02/2020

XPS Express for Employers

Bringing you the latest pensions news for employers

All employers should now review their pension strategy

At a glance

More than ever, employers need a formal pension strategy. External pressures to have one are increasing

The Regulator requires all schemes to have a long term target and a plan to get there. The Pension Schemes Bill cements this and will give new powers to enforce it

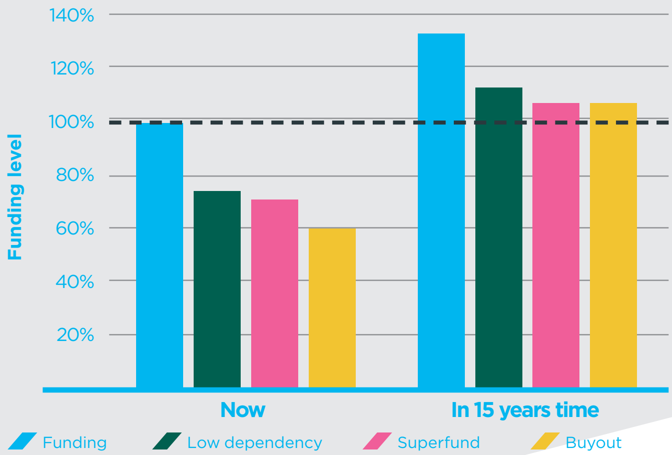
New end game opportunities are emerging e.g. superfunds and insurers looking for ways to meet schemes earlier on their journey – reducing risk

A good strategy will allow you to take advantage of these new opportunities. It will also provide a framework to manage the impact of member behaviour on your journey and set out contingency plans for when you are off track

Your strategy should include a framework to identify how company actions affect pensions. This is essential to protect against greater sanctions for employers

Is time a pension scheme asset?

Over time a scheme naturally becomes better funded and the cost of different targets converges. Benefitting from this requires good contingency plans to manage bumps in the road.



Source: XPS Radar

Pension strategy building blocks

Building block	Key questions	
Target	Does your target support your business strategy? Can you comfortably absorb funding shocks when you get there?	☐ Yes ☐ No
Timeframe	Are you giving yourself enough time to hit your target without extra cash? Are you leveraging all possible options?	☐ Yes ☐ No
Trajectory	Have you made sure you are not taking unnecessary risk on your journey? Do you have contingency plans if things go wrong?	☐ Yes ☐ No

Actions employers can take

As a first step, check if your scheme has a long term target, along with a plan and timeframe to get there. Then review your strategy by:

1. **Assessing the variety of long term targets now available, when you might get there, and if you can afford the risk that remains once there;**
2. **Reviewing investment strategy and ensuring there is no unnecessary investment risk on your way to your preferred target; and**
3. **Considering how formally supporting members and using contingent assets can help manage volatility on your journey.**

What the Pensions Regulator has said

Next month the Regulator will consult on its new funding code. It has already provided insights into what markers it may set for prudent and appropriate long term funding plans.

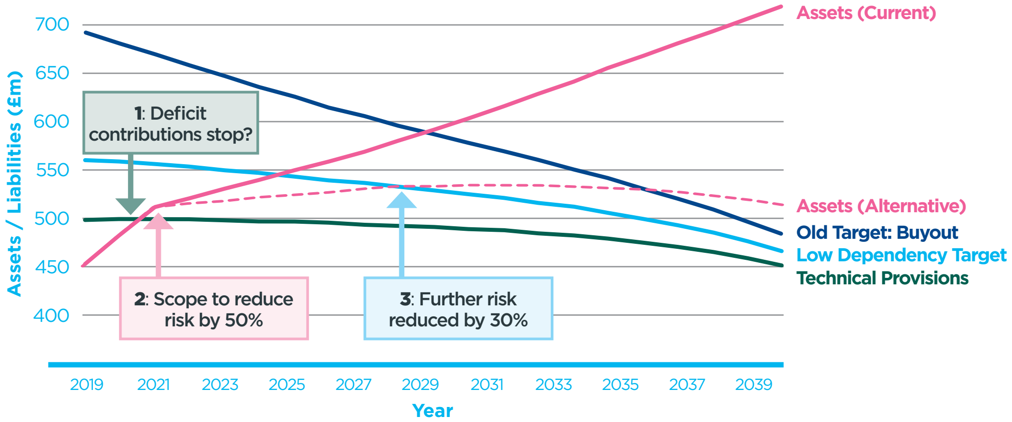
Area	Regulator comment
Target	Will not force schemes to have a transaction based long term funding target e.g. buyout. Likely to set a marker of low dependency. In terms of prudence it has indicated this may mean a liability discount rate between gilts+0.5% and gilts+0.25%.
Timeframe	The Regulator has indicated it will expect schemes to reach their long term targets by the time they are significantly mature. This is expected to mean when they have materially more pensioners than non pensioners. We estimate this to be between 10 and 20 years away for most pension schemes.
Trajectory	The Regulator is considering whether to apply a stress test to investments to ensure risk is being managed. Contingent assets could be used to support lower or longer cash funding on the journey.

Bringing it all together

In our experience the best pension strategies are discussed face to face between employers and trustees. Both can then discuss their own objectives and needs, to help frame an approach that works for both parties.

Crucially, any discussion is only effective if employers and trustees can quickly see the impact of different approaches or compromises. We have expanded our proprietary software, Radar, to support strategy and journey planning discussions – please see here. The chart below shows an example of how Radar helped support a discussion on managing investment strategy over the period to buyout in 15 years time.

Journey plan projection after modelling in Radar



1: Radar showed the scheme was on track to full funding in the short term.

2: As a result risk could be reduced and still reach the scheme's next target, low dependency funding, in 10 years.

3: When at the low dependency target, asset risk could be further reduced so the scheme would be able to buyout within 20 years – when significantly mature.

Source: XPS Radar

For further information, please get in touch with Vicky Mullins or Heidi Webster or speak to your usual XPS Pensions contact.

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