Global Pension Risk Survey 2019

UK Survey Findings

Long-term targets

AON
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Introduction

Welcome to the 2019 Global Pension Risk Survey findings concerning long term-targets. These findings form part of our overall 2019 survey of UK defined benefit (DB) pension schemes.

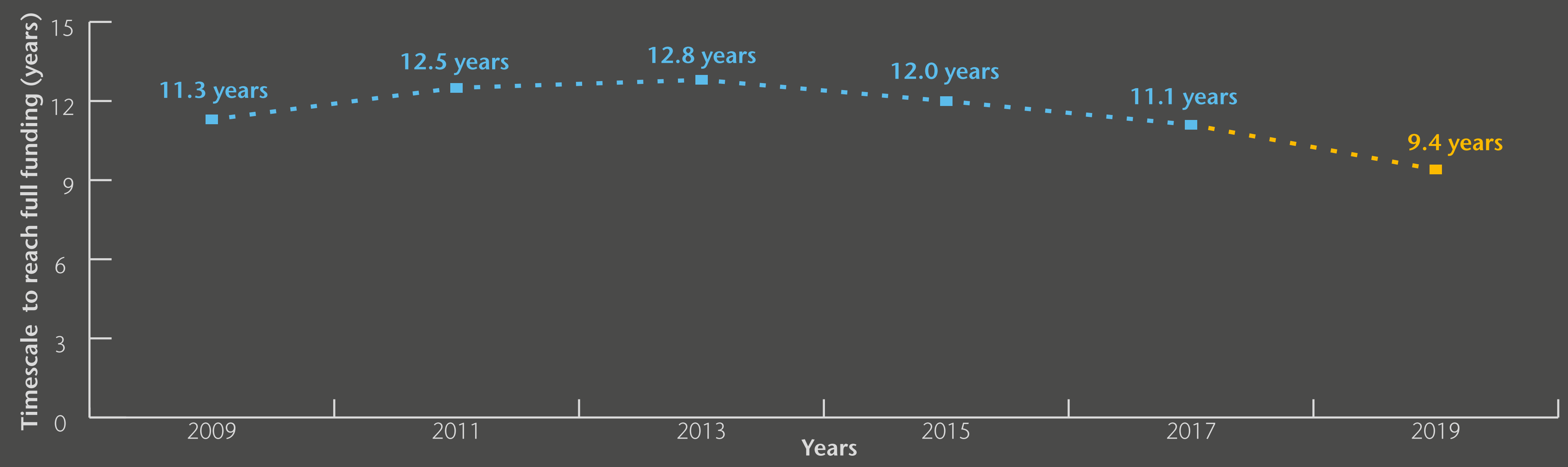
We carry out the Global Pension Risk Survey every two years, and looking back over the last decade, we can see how the pensions landscape has developed. Ten years ago, schemes were dealing with the fallout from the global financial crisis, and over the following years, increasing numbers of schemes closed to accrual in response to rising costs.

As a result, schemes began to set their sights on long-term, lower-risk destinations, but market conditions and, initially, rising longevity seemed to conspire against making progress. The ultimate low risk target forever seemed just out of reach. However, in recent years, schemes' long-term objectives have grown closer than they have ever been (see chart), as schemes mature.

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 decisions around long-term targets, management of liabilities, investment strategy and approaches to hedging longevity risk have come 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.

In this set of findings, we look in detail at how schemes have set their long-term targets. The survey findings relating to the other subject areas in the survey are available separately.

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

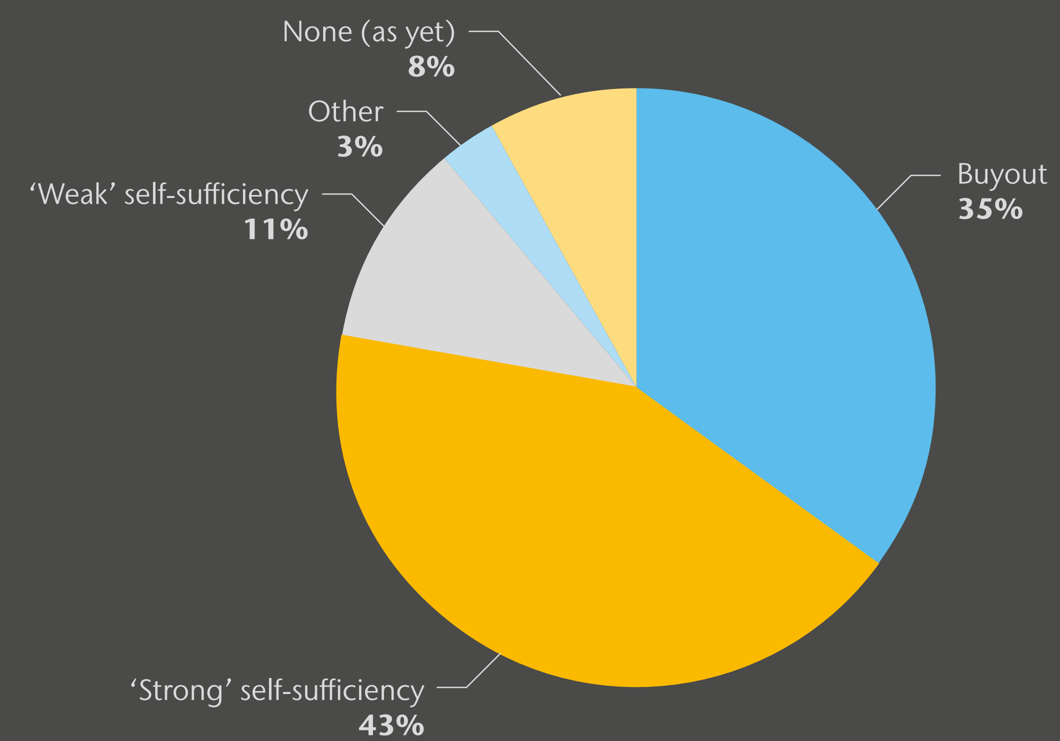
Nearly 2/3 of responses came from trustees

Long-term targets

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%).

Long-term targets



Aon insight

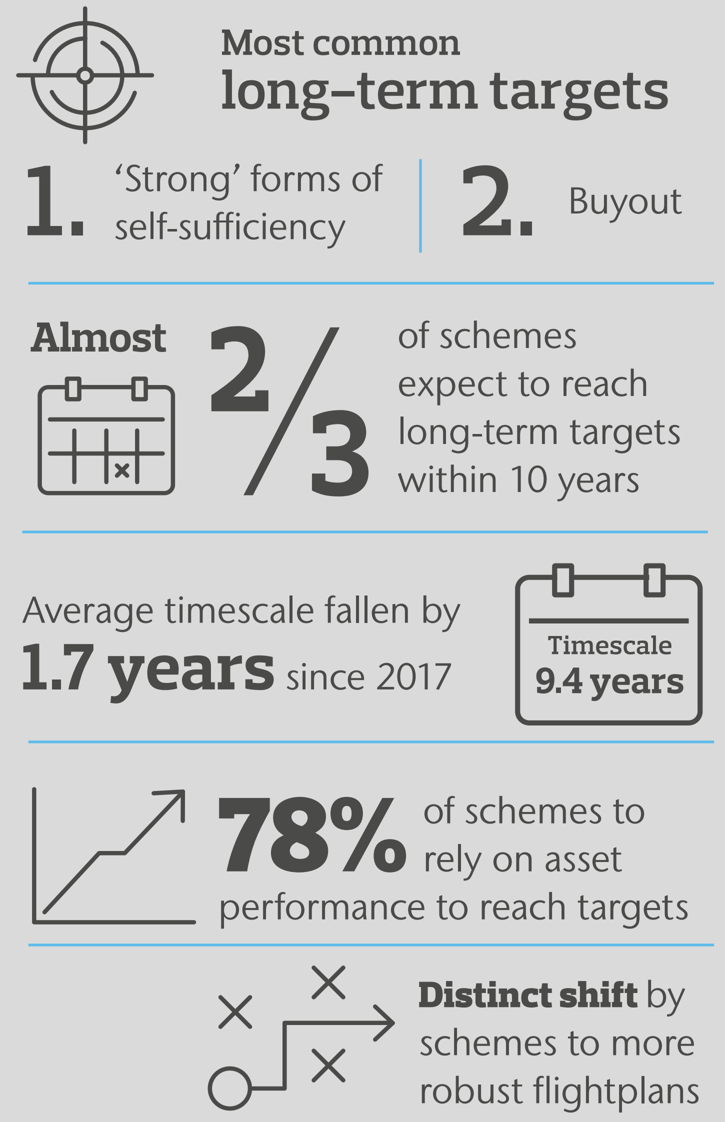
As schemes have seen improvements in funding positions, lower risk targets such as buyout seem more achievable and we see more schemes willing to set it as a target.

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.

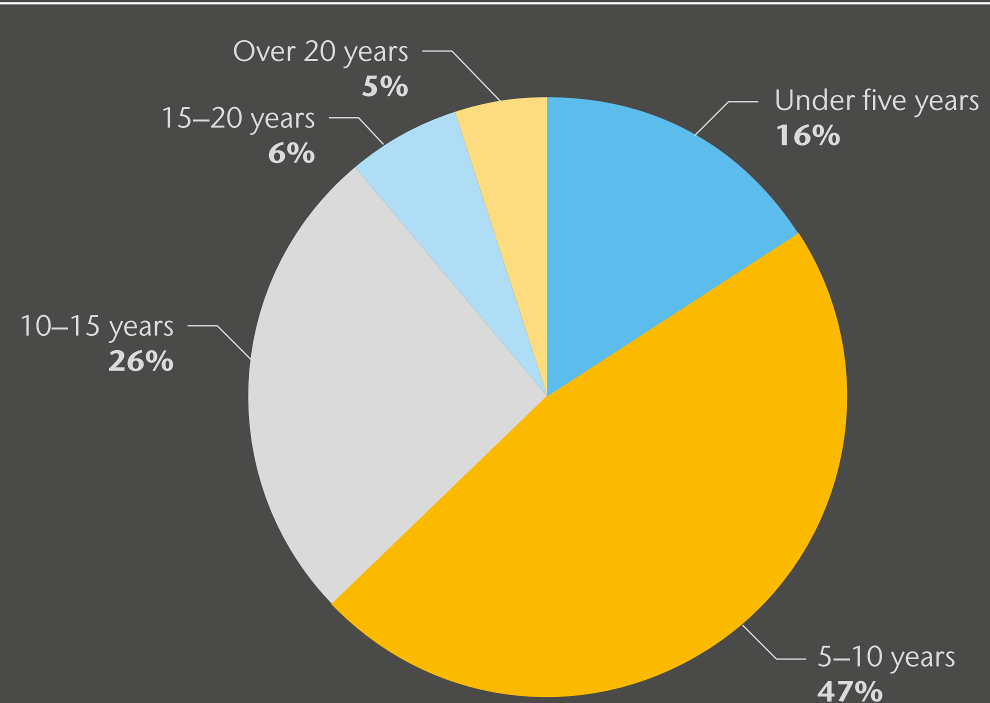
No respondents indicated that they were targeting commercial consolidators, implying that these nascent solutions are perhaps seen as a fallback option rather than a destination to be aimed for.

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

Key findings



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.

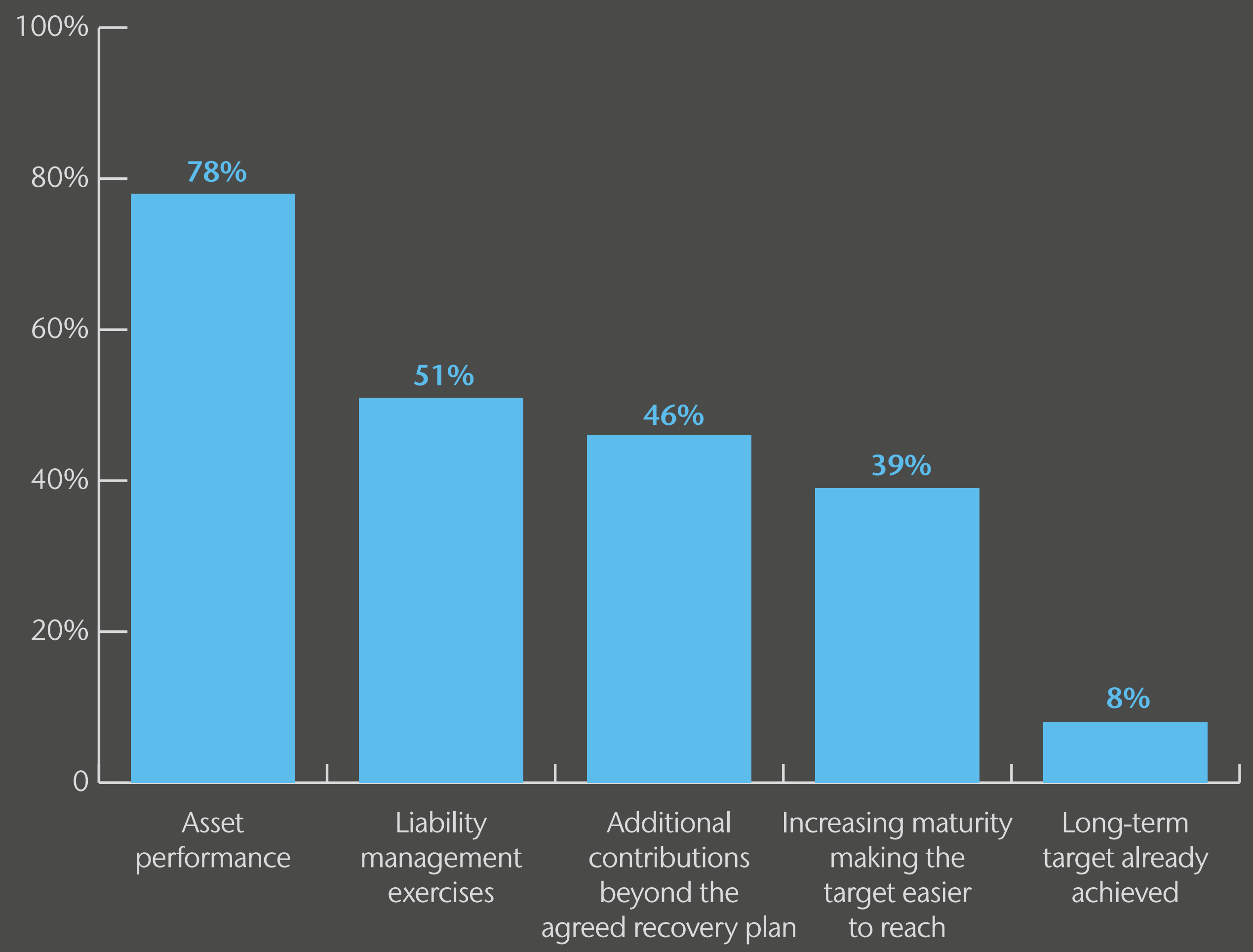
Aon insight

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).

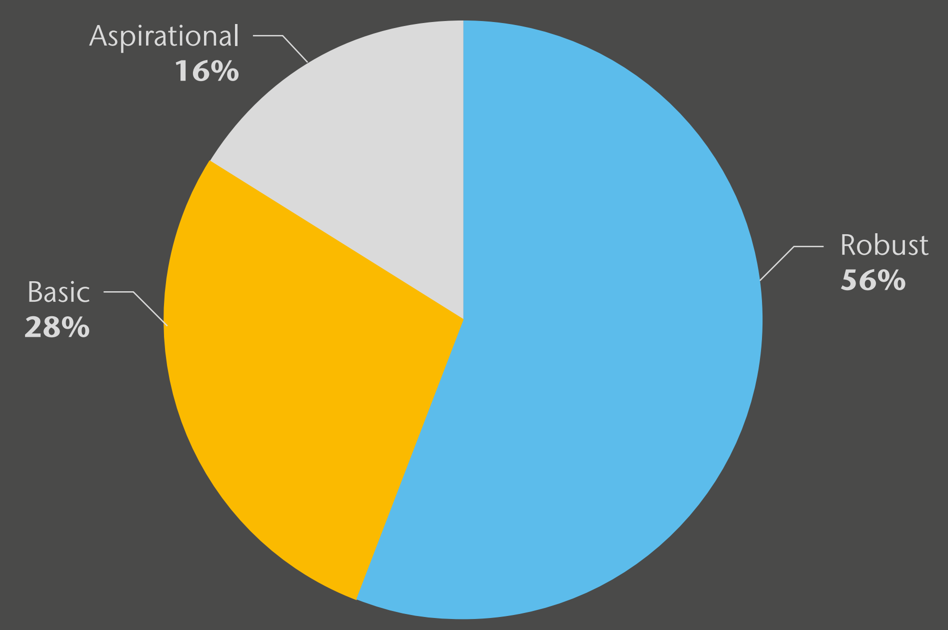
Most common was to rely (at least partially) on asset performance (78%). However, liability management was indicated as one action to reach the target by just over half of respondents. Interestingly, almost half of respondents expected contributions beyond the recovery plan to be an element of the actions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



Aon insight

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.

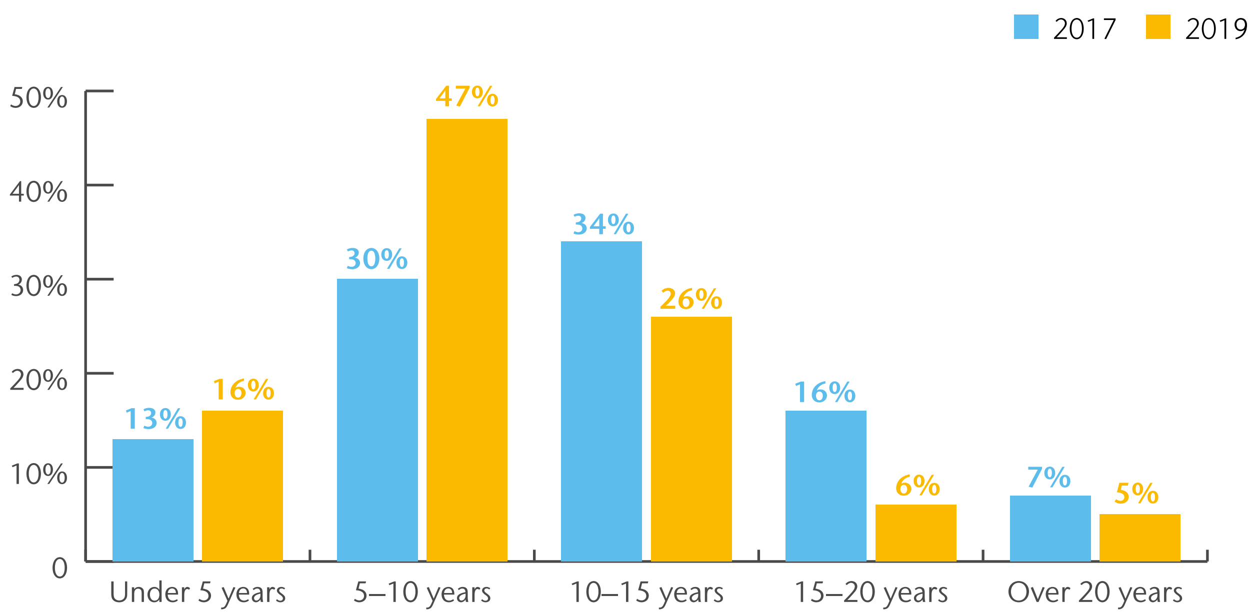
> "This project has achieved the outcome we really wanted. By a collaborative approach from all parties, we have been able to secure a deal which no one imagined possible at the outset"
>
> **Kully Janjuah, PA Consulting**

Long-term targets

In more depth

In more depth

Comparison of timescales to long-term target



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.

Aon insight

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.

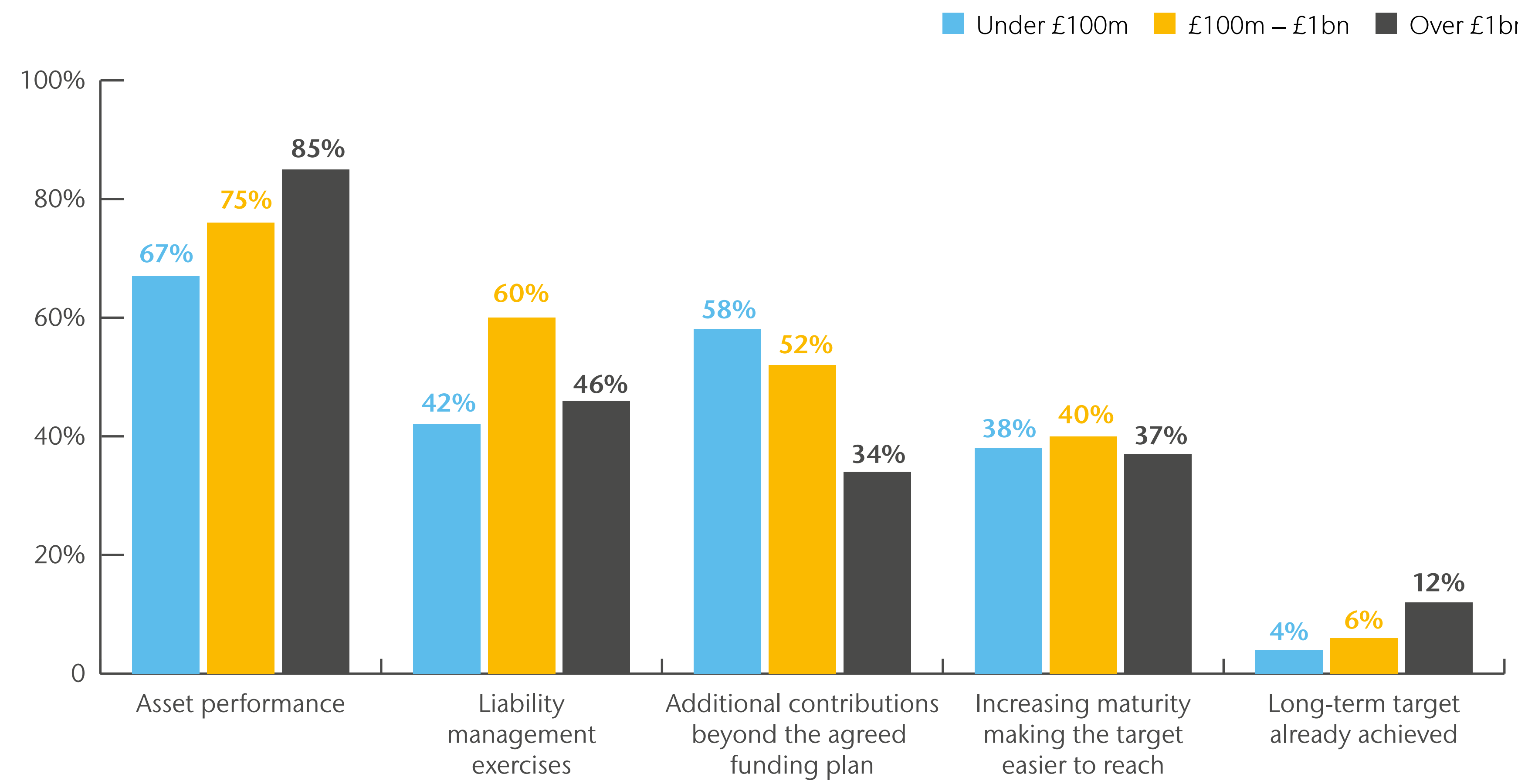
We see later in the survey that 23% of schemes have increased their holding in illiquid assets over the past 12 months. Schemes making such a change need to ensure this fits with their long-term strategy.

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



Aon insight

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%).

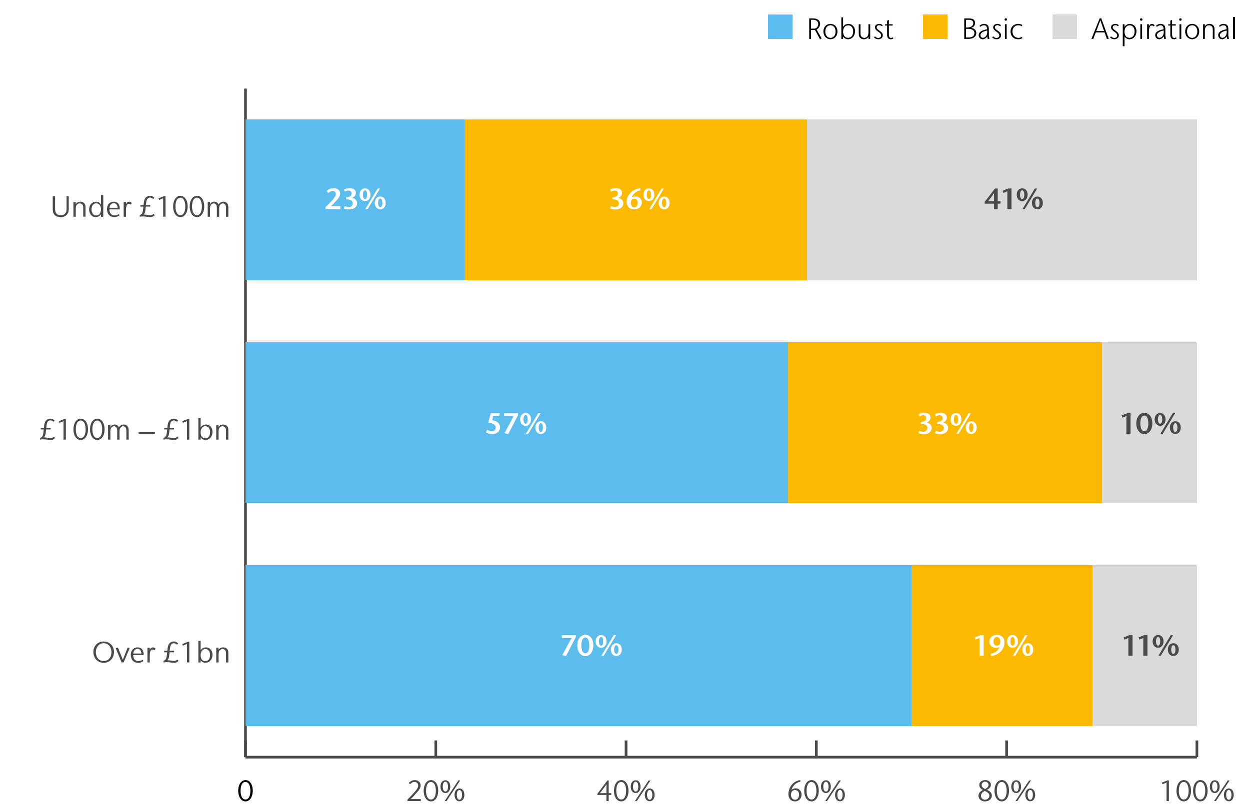
In contrast, larger schemes have seen a shift towards greater robustness since 2017. For example, the proportion of schemes with assets over £1bn with robust flightplans has risen by 10% to 70%.

Aon insight

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

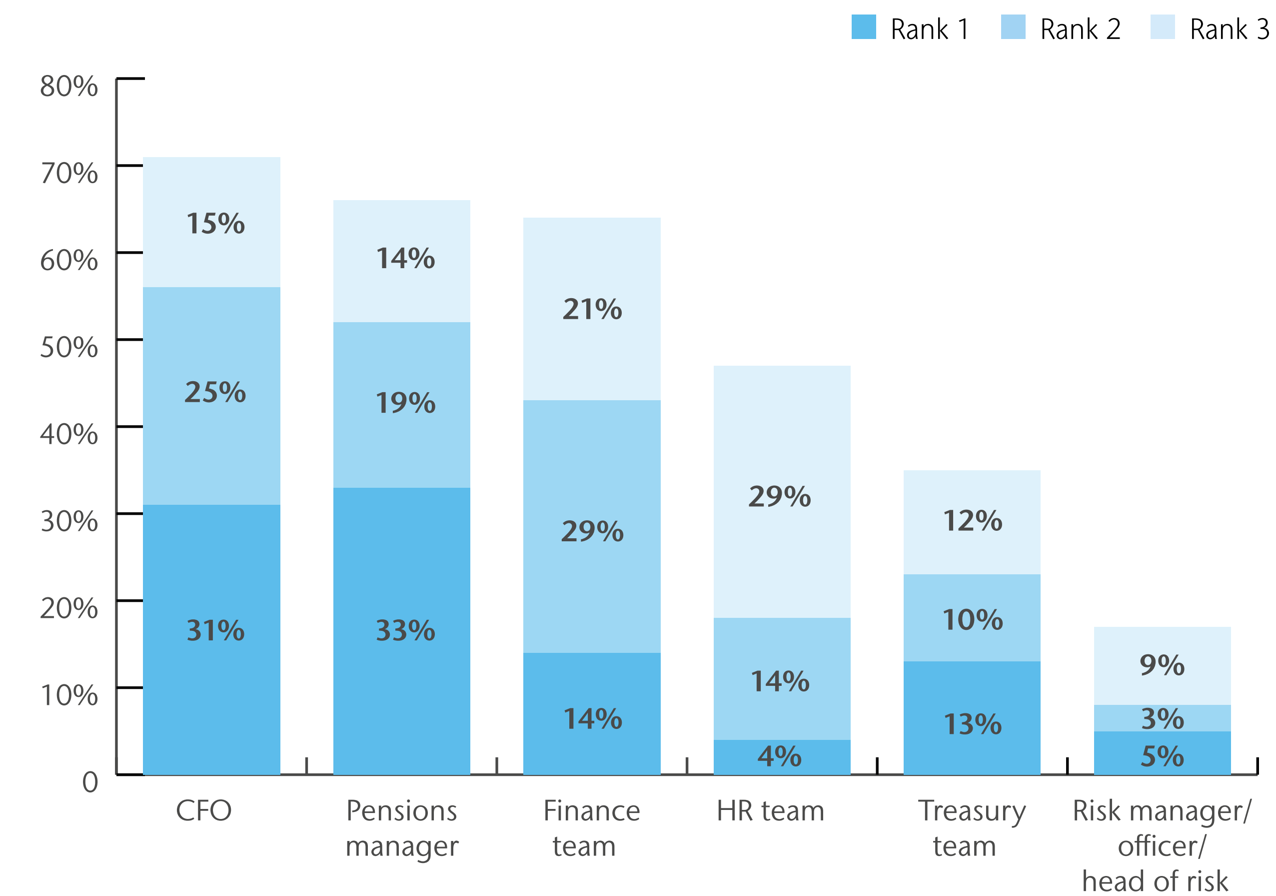


For the first time in 2019, we asked respondents who has the most responsibility within the sponsor for DB pensions, and we also asked respondents to rank the top three levels of responsibility.

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



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About Aon

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