# Future of Pension Funds 2011

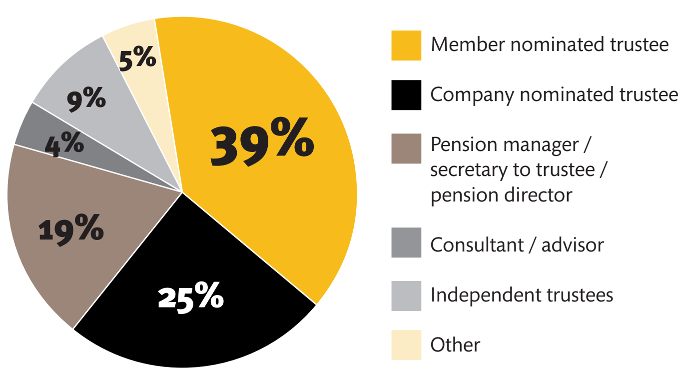
PENSION INSURANCE CORPORATION

What is the state of occupational pension schemes today and how do trustees feel about their challenging role? These are the questions which the annual Engaged Investor Future of Pension Funds 2011 Survey, in association with Pension Insurance Corporation, seeks to explore. Our study is one of the largest studies of pension trustees conducted, and one of the few genuinely independent surveys of trustees from all walks of life, up and down the country, with aggregate liabilities of at least £50bn.

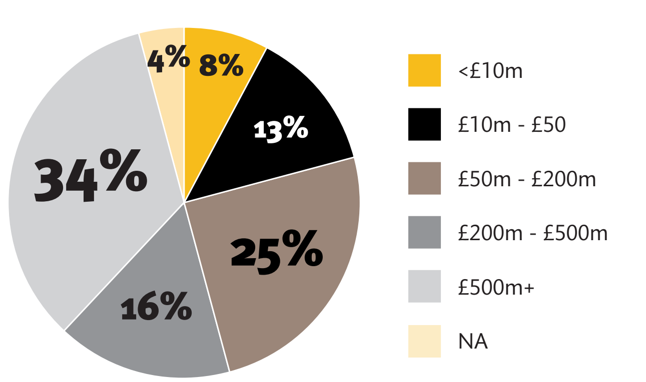
In the past year, trustees have continued to tackle many challenges which they have become familiar with; sizeable deficits, closures to new members and new accrual, volatile investment markets, low interest rates, the increasing longevity of their members and the onerous regulation which governs all occupational pension schemes. But in the last year they have also struggled with a major new problem – the indexation of benefits. Ever since the Government announced its intention to move to the Consumer Price Index (CPI) as the chosen inflation measure used to index state and public sector pension benefits, trustees of private sector occupational defined benefit have been wrestling with the question of whether they can and should do the same. As most trustees will now be aware, CPI is lower than the Retail Price Index (RPI) used by most schemes. Under pressure to reduce costs, some pension schemes have seized the opportunity to uplift pensions at the lower rate that CPI represents. But reducing the pensions of members – benefits which it could be argued they have effectively been promised – is by no means popular and many trustees have felt morally obliged to resist such a move. As trustees admit in this study, they are concerned that switching to CPI is unfair on their members.

A trend which this study tracked in 2010, and continues apace, is the growing interest in reducing the risk in pension schemes. De-risking, as it has become known, is a philosophy which most occupational defined

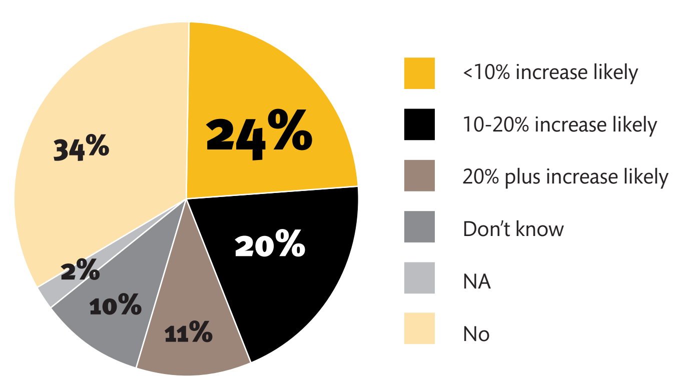
## PROFILE OF RESPONDANTS




## PROFILE OF PENSION SCHEMES



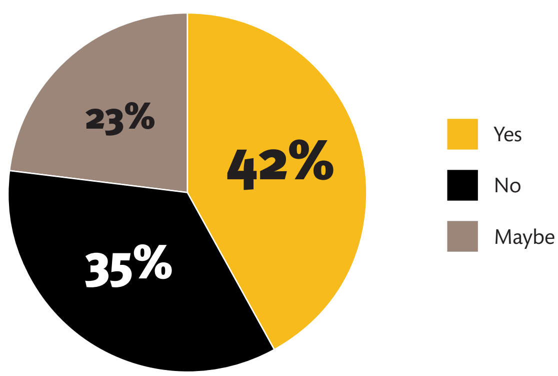

## PLANNING TO ASK FOR MORE CONTRIBUTIONS?




Pie Charts may not sum to 100% due to rounding

> “ Trustees of large occupational pension funds (£500m in liabilities or more) were more inclined to argue that they should be paid, with 53% in favour ”

**SHOULD 'LAY' TRUSTEES BE PAID?**




benefit pension schemes have accepted in the last few years, but approaches differ widely. While most pension schemes aim to reduce risk in the coming years, many are equally focused on reducing their deficit, often through investment returns. Trustees must reduce risk but still need healthy investment returns to improve funding levels; a paradox that seems at times impossibly difficult.

## OUR AUDIENCE

The Future Of Pensions Funds Trustee Survey was conducted from January to April 2011 of 197 readers of *Engaged Investor* magazine and website. 39% were member nominated trustees, 25% company nominated, 9% were independent trustees, 19% were secretaries to the trustees or pension managers, 4% were consultants and 4% ‘others’. The pension funds represented in this survey are a range of sizes; 15 schemes were less than £10m in liabilities, but 66 had £500m or more. On aggregate the schemes represented have at least £50bn in liabilities, likely considerably more. In addition to being company, member or independent trustees, 9% were chairs of trustee boards. Of the schemes that took part, 53% have independent trustees underlining the significant growth this role has seen in recent years.

**TACKLING A DEFICIT IS TRUSTEES' TOP PRIORITY**

**77%** plan to reduce risk

**55%** want more sponsor contributions

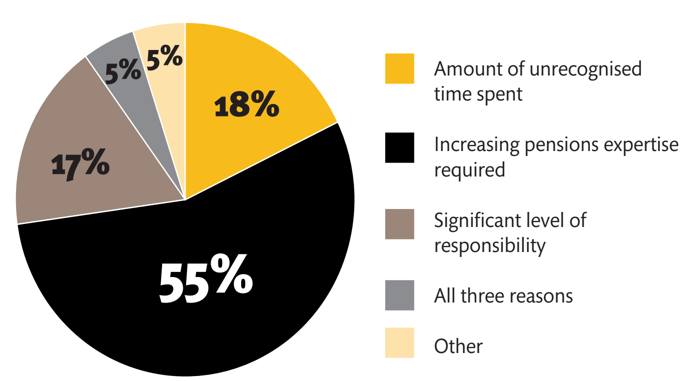
**55%** believe their role is increasingly complex

## TRUSTEES' OBSERVATIONS

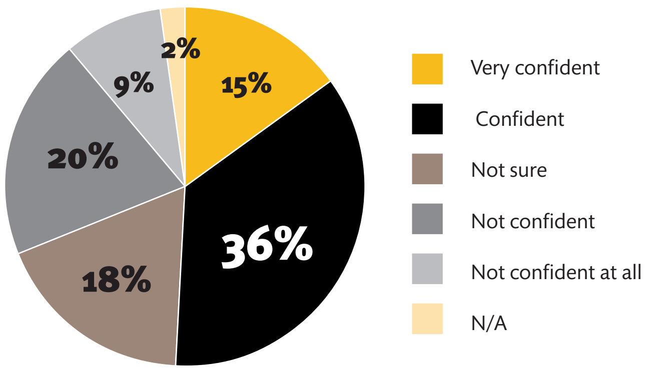
A question *Engaged Investor* has regularly asked trustees since launch in 2005 is whether ‘lay’ – ie non-professional – trustees should be paid for their pension scheme work. Trustees have often been split on this question, with 50% in favour either way in 2005 and 62% in favour of paying trustees in 2010. This year showed a substantial decline, with 43% in favour of paying trustees (34% said ‘no’ and 23% ‘maybe’.) Trustees of large occupational pension funds (£500m in liabilities or more) were more inclined to argue that they should be paid, with 53% in favour. Trustees revealed that the main reason why they deserved financial remuneration was the increasing amount of pensions expertise required to carry out their role (55% – the identical response to 2010’s survey); other leading reasons included the amount of time spent on trustee duties that went unrecognised (18%), and the significant level of responsibility of the role (17%).

Most measures of overall funding levels of UK occupational defined benefit pensions schemes show considerable deficits, despite improved investment performance in the last two years, so it is not surprising to find that funding a deficit is the top priority for most pension trustees (47%), with planning for the future (25%) and managing change (16%) the other most common top priorities; 7% cited dealing with pensions regulation as their top priority. With most pensions schemes less than fully funded, many substantially so, are trustees confident that their scheme would evade the grasp of the Pension Protection Fund (PPF) if their sponsoring employer became insolvent in the next five years? Confidence was high on the whole, but only marginally so. 51% of trustees said they were confident or very confident of achieving the minimum funding levels required to avoid the PPF, with 29% expressing little or no confidence, and 20% unsure. While some trustees have a good level of funding or are

**WHY SHOULD TRUSTEES BE PAID?**



## MEET PPF LIABILITIES?




> “ 22% expect to receive company assets, such as property in lieu of cash contributions to help fund their deficit ”

confident deficits can be made good, a substantial minority are not in such a healthy position.

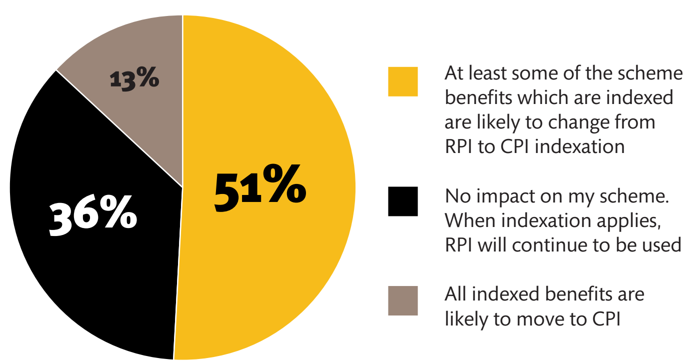
Unsurprisingly given the under-funding most trustees are experiencing, 55% expect to require increased contributions from their sponsoring employer following the next actuarial valuation. 22% expect to receive company assets, such as property in lieu of cash contributions to help fund their deficit.

But despite these very serious financial concerns, the appetite for reducing liabilities by adopting the Consumer Price Index as the mode of inflating pensions each year is limited. For most occupational DB schemes, the ability to move from RPI to CPI depends on the wording of their trust deed and rules. If the rules refer to the ‘Government’s pension increase order’ – or words to that effect – that should allow or even oblige the trustees to now adopt CPI. Where the rules refer explicitly to RPI that becomes more difficult. In reality, the wording of most deeds allows CPI indexation for deferred member pensions, but not for increasing pensions in payment. The only way around this would be for the Government to adopt a ‘statutory override’ to allow trustees to override the letter of their rules. The coalition has indicated it is not minded to do this, and in fact only 24% of those surveyed said they would use it if it existed. In fact only 24% welcomed the move towards CPI, with 32% concerned about the uncertainty surrounding the change and 44% believing it unfair to pensioners, who would most likely receive lower pensions over time. Despite their clear dissatisfaction for the change, 51% expect to index at least some of their benefits in line with CPI, with 13% moving all their benefits to CPI and 36% making no adjustment at all.

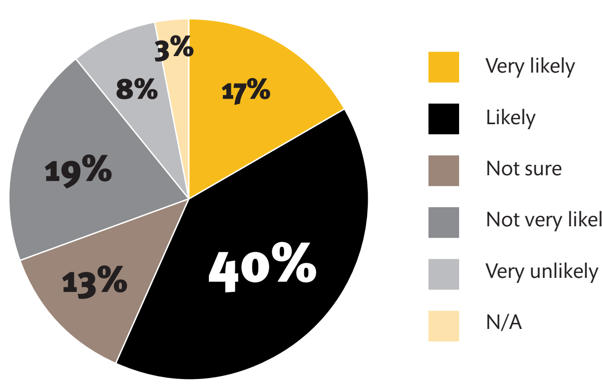
### WHAT’S THE PLAN?

With deficits riding high on the agenda for most trustees, what is their goal, and how will they get there? For most trustees, their short-term and long-term goals are similar. They aim to be fully funded, or self-sufficient. In the long term 22% expect to buy-out – only 5% expect that to happen in the short term – but on the whole the intention of most trustees is clear; for the foreseeable future their aim is to get back to 100% funded (or remain there for the lucky few.) So how likely is this plan going to be realised? Only 58% of trustees said they were ‘likely’ or ‘very likely’ to achieve this target within 10 years; 28% felt it was ‘unlikely’ or ‘not very likely’. It seems that while trustees present a united front in terms of their ambition, a sizeable minority lack conviction that their targets are attainable within a decade. Perhaps the lack of confidence is to do with a reluctance to take risk. In order to bridge funding gaps, trustees would have to take risk with their investments and /or require additional contributions from their sponsor. A significant majority (77%) plan to reduce their risk taking over the next few years, through a variety of strategies. Most popular remains liability driven investment strategies

## IMPACT OF CPI




## FULLY FUNDED IN 10 YEARS?



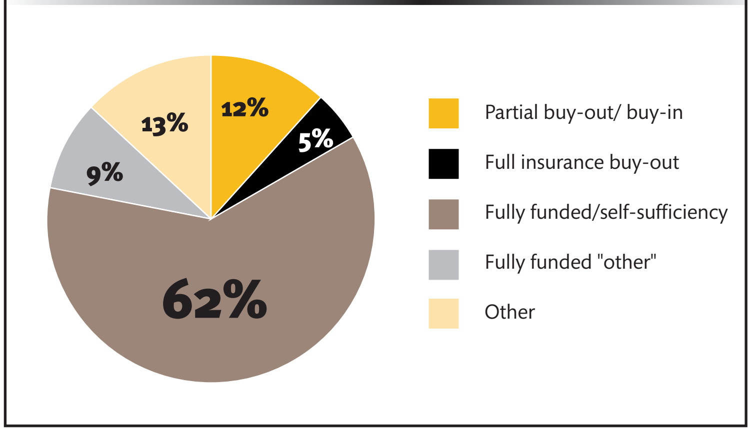

**73%** plan to cut equities

**44%** believe CPI ‘unfair on pensioners’

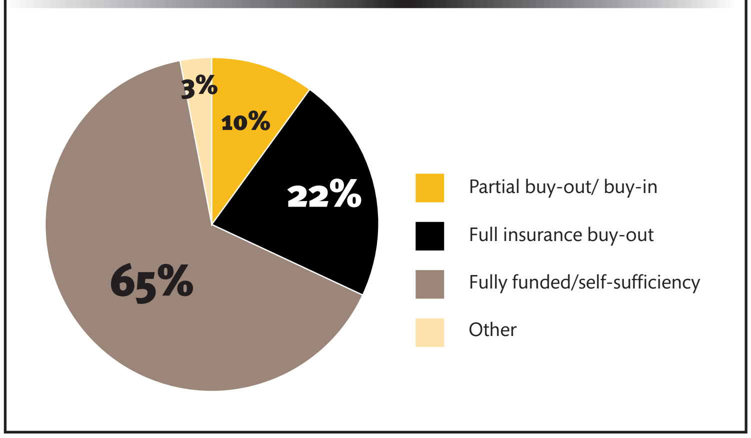
**47%** have deficit as top priority

**85%** happy with investments

**SHORT TERM GOAL**




**MEDIUM TO LONG TERM GOAL**




(56%), followed by longevity insurance (30%) and partial buyout/ buy-in (27%). Fiduciary management (9%) and full buyouts (6%) were the least popular. There is a similar desire for training in all these areas among the trustees surveyed.

### APPETITE FOR INSURANCE-BASED DE-RISKING

Attitudes towards insurance-based de-risking, such as buy-ins and buy-outs and longevity swaps varied but on the whole a significant minority include them as part of their planning. 54% have already used some form of insurance-based de-risking or plan to, while 43% ruled it out. Of those currently considering insurance solutions, 73% were looking at buy-outs, with the rest split between buy-ins and longevity swaps. Ultimately, 31% of all trustees expect to buy-out at some point, with 46% believing this to be 'unlikely' or 'very unlikely'. Buy-outs, however, require a scheme to be more than fully funded on a technical provisions basis; typically 120% to 140% funded. Bringing the scheme up to this level is typically a cost borne by the employer, yet 'cost' was cited as the biggest barrier to de-risking (61%) with a wide variety of other set-backs hampering the rest of the respondents.

**58%** expect to be fully funded within 10 years

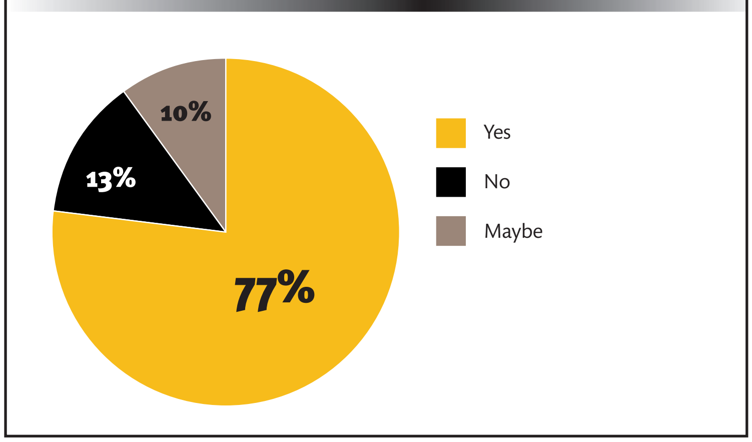
**43%** want trustees to be paid

**31%** will buyout at some point

### CONCLUSION

Trustees continue to struggle with the twin challenges of improving funding levels and reducing risk. The appetite for de-risking is high, but so too is the desire to eradicate deficits. The struggle as to how to grow assets fast enough to meet their funding target, while reducing the risk they take, is one that most trustees will be familiar with. As a result, most expect to ask sponsors for higher contributions in the coming years in order to maintain this trajectory. Trustees are, however, broad minded in the range of de-risking options they are considering with most investigating more than one de-risking solution. These are complex challenges, however, and it is not surprising that most trustee who feel they should be paid for their role cite the increasing complexity of the role as the main reason. Running an occupational pension fund today is certainly a difficult task; one that trustees are rising to, but in order to do so they must grapple with sophisticated financial solutions; not a task for the faint-hearted. ■

**REDUCE RISK?**




**DERISKING OPTIONS UNDER CONSIDERATION**