HYMANS ROBERTSON

Corporate pensions: from endgame to adequacy – what next?

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At Hymans Robertson's third annual corporate pensions conference, delegates heard about the changes coming to pensions, and how employers can overcome the associated challenges to do the right thing for their employees, scheme members and other stakeholders.

PENSIONS REFORM

The evening kicked off with a discussion of pensions reform. Surplus sharing, superfunds and sponsor swaps are three of the biggest changes coming to the DB pensions world. But they're not the only ones – the Pension Schemes Act, forthcoming regulations and regulatory nudges could lead to more large schemes running on and many small schemes consolidating.

These policy shifts are a risk for sponsoring employers, but also a huge opportunity. Mindsets still need to change after years of thinking a certain way. For pensions to be sustainable, assets need to grow, which means that schemes may need to re-risk their assets after a long time of de-risking, but now from a position of much healthy funding levels.

The government doesn't have all the answers yet, so employers can influence how policy will change. It's worth doing that so they don't end up getting dragged along. The message: don't be a passenger.

RETIREMENT ADEQUACY

Alongside policy change, retirement adequacy will be one of the biggest workplace challenges over the next 10 years. Auto-enrolment has been great at getting people to save for retirement, but it's also created misleading expectations of how much someone needs for a comfortable retirement. Many people aren't saving enough, leading to a 'crisis of adequacy'.

Employers are waking up to this challenge, and employees seeing their projected income on Pensions Dashboards will only make it more urgent. Employees not saving enough for an adequate retirement can affect costs, workforce management and productivity. As with any business risk, employers need to start managing it early.

There are challenges, as retirement patterns and behaviours are becoming less binary and predictable. Employees are retiring later, working while taking a pension, or returning to work after a spell of retirement. Before spending money on fixing adequacy challenges, an employer should research where the adequacy problems are in the workforce. That way, their spend can be focused on helping the employees who need it.

Other options can help too. The right contribution structure can redistribute costs rather than increase them. Employees can be helped to make the right choices through targeted support, perhaps backed up with modelling. There's a range of default decumulation solutions emerging, and employers need to think about what's important for their workforce when reviewing their providers and their retirement offerings.



CALUM COOPER **JOHN HAMILTON**
STAGECOACH PENSION SCHEME

Then there are ways to make the money work harder. Higher investment returns can make a material difference over decades, whether through a master trust, group personal pension or collective defined contribution (CDC) arrangement.

A whole-of-life CDC scheme can pay 20% to 30% more income in retirement than other DC solutions, and its design can help to close the gender pensions gap. There's only one CDC scheme now, but from the middle of next year we expect CDC master trusts to become available to employers.



KATHRYN FLEMING HANNAH ENGLISH PAUL WATERS MARK STANSFIELD

Barriers to action – what can stop us implementing a strategy

It can feel stressful choosing the right endgame from a growing list of options. The wrong choice or inaction could add costs or lead to missed opportunities.

When faced with a stressful choice, most of us fight, flee or freeze. A pension scheme trustee or sponsor might keep fighting over a surplus, flee from making a choice by doing endless analysis or freeze and do nothing.

For decades, employers had the same objective as trustees: to close a deficit. But discussions aren't usually about deficits anymore, they're about endgames, where views can often diverge and regulatory guidance is still evolving. It's important for employers and trustees to negotiate, align and get clear on strategy before doing anything. For example, surplus history analysis can inform what to do with a surplus, often the biggest question around endgame planning. Employers should also think about the practicalities and operational implications of delivering a particular strategy.

If stakeholders don't align, the investment strategy also suffers. The scheme often either takes more risk than it needs or misses out on returns. It's important to look closely at every part of the portfolio.

Data quality is often a barrier to action. It matters more than it used to: risk transfer, Pensions Dashboards and GMP equalisation require accurate data not just for one member but potentially for thousands. Bad data could lead to revised insurer pricing or a longer than expected data preparation phase of GMP equalisation.

Schemes need to move from most data being right most of the time to all data being right all the time. Yet most schemes don't know what their data quality is like, or where the issues are. A data audit is essential for proper planning.



MARTIN POTTER LEONARD BOWMAN ROSS FLEMING SCOTT FINNIE

The 3am wake-up call

The conference ended with Hymans investment consultant Ross Fleming sharing what keeps him up at night.

Corporate debt makes up a quarter of all assets that DB schemes hold. It's so familiar that we may have stopped thinking about its risks.

A scheme targeting buy-in holds corporate bonds to hedge against insurer pricing, though insurers don't do that as closely as we may think. A scheme targeting run-on might hold corporate bonds for their attractive returns, but recent tight spreads have made the returns less attractive.

Ross posed the idea that the real risk is not spreads, but default. Rapidly changing technology, eg artificial intelligence (AI) can disrupt whole industries over the next few decades. Will the companies we're investing in now still be economically relevant in a radically different world?

The message isn't to abandon corporate bonds, but to think harder about them, whether your destination is buy-in or run-on.

To discuss what the changing pensions landscape means for your organisation, please get in touch.



ROSS FLEMING

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