

Global Pension Risk Survey 2019

UK Survey Findings
Managing DB risk

Introduction

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

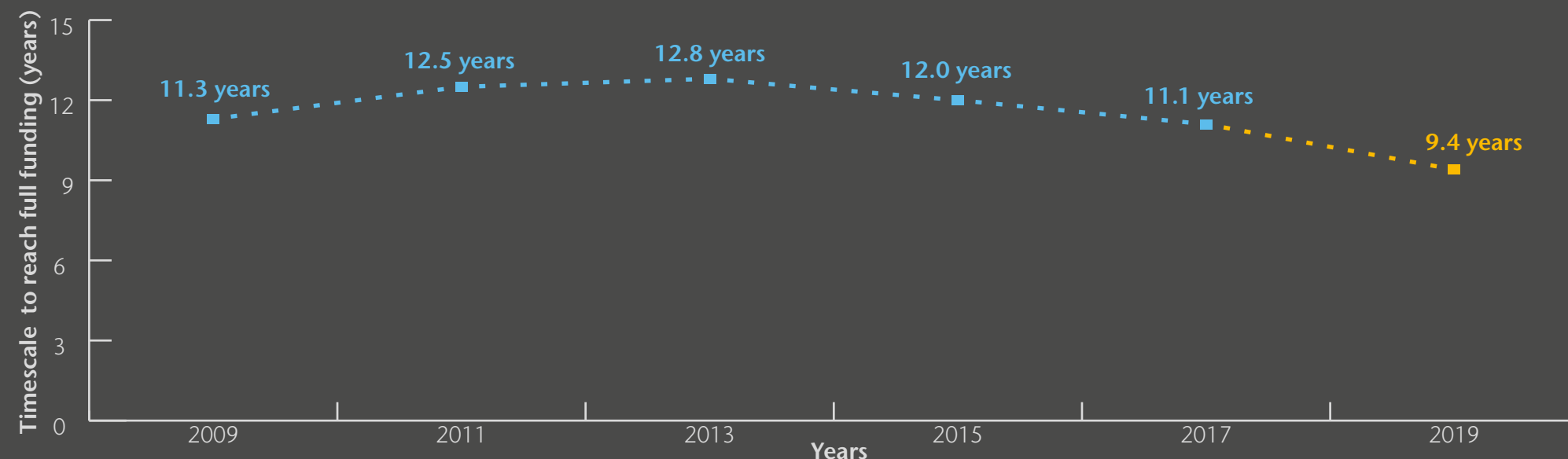
We carry out the Global Pension Risk Survey every two years, and looking back over the last decade, we can see how the pensions landscape has developed. Ten years ago, schemes were dealing with the fallout from the global financial crisis, and over the following years, increasing numbers of schemes closed 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 managed their non-investment risks. 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.

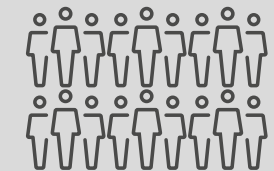
Survey demographics at a glance

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

Managing DB risk

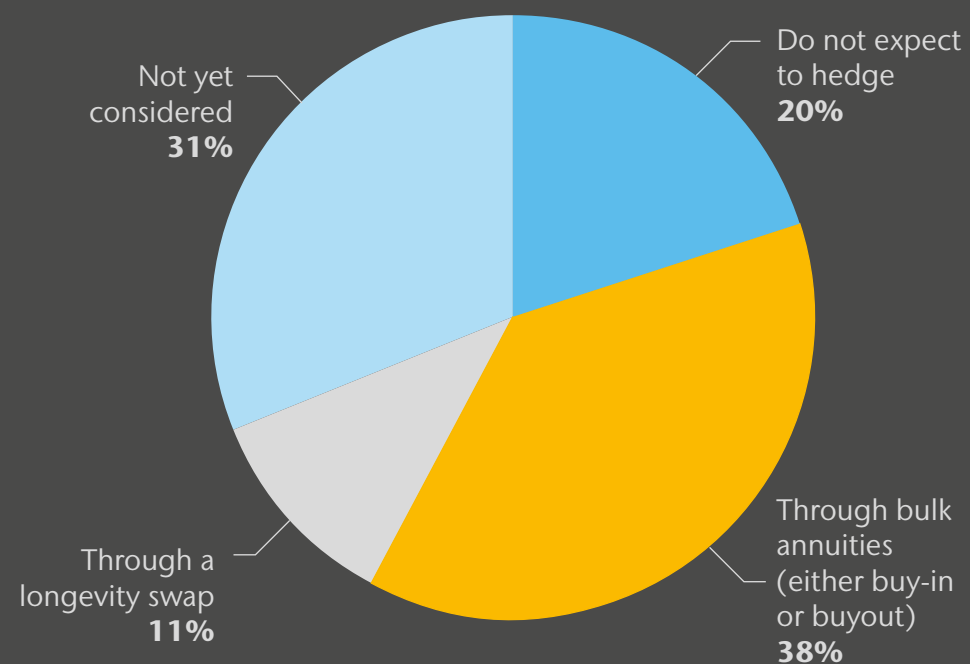
We saw in the results for schemes' long-term targets that a larger-than-ever proportion have buyout as their long-term goal, so we asked respondents about their plan for managing longevity risk.

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.

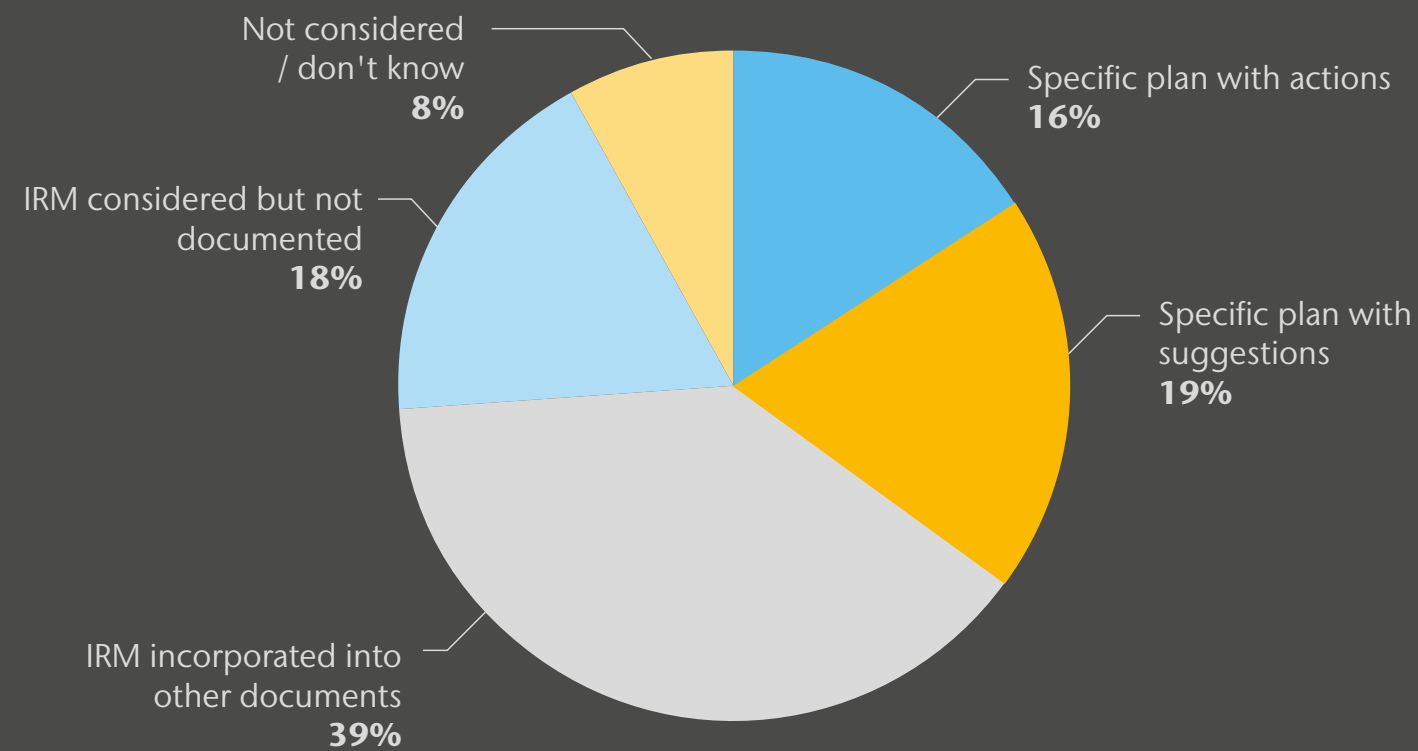
The proportion of schemes with a specific IRM plan with actions has leapt from 4% in 2017 to 16% in 2019, with smaller increases to the proportions that have IRM plans with suggested actions and those that have IRM incorporated into other documents, with the latter remaining the single most common answer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

Managing DB risk

In more depth



In more depth

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

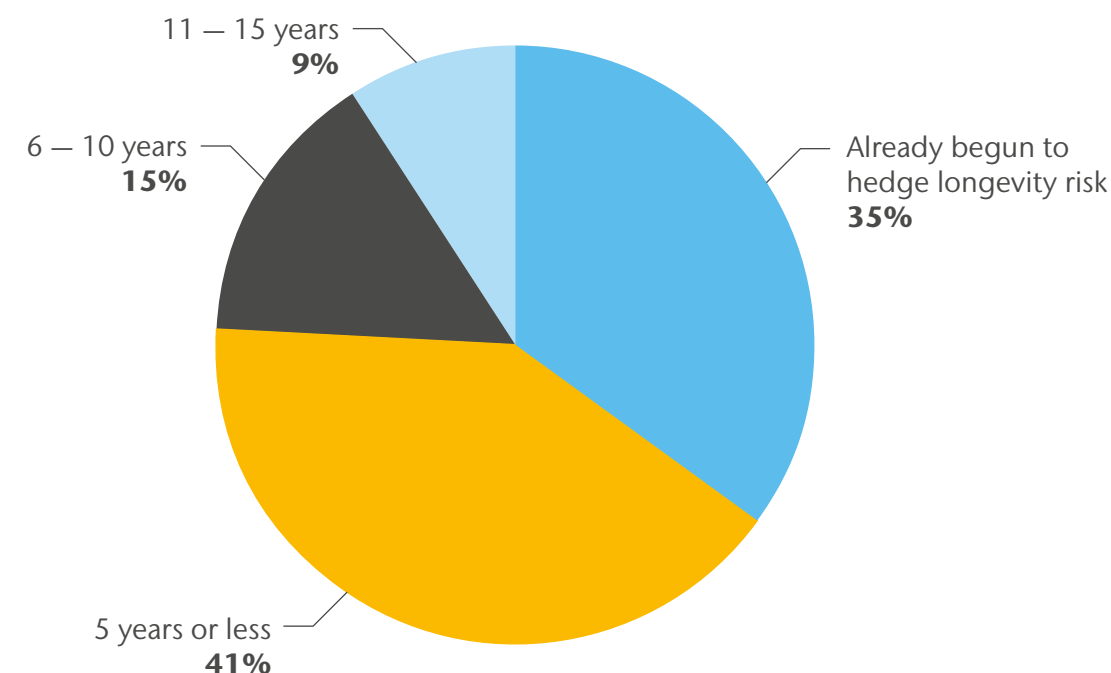
As proportion of respondents who had considered their longevity hedging policy



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

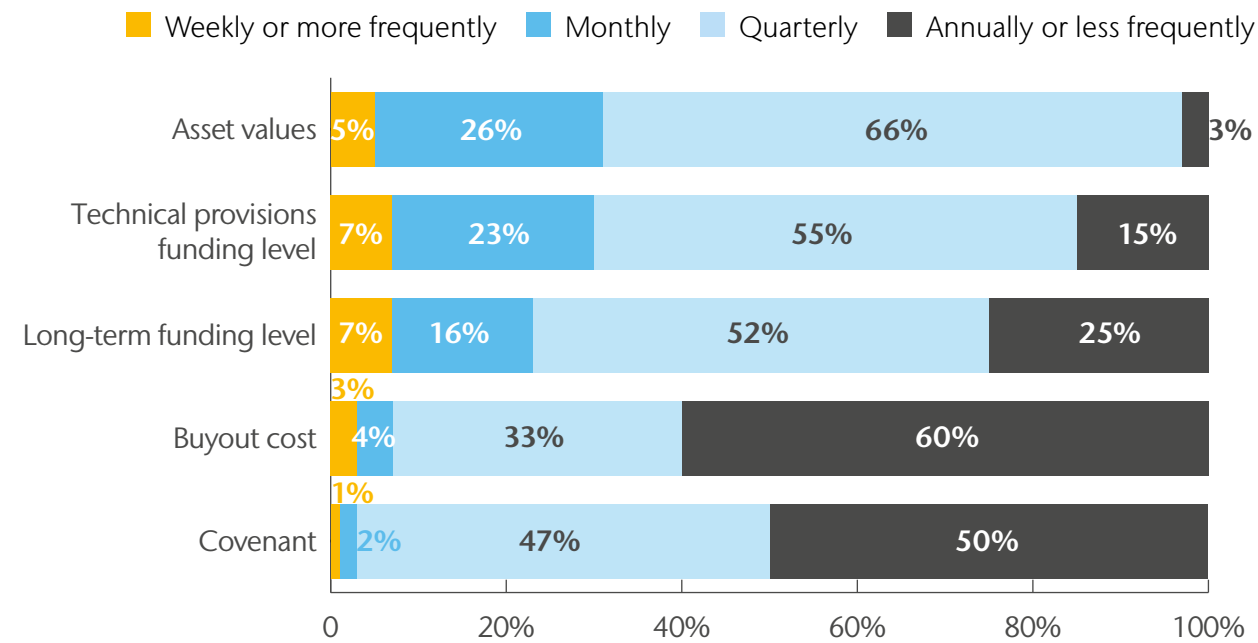


We asked schemes which intend to hedge longevity risk about their timescale for doing so. The vast majority of schemes have either already begun to hedge longevity risk or expect to do so in the next five years. These figures are similar to those from the 2017 survey results, except there is no longer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

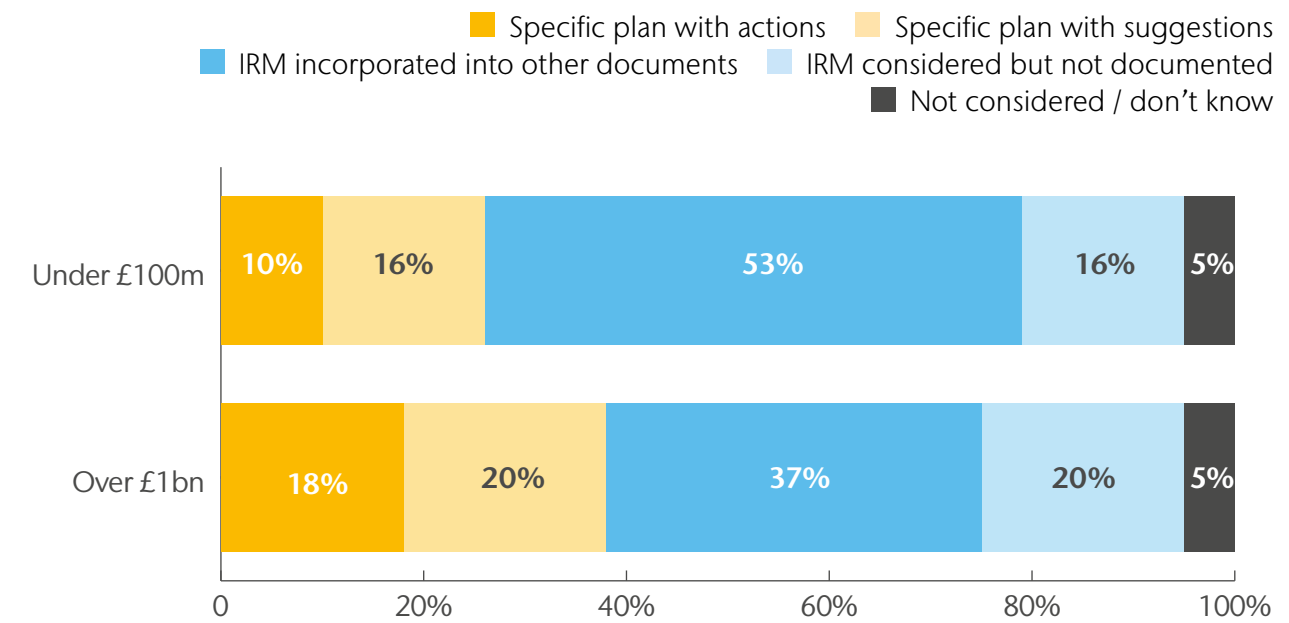


Asset values remain the scheme statistic that is measured more frequently than annually the most often (97%). Almost one in three schemes measure both asset values and the Technical Provisions funding level monthly or more frequently, with the long-term funding level measured this frequently by almost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

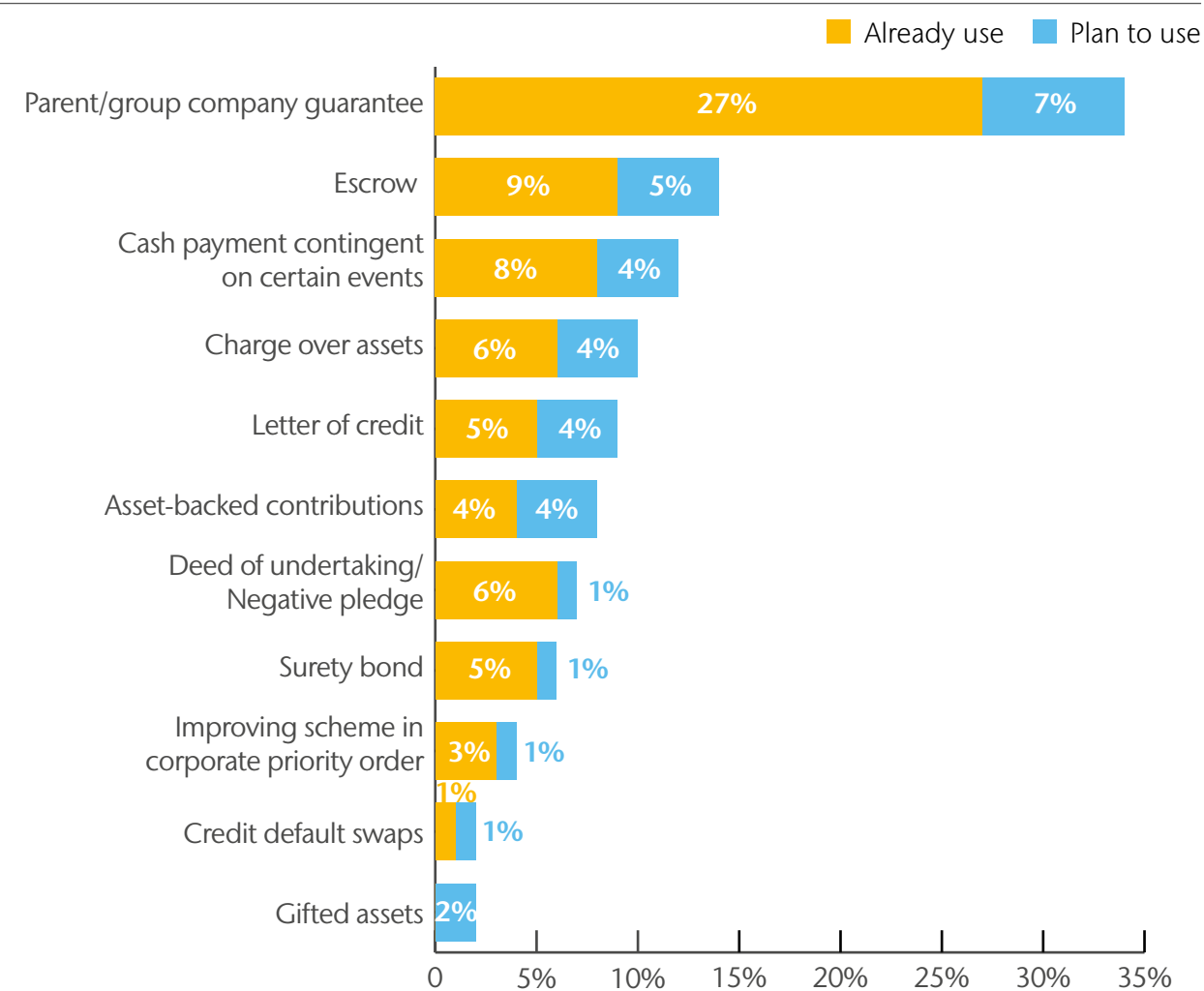


The approach to IRM plans shows a distinct size trend. Larger schemes are more likely (18% compared to 10%) to have a specific plan with actions than smaller schemes, and they are less likely to have incorporated IRM into other documents (37% compared to 53%).

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.

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