Willis Towers Watson

Developing a strategy to manage defined benefit pension risk

The Willis Towers Watson approach

The challenge

As a defined benefit pension scheme sponsor or trustee, you are confronted with a spectrum of risks which can affect your scheme's funding, creating uncertainty over pension costs and scheme security.

Now, more than ever, it is important to ensure there is a strategy in place to manage these risks. This strategy should reflect the combined goals of both the trustee and sponsor.

Your pension risk management strategy needs to consider all options available to improve the chance of reaching the scheme's ultimate goal. As the future unfolds, the plan needs to be dynamic and flexible enough to reassess the options and identify the best way forward, taking advantage of the right opportunities as and when they arise.

Sources of pension risk:

Economic – The economic outlook drives the value of the scheme's assets and liabilities. In recent years this outlook has been stressed, meaning that for many schemes, the funding position has deteriorated.

Longevity – People are living longer than previously anticipated, meaning that pension promises are now more costly than expected.

Legislative – Changes in legislation and the political backdrop continue to have a direct impact on pension entitlements, generating additional costs and uncertainty.

So how does Willis Towers Watson help clients formulate and implement a strategic risk management plan?

Step 1 – Understanding the problem and potential options

An interactive desktop review can help you understand how certain actions can affect your scheme's funding, costs and risks. The aims of this review are:

- To show how various risk management actions impact your funding position, cash requirements and risk exposure
- To give you an understanding of how designing the actions differently could impact on these measures
- To consider the indicative impact of changes to funding assumptions and asset allocation against the same metrics

Figure 1. **Sample desktop review using Willis Towers Watson's Pension Roadmap tool**

By quantifying the risk reduction impact of each option, a clearer picture will emerge and the most suitable de-risking actions for the scheme can be identified.

Step 2 – Building a prioritised action plan

Your prioritised action plan will document the business case for your chosen actions, setting out:

- Your objectives for managing the scheme's risks
- A quantitative assessment of the options you would like to consider
- A framework and prioritised action plan for implementing the right actions for your scheme

A prioritised set of steps, created to meet your objectives, ensures the actions you take are suited to your scheme's unique position.

Figure 2. **Example risk management action plan**

Action	Technical provisions (£m)		Accounting (£m)	Self-sufficiency (£m)	Action now?	Comments
	Reduction in size	Reduction in deficit	Reduction in deficit	Reduction in deficit		
Pension increase exchange (PIE) for pensioners	3.7	3.7	4.2	4.8		Write out to all pensioners providing the option of an exchange of non-statutory inflation-linked increases for a higher, non-increasing pension
Partial buy-in for the highest pensioner liabilities	–	4.5	–	5.5		Exchange some scheme assets for an insurance policy which provides a cash inflow to exactly match the outgo for some of the pension payments
Retirement transfer option (RTO) bulk exercise	20.0	2.0	0.8	3.8		Write out to over-age-55 members, with details of the option to transfer and access immediate retirement choices which better suit their needs
Retirement transfer option (RTO) embedded process	13.3	1.3	0.5	3.1		Embed details of the option of a transfer to access retirement flexibility in all retirement illustrations
Pension increase exchange (PIE) at retirement	4.1	4.1	4.7	6.0		Embed the option of an exchange of non-statutory inflation-linked increases for a higher, non-increasing pension into retirement illustrations
Longevity hedge for pensioner members	–	(10)	(8.0)	–		Enter into an arrangement which locks into a fixed cost and removes the financial risk of members living longer than expected
Buyout of whole scheme	n/a	n/a	n/a	n/a		Secure all future benefit payments through the purchase of insurance contracts, and wind-up the scheme (significant cash contributions required)
Enhanced transfer values (ETVs) for deferred members	12.0	–	1.8	4.2		Write out to all deferred members, with details of an uplifted transfer offer (significant cash contributions required)

Step 3 – Carrying out the actions

The prioritised plan will identify the actions you need to consider now, and those which should be looked at further down the line.

Strong implementation, consulting and operational focus will ensure a robust delivery.

Step 4 – Monitoring

To avoid missing opportunities, the position needs to be reviewed against the plan. There may be some opportunities which can present themselves, and preparation can ensure you are ready to execute as soon as the time is right.

We can put in place a framework to monitor the progress and changing priorities or new opportunities, whilst also providing clarity and certainty for your stakeholders.

Further information

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