HYMANS ROBERTSON

Case study:

A balanced and integrated approach to risk management

The challenge

Our client, a consumer goods company with a £4bn scheme, was under pressure from its scheme trustees to increase contributions and move quickly to a minimal risk basis. In 3 stages, we helped them implement a genuinely integrated approach to risk management which balanced the interests of all stakeholders.

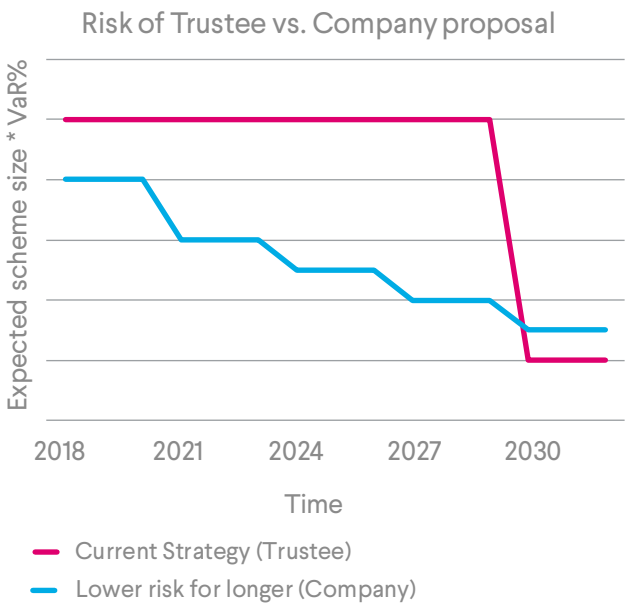
Stage one – aligning the scheme risks to the covenant

We helped the company and trustees recognise that the scheme would reduce in size by 20% over the next 12 years. Coupled with the trustees' intended levels of asset de-risking, the scheme risks would reduce by c.85% over the same timeframe.

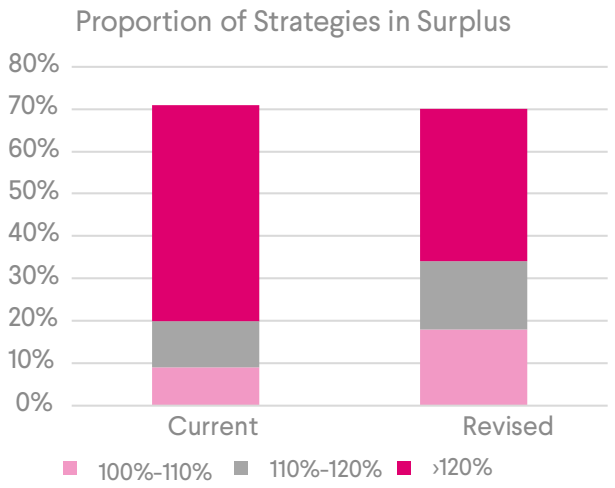
However, it was highly unlikely that the covenant would weaken by the same amount. Aiming for too strong a funding target creates risk in the short term – through a combination of adding to the contribution requirements and an unnecessarily high level of shorter term investment risk. A "high risk then no risk" strategy simply didn't align with the durability of the covenant.

Key benefits achieved:

- No increase in contributions
- Immediate investment risk reduction
- Moderate-risk target reached within given timeframe
- Agreed path for future de-risking
- Contingency plans in place when additional contributions are needed



The lower target then enabled immediate de-risking, reducing funding volatility and providing the company with additional cost certainty. The higher growth asset strategies were simply overshooting the target. The graph below shows the proportion of time the scheme is expected to be greater than 120% funded: either the target is wrong, or there's too much risk being taken.



Stage two – creating time-based triggers for de-risking

The de-risking triggers were set at different levels depending on whether the funding plan was on track. This allowed a clear path of future de-risking, while remaining sensitive to prevailing market conditions.

Stage three – setting contingency plans for additional contribution payments

To ensure the trustees were happy that no immediate increase in contributions was needed, we agreed detailed contingency plans setting out triggers for when additional contribution payments would be required. These triggers reflected a combination of the probability of reaching the funding target and covenant indicators - so that payments were triggered only when they were most needed.

We also agreed that the probability of reaching the target could reduce gradually as the target becomes closer. When the scheme is about to reach the target, a probability much higher than 50% means that too much risk is being run. Therefore, the need to reduce risk should become the higher priority.

The outcome

Through this approach, the scheme and sponsor benefit from:

- No increase in contributions;
- An immediate reduction in investment risk;
- A moderate-risk target in the same timeframe as the trustees wanted to reach a minimal-risk target;
- An agreed path for future de-risking with "intended" and "minimum" levels of de-risking; and
- Contingency plans that specified when additional contributions could be triggered – based on both funding and covenant indicators.

The outcome balanced the interests of all the stakeholders involved, and proved the advantages of setting an appropriate target, and integrating the three dimensions of funding, investment and covenant.