HYMANS ROBERTSON

Shaping corporate pension strategies for the future

At our recent London event, we explored two key themes through panel discussions that we believe companies should focus on over the next few years.

1. Strategic management of existing Defined Benefit (DB) and Defined Contribution (DC) Schemes, to maximise value relative to the corporate risk appetite.
2. The serious and ongoing issue of inadequate and unequal retirement provision in the UK workforce.

Below is a brief recap of some of the themes and ideas the panels explored.

Management of existing DB and DC schemes

DB Schemes

Since the 2023 Mansion House speech there has been increasing noise in the market around alternative options to carrying out a full scheme buy-in or buy-out at the first opportunity, and the potential untapped value for companies if they consider running on their schemes. But what is the reality?

It seems to us the market is moving. Maybe not yet a wholesale shift to a new strategy, but certainly the new landscape is causing trustees and sponsors a moment of pause. In our most recent annual survey of companies, 70% say they have recently reviewed their endgame strategy. For many, right now the answer may simply be “let’s not rush into a decision”, but there’s no doubt some interesting discussions are happening, particularly where designs are being looked at for win-win outcomes for sponsors and members.

Linked to this, we discussed the evolving solutions providers are considering bringing to market. With two Clara-Pensions transactions behind us and an evolving regulatory backdrop – will this lead to further innovation?

We believe it will, for example:

- New consolidator models, making run-on more efficient at scale and therefore more attractive to a larger set of schemes.
- Creative risk transfer solutions that combine cheaper options for sponsors but also the potential for better member outcomes than a traditional buy-in or buy-out.
- More options for accessing DB surpluses to fund DC contributions outside the scheme trust.

For a scheme still focused on the buy-out route, we discussed recent cases where the company has been asked late in the day to provide indemnities at the point of buy-out. This has triggered questions from the company on how confident they could be that issues would not emerge in the future, particularly as they believed that a buy-out would remove all DB pensions risk in the future. Perhaps this is a question that needs to be worked through before the buy-in stage and not left to the buy-out completion?

In the investment space, there was a good discussion around whether company decision makers had enough of a handle of how investment hedging worked and exactly what it was seeking to achieve under different strategies. A key potential area of value gain or loss depending on how effectively it was used.

Illiquid assets continue to be a challenge for schemes looking to reduce their exposure to them in the shorter term. There was also an interesting discussion around future systemic risks, and whether higher holdings in corporate credit is the next area of concern for the UK Government.

DC Schemes

The DC market has rapidly grown and evolved in the last ten years, and today we're seeing many corporates run their arrangements through a provider's offering (eg group personal pension or master trust).

We agreed that since corporate pension spend is likely to be the second biggest benefit spend after salaries, it's crucial to have good oversight of this spend and be confident that a chosen provider is delivering value and good outcomes for members.

There was discussion about how providers are making significant developments to their propositions to improve outcomes, while also developing their solutions to help corporates align their Diversity, Equity and Inclusion (DEI) and Environmental, Social and Governance (ESG) ambitions with their pension offering.

We also discussed that, to achieve this, corporates will need to regularly review and compare their offerings, ensuring they are capturing all available value. Where this is not the case, they should challenge their providers to deliver more or be prepared to switch providers.

The future of UK retirement provision

Our second panel explored the current state of UK retirement provision and what the future could look like. The start of the discussion was quite sobering, as illustrated by some of the following statistics:

- The number of people not saving enough for a minimum retirement lifestyle has **increased by 1.2 million people** in the last year.
- **38% of savers are not on track** for PLSA's 'minimum retirement lifestyle.
- Due to the recent cost of living crisis, a member in their mid-50s would need to **defer retirement by one to two years** to achieve the same outcome.

But it was not all bad news, as the discussion shifted to potential solutions for this emerging crisis. Recent market surveys suggest that companies are worried about this (85% say they feel responsible for ensuring their employees have an adequate retirement income) and they see the need for them to play a role in the solution. Over 80% of companies say they expect to make a material change to the design of their retirement savings offering within the next five years. How might that happen?

It could be driven by future changes to automatic enrolment (AE) requirements, whether that's through the reduction in entry age criteria from 22 to 18 and the removal of the Lower Earnings Limit so that pensions are paid form the first pound of earnings. We also discussed if AE regulations may go further in the future and increase the minimum contribution rate from 8% to 12%.

Even if this doesn't happen, companies over the longer term may look to increase company contribution levels, but this should be done with care. Simply increasing contributions may not address inequalities of savings within a company workforce. Employers need to understand their membership and the causes for current inequalities. This can be a quick win, before looking at more expensive options such as new benefit designs.

Looking beyond traditional DC, of course we are now in the world of collective DC (CDC). The panel discussed how this is an umbrella term and a whole spectrum of risk sharing designs under this banner could emerge over the next few years, by allowing underlying assets to remain invested and risks pooled in later life which can transform outcomes. The potential rewards for employers and members are great, with modelling suggesting 50%+ better member outcomes in median scenarios, but also less painful downside outcomes.

By this time the evening was moving along and we entered even more creative territory as we asked the question whether DB, as a solution for future working generations, was a non-starter or could still play a role. Some interesting ideas emerged, in particular what could be achieved by combining elements of existing DB and DC designs.

One way to do this would be to offer career average DB accrual up to a certain level of salary and then DC contributions on top. It was noted that in current market conditions the cost of DB accrual is less than half what it was three years ago. But how could companies protect themselves against a fundamental and long-lasting reduction in gilt yields?

There are designs that would do this, for example by the company first setting its contributions budget, out of which it provides a modest level of DB accrual plus the balance as a DC contribution. If gilt yields were to return to 2020/21 levels, the cost of DB accrual might take up most of the company's budget but, if employees thought this was not a good deal, they could always choose to take the full company budget as a DC contribution.

A call to action

Managing legacy schemes and planning for future retirement provisions are constantly evolving challenges for companies - there's rarely a quiet time for decision-makers. However, even by historical standards, we're now experiencing a period of significant change in the economic, legislative, and societal impact of retirement savings.

This presents both opportunities and risks for employers. The only certainty is that companies who stay on top of all issues and options will achieve the best outcomes for their stakeholders.

Contact us

If you'd like to find out more about any of the topics covered in this event summary, please get in touch.

Leonard Bowman
Partner and Head of Corporate Consulting
leonard.bowman@hymans.co.uk

Hymans Robertson LLP is a limited liability partnership registered in England and Wales with registered number OC310282. Authorised and regulated by the Financial Conduct Authority and licensed by the Institute and Faculty of Actuaries for a range of investment business activities.

© Hymans Robertson LLP 2024. All rights reserved.