

## The Trustee's Role in Closed Pension Schemes

Flightpath, Road Map, End Game Wind Down,.....

Whatever you choose to call it, most sponsors of defined benefit (DB) pension schemes have chosen other avenues of pension provision for their ongoing reward strategy, and are looking at ways to remove the impact of legacy defined benefit liability from their balance sheet.

### Setting the Target

While a few employers are content to let their schemes continue unchecked, many are actively looking to set a strategy for their scheme with the aim being to restrict the impact that their legacy DB pension liabilities have on the ongoing running of their business. A key part of the Trustees' role is understanding the employer's intentions and agreeing how they are prepared to support the employer in achieving them.

Target strategies will vary between sponsors, but could include:

- A full buy-out of DB pension liabilities.
- The buy out or "buy in" of certain tranches of benefit.
- Self sufficiency i.e being fully funded on a prudent Technical Provisions basis, so that no further deficit reduction contributions should be needed.
- Reducing investment, inflation or longevity risk
- Reducing the scheme's liabilities

While the target reflects the sponsor's objectives, he should work in tandem with the Trustees in setting and implementing them, particularly where additional funding might be required.

### Taking the Opportunities

While working towards an agreed strategy, opportunities may arise where the Trustees can take advantage of good investment performance or changed market conditions. These might be identified by inbuilt triggers within the strategy or by a smart adviser pro-actively alerting the Trustees.

These windows of opportunity can be very short – particularly for annuity purchase - and Trustees must be prepared to act quickly when they arise. Where de-risking or liability reduction is on the agenda, it may make sense for Trustee training to have been delivered before the process starts in earnest, so that no time is lost when an opportunity arises.

Overleaf we summarise the Trustee role in some of the more common de-risking and liability management exercises. Where any of these are under consideration or actually taking place, there will be significant additional demands on the Trustees.

### **Buy-Out**

Full buy-out, with the consequent removal of all liabilities may be many employers' ultimate objective, although it is unlikely to be feasible for most in the short term.

The scheme strategy may identify criteria where buy-out can be considered, but more likely the impetus will come from an alert adviser.

### **Buy In**

One of the common steps towards buy-out is the buy-in of certain tranches of liability whereby where annuities can be purchased in the Trustees' name to match certain pension liabilities, thereby removing inflation, investment and longevity risk for a one-off premium.

Buy-in is an investment decision and, with annuity rates and market conditions changing rapidly, the Trustee role is to identify the opportunity and drive the decision through with the employer and insurer.

### **Investment Strategy**

The most obvious way of de-risking a pension scheme is by moving the investments to less volatile (and potentially less rewarding) assets. This may happen in a well funded scheme where a Liability Driven Investment (LDI) strategy might be introduced to maintain the funding level, or where the Trustee and employer simply wish to reduce volatility with the acceptance of additional contributions being needed to make good any deficit.

Sometimes an LDI strategy will aim at removing certain unrewarded risk such as inflation or longevity, whilst retaining some investment risk in the form of return seeking assets such as equities.

The investment strategy is determined by the Trustees, with employer consultation, and will typically be reviewed after an actuarial valuation. The Trustees need to actively monitor their investments in the intervening period to ensure that performance is as intended.

### **Enhanced Transfer Values (ETVs)**

Sentiment towards ETVs, in which members are offered an incentive to transfer their entitlement to another pension arrangement, is mixed. Nonetheless, they remain a legitimate and effective way of reducing pension scheme liabilities.

ETVs are driven by the employer, but we would expect engagement with the Trustees from an early stage. The formal Trustee role is limited, but they will want to be satisfied that the exercise is being run in accordance with regulations and guidance, and that members are being given access to suitable independent financial advice.

### **Pension Increase Exchanges**

In these, the members are offered a higher immediate rate of pension in exchange for giving up rights to certain future pension increases. As with ETVs, this is an employer driven liability reduction exercise, which can be contentious, but beneficial to some members.

The Trustee's role is also similar in terms of wanting to be satisfied that members are given suitable information and advice upon which to make a decision.