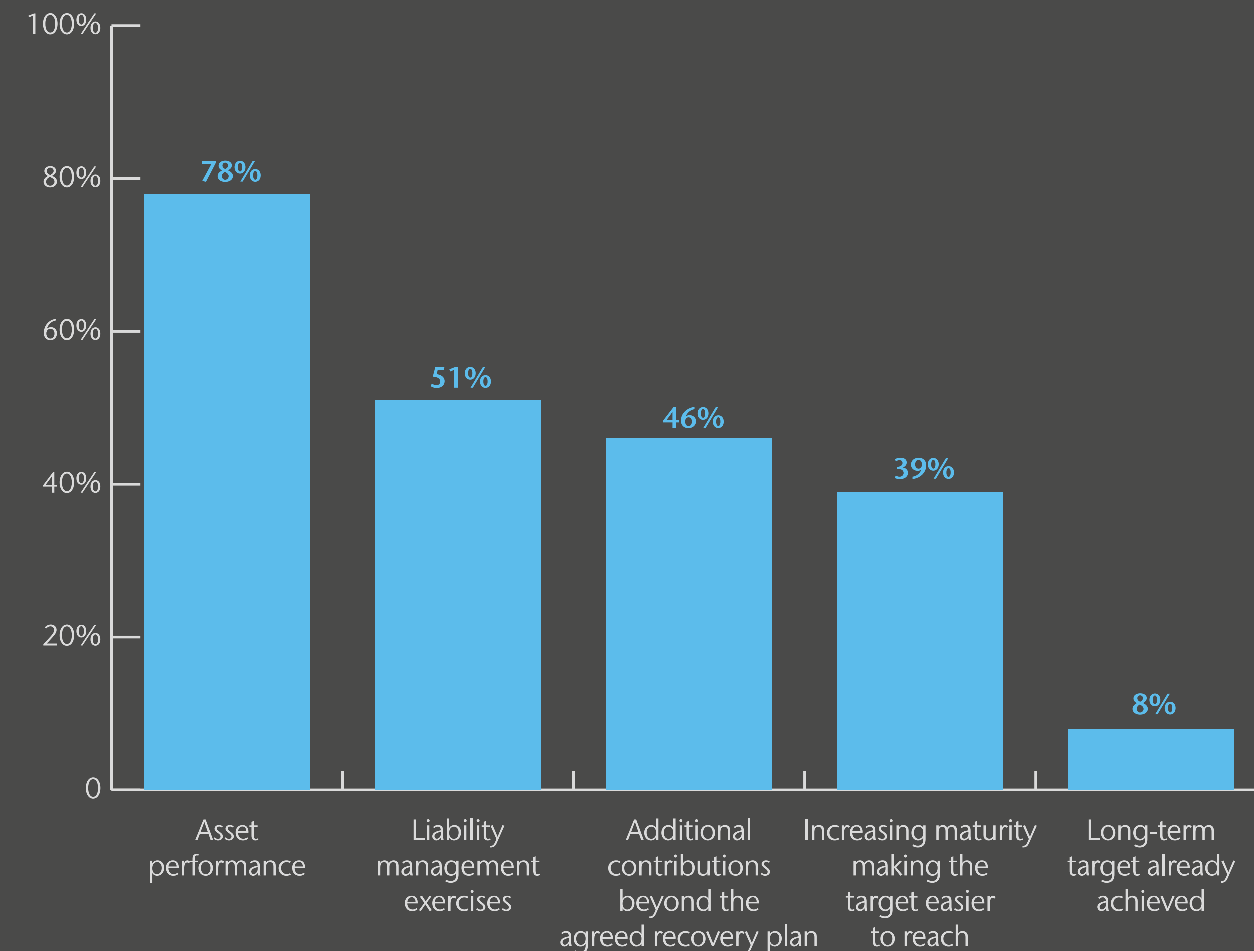
The most common answers were 5–10 years (47%) and 10–15 years (26%), and almost two in three schemes now expect to reach their long-term target within 10 years. This means that the overall average timescale has fallen from 11.1 years in 2017 to 9.4 years in 2019, a reduction of 1.7 years in the last two years.

Schemes are closing the gaps to their long-term destinations and the ultimate goal is now within sight. The increasing maturity of UK DB schemes is something we see reflected in the results throughout this survey.

We asked how schemes expected to reach their long-term target (multiple selections were possible).

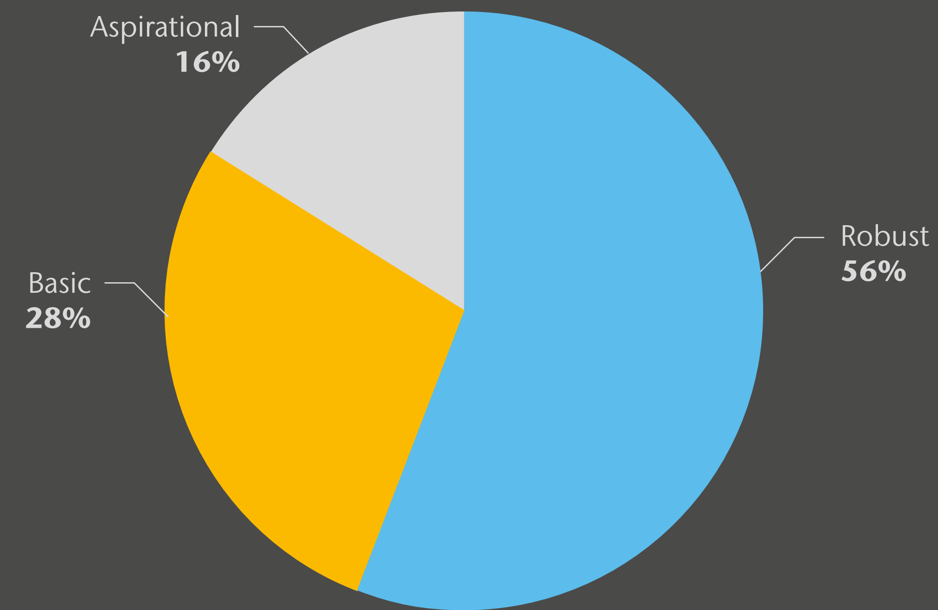
Most common was to rely (at least partially) on asset performance (78%). However, liability management was indicated as one action to reach the target by just over half of respondents. Interestingly, almost half of respondents expected contributions beyond the recovery plan to be an element of the actions to reach the long-term target.

Actions to reach long-term target



We asked respondents how robust their 'flightplan' to reach the long-term target is. Overall, 56% indicated their flightplan was 'robust' and only 16% said it was 'aspirational'. This shows a shift in the framing of flightplans from the 2017 survey, when the equivalent responses were 51% robust and 22% aspirational.

Robustness of flightplan



The results indicate that schemes have worked hard in the two years since our last survey to specify and 'bench test' their flightplans and it is pleasing that only 16% still have aspirational plans. However, TPR will be expecting those schemes to develop and implement flightplans — ideally robust ones — at the earliest opportunity.

Success story

PA Consulting expected that their scheme would run on a self-sufficient basis for 10+ years. This was challenged by the Aon team, who showed that buyout was achievable in much shorter timescales with no further cash contributions. By combining a successful series of member option exercises and bulk annuities, all liabilities were secured, leaving the scheme with a small surplus.

"This project has achieved the outcome we really wanted. By a collaborative approach from all parties, we have been able to secure a deal which no one imagined possible at the outset"

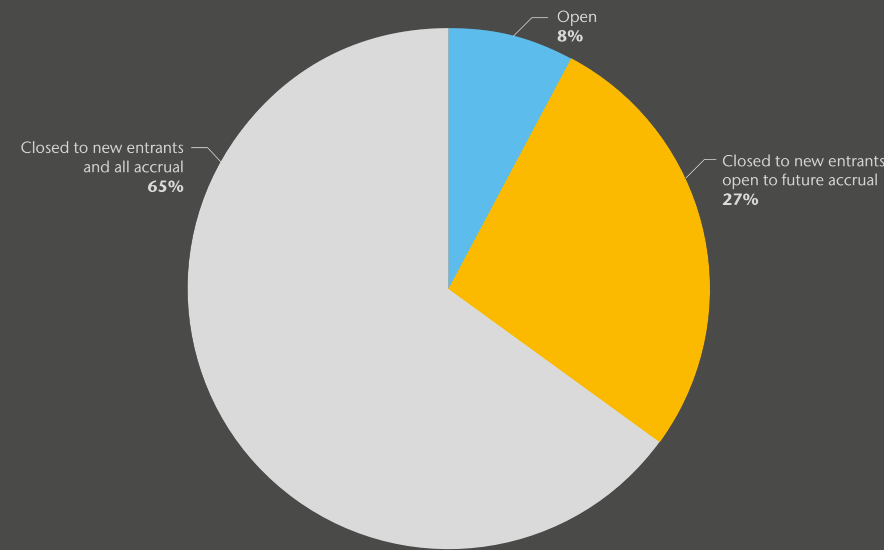
Kully Janjuah, PA Consulting

Managing benefits and liabilities

Managing benefits and liabilities

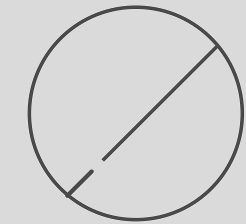
How has the trend in DB scheme closures played out over the last four years? Our survey results show a significant increase in the proportion of schemes closed to future accrual — 65% in the 2019 survey, up from 45% in 2015 and 53% in 2017.

Scheme status



Almost two in three DB schemes in the UK are closed to all accrual, underscoring the general move in the private sector towards DC for future pension provision. You can read more about global DC trends in our Global DC Pension and Financial Wellbeing Survey. Against this backdrop, it is unsurprising that DB schemes are maturing, a key theme in this survey.

Key findings



65% of UK DB schemes are closed to all accrual

45% in 2015 | 53% in 2017

Only 15% of schemes are unlikely to use a flexible retirement option liability management exercise in next 12–24 months

54% of schemes quote transfer value figures at retirement.
Up from 30% in 2017

Over 2× the number of schemes offering partial transfers compared to 2017

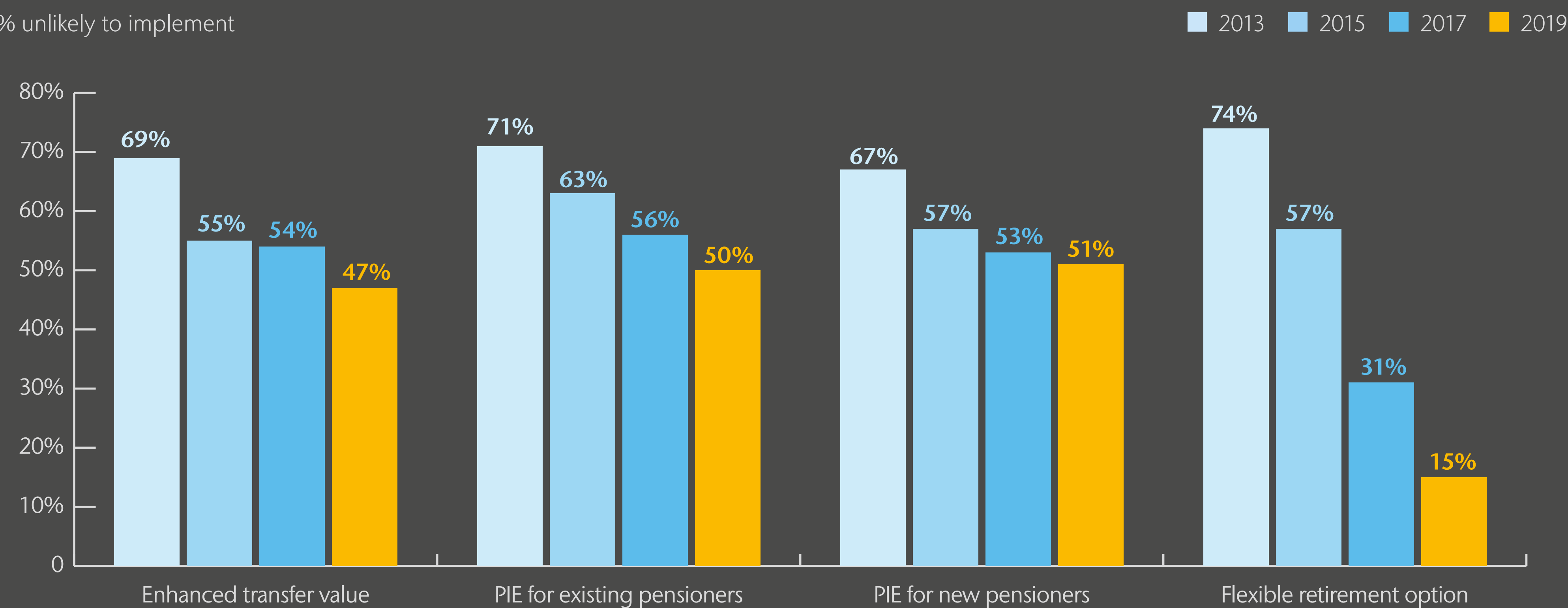
Alongside the increased proportion of closed schemes, there has been a noticeable change in attitudes to liability management. Looking back at previous Global Pension Risk Surveys, we can chart this back to 2013, prior to the changes introduced by the 2014 Budget. The chart below shows the percentage of respondents unlikely to implement each option.

The increasing acceptance of liability management exercises has been dramatic, particularly for the flexible retirement option (communicating transfer options alongside retirement options in the scheme) where only 15% of schemes say that they are unlikely to implement such an option in the next 12–24 months.

Indeed, trustees increasingly regard a flexible retirement option as good governance, making sure members are aware of the full range of options available to them, with any funding improvement or risk reduction a secondary benefit to the scheme.

Steady, although smaller, reductions are also seen for the other liability management actions.

Changing attitudes to liability management



Success story

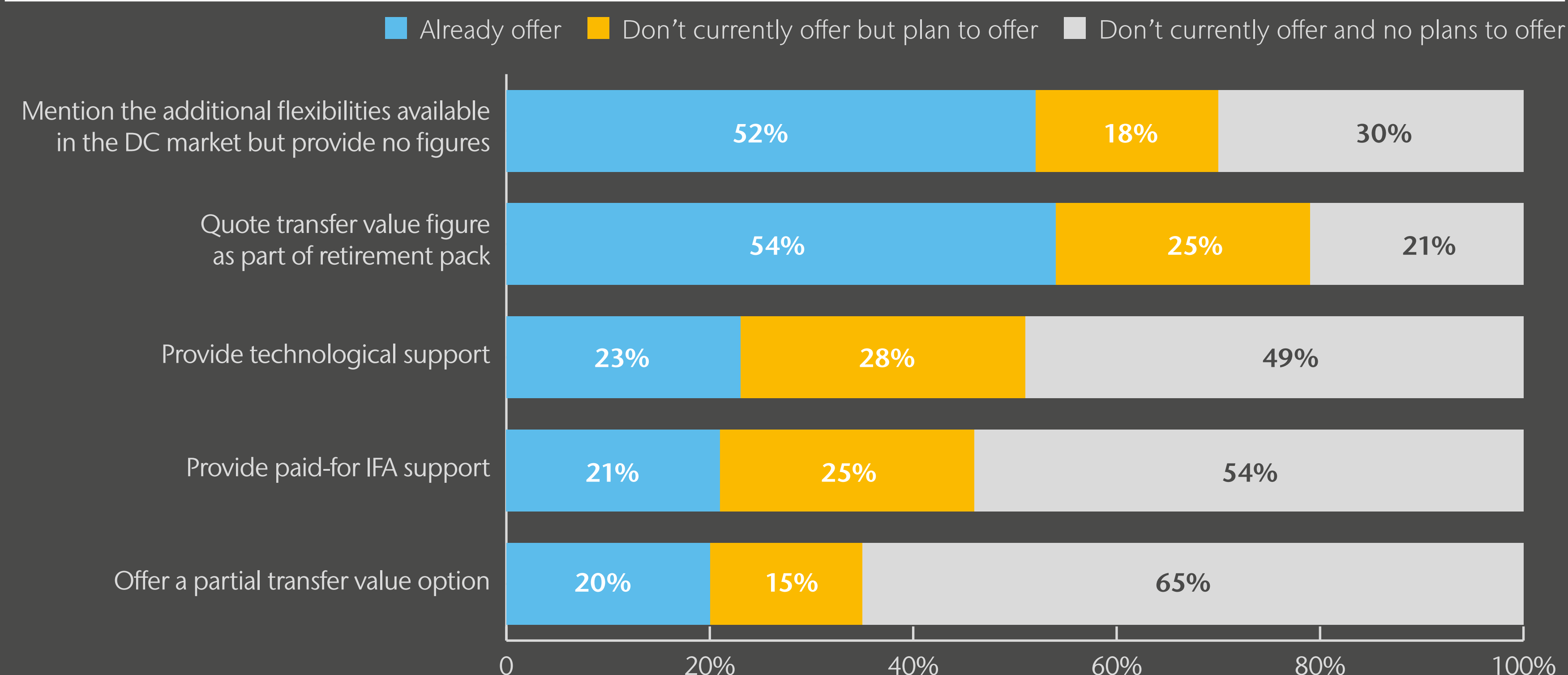
Phoenix Group, together with the Trustee of the PGL Pension Scheme, were keen to provide a range of retirement options for their members and also ensure that members had the necessary information to make fully informed decisions. As well as redesigning their scheme website to provide better information, they introduced an online retirement modeller (Aon Retirement Options Model – AROM) and provided access to an IFA with impartial advice provided at no cost to the member. The scheme saw a change in the retirement choices made by members, which can be attributed to improving the visibility of the retirement options and providing improved support.

"We were very keen to be able to offer our members an improved level of guidance and education on their retirement options and we are pleased that a high proportion of members are making use of these tools to make better informed decisions about their retirement"

Gary Needham, Head of Corporate Pension Operations, Phoenix Group

When supporting members through the retirement process, there is a large range of approaches that schemes can take and we asked about some of the most common options.

At-retirement support



There are several interesting features in these results, relating both to the provision of information and options, and to the support alongside it to help members in making fully informed decisions.

The proportion of schemes quoting transfer value figures at retirement has risen from 30% to 54% between the 2017 and 2019 surveys. Over the same period, the proportion offering partial transfers has risen from 9% to 20%.

Over 20% of schemes now already offer paid-for IFA support, with a further quarter of schemes expecting to do so. Over half of schemes either already provide, or plan to, technological support to members at retirement.

These results demonstrate the rapid development of at-retirement support for members. The majority of schemes now quote transfer values at retirement, and some schemes have followed that through into permitting partial transfer values, so that members can manage their DB savings more easily.

However, IFA advice is required for any transfer of over £30,000, so providing information is only one side of the coin. Schemes are rising to this challenge through, for example, provision of paid-for IFA support. This allows the scheme to fully vet a suitable IFA and provide significantly better value through 'bulk buying' those services than the individuals concerned could manage alone.

Advice from IFAs along with the increased prevalence of technology solutions help members understand their options better — and so make more informed choices.

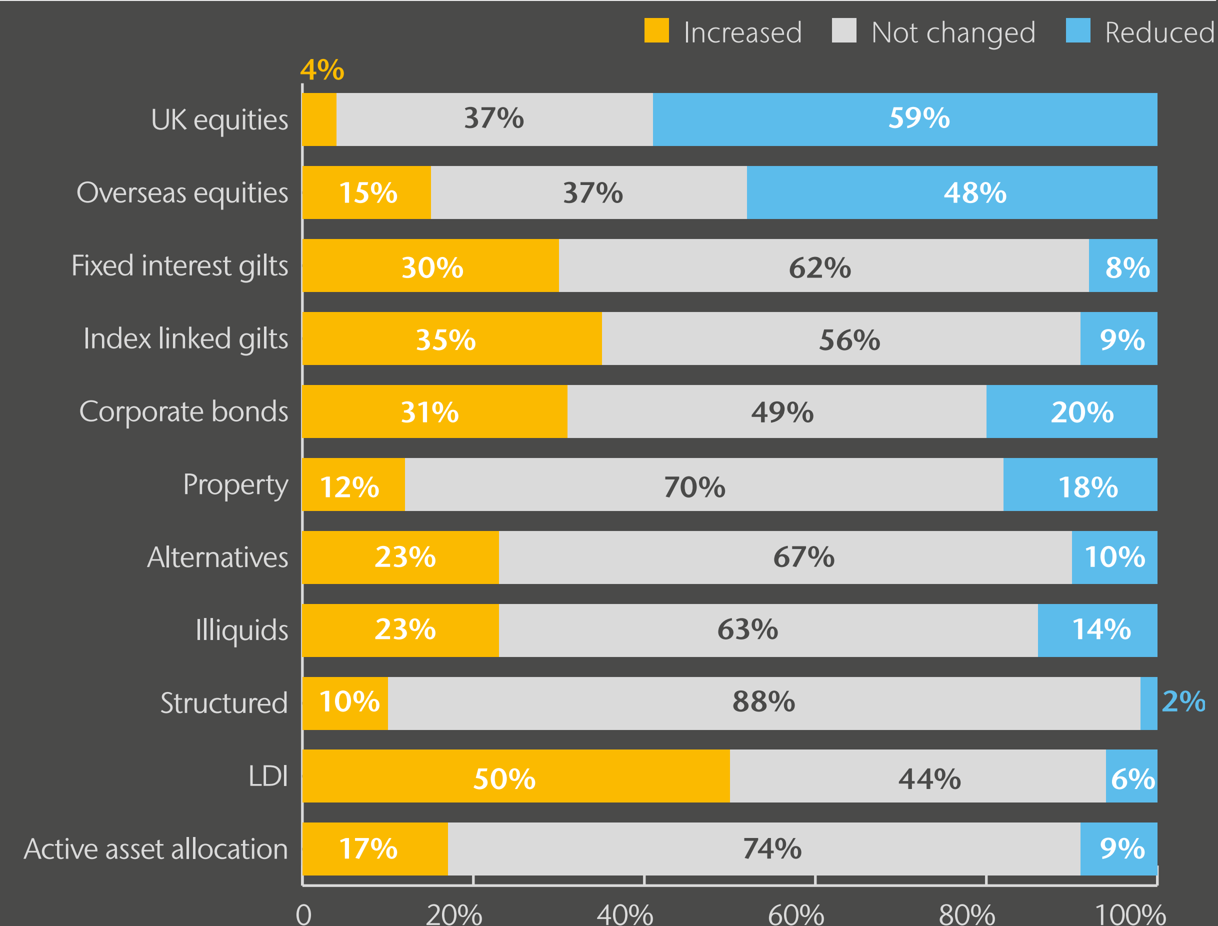
Investment strategy considerations

Investment strategy considerations

The themes of maturing pension schemes and reducing time to reach long-term targets are also reflected in the investment strategy responses.

The primary trend is the continuation in de-risking initiatives on the back of improved funding positions. This has been partly driven by the strong equity market performance, with schemes looking to reduce equity market risk and increase hedging levels. Additionally, it is noticeable that a number of schemes are looking for a better understanding of their future cashflow needs and to identify asset classes — including less liquid structures — that could help meet those requirements.

Actual investment changes over last 12 months



Respondents were asked what investment strategy changes they had made in the last 12 months. The responses demonstrate very clearly a reduction in allocations to riskier asset classes such as equities and increases to risk-reducing assets such as LDI (increased by 50%) and gilts (increased by a third).

There has also been a noticeable increase in asset classes that could be used as part of a cashflow matching portfolio such as corporate bonds (31%) and certain illiquid assets (23%).

Key findings

Clear allocation reduction in riskier asset classes

Allocation increase in risk-reducing assets

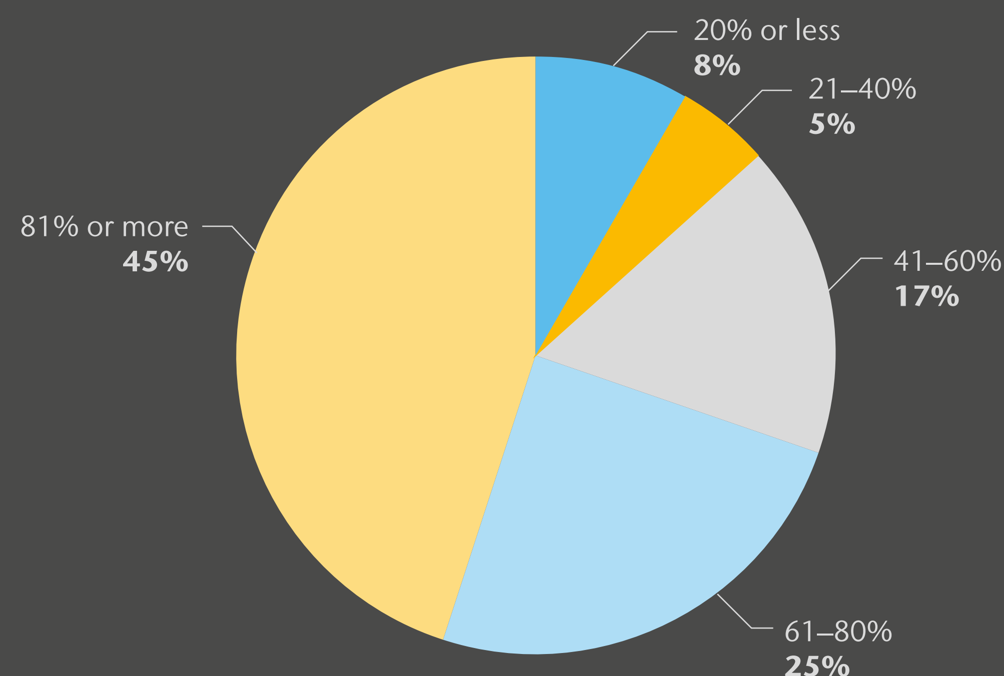
45% of respondents are hedging **over 80% of interest rate risk**

A rise from less than 30% in 2017

Almost 2/3 delegate manager monitoring to their advisers

Around 1/4 delegate full fiduciary mandates

Interest rate hedging ratios



We have long been advocates of pension schemes looking to hedge liability risks, where affordable, and it is encouraging to observe that more respondents have reduced their liability risks. We view exposure to interest rate risk as a significant and often unrewarded risk, and a scheme's risk budget is often better 'spent' elsewhere within a diversified portfolio of growth assets to help generate returns.

Where clients have taken this advice, they have been insulated from the material fall in gilt yields experienced in recent years and the adverse impact this would have otherwise had on funding levels. As a result, some of these clients are now in a position where their endgame is now within reach.

Linked to the general de-risking trend, it is interesting to note that levels of liability hedging have increased materially compared to our previous survey.

45% of respondents to this year's survey are hedging over 80% of their interest rate risk, with just 30% of schemes hedging less than 60%.

This is compared to our 2017 survey, where less than 30% hedged more than 80% of interest rate risk and almost 60% of respondents hedged less than 60%.

The results for inflation hedging levels are very similar.

Success story

A pension scheme was looking to de-risk its return-seeking portfolio by reducing its allocation to equities following funding level improvements.

Aon worked with the scheme to design a portfolio of cashflow-generative assets to replace their equity portfolio. A new portfolio of mainly illiquid assets, with allocations to direct lending, property debt and infrastructure was put in place and was designed to:

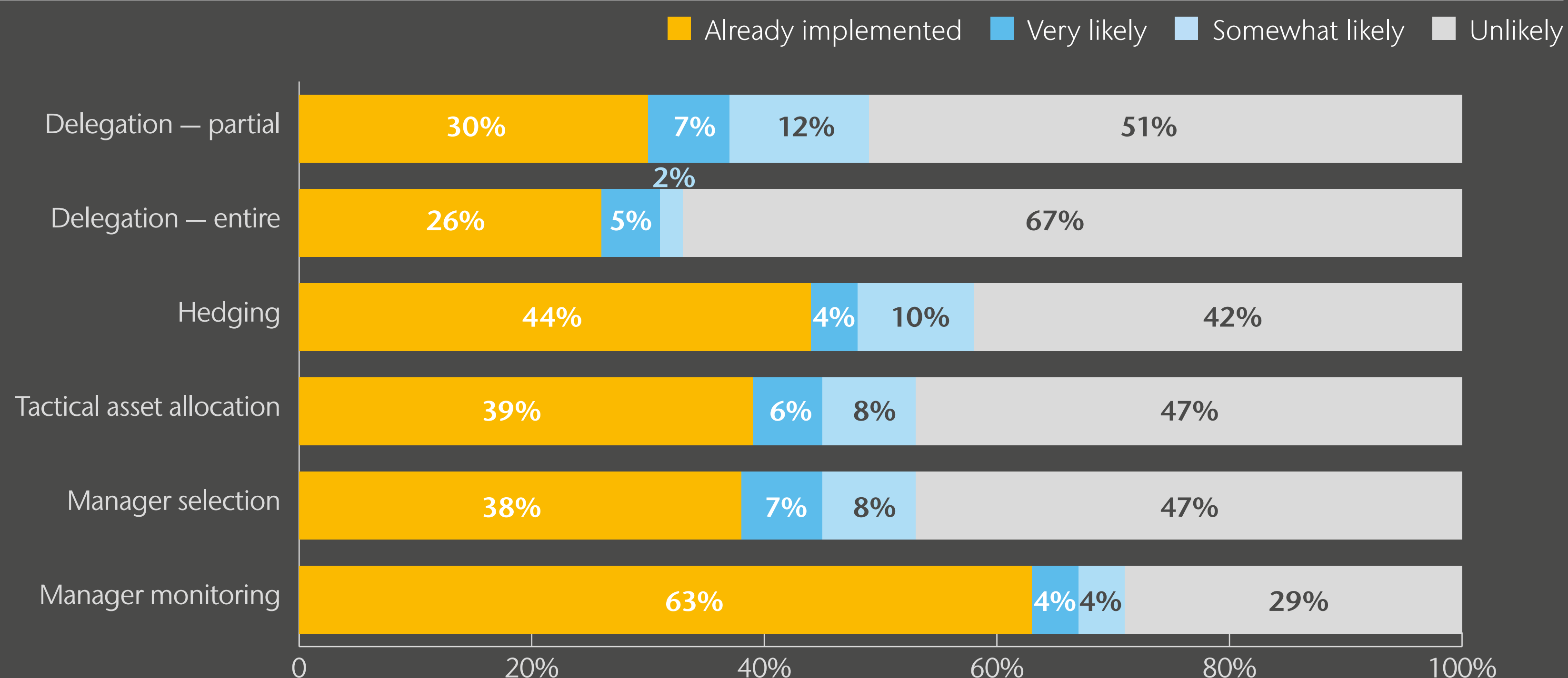
1. De-risk the scheme's assets while maintaining sufficient expected return to meet the trustee's long-term objectives
2. Increase cashflow income, which could be used to meet benefit payments and expenses
3. Take advantage of illiquid investment opportunities which were attractive from a risk/return perspective

We ensured that the expected income from the new return-seeking portfolio would be sufficient to meet a majority of the scheme's expected cashflow needs. The new portfolio is projected to be more efficient and a greater proportion of the scheme's cashflows are expected to be met through the asset income.

The survey also asked schemes which elements of their investment strategy and implementation they had delegated or planned to in future.

We continue to see many schemes looking to delegate certain functions to their advisers. These tasks range from manager monitoring (with almost two-thirds of respondents delegating this responsibility) right through to full fiduciary mandates (around one quarter of respondents).

The number of schemes looking to implement a partial fiduciary mandate over the next 12 months is significantly higher than those looking to implement a full mandate.



The demands on pension scheme trustees and sponsoring employers continue to grow due to the ever-increasing level of regulatory requirements, the range and complexity of options and time required to agree solutions.

Attitudes towards delegation continue to evolve, with more respondents open to delegating manager selection and monitoring responsibilities to their adviser. This is a trend that we have seen with our clients and one we expect to continue.

We are not surprised that the results indicate a reduction in the level of activity taking place earlier in the year. We observed this trend at the time and it appears to be linked to the Competitions and Markets Authority (CMA) review of the industry which took place over the past couple of years.

Interestingly, we have seen a noticeable uptick in activity over the months since the CMA findings were published and we expect to see many schemes continue to assess the relative merits of fiduciary management as a way of implementing their strategies in the future.

Also linked to the CMA review, we expect the role of third-party evaluators and professional trustees in assisting in the decision-making process to become more important.

Managing DB risk

Managing DB risk

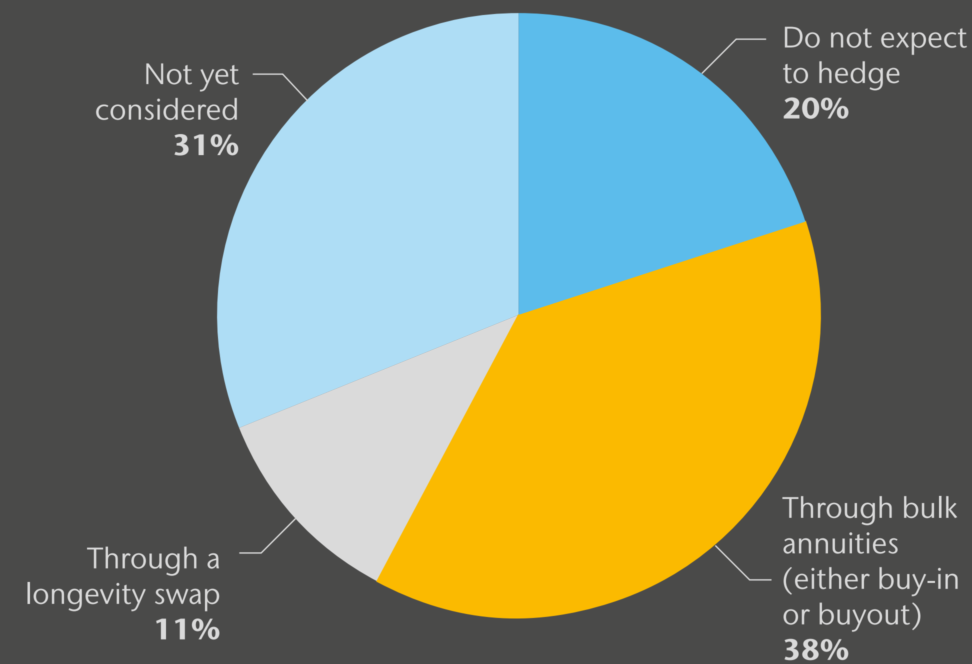
We saw in the results for schemes' long-term targets that a larger-than-ever proportion have buyout as their long-term goal, so we asked respondents about their plan for managing longevity risk.

Whereas only around 5% of respondents had no policy on hedging interest rate and inflation risk, nearly a third of respondents had not yet considered whether they planned to hedge longevity risk in the future.

In 2017, 36% of respondents planned to hedge longevity risk. That figure has risen to 49% in this survey.

Of the schemes that have considered their approach to longevity risk, the majority expect to purchase bulk annuities either as standalone buy-ins, or most likely on the route to buyout.

Longevity risk management



Key findings

13% increase in respondents planning to hedge longevity risk since 2017

Nearly 1/3 of respondents had not yet considered hedging longevity risk

IRM plans

Almost 3/4 of schemes have an IRM plan documented in some way

35% of respondents have a specific IRM plan

39% have an IRM plan incorporated into other documents

The lower levels of hedging longevity risk, compared to interest rate and inflation risk, may be for good reasons if schemes have been tackling more pressing shorter-term risks in recent years. But with schemes maturing rapidly, this is an issue that will need to be addressed in the coming years. Given the lead-in time that can be required to understand data and benefits before going to market, the schemes that are best prepared will be best positioned to capture attractive market pricing.

If we extrapolate the survey findings for those who plan to hedge longevity risk to the entire DB market, that equates to approximately £200bn of longevity swaps and £750bn of bulk annuities yet to be purchased. Given that the market is currently around £30bn a year, we expect to see more capital coming into the market in the future, otherwise there could be capacity issues.

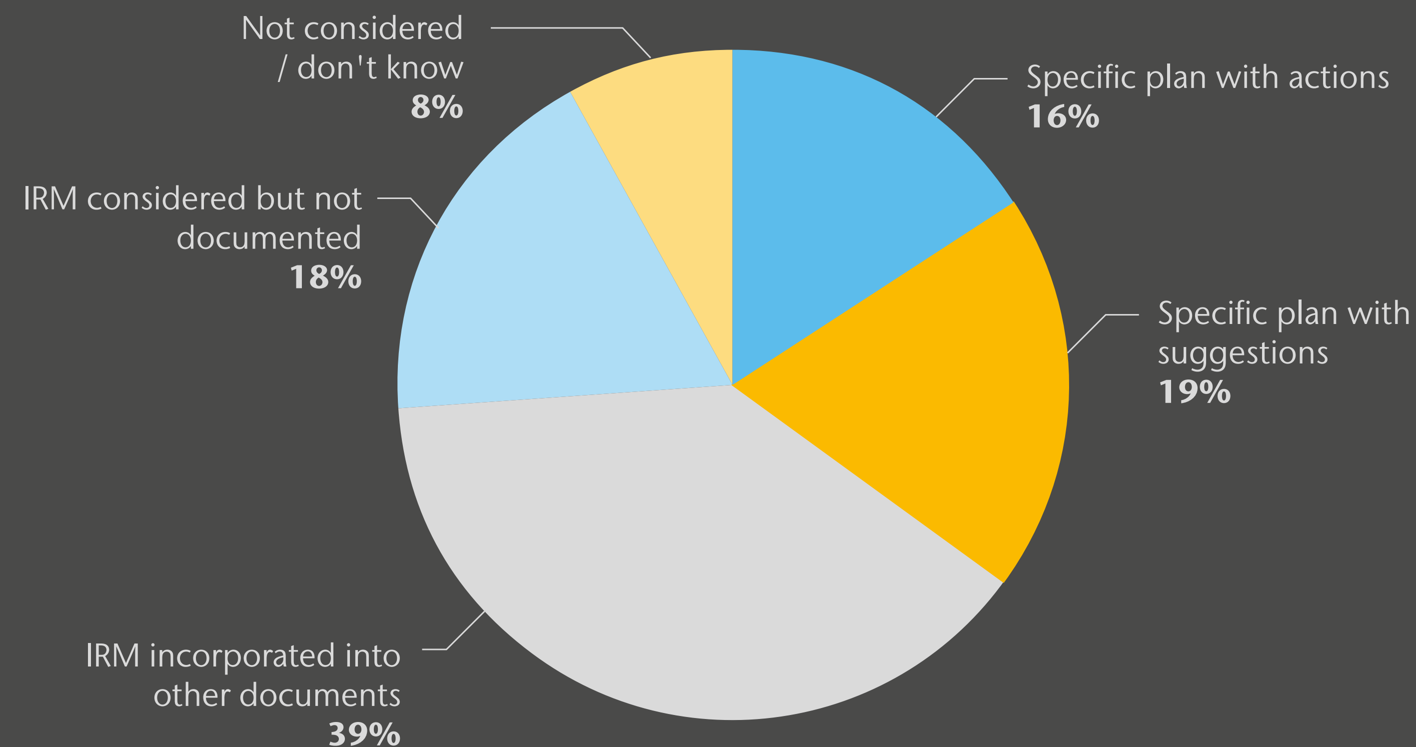
We asked respondents about their approach to Integrated Risk Management (IRM) plans, something that TPR has been pushing trustees strongly to adopt during the last two years.

The proportion of schemes with a specific IRM plan with actions has leapt from 4% in 2017 to 16% in 2019, with smaller increases to the proportions that have IRM plans with suggested actions and those that have IRM incorporated into other documents, with the latter remaining the single most common answer (39%).

This means that almost three in four schemes in 2019, up from just over half in 2017, have an IRM plan documented in some way, a result that no doubt TPR will be pleased with.

It is pleasing to see the sharp increase in the proportion of schemes with specific IRM plans. However, that does leave a quarter of schemes in 2019 that either have not considered IRM or have not documented their plan. We expect that TPR may challenge these schemes on this point.

Approach to Integrated Risk Management (IRM) plans



Success story

Rentokil Initial carried out a series of member options exercises before securing all liabilities in the scheme with an insurer, leaving a small surplus.

The scheme started with a deficit on the buyout basis. Pension Increase Exchange (PIE) and enhanced transfer value exercises, along with careful negotiation with the insurer, enabled a £1.5bn full scheme buyout which included cover of residual risks for a complex scheme and allowance for GMP equalisation and resulted in a small scheme surplus.

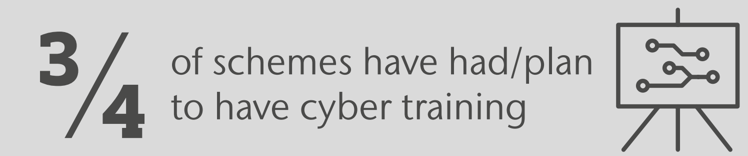
> "This is great news for members. After many years of support from Rentokil Initial and careful management with Aon (our actuary)... we can now secure our members' benefits through Pension Insurance Corporation (PIC)... I want to thank our advisers, Aon, and our lawyers, Linklaters, for their help in arranging a strong agreement with PIC which will continue the excellent pensions our members enjoy"
>
> Chris Pearce, Chairman of Trustee

Hot topics

Hot topics

Key findings

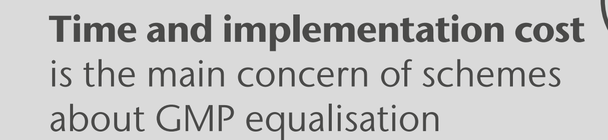
3/4 of schemes have had/plan to have cyber training



44% have not carried out and do not plan to carry out a review of data transfer agreements

2/3 have no documentation of cyber risks, mitigations and procedures

Time and implementation cost is the main concern of schemes about GMP equalisation



13% of schemes are concerned about carrying out GMP equalisation incorrectly

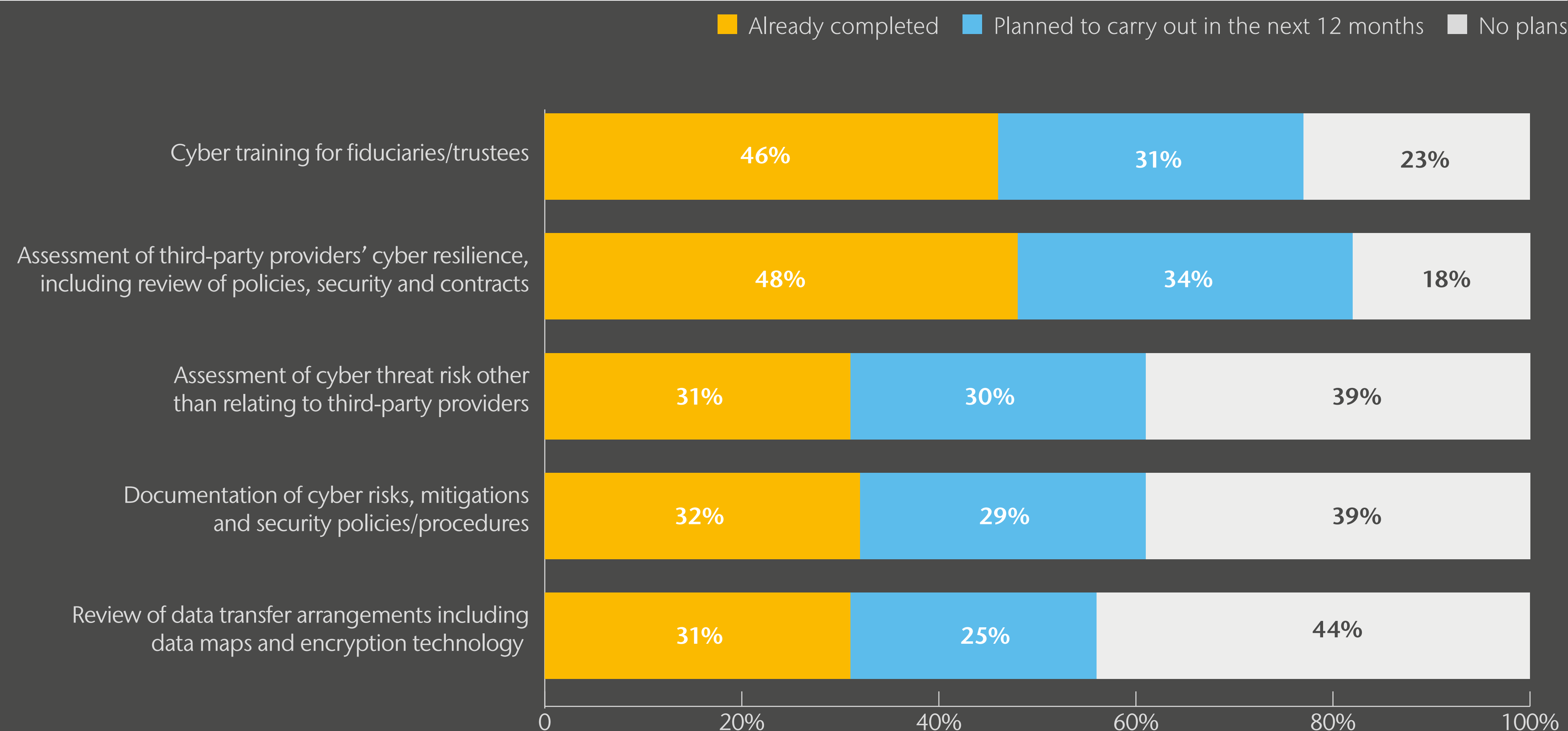
Hot topics | Cyber risk

Cyber risk is an increasing threat to modern businesses, and something that pension schemes are not exempt from. Thankfully, over 95% of respondents said that their scheme had not been affected by cybercrime, but a handful of respondents confirmed that they had been affected and, unfortunately, we expect that this figure is only likely to increase.

It was encouraging to see that three in four schemes have had cyber training or plan to have it in the next 12 months. We also see that almost half of schemes have already carried out an assessment of third-party providers' cyber resilience, with more on the way. However, that leaves a significant proportion of schemes (almost one in five) with no plans to act on this risk.

Two-thirds of schemes currently have no documentation of cyber risks, mitigations, and security policies and procedures. Broadly half of respondents have not carried out and do not plan to carry out a review of data transfer agreements. This seems especially high given recent GDPR requirements.

Actions to prevent a cyber incident



It was encouraging to see that schemes have been taking actions to prevent a cyber incident. As with the respondents to our 2018 Global Benefits Governance Survey, cyber security is clearly a priority. As a first step in understanding cyber threats to schemes, schemes should be carrying out an assessment of both themselves and third-party providers. Even this can be a challenging task as there are many processes to consider and most schemes have many providers.

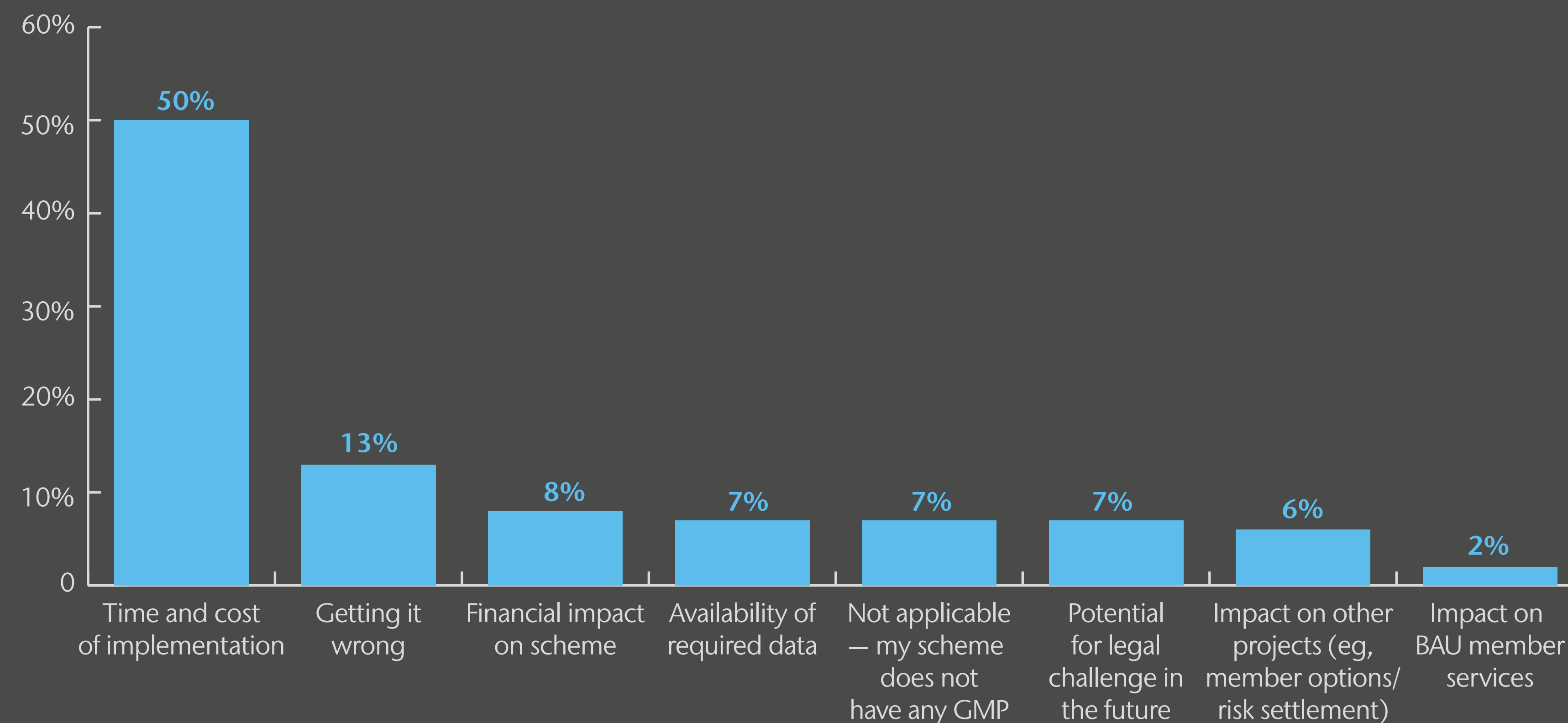
An updated code of practice on internal controls is also due from TPR later this year, which we expect to include explicit references to cyber risks. This should be a call to action for schemes that have not taken any action to date, and we expect that these statistics will change when we come to the next Global Pension Risk Survey in 2021.

Hot topics | GMP equalisation

In October 2018, the High Court finally confirmed that Guaranteed Minimum Pensions (GMPs) accrued in private sector pension plans between 17 May 1990 and 5 April 1997 must be equalised between men and women. This will be a big project for schemes over the coming years because it involves looking back over such a significant period in the history of pension schemes.

As part of the survey, we asked respondents what their top three concerns were in relation to GMP equalisation.

GMP equalisation — main concerns



The time and cost of implementation was significantly ahead of other concerns, with 50% of schemes having it as their main concern. This was the main concern for small, medium and large schemes. The second most commonly-selected main concern was that the equalisation process would not itself be carried out correctly (13%).

The concerns over the time and cost of GMP equalisation are not surprising given the scale of the project; particularly as this is, in general, an unwelcome exercise for pension schemes. Key to managing costs will be effective project planning and management, and in July 2019 The Pensions Administration Standards Association (PASA) released a checklist that schemes can use to prepare for the project. Schemes that have not yet taken action can learn from the first movers in order to manage time and costs effectively.

It will be equally important to ensure that the equalisation process is carried out accurately, so no repeat work is needed. This risk can be managed by having experienced advisers who are close to industry developments.

Executive summary

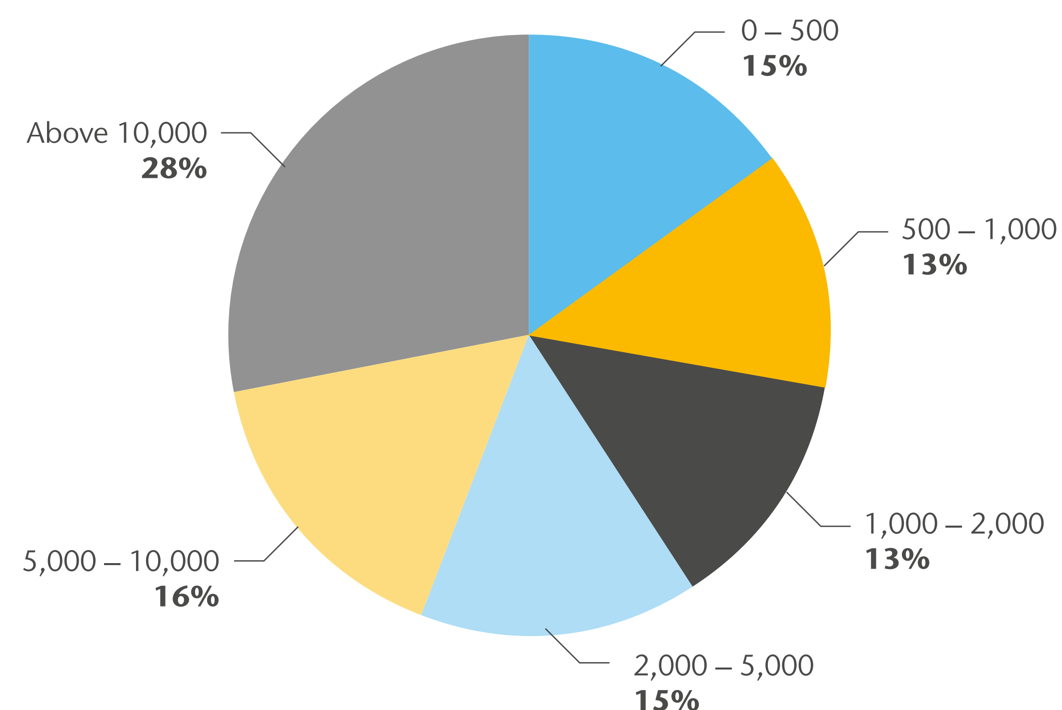
In more depth

We had a total of 170 UK responses to the 2019 Global Pension Risk Survey, covering schemes of all different sizes, from the small with only a handful of members (15% of respondents' schemes had fewer than 500 members) to the very large with hundreds of thousands of members (28% of respondents' schemes had over 10,000 members).

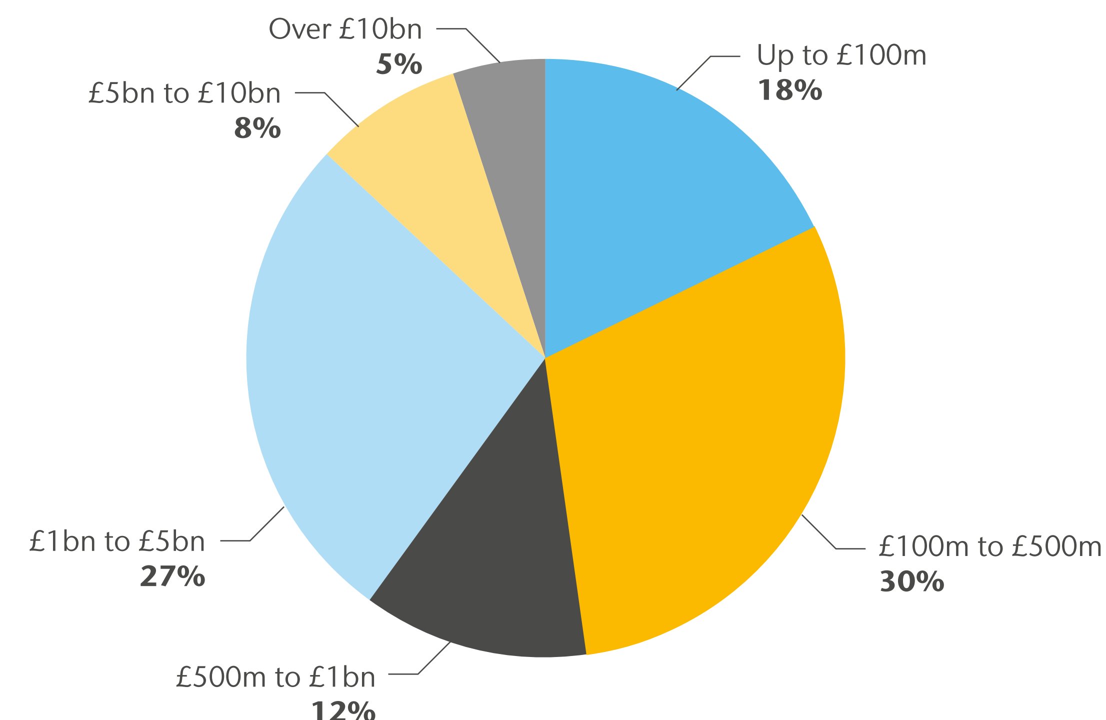
Nearly two-thirds of the survey responses came from trustees, including professional trustees. The majority of the remaining responses came from pensions managers and scheme sponsors.

The survey responses also covered a wide variety of schemes by asset size. Nearly 20% of the responses were for sub-£100m schemes, which we have defined in these results as 'small' schemes, while 40% of responses related to schemes with over £1bn of assets, which we have defined as 'large' schemes, with the remainder 'medium' sized. At various places in the survey report we have split the results by scheme size to see how industry trends are affecting schemes of different sizes.

Respondents based on number of scheme members

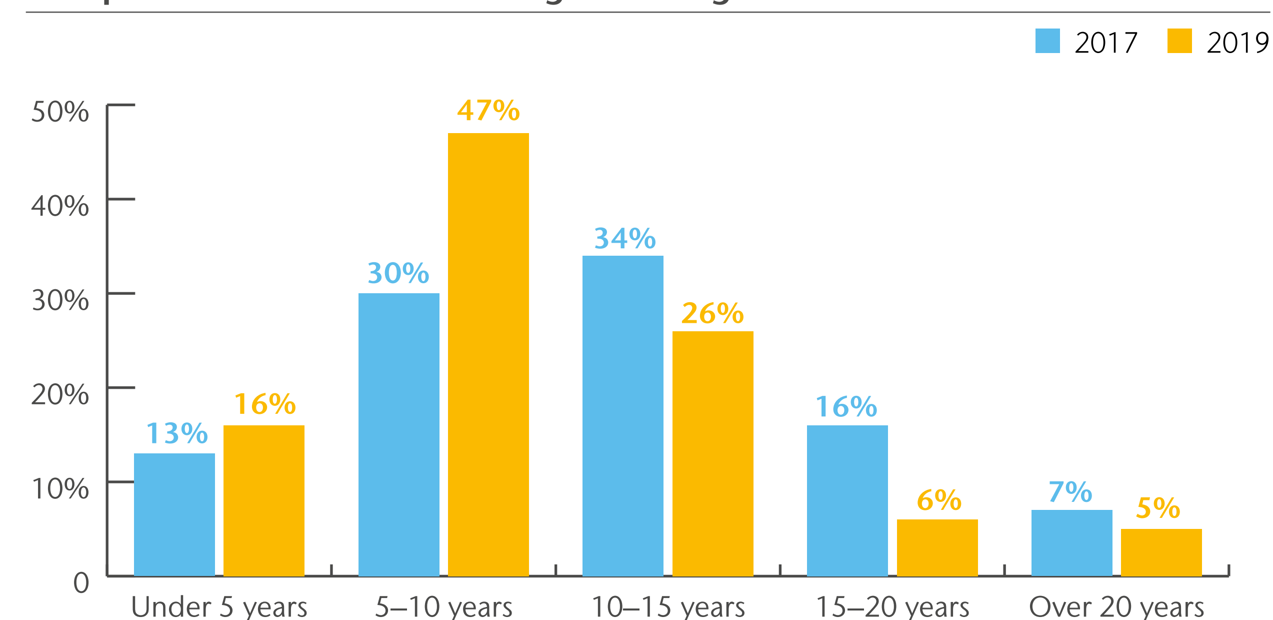


Respondents based on scheme asset size



Long-term targets

In more depth | Page 1 of 4



The diagram shows the breakdown of timescales to reaching the long-term target in the 2017 and 2019 surveys in five-year groupings.

The step up in the number of schemes in the 5–10-year band since 2017 is very clear, with a smaller increase in the under-five year band.

Some of the schemes that were in the under-five year band in 2017 will have reached their long-term target in the intervening two years, so no longer appear in this analysis.

This means that the reduction in target timescales has been greater than appears at first sight.

In addition, schemes whose timescale in 2017 was in the 15–20-year band appear to have taken definite steps to reach their targets sooner. The proportion in this band has fallen from 16% to 6%.

There remains a small proportion of schemes (5% in 2019) which still have very long (over 20 year) timescales to reach their long-term targets. No doubt there are individual circumstances behind the reasons why this is the case.

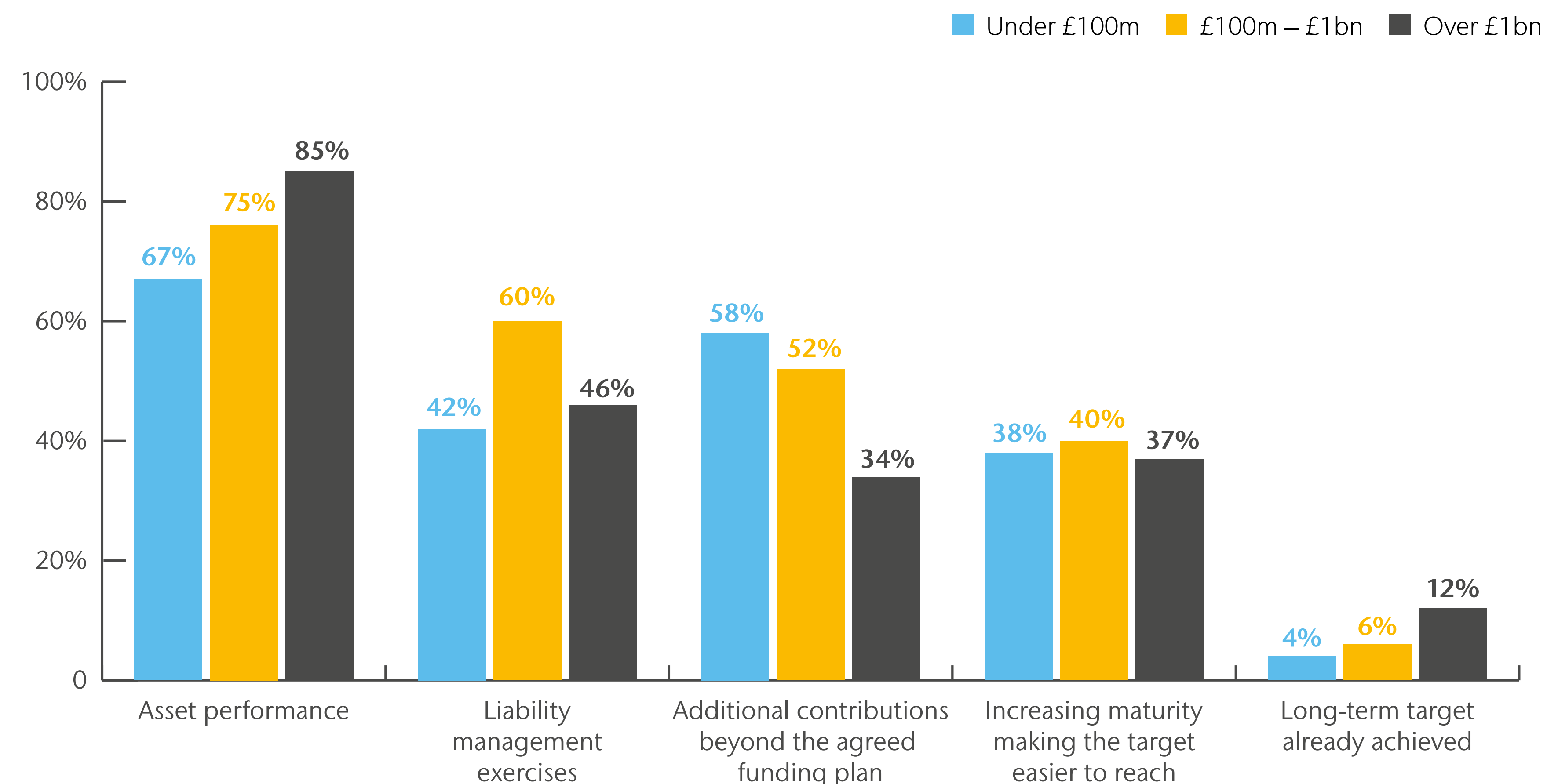
We see later in the survey that 23% of schemes have increased their holding in illiquid assets over the past 12 months. Schemes making such a change need to ensure this fits with their long-term strategy.

There is a trend for smaller schemes to be more likely to include additional contributions in their plan to reach the long-term target, with almost three in five schemes with assets under £100m planning for this.

Conversely, the larger the scheme, the more likely it is to include asset performance in its long-term plan (85% of schemes with assets over £1bn indicated this action).

Schemes with assets between £100m and £1bn are the most likely (three in five schemes) to be expecting to conduct liability management exercises to reach their long-term targets.

Actions to reach long-term target by scheme size



In reality, a great many schemes expect to take multiple actions to reach their targets. However, the reliance on additional contributions beyond the recovery plan was surprising because the sponsor's obligations to fund the scheme only relate to the recovery plan, and additional pension contributions will reduce the cash available for other investments. We expect alternative financing options will play a significant part in negotiations to avoid sponsors facing issues of trapped surplus.

The robustness of flightplans continues to vary widely by scheme size. Schemes with assets over £1bn are significantly more likely to have robust flightplans than schemes with assets under £100m (70% compared to 23%).

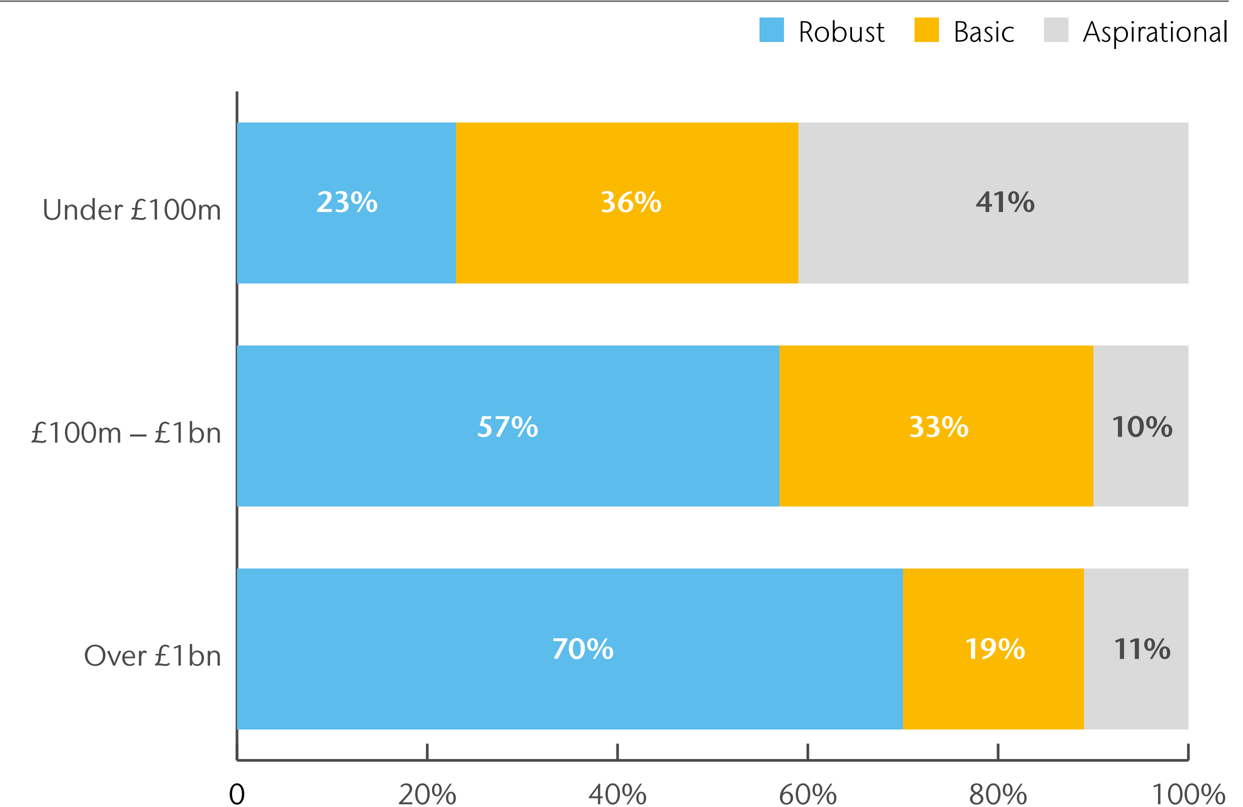
In fact, smaller schemes (assets under £100m) have seen a fall in the proportion with robust flightplans since 2017 (41% to 23%).

In contrast, larger schemes have seen a shift towards greater robustness since 2017. For example, the proportion of schemes with assets over £1bn with robust flightplans has risen by 10% to 70%.

The fall in the proportion of sub-£100m schemes having robust flightplans may be a result of their re-evaluating over the last two years what is needed for a flightplan to be considered robust.

We expect TPR will be somewhat concerned about the 41% of schemes with assets under £100m which continue to have a flightplan described as 'aspirational'; this proportion remains stubbornly unchanged from 2017.

Robustness of flightplan by scheme size

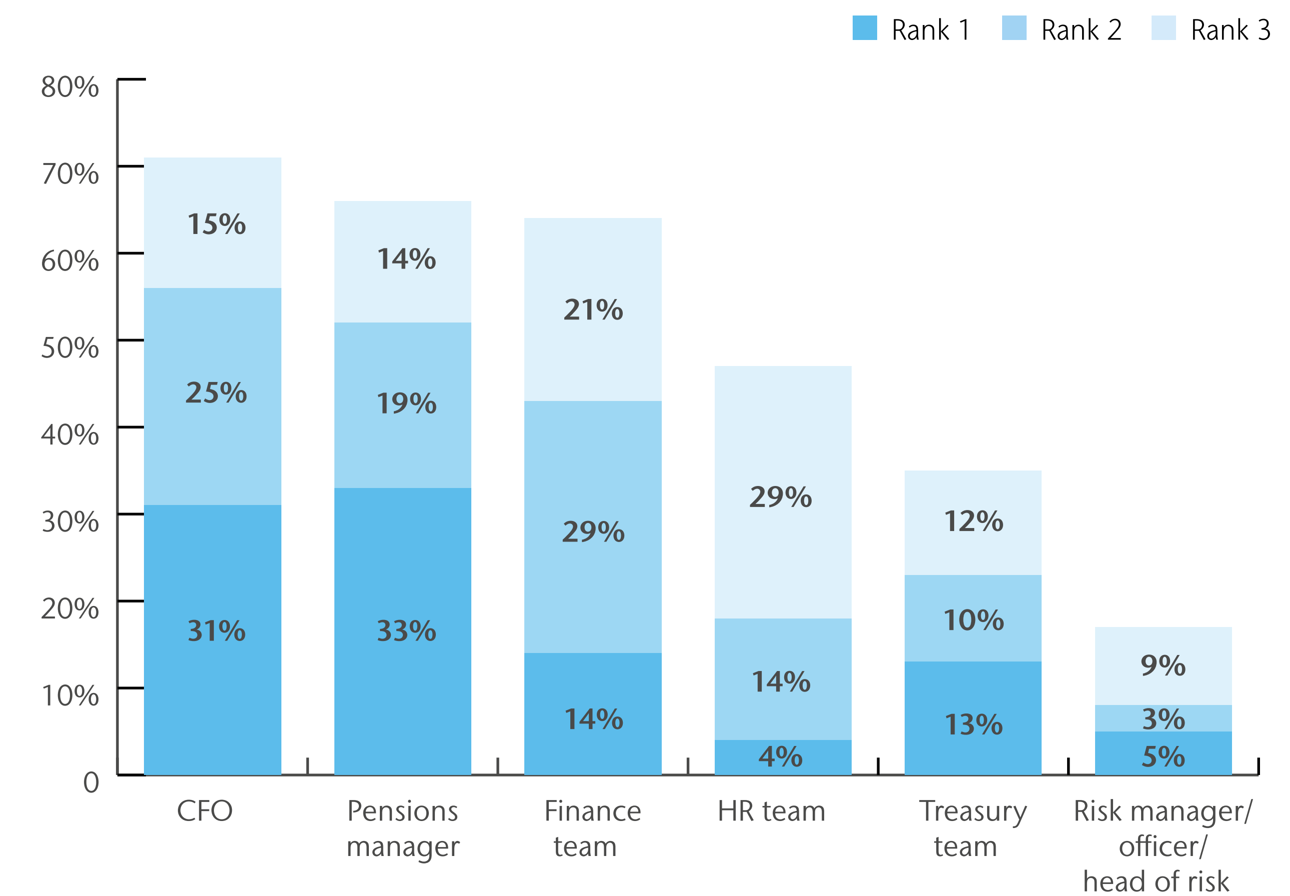


For the first time in 2019, we asked respondents who has the most responsibility within the sponsor for DB pensions, and we also asked respondents to rank the top three levels of responsibility.

Not surprisingly, the most common role with primary responsibility was the pensions manager at 33%. However, they only narrowly exceeded the Chief Finance Officer (CFO) as having primary responsibility (31%).

And the HR team becomes increasingly significant as we go down the rankings — in fact, they were the most commonly ranked third role for responsibility for DB pensions.

Ranking of responsibility for DB pensions



Managing benefits and liabilities

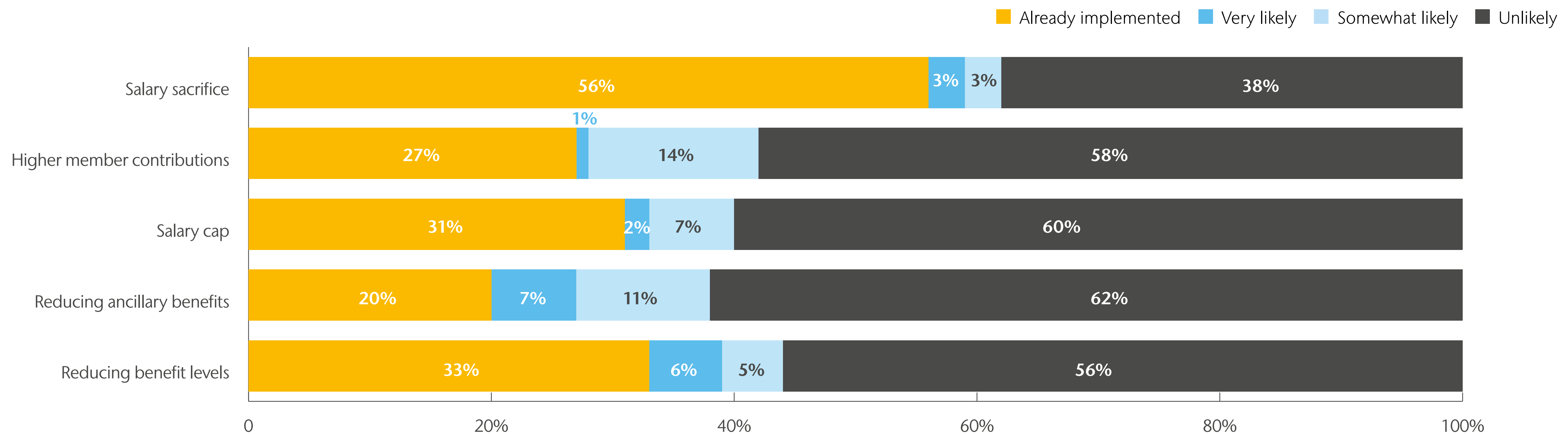
In more depth | Page 1 of 3

For schemes that remain open to future accrual, we asked about the potential implementation of other actions that schemes and sponsors can take to manage the cost and risk of defined benefit provision. For each action, we asked whether it has already been implemented, whether it was considered very likely or somewhat likely that the scheme would implement it in the next 12–24 months, or whether it was an action that was unlikely to be implemented.

Compared to the 2017 survey results, the proportion of schemes that consider themselves very likely or somewhat likely to implement these changes has fallen across all categories.

These results suggest the days of tinkering with benefit design might be coming to a close and that only the ultimate option of closing to future accrual remains.

Benefit actions

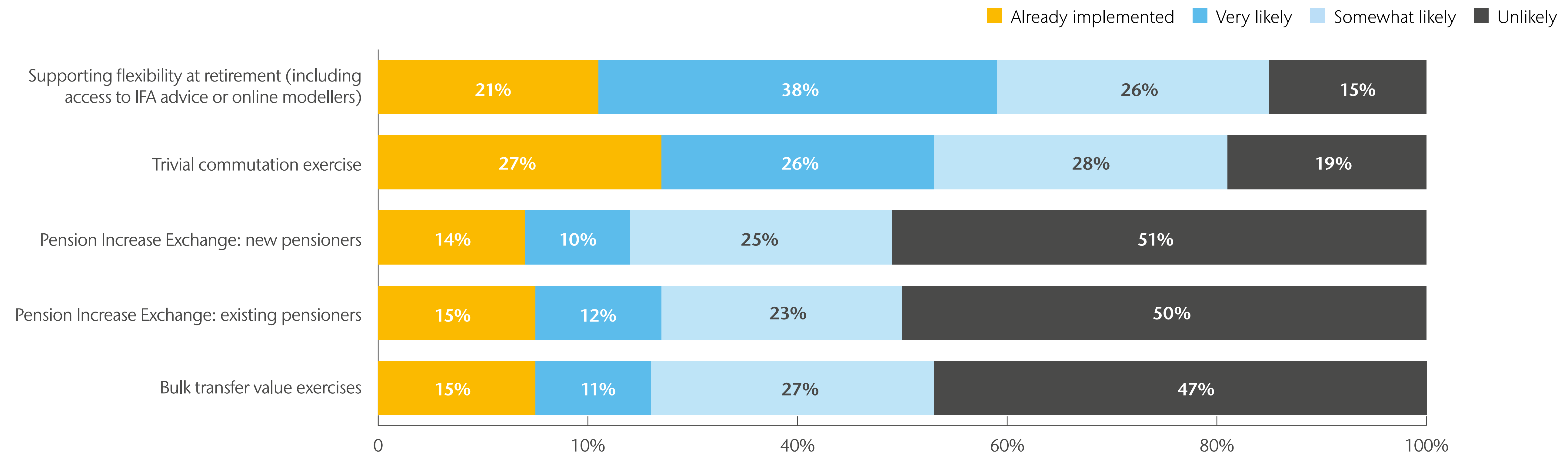


The chart below shows the five most common liability management exercises. We asked respondents whether they had already carried them out for their scheme, whether they were very or somewhat likely to implement them in the next 12–24 months, or unlikely to implement them.

These results demonstrate just how embedded liability management is now — and in all its guises, with essentially half or fewer of respondents saying they would be unlikely to implement each of the different options.

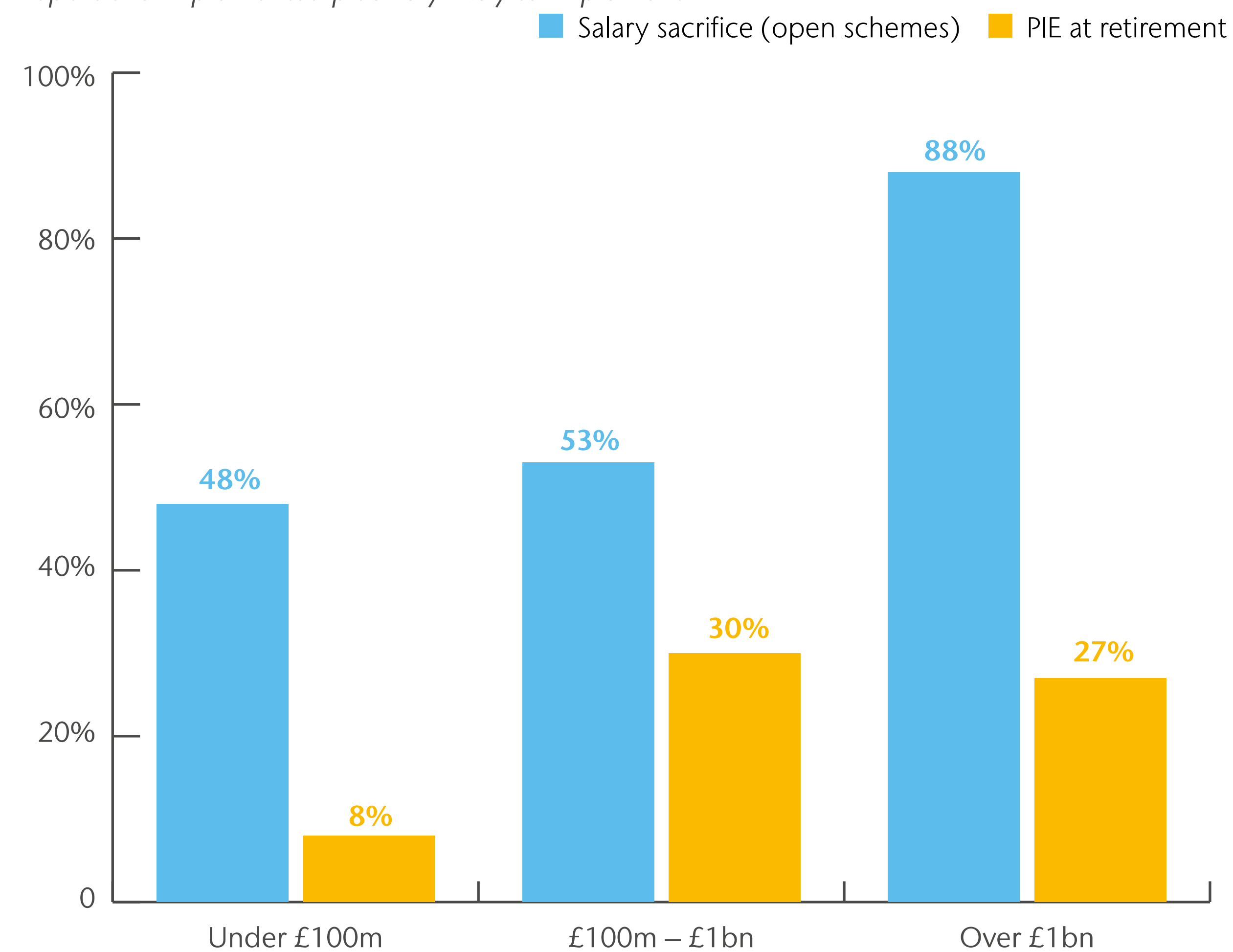
Schemes that are planning to implement these actions in the near term should, however, make sure that they are aware of the requirements of The Pensions Regulator's Code of Practice to ensure exercises are run properly. Careful project management is key to ensuring that liability management exercises are successful and deliver the desired outcomes for both trustees and sponsors.

Liability management actions



Liability actions by size

Proportions implemented plus very likely to implement



However, when we look at the survey responses by size of scheme, we see an interesting difference in levels of implementation (measuring those respondents who had implemented or were very likely to implement). This chart shows salary sacrifice and PIE at retirement, but similar results were apparent for many of the other benefit change and liability management options.

These results show that smaller schemes are much less likely to have implemented (or be very likely to implement) salary sacrifice and PIE at retirement than their larger counterparts. This suggests that they are potentially missing out on providing more efficient accrual of benefits to members and on offering their members the full range of choices at retirement.

Aon has launched an implemented solution to make actions such as PIE or transfer value exercises accessible to smaller schemes in a cost-effective and efficient manner.

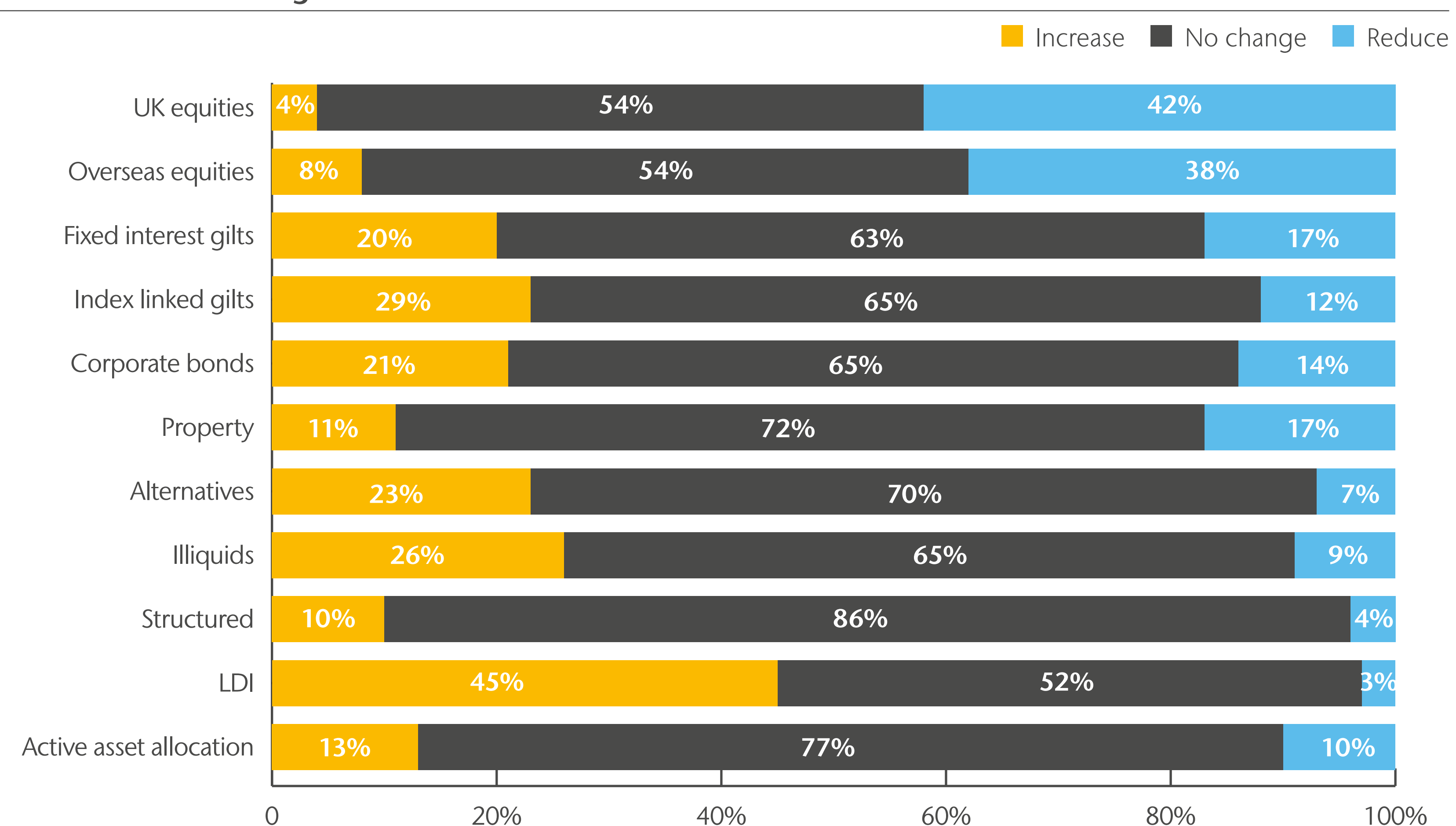
Investment strategy considerations

In more depth | Page 1 of 2

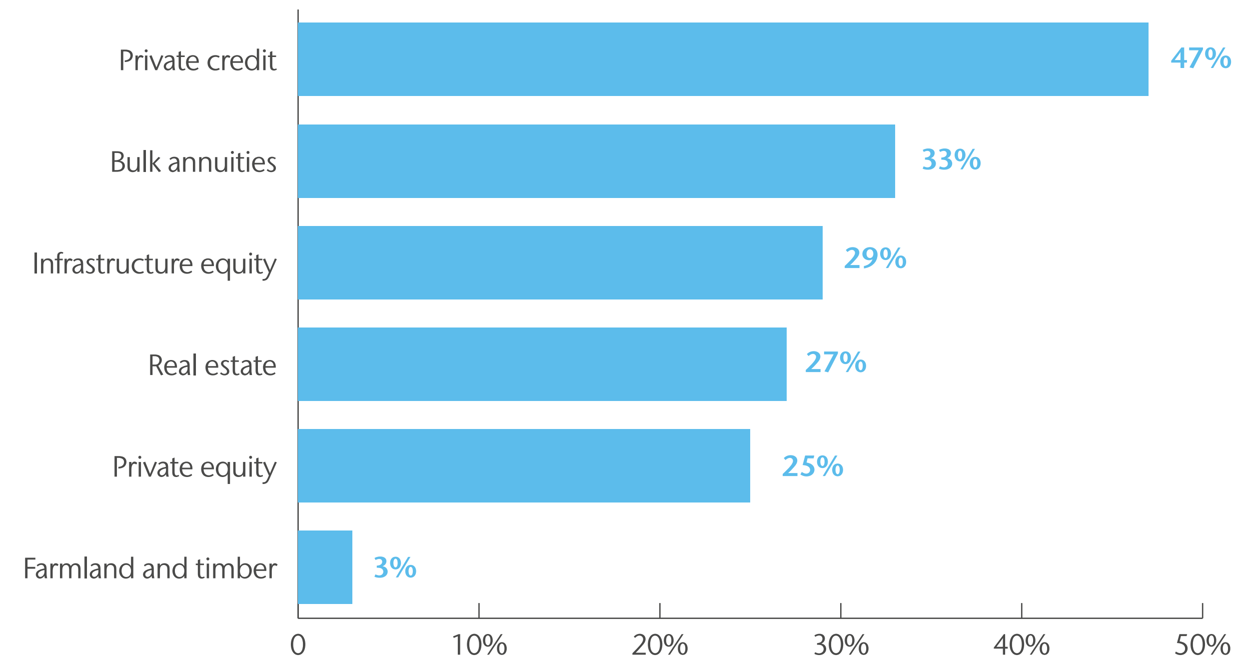
We have discussed the actions taken by respondents over the past 12 months in terms of asset allocation, and the de-risking trend looks set to continue.

Around 40% of respondents anticipate reducing their equity allocations further over the next 12 months, with LDI again expected to be the asset class with the highest increases. With a large amount of activity planned over the next year, cost of change is going to be important and having full transparency will be key.

Expected investment changes over next 12 months



Anticipated investments in illiquids



In terms of anticipated increases across illiquid asset classes, it is interesting to note where respondents are expecting to increase exposures.

Around one-third of respondents anticipate purchases in bulk annuities, again reflecting the increasing maturity and funding level of pension schemes in general (and a trend that we discuss in the next section of this survey).

We also see interest across a range of different illiquid asset classes, ranging from asset classes such as infrastructure with 20- to 25-year time horizons through to more cashflow-generative private debt type approaches.

We continue to see great interest in less liquid asset classes, as pension schemes look to investment ideas which can provide diversification from more traditional markets, but are also able to provide predictable levels of income — a feature increasingly important as schemes reach full funding on their Technical Provisions.

In particular, approaches such as real estate debt, direct lending and bank capital relief have been implemented by our clients.

The key advantage of investing in these asset classes is the income generation offered. Returns are predominantly driven by income with security offered by asset backed/contractual cashflows and/or seniority in the capital structure.

The range of strategies available provides flexibility in that they can form part of a scheme's growth portfolio or part of its de-risking strategy. The income-orientated nature means they are likely to be more defensive, while the lack of reliance on capital appreciation is also attractive in a range of market environments and scenarios.

It is worth noting that there has been a huge interest in these areas over recent years and this 'overcrowding' means that a robust approach to manager and fund selection is vital.

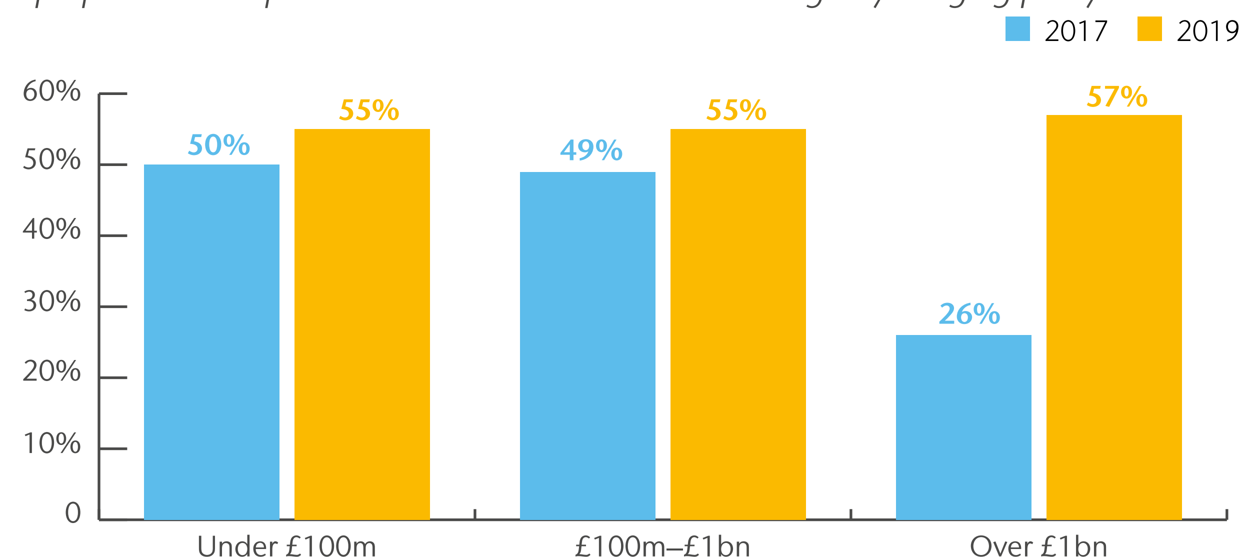
Managing DB risk

In more depth | Page 1 of 3

The chart below shows how the proportion of schemes expecting to hedge longevity risk through bulk annuities has changed by scheme size between the 2017 and 2019 surveys.

Expected to hedge through bulk annuities

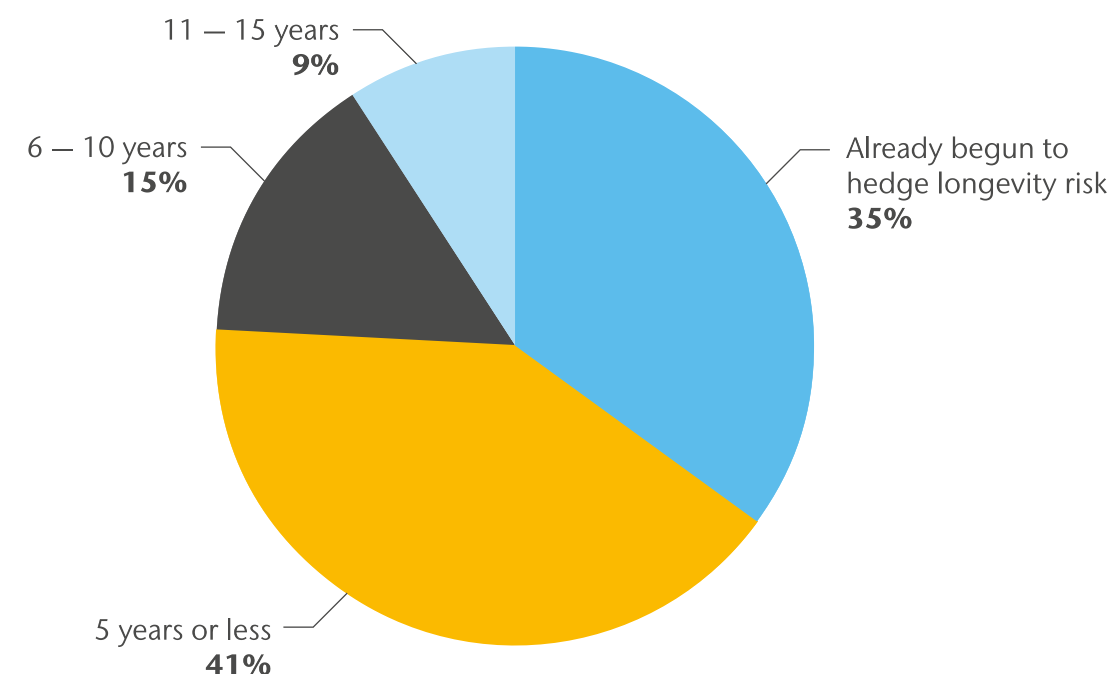
As proportion of respondents who had considered their longevity hedging policy



In previous surveys, we have seen that the smallest sub-£100m schemes are most likely to expect to purchase bulk annuities, but these are increasingly seen as options for all schemes and, in particular, the largest schemes, as shown very clearly in these results.

In 2016 and 2017 we saw no transactions above £1bn. Since then there have been several £multi-billion bulk annuity deals, the largest being the deal between the Rolls-Royce UK Pension Fund and Legal & General in respect of over £4.6bn of pensioner liabilities. Therefore, large schemes can have confidence that size is no longer a barrier to these deals.

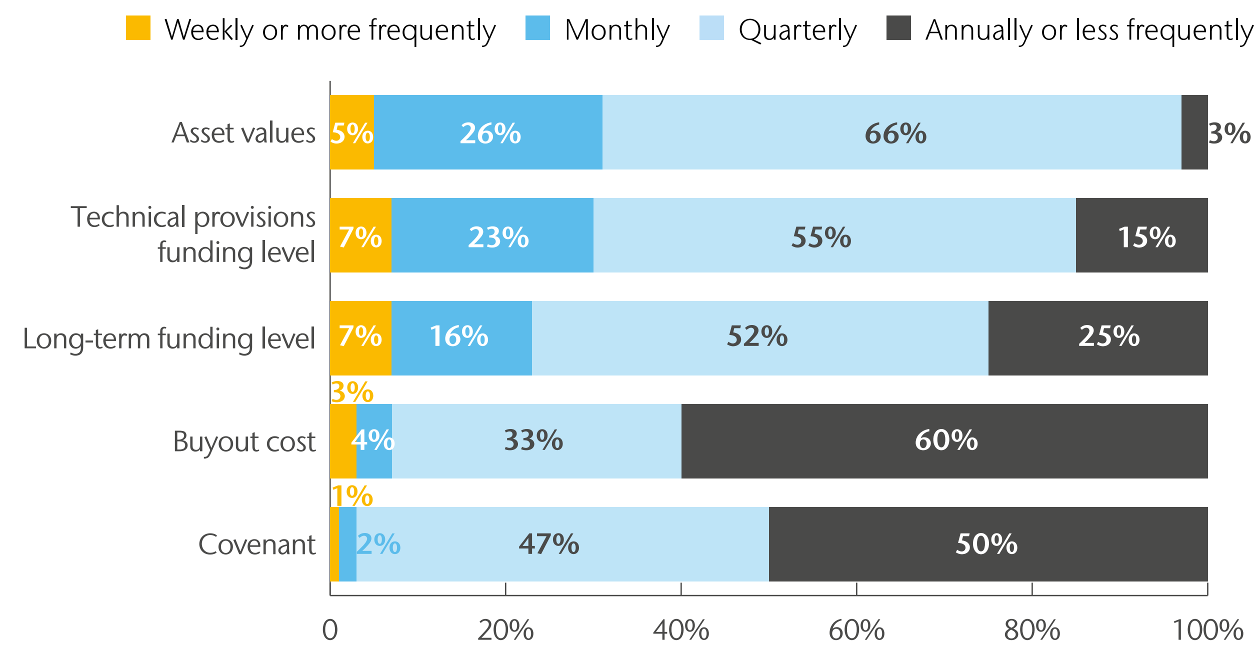
Timescales for starting to hedge longevity risk



We asked schemes which intend to hedge longevity risk about their timescale for doing so. The vast majority of schemes have either already begun to hedge longevity risk or expect to do so in the next five years. These figures are similar to those from the 2017 survey results, except there is no longer a tail to the data — all those schemes that plan to hedge longevity risk expect to start doing so within the next 15 years.

These results show that partial longevity transactions are standard in this market, so schemes do not need to wait until they have reached full funding on a buyout basis before transacting a bulk annuity.

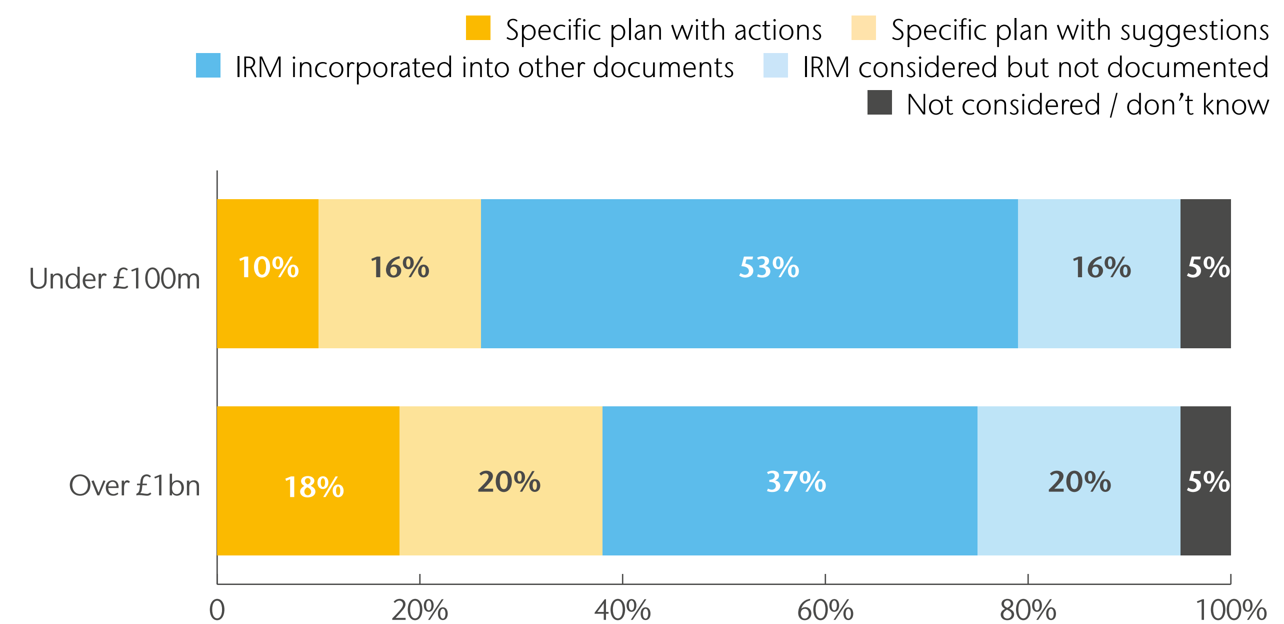
Frequency of risk monitoring



Asset values remain the scheme statistic that is measured more frequently than annually the most often (97%). Almost one in three schemes measure both asset values and the Technical Provisions funding level monthly or more frequently, with the long-term funding level measured this frequently by almost one in four schemes.

As expected, the increased focus on buyout means that it is monitored more regularly. In the 2017 survey, two-thirds of respondents said that they monitored the buyout cost of their scheme only annually or even less frequently. In the 2019 results, this figure has dropped to 60% and we expect it to continue falling as more and more schemes get closer to their long-term target.

Approach to Integrated Risk Management plans by size

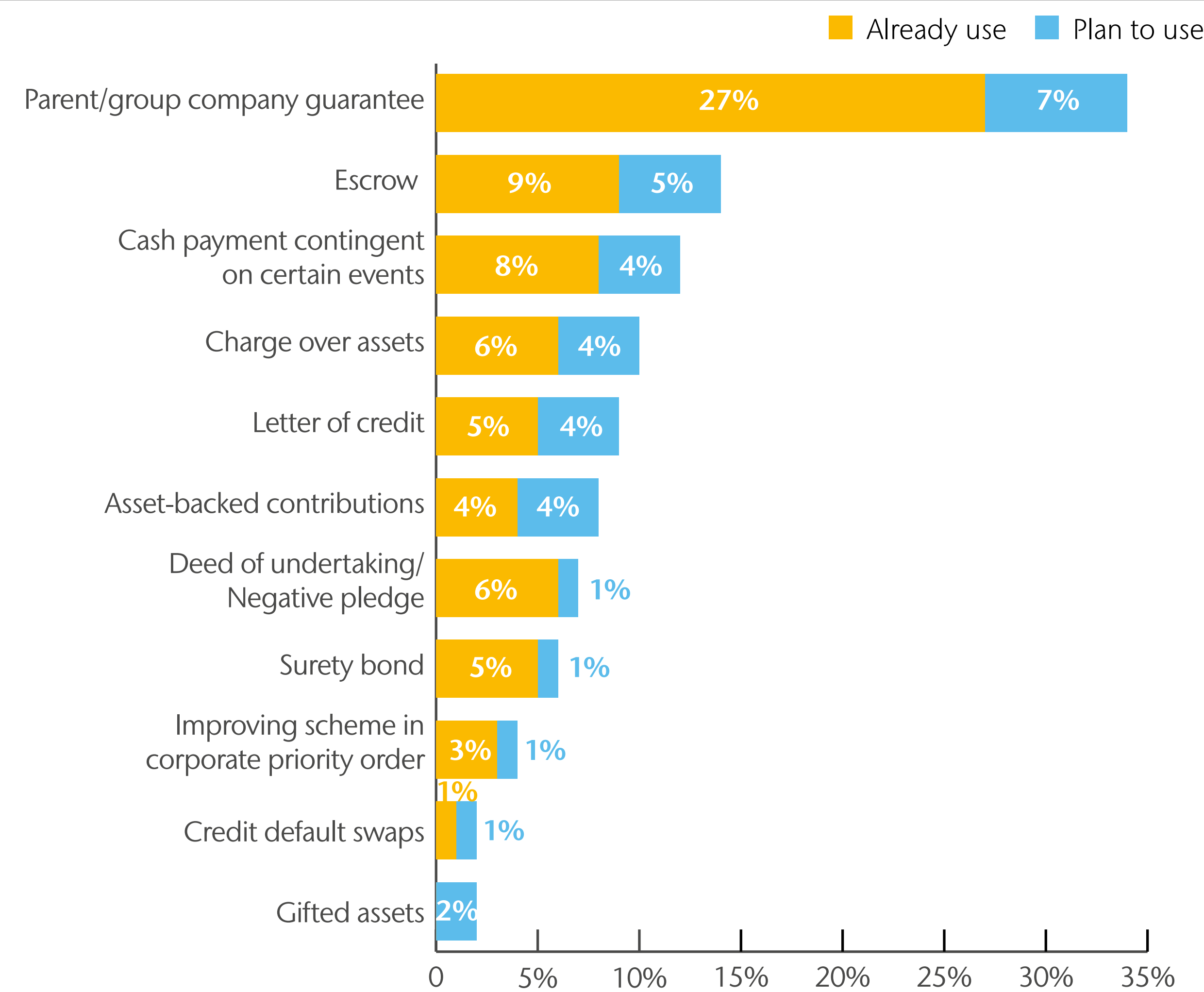


The approach to IRM plans shows a distinct size trend. Larger schemes are more likely (18% compared to 10%) to have a specific plan with actions than smaller schemes, and they are less likely to have incorporated IRM into other documents (37% compared to 53%).

However, smaller schemes have taken the most action to consider and document their IRM plans: in 2017, 56% either had not considered IRM or had not documented their IRM plan. In 2019, that proportion has fallen to 21%, which is smaller than the equivalent figure for larger schemes (25%).

Contingent assets are now being used for various reasons including supporting covenant, financing deficits, matching contingent liabilities and managing trapped surplus. In doing so, they provide additional support to trustees, but in a way that can be more suited to the sponsor than cash financing that cannot easily be reclaimed. As the chart below shows, there is a wide variety of alternative financing options that schemes either use or plan to use.

Alternative financing options



Parental guarantees remain the most popular type of alternative financing, as has been the case in previous years.

The proportions of schemes using most of the alternative financing options have remained essentially unchanged from 2017. Having said that, contingent cash has become successively less popular since 2015, with now only 12% of schemes using or planning to use this option, down from 15%. Surety bonds, however, have increased in popularity, with 6% of our respondents using or planning to use them in 2019 compared to just 3% in 2017.

It is interesting that contingent cash contributions have become steadily less popular; perhaps a reflection that market conditions have tended to mean that the payments were triggered, making these payments guaranteed.

Conversely, the rise of surety bonds shows that this source of support that does not affect existing overdraft and loan facilities has become an embedded part of UK pensions.

Hot topics | Cyber risk

In more depth

We asked schemes questions to understand the plans they have in place to respond to a cyber incident.

To supplement training, within the next 12 months, half of schemes expect to have completed a 'war game' exercise where the participants discuss what actions they would take in the event of a cyber incident. Such exercises bring cyber risks to life as they help participants focus on the issues that matter to their scheme.

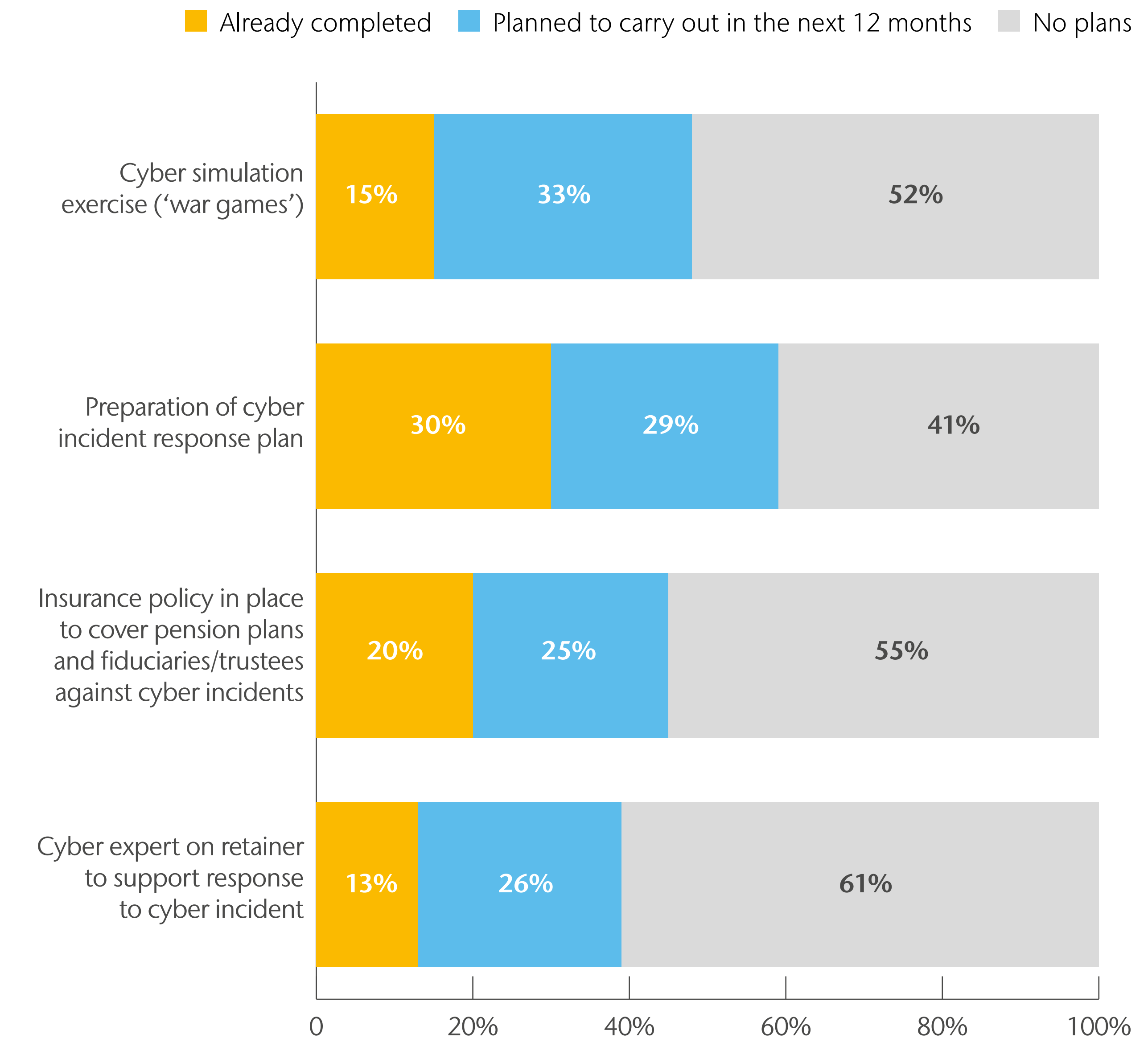
Surprisingly, over 40% of respondents have no intention of having a cyber incident response plan, despite TPR explicitly saying that schemes should have one.

When looking in more detail at the cyber risk results, we see that many schemes are yet to take action. We expect this is because cyber risk has only recently had more coverage in relation to pension schemes.

The lack of cyber insurance is not surprising. In fact, given the lack of cyber insurance in the market we are surprised that 20% of schemes believe they already have cover. With corporate policies usually not extending to trustees, and trustee liability policies only effective if there is a claim against the trustees, we suspect that actual levels of insurance are much lower than this survey suggests.

One of the most popular aspects of cyber insurance is access to an expert in the event of a cyber incident. It is encouraging to see some schemes putting this in place.

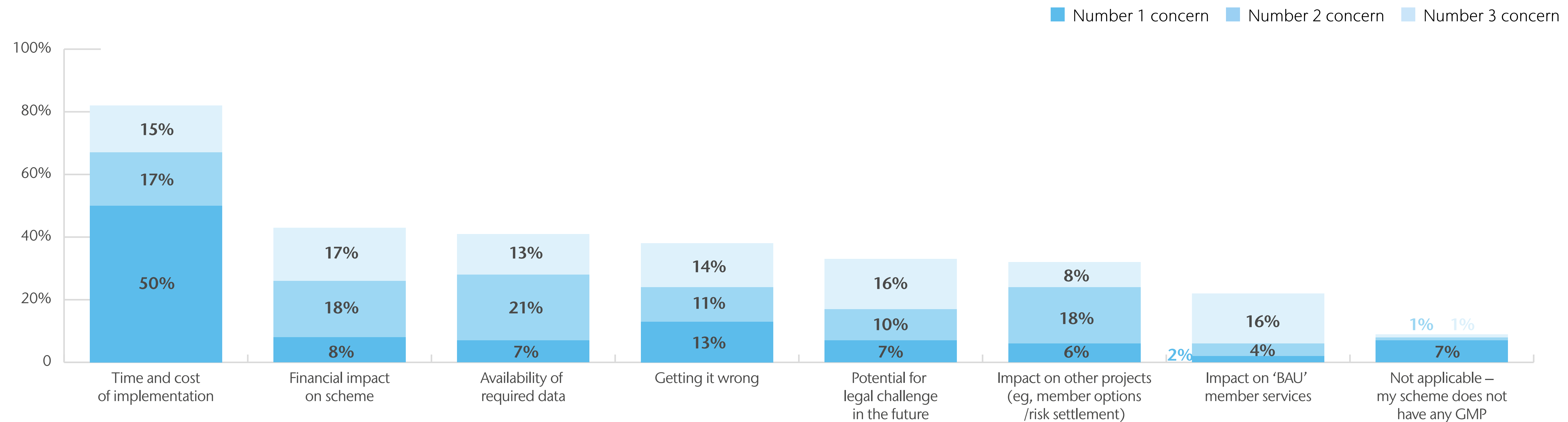
Actions in response to a cyber incident



Hot topics | GMP equalisation

In more depth | Page 1 of 2

GMP equalisation — top three concerns



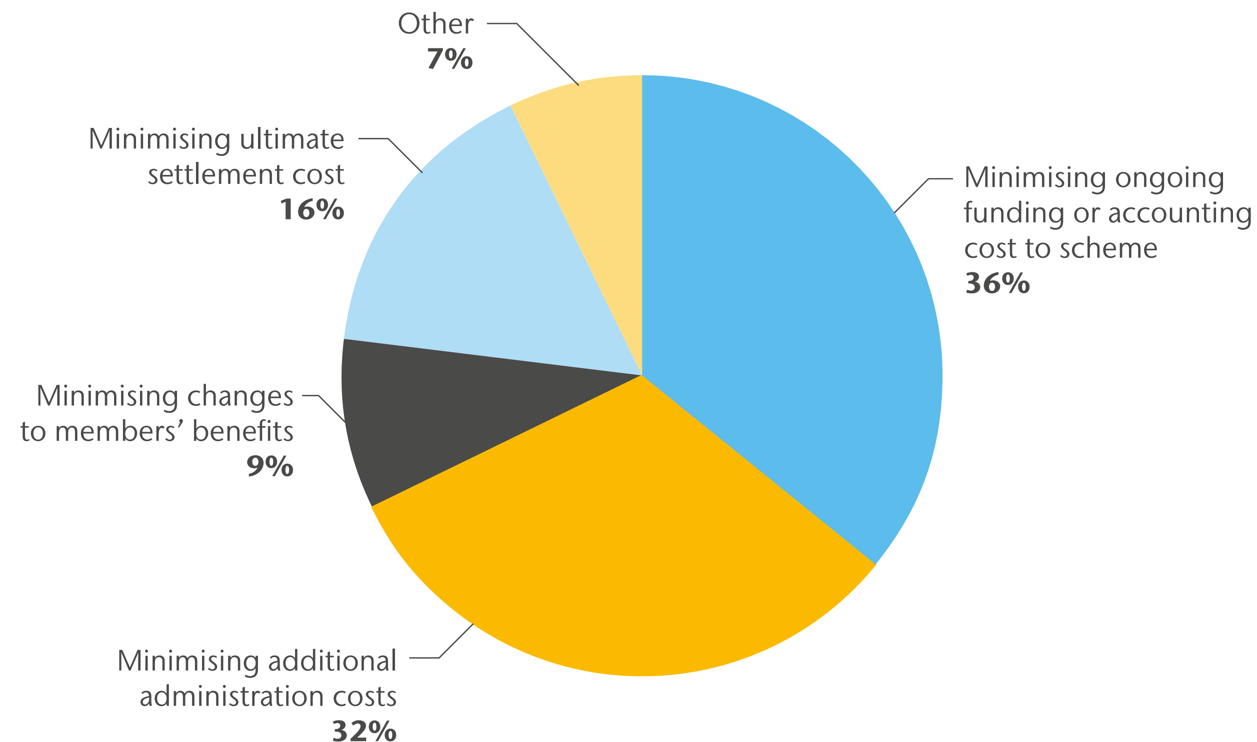
Looking in more detail to see what concerns respondents included in their top three, we still see that time and cost of implementation was significantly ahead of other concerns and was in the top three concerns for 82% of respondents. The next three biggest were the financial impact on the scheme, the availability of required data and the risk of getting the equalisation wrong, each being selected by around four in 10 respondents.

The financial impact has typically been a concern because sponsors need to include the additional liability in their profit and loss account. It can be material in that context, even if it is more modest in the context of additional scheme liability as a whole.

Data is a challenge for many schemes as the data needed is from many years ago. PASA is looking at guidance on how difficult-to-acquire or lost data can be managed.

As noted in the high-level results section, it will be essential that the equalisation is done accurately first time.

GMP equalisation — key considerations



The judge on the Lloyds case allowed a number of different methods to be used for GMP equalisation that used either a dual records approach or GMP conversion to deliver the newly-equalised benefit. Dual records is an administration solution that continues to compare the member and the equivalent member of the opposite sex over time, whereas GMP conversion converts the benefit into a new form to deliver the value of an equalised benefit.

Sponsors will have the right to decide whether GMP conversion is right for their scheme, but trustees have significant powers in setting any conversion terms, so in practice sponsors and trustees need to work together on setting the objectives for GMP equalisation projects.

In deciding which method to use, respondents' most important considerations were the ongoing funding or accounting cost to the scheme (36%) and the additional administration costs (32%).

These results echo the finding that the costs of GMP equalisation are a key concern. However, comparing the costs of the different methodologies will involve not just the accounting and funding costs, but also long-term administration cost impact compared to implementation cost. These are not easy comparisons to make.

It is interesting to note that despite buyout increasing in popularity as a long-term funding target, minimising the ultimate settlement cost was the most important consideration for only 16% of respondents, although it could be an important secondary consideration for many more.

We believe that action can and should be taken now to consider the information that can be gathered about data and benefits, even if it is more cost efficient not to rush too fast to implementation.

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