AON
Empower Results®

# Introduction

Welcome to the 2019 Global Pension Risk Survey, which includes information in respect of the Irish responses.

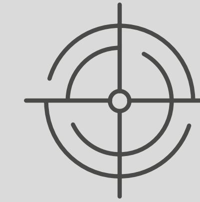
Aon carries out the Global Pension Risk Survey every two years and, looking back over the last decade, we can see how the pensions landscape has developed. Ten years ago, schemes were dealing with the fallout from the global financial crisis, and over the following years, increasing numbers of schemes restructured by, primarily, either winding up or closing to accrual in response to rising costs.

As a result, ongoing schemes began to set their sights on long-term, lower-risk destinations, but market conditions and rising longevity seemed to conspire against making progress.

The majority of schemes in funding difficulties entered into long-term funding proposals (recovery plans) of up to 10 years. Many of these funding proposals have now come to an end or are entering their last few years of deficit contributions. So now is a good time for schemes to think about next steps and set long-term goals. This long-term planning — as with other strategies and approaches — is mirrored around the world and not specific to Ireland.

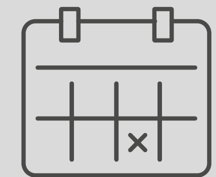
The remainder of this report sets out how Irish schemes are, in general, positioned in comparison to the rest of the world.

## Key findings

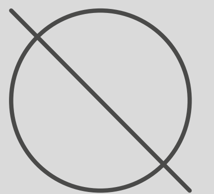


Growing trend towards **funding for self-sufficiency or buyout** as long-term target

Over time, expected timescales to achieve long-term targets have **generally decreased**

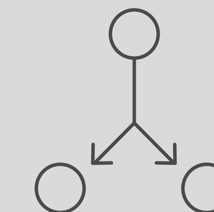


**Approximately 1/3** schemes are now closed to future accrual



**Increased exposure** in matching assets and illiquid assets

**Reduced exposure** to equity markets

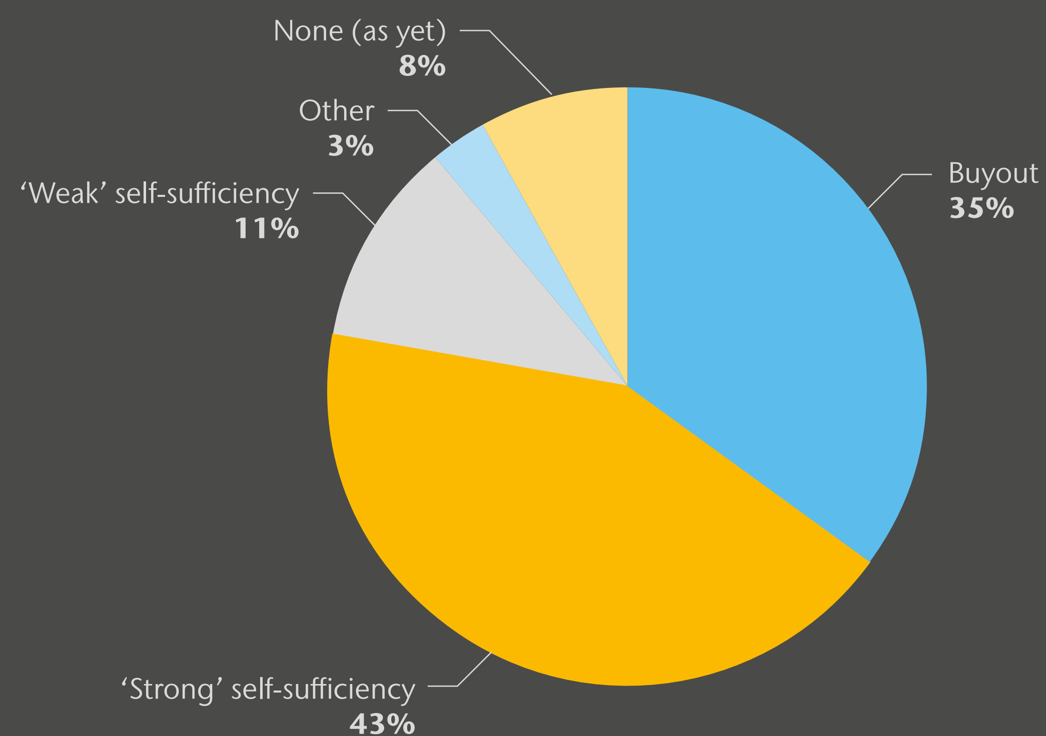


Fiduciary investment management **grown dramatically in Ireland**

# Funding targets

There has been a growing trend globally towards funding for self-sufficiency, defined here as running a scheme with a largely risk-free investment strategy, or on a buyout basis. We are also seeing this growing trend in Ireland; many schemes have targeted a self-sufficiency basis but are also moving to fund on a buyout basis due to the Irish minimum funding standard effectively pushing schemes in this direction. This is particularly true for mature and maturing schemes. As an example, 89% of schemes in the UK are targeting self-sufficiency or buyout targets (see chart below).

**Long-term targets**

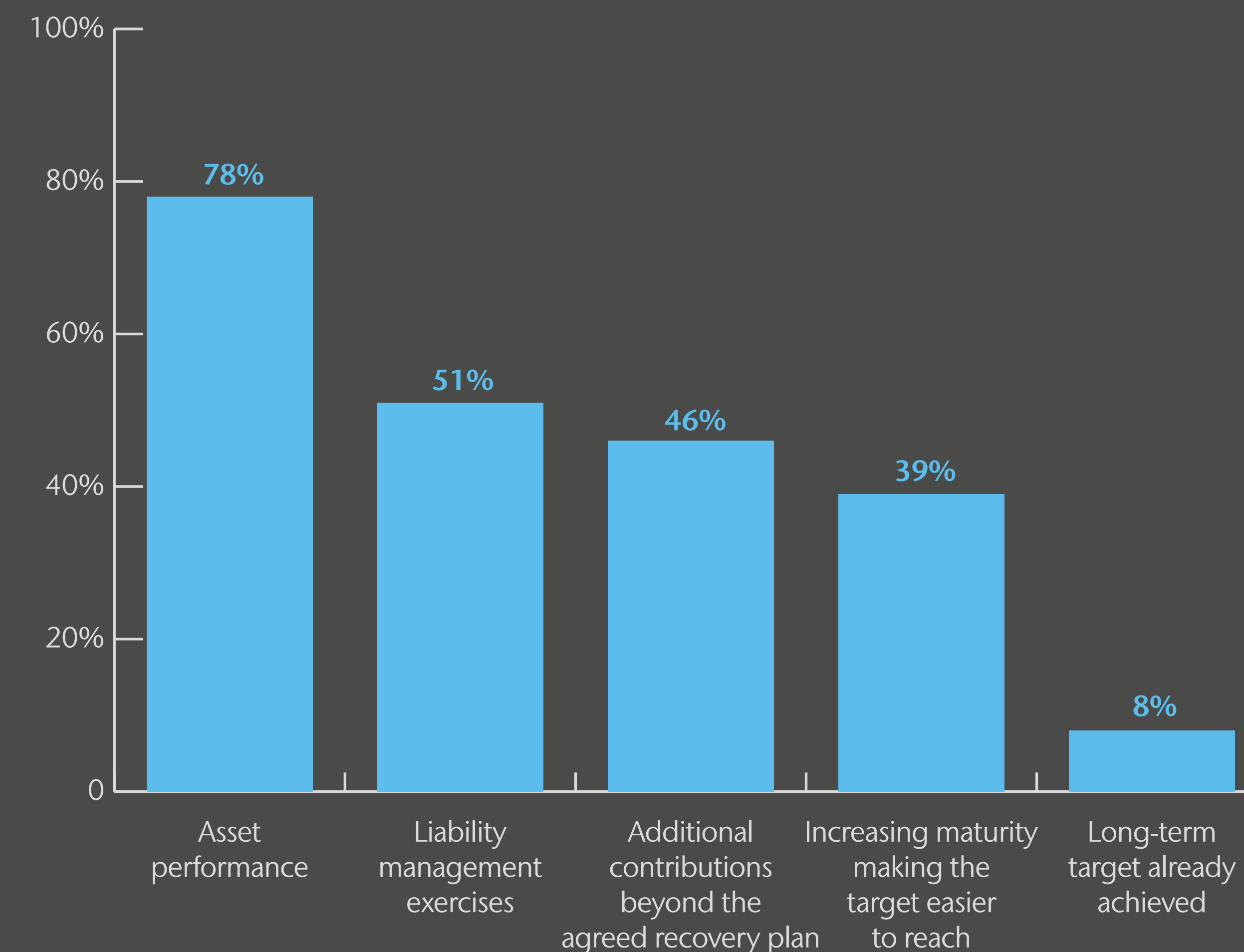



*Source: Aon UK Global Pension Risk Survey 2019*

# Achieving long-term targets

Schemes are looking to investment returns which outperform discount rates over time to help them meet their long-term targets. This is particularly true in the UK and Ireland. Future liability management exercises are also expected to play a big role, while increases in contributions beyond rates set out in funding proposals can also be expected to be a feature. The below bar chart illustrates expectations in the UK.

**Actions to reach long-term target**

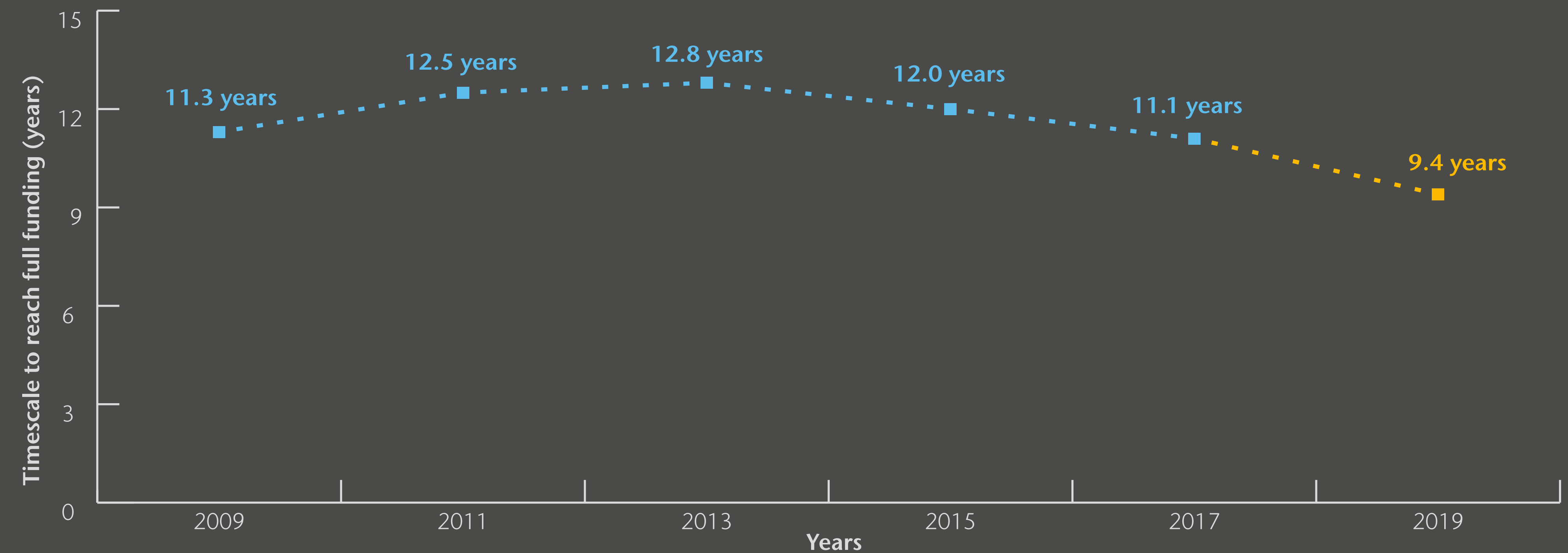



*Source: Aon UK Global Pension Risk Survey 2019*

# Timescales

The graph to the right shows the expected time to achieve long-term targets among UK respondents to the survey; the shape is broadly representative of what we are seeing in Ireland. As funding levels deteriorated after the last economic crisis, timescales increased as longer funding proposal periods were put in place. Over time, as funding levels and more robust plans have been agreed between companies and trustees, expected timescales have generally decreased. Legislation has also reduced maximum deficit recovery periods to six years. However, since this survey was carried out in the summer, the rate of decrease has slowed, mainly due to headwinds such as the low bond yield environment prevailing in the Eurozone.

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




*Source: Aon UK Global Pension Risk Survey 2019*

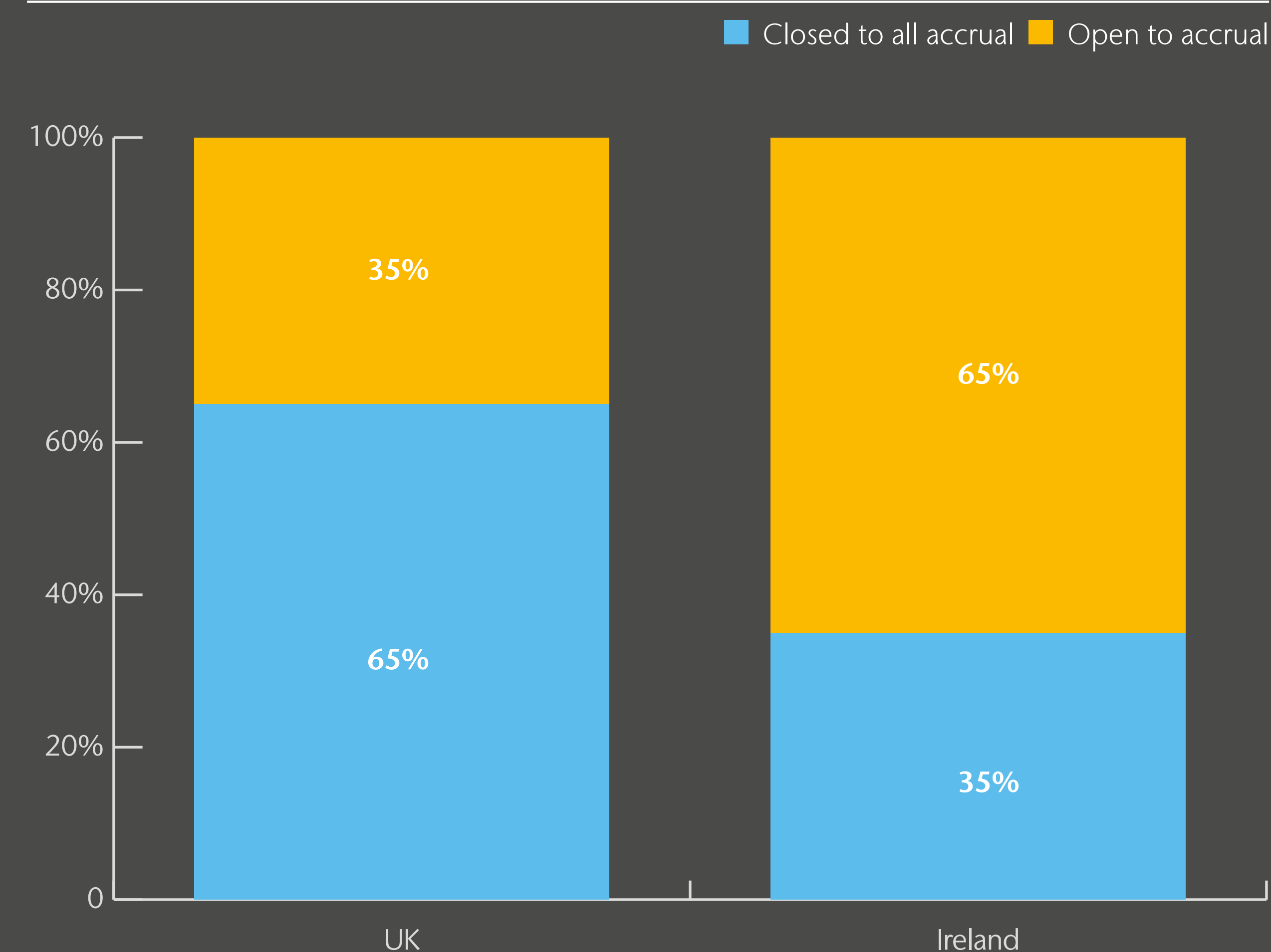
# Liability risk mitigation

Other countries (especially the UK due to pension freedoms) have moved to using bulk annuity purchases and member options such as enhanced transfer value (ETV) and Pension Increase Exchange (PIE) exercises to manage liabilities. The Irish annuity market is not as competitive as other jurisdictions (notwithstanding increased interest from overseas providers), while differences in design compared to the UK market mean that the Irish market does not easily lend itself to certain solutions such as the use of PIEs. ETV exercises have, however, proved to be quite popular in recent times, assisted by more profitable employers, positive investment markets and increased benefit flexibility, such as the availability of income drawdown and potential for higher amounts of tax-free lump sums.

We have seen, both from the results and from experience, that most schemes have taken some form of action in terms of mitigating risk. In fact, we highlighted the high level of mitigation already implemented in our 2017 survey results. We know from recent Pensions Authority statistics that approximately one in three schemes is now closed to future accrual.

Others that have not closed to accrual have reduced benefits in other ways, such as implementing caps on pensionable salaries or reducing/eliminating the award of discretionary benefits. The vast majority of schemes are now closed to new members. Further benefit changes may be implemented in future, but closure to accrual is currently the most popular choice of action and this trend can be expected to continue, particularly if ultra-low bond yields persist and make the cost of continuing accrual unsustainable. Indeed, increased governance costs, expected to arise on the back of IORP II implementation, will have a disproportionate impact on smaller schemes and may lead to a further raft of windups. The chart to the right compares Ireland to the UK in terms of closure to accrual. Both counties have also reported that less than 10% of schemes remain open to new members.

**Trend to closure**

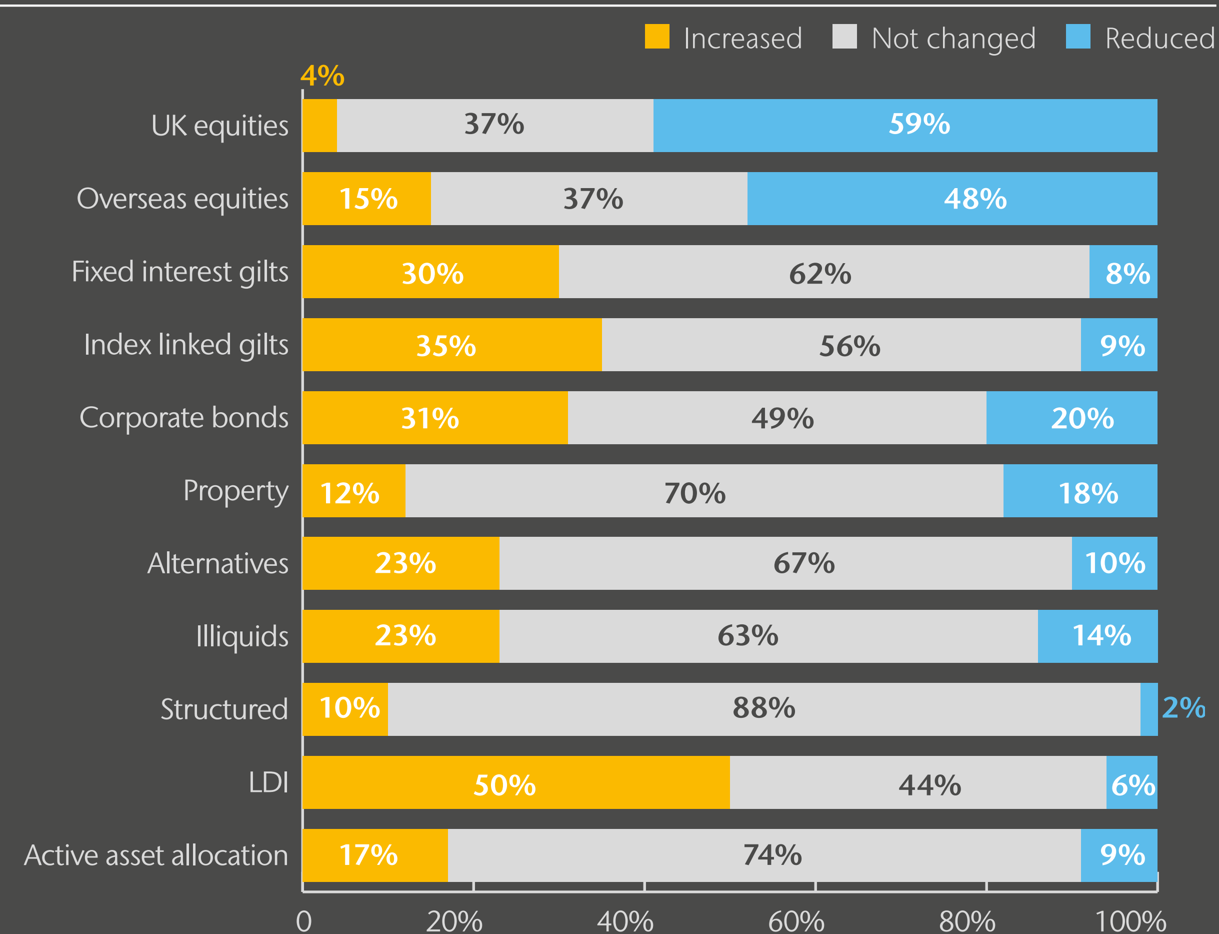



*Source: Aon UK Global Pension Risk Survey 2019*

# Investment strategies

Schemes in Ireland and across the world continue to reduce their exposure to equity markets, while increasing investments in matching assets such as fixed interest and index linked bonds. We have also seen increased investment in illiquid assets, such as infrastructure funds, over the last two years. This UK chart is typical of worldwide trends.

### Actual investment changes over last 12 months




*Source: Aon UK Global Pension Risk Survey 2019*

Schemes have reported that they will continue to look to de-risk out of equities and into matching assets, with some appetite also visible for further illiquid assets. This statistic is following the trend of schemes, in many cases, taking the opportunity to de-risk when they hit pre-determined funding levels or time-driven triggers. General sentiment towards equity markets and the economy in general, along with an increased focus on hedging liability risk (see next section) have also led schemes to further diversify out of equities and into LDI-type assets and illiquid assets. Within equity strategies, we see an increasing number of schemes broaden their equity mandates to include factor investing; diversified growth/absolute return funds also remain popular, although perhaps as part of a fund-of-funds solution rather than by exposure to single managers.

We are also seeing evidence that some schemes are not investing in illiquids due to a lack of resources. Some schemes have found either full or partial fiduciary management – the practice of delegating tactical decisions on some elements of their investment to experts – to be a good solution here. This is in contrast with countries like the UK, where the main reason for not going down this path is primarily schemes' objective of buying annuities in the short to medium term.

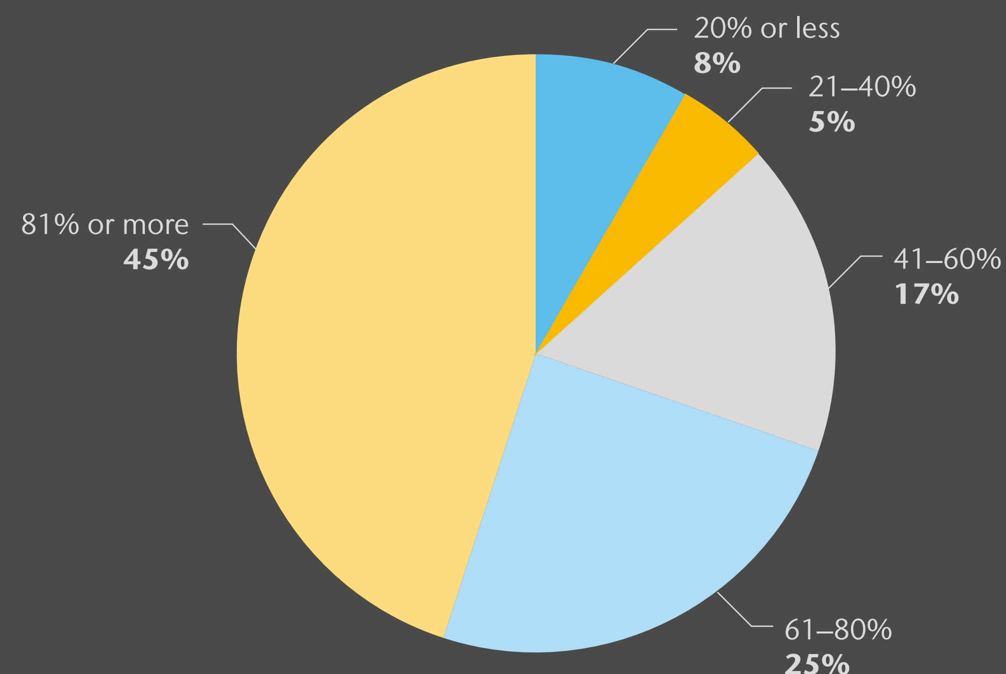
That said, schemes in Ireland are still focused on buying annuities to back benefits; around €2bn of liabilities has been settled in the past five years, which is a significant proportion of the Irish DB pension market.

# Hedging strategies

In our 2017 survey, we highlighted the worrying statistic of respondents who either reported that they did not know their scheme inflation and interest rate hedging level or reported a level of less than 20%.

The issue has taken up more time in trustee meetings in recent years. However, Ireland still lags well behind other countries such as the UK, where almost half of respondents reported an interest rate hedge of over 80%.

**Interest rate hedging ratios**




*Source: Aon UK Global Pension Risk Survey 2019*

Fiduciary investment management (where a third party provides asset management and advisory services on an integrated basis) has grown dramatically in Ireland in recent times. With an increased focus on an integrated risk management approach, encouraged not least by the Regulator and impending legislation, we would expect a significant increase in hedging strategies in the near future.

# Alternative funding and legislation

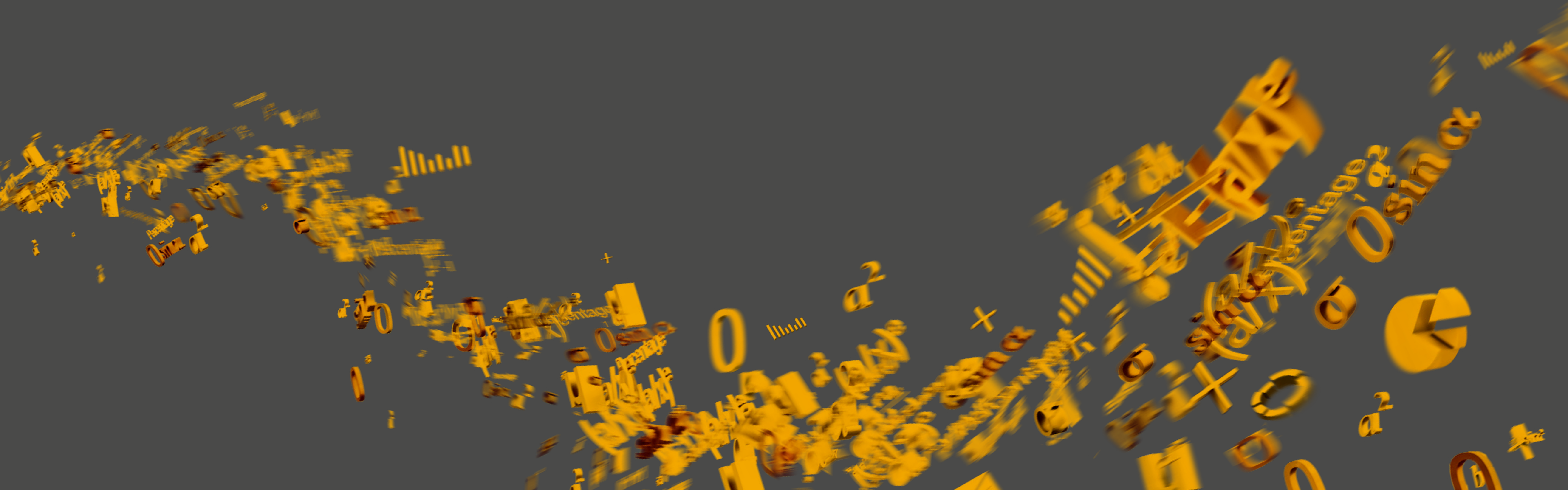
Consistent with our 2017 survey, the use of alternative non-cash funding does not play a widespread role in the financing of Irish DB schemes, partly due to scheme size and costs associated with implementing such solutions. Where such options are used, a parent or group guarantee is still the most popular type of alternative to cash contributions, with contingent assets, negative pledges and letters of credit having a smaller role.

Proposed legislation regarding a mandatory notice period for sponsors to give to trustees when looking to cease contributions (and thereby giving trustees an opportunity to demand additional funding) is not expected to have a major impact on most Irish schemes. This is either because there is already a notice period in governing documentation or because the employer covenant is deemed sufficiently strong and the company is not expected to cease contributions.

The impact of other legislative changes such as the IORP II directive may lead to some schemes looking to outsource more work to third-party providers. The requirement to have specific key function holders such as internal audit and risk management will increase governance costs, while 'fit and proper' requirements on trustees are likely to increase opportunities for professional trustees or master trusts in Ireland or elsewhere in the EU. The requirement for schemes to consider ESG (environmental, social and corporate governance) factors as part of investment strategy discussions will also be a new development. The full impact of IORP II is yet to be seen and will depend on the exact (delayed) implementation of this EU directive in Ireland.

# Conclusion

The environment for pension schemes within Ireland continues to evolve. Over the past two years, since our last survey, we have seen schemes starting to enter the last period of their recovery plans following the financial crisis of 2007/08; now is seen as an ideal time for the implementation of longer-term targets. The timescale for these targets continues to decrease for most schemes, with investment de-risking high on the agenda as funding levels improve. Hedging strategies are gaining more traction, but there is still a relatively low level of both interest rate and inflation hedging across schemes. Unfortunately, the fall in bond yields experienced in mid-2019 could act as a stumbling block to further progress in this area and may push out the timeframe by which schemes reach their targets.



# Contacts

**Kathy Murphy FSAI FIA**

Retirement and Investment Business
+353 1 4705343
katherine.murphy@aon.com

## About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

**© 2019 Aon Hewitt (Ireland) Limited. All rights reserved.**

Aon Hewitt (Ireland) Limited trading as Aon is regulated by the Central Bank of Ireland.

Registered in Ireland No. 356441 | Registered office: Block D | Iveagh Court | Harcourt Road | Dublin 2 | Ireland.

To protect the confidential and proprietary information included in this material, it may not be disclosed or provided to any third parties without the prior written consent of Aon Hewitt (Ireland) Limited.

Aon Hewitt (Ireland) Limited does not accept or assume any responsibility for any consequences arising from any person, other than the intended recipient, using or relying on this material.

**aon.com**