HYMANS ROBERTSON

CASE STUDIES

Understanding the needs of large DB schemes

In the UK, a significant proportion of defined benefit (DB) scheme assets are held by a small number of large schemes. These large schemes have unique needs and face different challenges compared to smaller ones. As advisers to over half of the twenty largest schemes in the UK and one in five with assets above £1bn, we understand these different needs and want to share our insights through a series of case studies.

Unlocking the power of surplus sharing: a case study

In this case study, we share how we helped a multi-billion pound scheme design and implement a surplus sharing framework agreement.

The client's scenario

Our trustee client had been considering buy-out due to their robust funding position and material surplus and was well progressed on that strategic journey. However, after revisiting the options open to them, the trustees agreed to run-on the scheme, retain more investment risk for longer, and use the surplus to benefit various stakeholders. The agreement also retains optionality for the future direction of the scheme.

Incentivising the trustees

Generally speaking, schemes have their own rules and arrangements governing surplus sharing. In this case, the trustees had a clear plan outlining how the surplus would be shared in a buy-out scenario. But as this new direction meant retaining more risk for longer, it was important that the trustees had sufficient incentive to do so. Put simply, there had to be something positive for the DB members. One way in which we tackled this was to ensure we protected the scheme's readiness for a buy-in transaction at any time.

Enhanced benefits for DB members

We also secured enhanced benefits for members. The primary areas that can be considered in enhancing benefits are through more generous pension increases, or from augmenting existing benefits. Other changes can include improved member options or enhanced member decision support. It is also important to consider intergenerational equity and make sure that different groups of members benefit fairly.

Using surplus for defined contribution (DC) provision

With positive outcomes secured for DB members, the trustees agreed that most of the surplus could be used to fund the employer's DC pension provision. Although the current intention is to use the surplus to fund DC contributions, that's not set in stone – it might be used differently by the employer in the future.

Monitoring risk, funding level and liquidity

As you'd expect, the surplus will reduce over time, so we implemented measures to protect the ability to buy-out in the future. Areas trustees can consider include risk buffers, where an action kicks in at certain trigger points, as well as contingent support. Setting triggers for when surplus sharing is switched on and off and agreeing on how the surplus will be shared between members and the employer are crucial.

Key takeaways

A key reflection we took from this exercise is that it's worth pausing, taking stock and re-visiting a scheme's strategy, even if it's progressed quite far down the route of preparing for buy-out. For this scheme, the regulatory direction of travel shifted the perspective and tilted the scales in favour of running on for longer, with the aim of creating and sharing the surplus whilst protecting members.

Secondly, it's likely that trustees will need incentives to run-on with the aim of creating and sharing surplus – we found that enhanced benefits for members were an effective way to do this. Lastly, it's crucial to have an experienced adviser who can help the trustees and employer find a mutually beneficial path.

To discuss surplus sharing in more depth and to learn from our first-hand experience, please get in touch.

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