2020 Emerging Trends in DB Survey

October 2020

Willis Towers Watson

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Executive summary

Top priorities

Despite the economic difficulties associated with the Coronavirus pandemic, ‘GMP equalisation’ is the top priority for schemes in the next 12 months.

‘GMP equalisation’

Schemes are seeking to address ‘GMP equalisation’ over the next 2-3 years. Almost three quarters seeking to complete back payments by 2022.

Funding

There is a trade off between scheme security and business recovery: Trustees aim to shorten the time to meet schemes’ long term targets, while corporates expect to extend it.

Covenant after COVID-19

1 in 3 say the sponsor’s ability to support the scheme has weakened in the short term; 1 in 6 say it has in the long term.

Plan design

Nearly half of sponsors with ongoing DB accrual expect either to close the scheme or reduce its generosity within the next 3 years.

De-risking

In the next 3 years, 4 in 10 schemes are looking to complete a bulk annuity transaction or longevity swap.

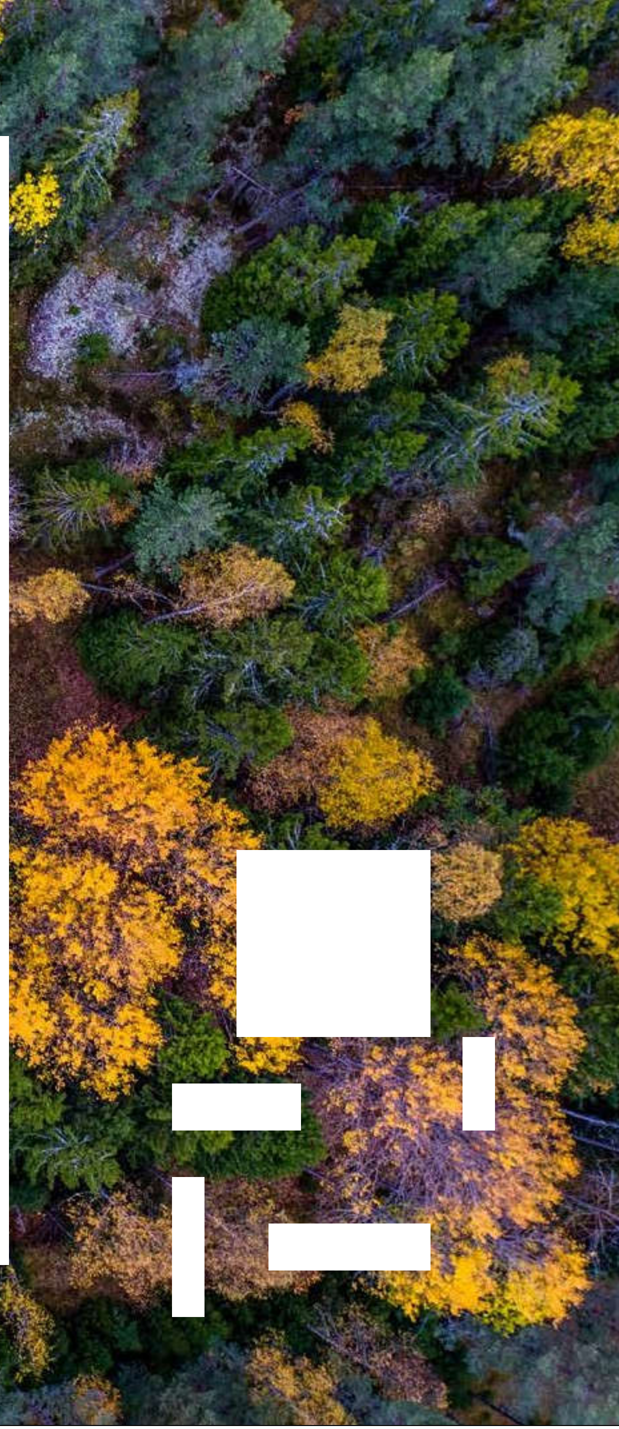
Governance

In the next 3 years, more professional trustees and schemes outsourcing more of their functions are expected to be the key trends.

About the survey

The survey was conducted between 27 August and 7 October 2020 and includes 129 responses.

100 respondents had a trustee focus (79 trustees [of whom 20 were independent professional trustees] and 21 pension managers or Trustee Scheme secretaries whose primary focus is supporting the trustees). 29 were corporate representatives.



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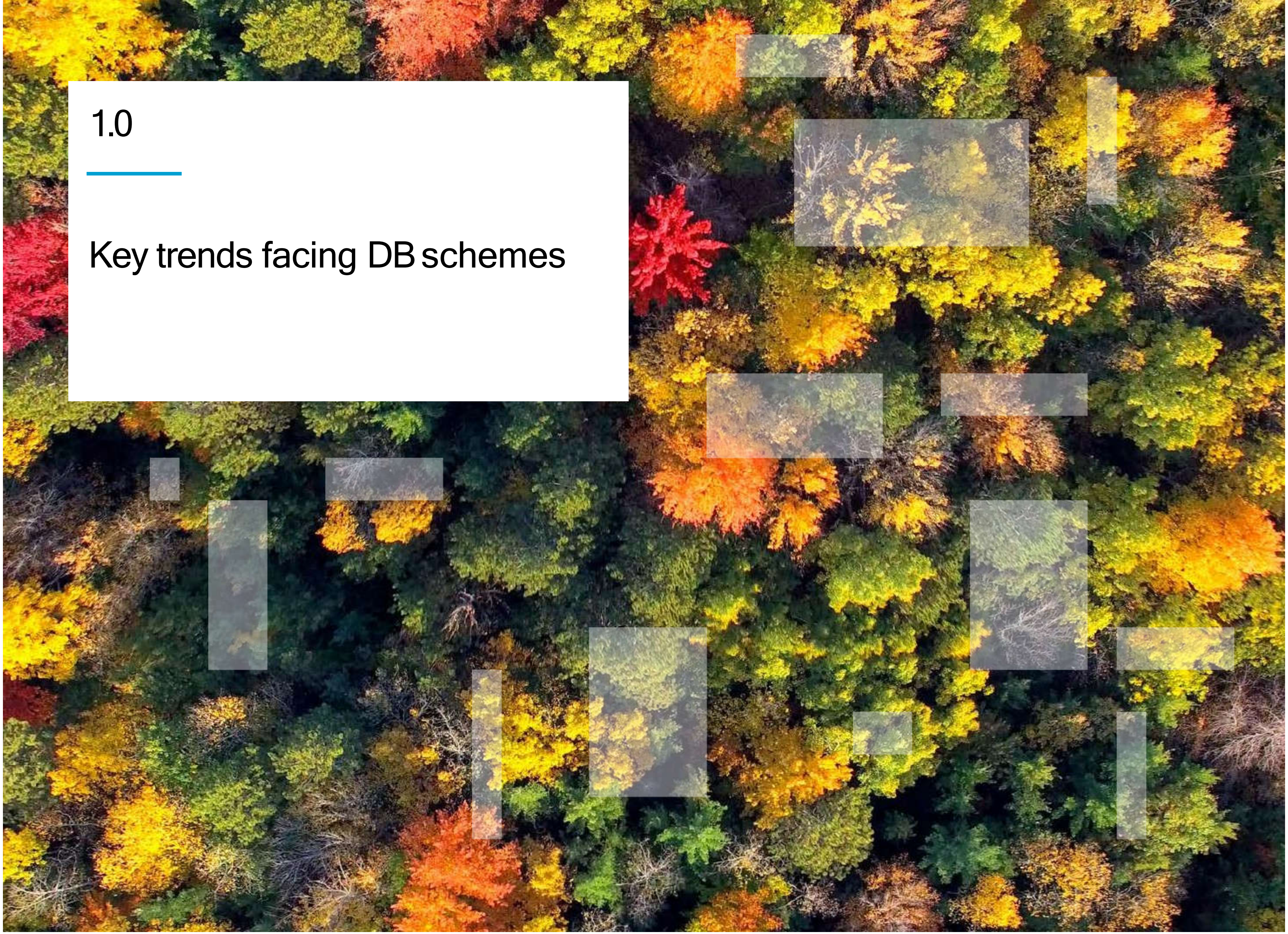
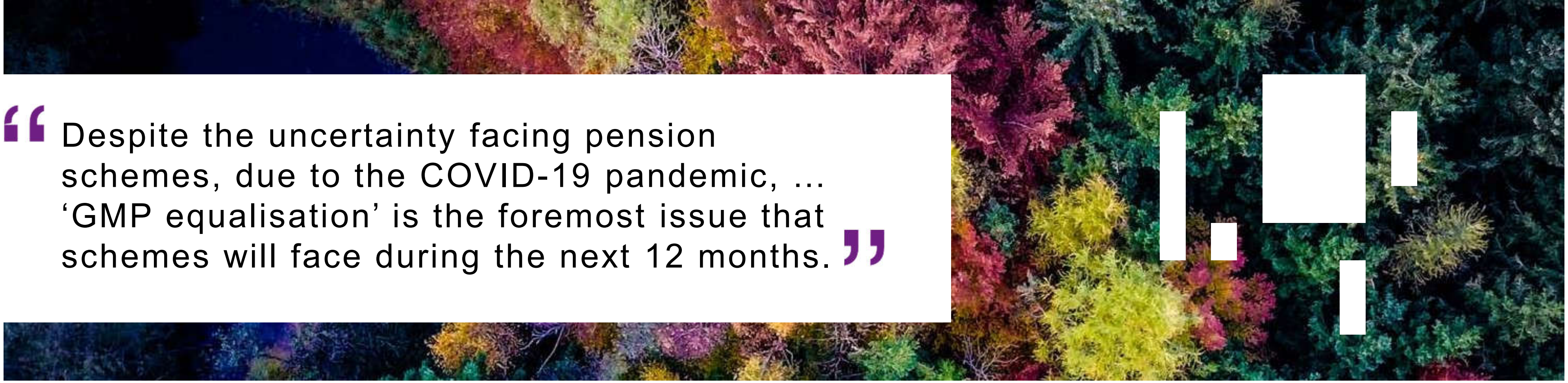
Key trends facing DB schemes





> “Despite the uncertainty facing pension schemes, due to the COVID-19 pandemic, … ‘GMP equalisation’ is the foremost issue that schemes will face during the next 12 months.”

Key priorities

Despite the uncertainty facing pension schemes, due to the COVID-19 pandemic, participants report that ‘GMP equalisation’ is the foremost issue that schemes will face during the next 12 months (Figure 1).

For most respondents the immediate focus on ‘GMP equalisation’ is expected to last for the immediate future and when looking three years and beyond, many schemes see their focus returning to long-term journey planning.

Alongside this we see a heightened focus on de-risking over the medium term, with transactions (bulk annuities or longevity swaps) the seventh ranked priority for the next year, but the third ranked priority over three years.

Figure 1: Which are the most important issues that you see impacting your pension scheme over the next …

Rank	1 year	3 years
1	‘GMP equalisation’	Long-term journey planning
2	Long-term journey planning	Investment strategy
3	Investment strategy	Buy-in/buy-out/longevity swaps
4	Funding/contribution negotiations	‘GMP equalisation’
5	Sponsor covenant	Sponsor covenant
6	Administration	Funding/contribution negotiations
7	Buy-in/buy-out/longevity swaps	Administration
8	Member communications	Dealing with The Pensions Regulator
9	Dealing with The Pensions Regulator	Expected changes to RPI
10	Expected changes to RPI	Member communications
11	Members transferring out	Members transferring out

Respondents could select up to three options

Potentially reflecting the difficult current economic environment and market uncertainty, investment strategy is the third most important area of focus for next year, and the second one looking three years ahead.

One issue where we saw divergence between those with a Trustee focus and those with a Corporate focus was funding negotiations (which ranked fourth for trustees over the next year, but second for corporate respondents). Some trustees may face tougher negotiations than they anticipate.

Plan design

After seeing a major trend to plan closure over the period 2015 to 2018, we saw DB plan closure slow in 2019 (Source, Willis Towers Watson FTSE 350 DB pension scheme report 2020).

In this survey, we can see that economic turbulence is leading employers to take another look at this position. Nearly half of corporate respondents with DB schemes open to accrual report that they are the likely to close or reduce the generosity of these schemes in the next three years.

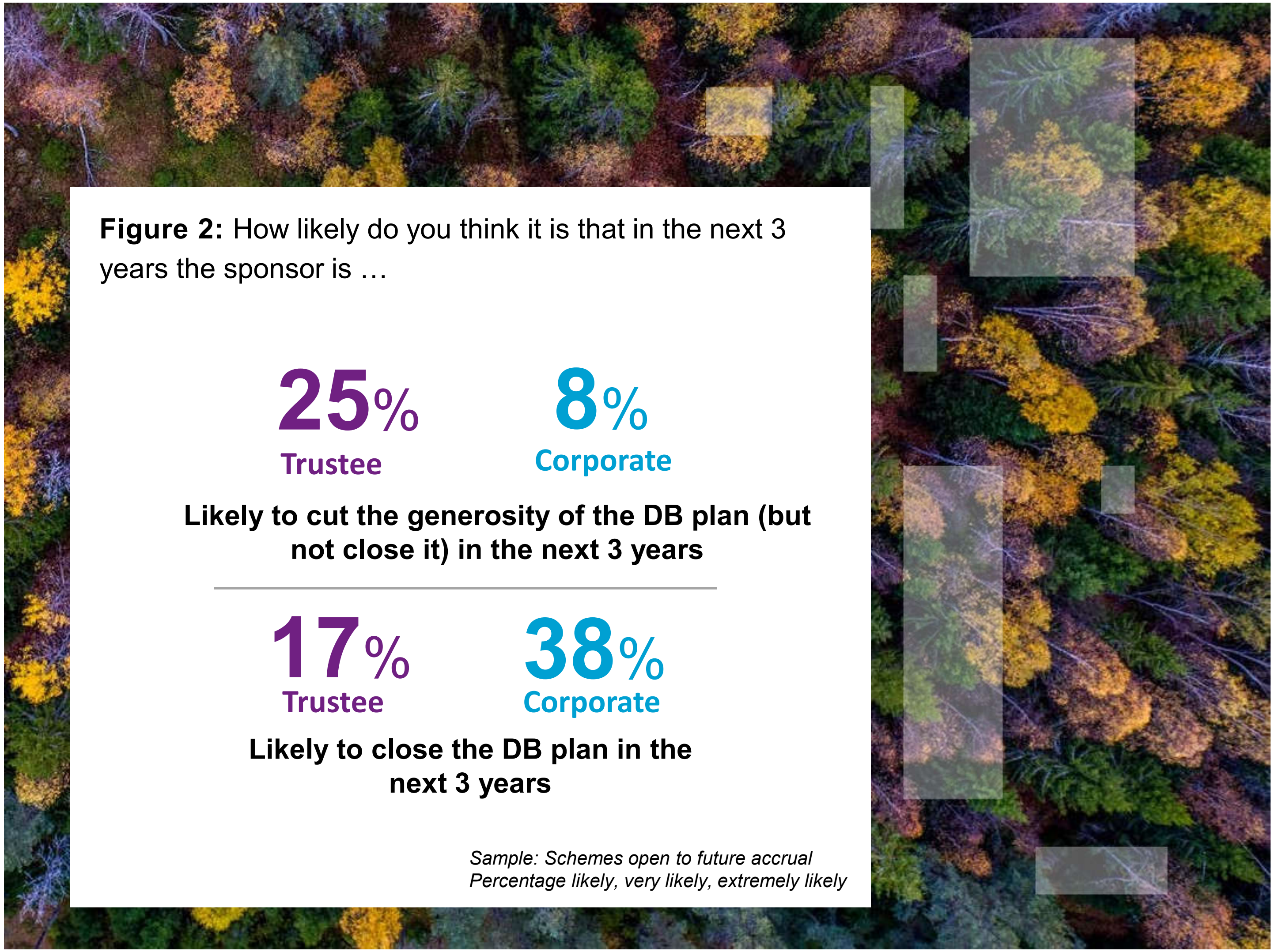


Figure 2: How likely do you think it is that in the next 3 years the sponsor is …

25% Trustee

8% Corporate

Likely to cut the generosity of the DB plan (but not close it) in the next 3 years

17% Trustee

38% Corporate

Likely to close the DB plan in the next 3 years

Sample: Schemes open to future accrual
Percentage likely, very likely, extremely likely

De-risking transactions

With many pension schemes now moving closer to their long-term objectives we are seeing a heightened interest amongst trustees and sponsors in reducing DB pension risks.

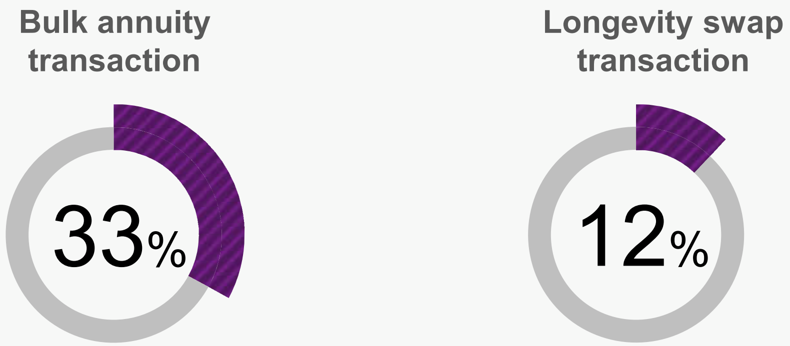
2018 and 2019 were record years for the bulk annuity market and 2020 is also on track to be one of the busiest years to date. Fewer very large transactions have made it easier for smaller schemes to get providers' attention, and wide credit spreads in March and April delivered attractive pricing for schemes already in the market.

One third are looking to pursue a bulk annuity transaction in the next three years, and around one in eight say it is likely that they will look to enter a longevity swap during that time (Figure 3).

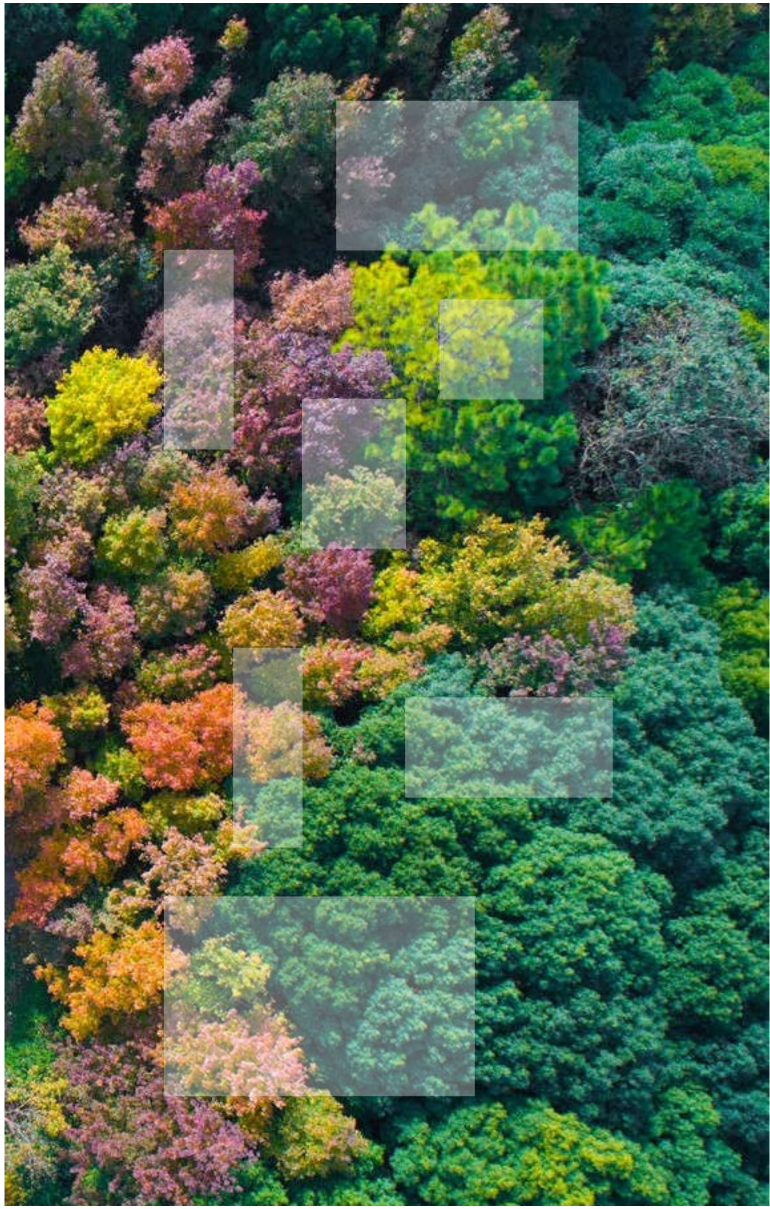
There is some overlap between these groups. In total, 40% of schemes are likely to do either a bulk annuity or a longevity swap transaction.

The short-term horizon therefore suggests significant activity to reduce pension risks and continuing growth in the buy-in and buyout market. This level of demand would be likely to see the market at full capacity and there are questions about whether the market can accommodate long-term demand.

Figure 3: How likely to do you think it is that your pension scheme will look to take any of the following actions in the next 3 years?



Percentage of likely, very likely, extremely likely



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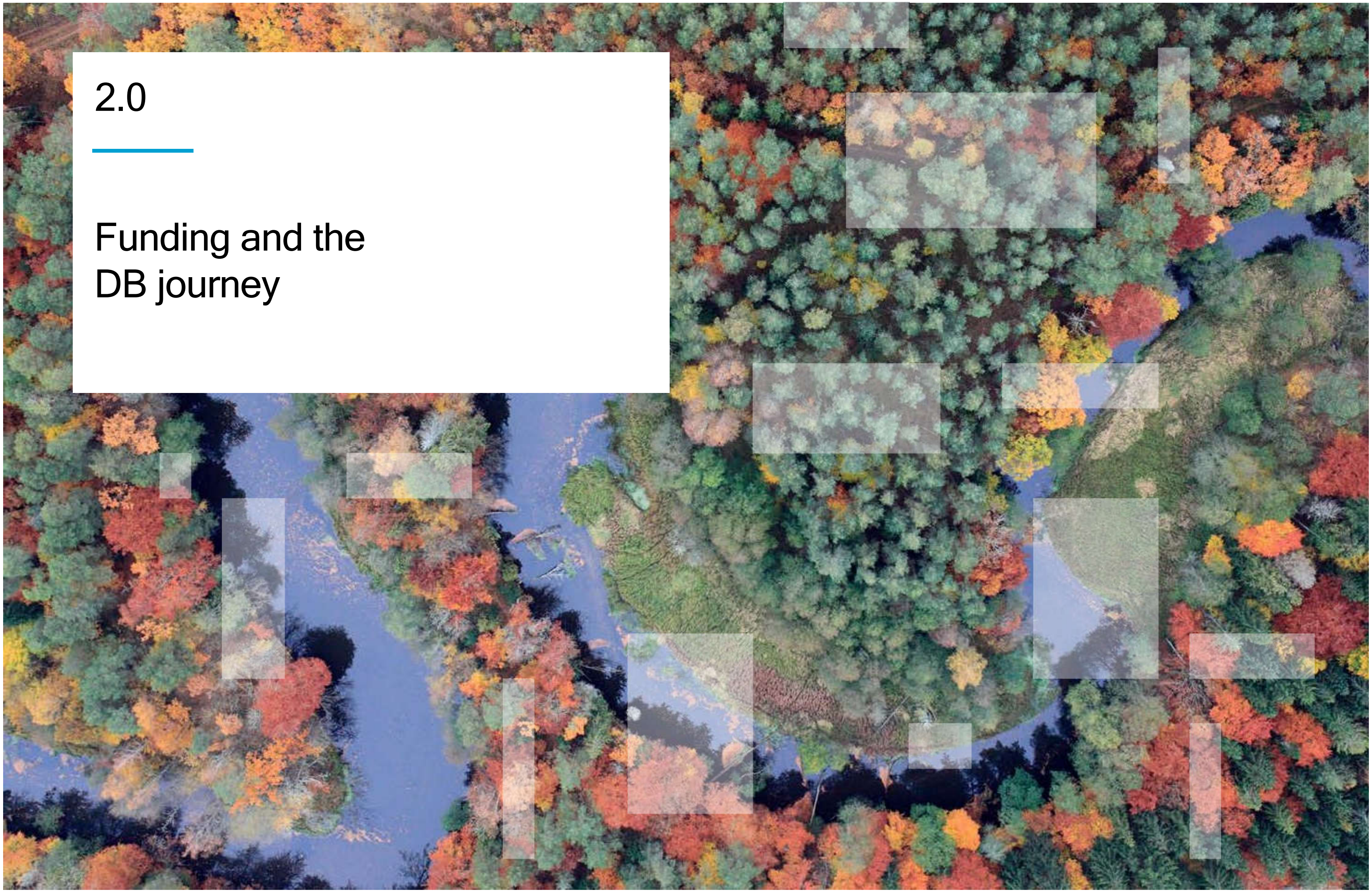
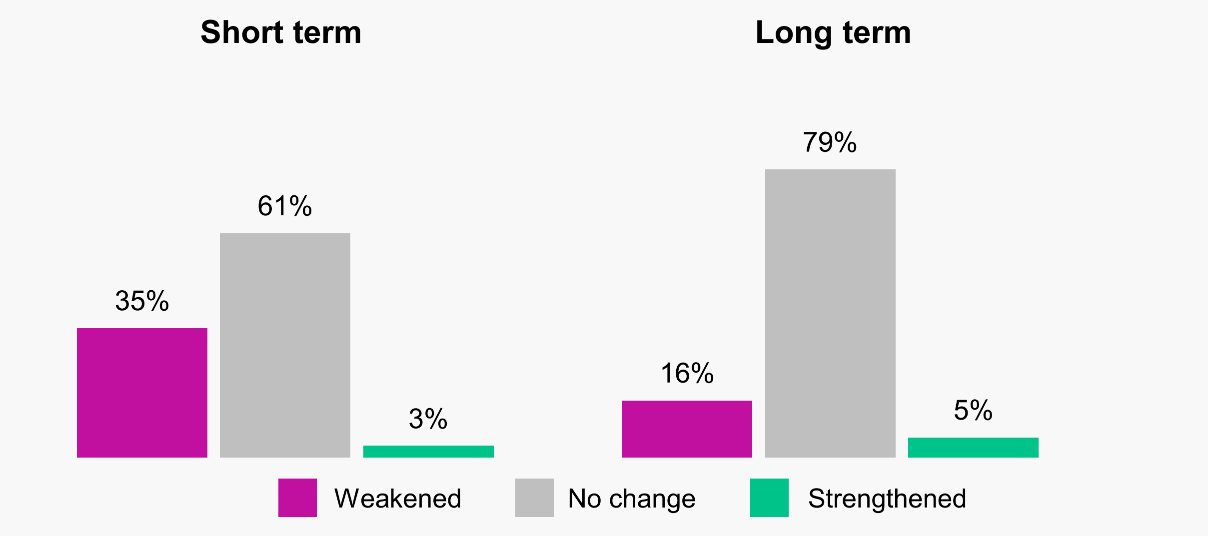
Funding and the DB journey



COVID-19, covenant and expectations for new funding agreements

Figure 4: What difference do you think the COVID-19 pandemic and economic crisis has made to your sponsor's ability to support the scheme?



Note: percentages indicate 'Weakened'/'Weakened significantly' and 'Strengthened'/'Strengthened significantly'. Numbers may not sum to 100% due to rounding

Most journey plans would be imperilled by a rapid deterioration in the sponsoring employer's ability to support the scheme. The Coronavirus pandemic, and the economic dislocation it is causing, therefore represents a fundamental challenge for many schemes.

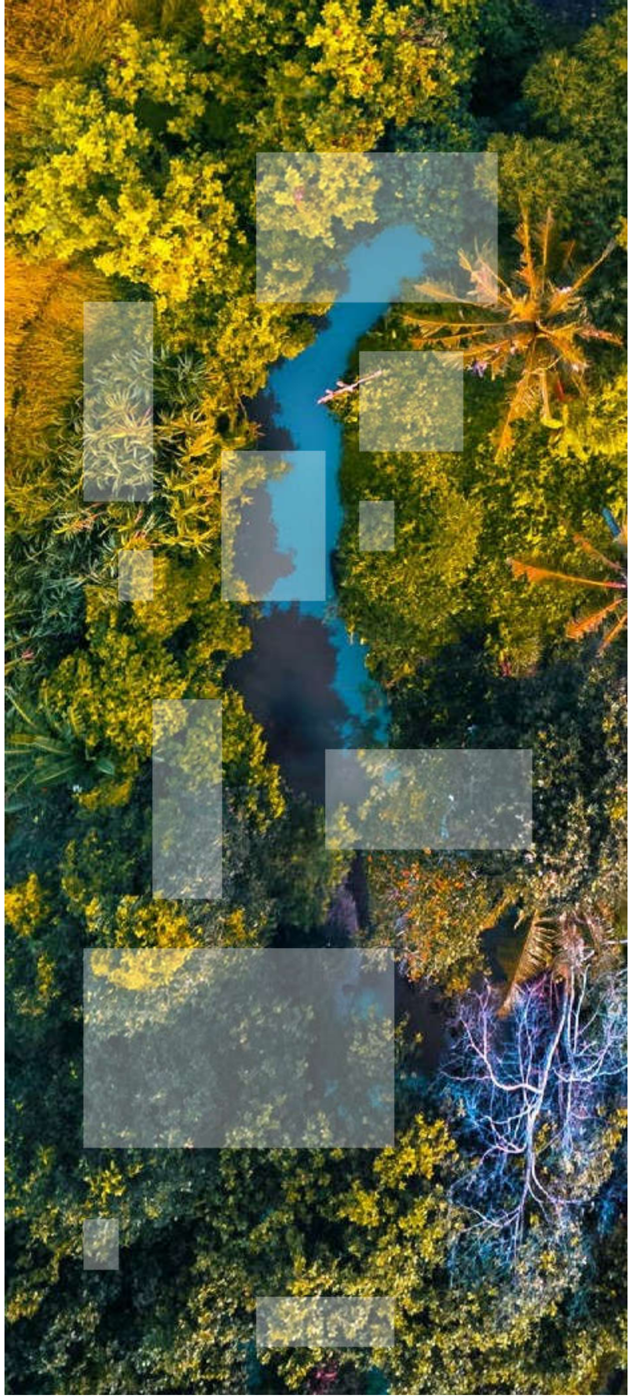
Around a third of respondents feel COVID-19 has weakened the scheme sponsor's ability to support the scheme in the short term and around 1 in 6 in the long term (Figure 4).

With funding positions typically worsening over the course of 2020 as well, this is presenting a particularly challenging backdrop to negotiations.

As a result, 24% expect a later recovery plan end date at the next actuarial valuation (with only 7% expecting an earlier end date). By contrast, 35% of respondents to our pre-pandemic 2019 survey expected a shorter recovery plan.

Meanwhile, 28% of respondents expect their scheme's deficit reduction contributions to grow, compared to 17% in 2019. 12% expect deficit contributions to fall.

Despite perceptions of covenant having weakened in many cases, the proportion expecting stronger technical provisions is lower in 2020 (27%) than in 2019 (41%).



Long-term goals

In Figure 5, we report the time frame over which schemes expect to achieve their long-term goals.

Whilst in 2019 results from trustee and corporate respondents are in broad alignment, our 2020 data shows a sharp contrast: trustees expect a shorter period to achieve the scheme's long-term goals than corporates do.

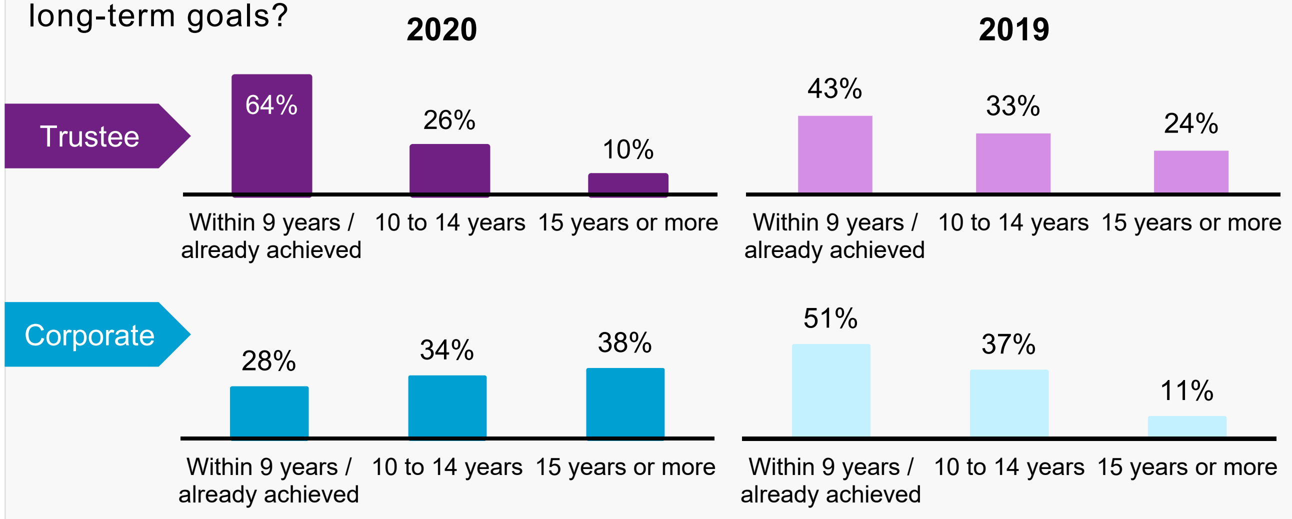
64% of trustee respondents now expect to achieve the scheme's long-term objectives in no more than nine years. By contrast only 28% of corporate participants report this expectation.

In addition, trustee respondents on average expect a shorter period to achieve their desired long-term position than they did a year ago. For corporate respondents the reverse is true.

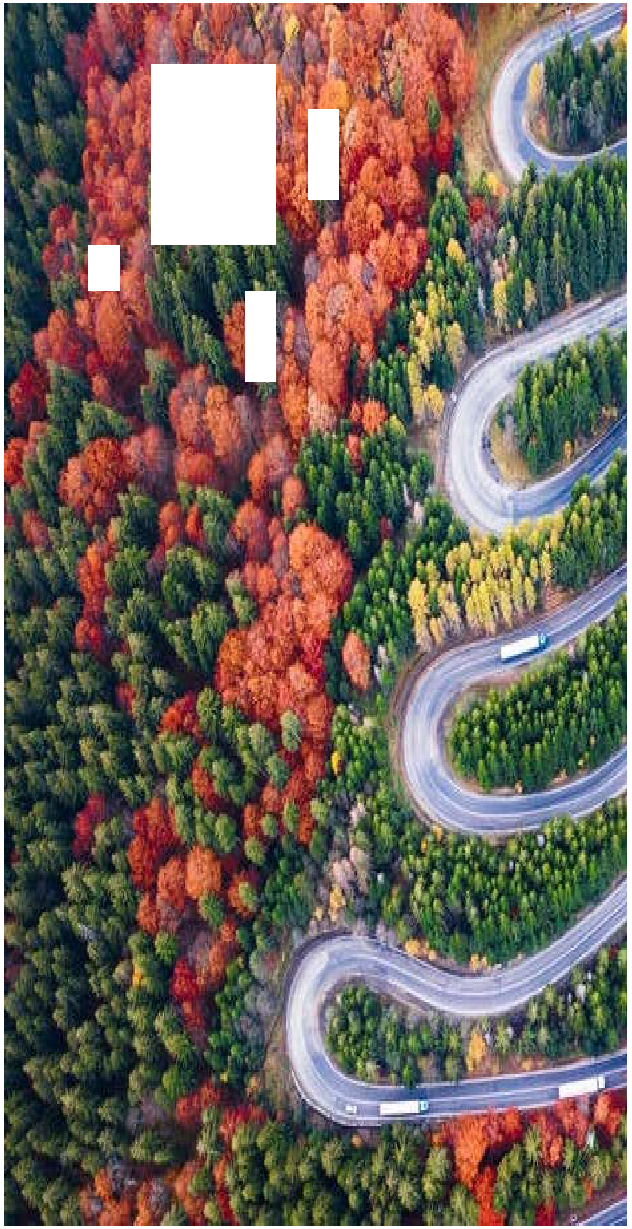
Schemes face conflicting pressures on their long-term goals and the strategies for delivering these. On the one hand, upcoming changes to the funding regime are designed to move funding to a lower risk state and The Pensions Regulator (TPR) is focussed on making benefits more secure.

On the other hand, economic circumstances are placing sponsoring employers under considerable strain and schemes will need to be very conscious about balancing member security with employer costs.

Figure 5: When do you expect your scheme to be in a position to achieve its long-term goals?

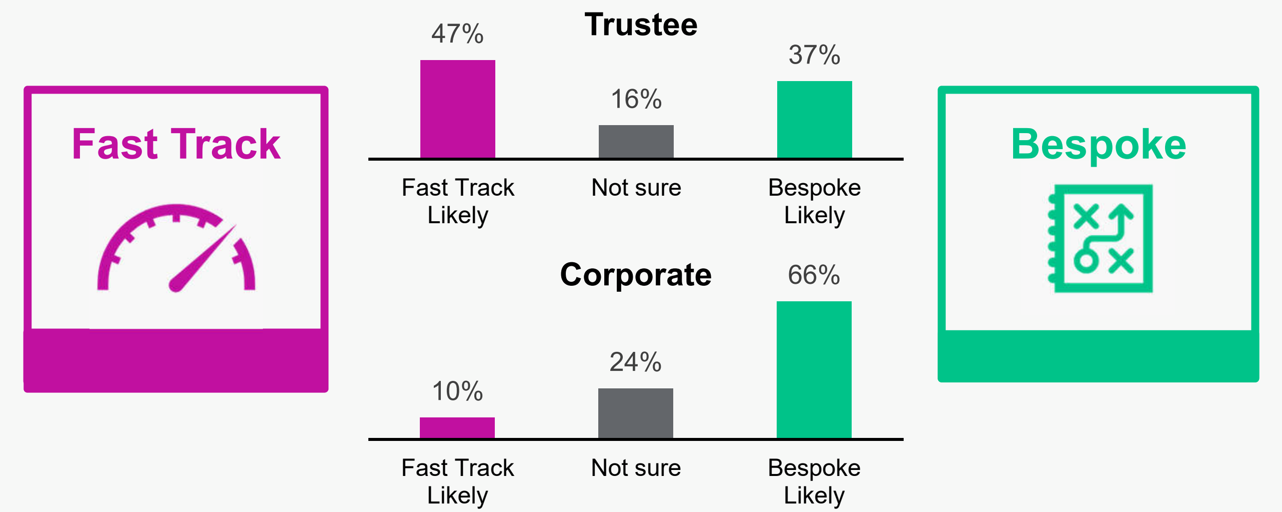


*Note: 'Don't know' responses are excluded. Numbers may not sum to 100% due to rounding.



The new funding regime

Figure 6: How likely is it that your scheme will adopt a Fast Track or Bespoke approach?



Note: percentages indicate 'quite likely' or 'very likely'

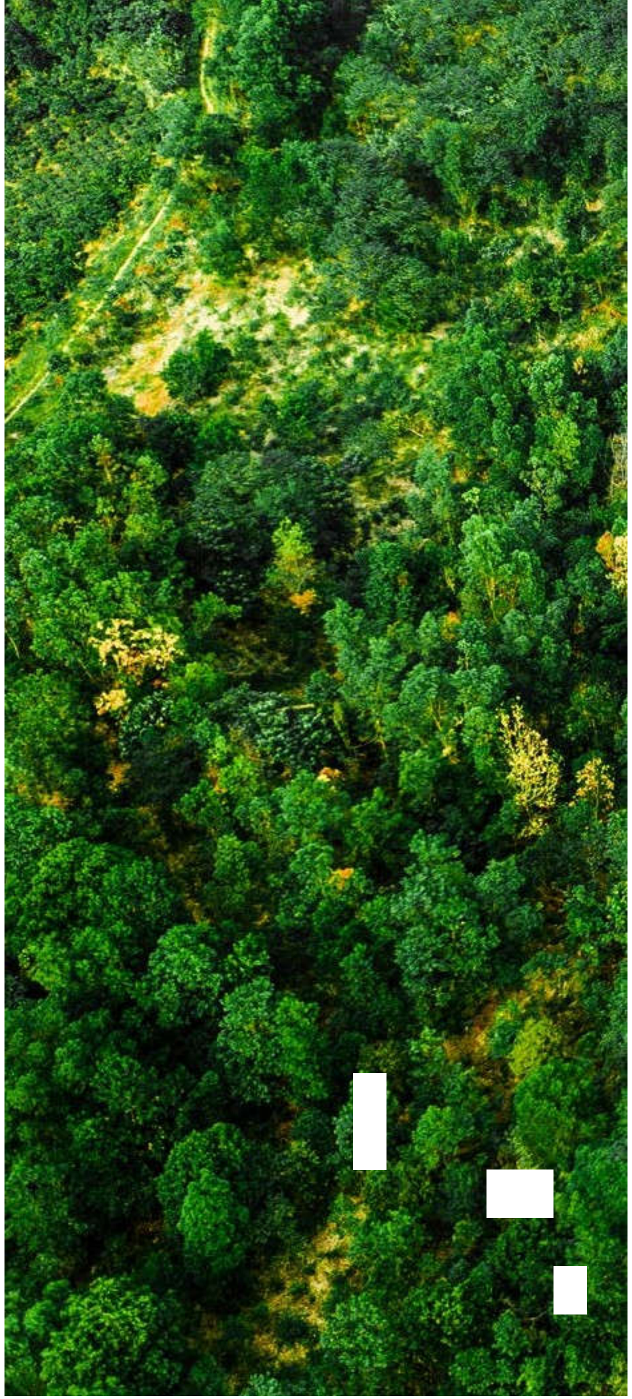
TPR is consulting on a new Code of Practice on DB funding. It proposes that schemes should have little reliance on the sponsor by the time they are significantly mature, with funding targets converging on this objective over time.

There would be a twin track approach to regulating the funding agreements that are designed to meet this objective:

- New quantitative 'Fast Track' guidelines would cover assumptions and recovery plans. Schemes following these could expect light-touch supervision.
- Schemes could take a 'Bespoke' approach if aspects of Fast Track were judged inappropriate or unaffordable, but Bespoke agreements would attract more scrutiny.

In Figure 6 we report respondents' views on the proposed regime. Trustees are split between the two approaches: 47% suggest they are likely to use the Fast Track, compared to 37% favouring the Bespoke route. By contrast, corporate respondents strongly prefer the Bespoke approach (66% to 10%).

Most respondents expect the new funding regime to lead to negotiating power shifting to trustees: over half agree with the statement that "the new regulatory approach is likely to increase sponsor payments to pension schemes".



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‘GMP equalisation’

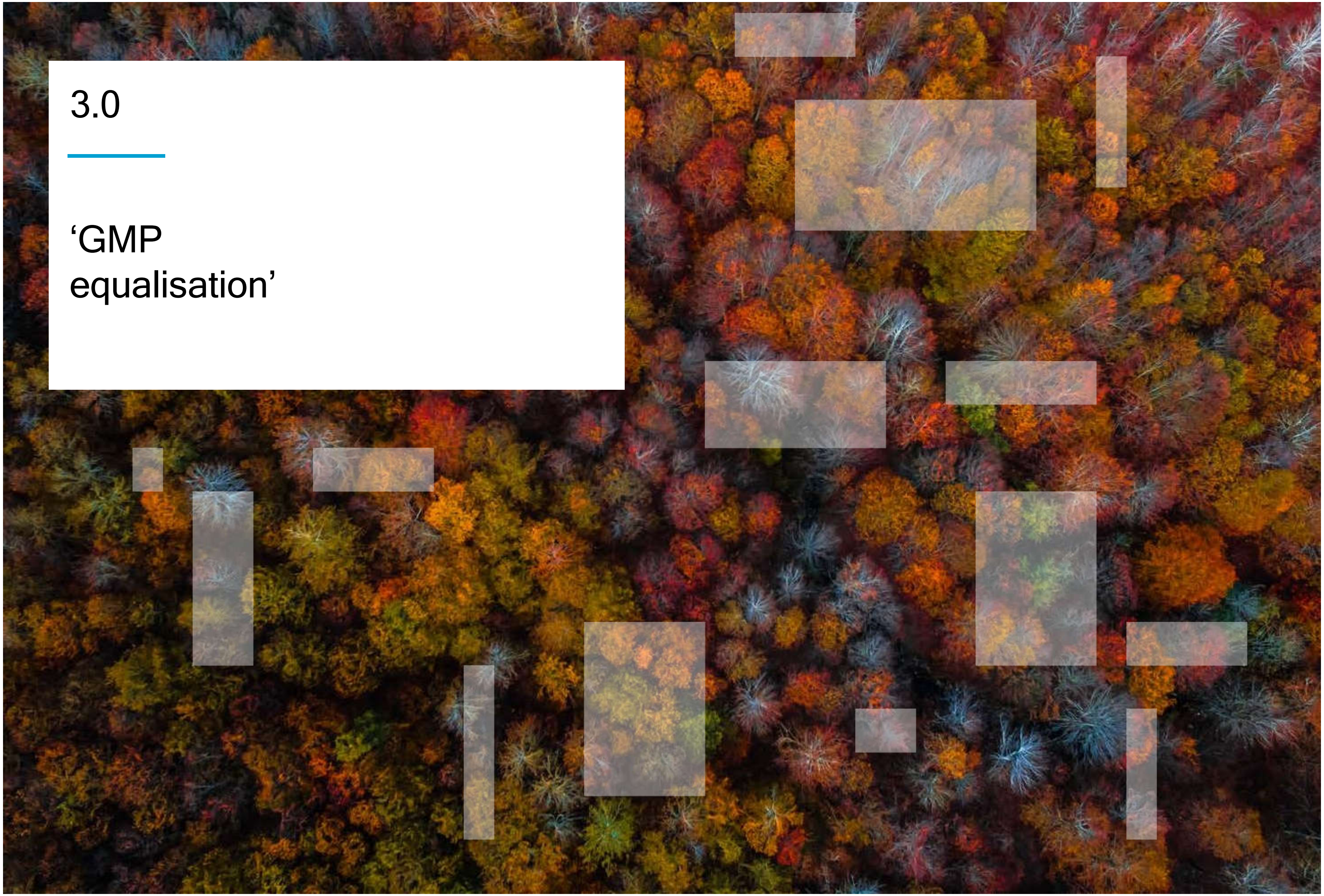
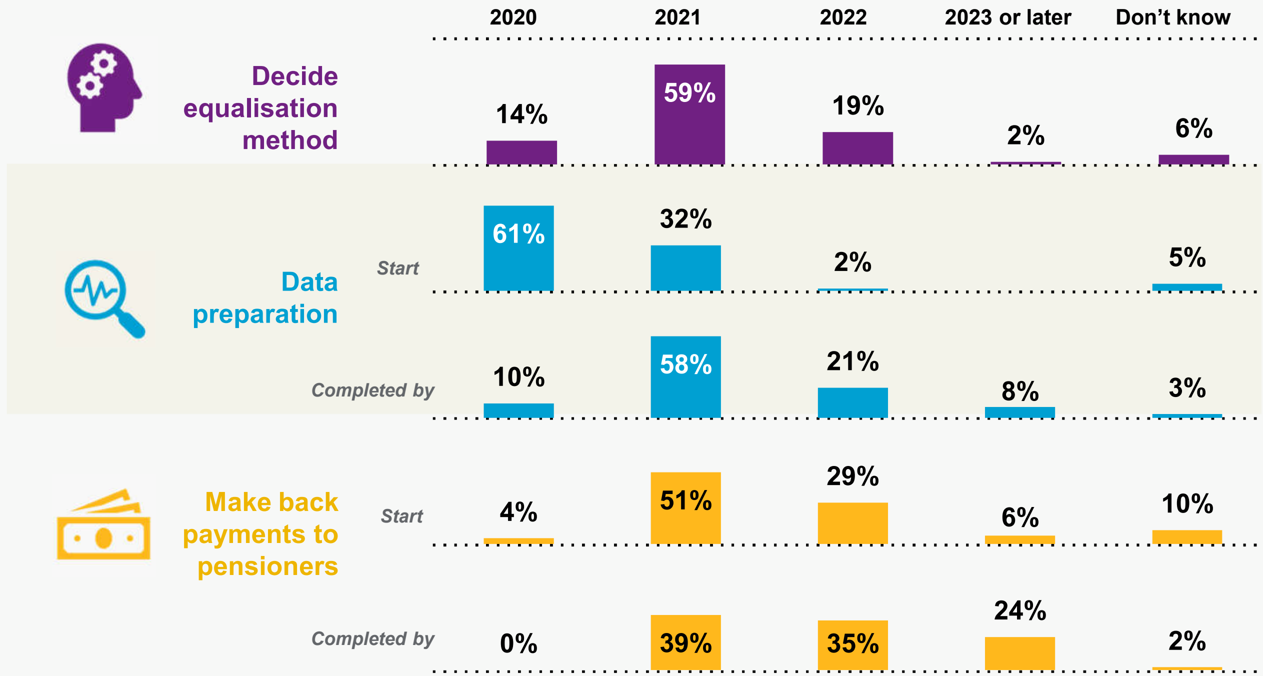
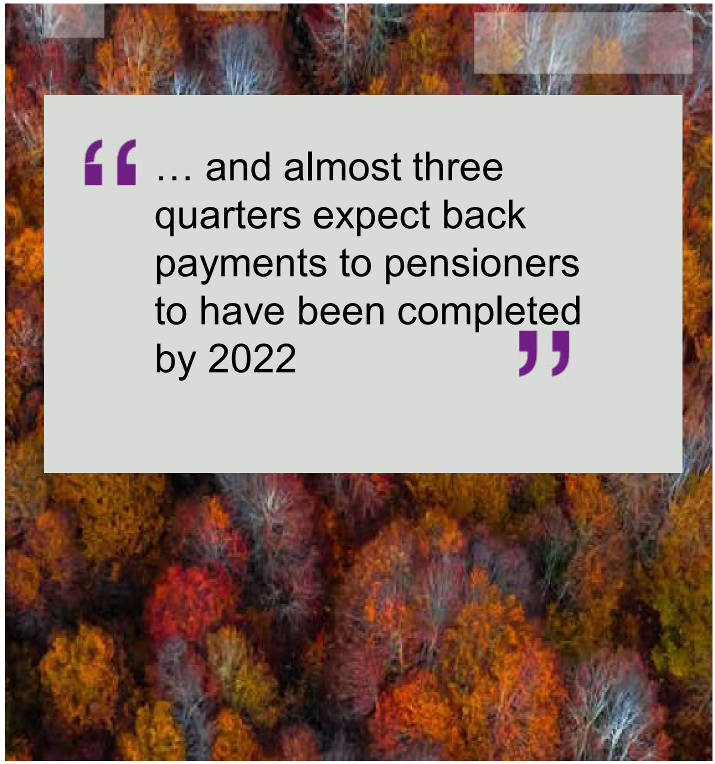


Figure 7: When do you expect your scheme to complete the following GMP issues?



*Note: Percentages may not sum to 100% due to rounding. All respondents who answered either a start or end date are included.



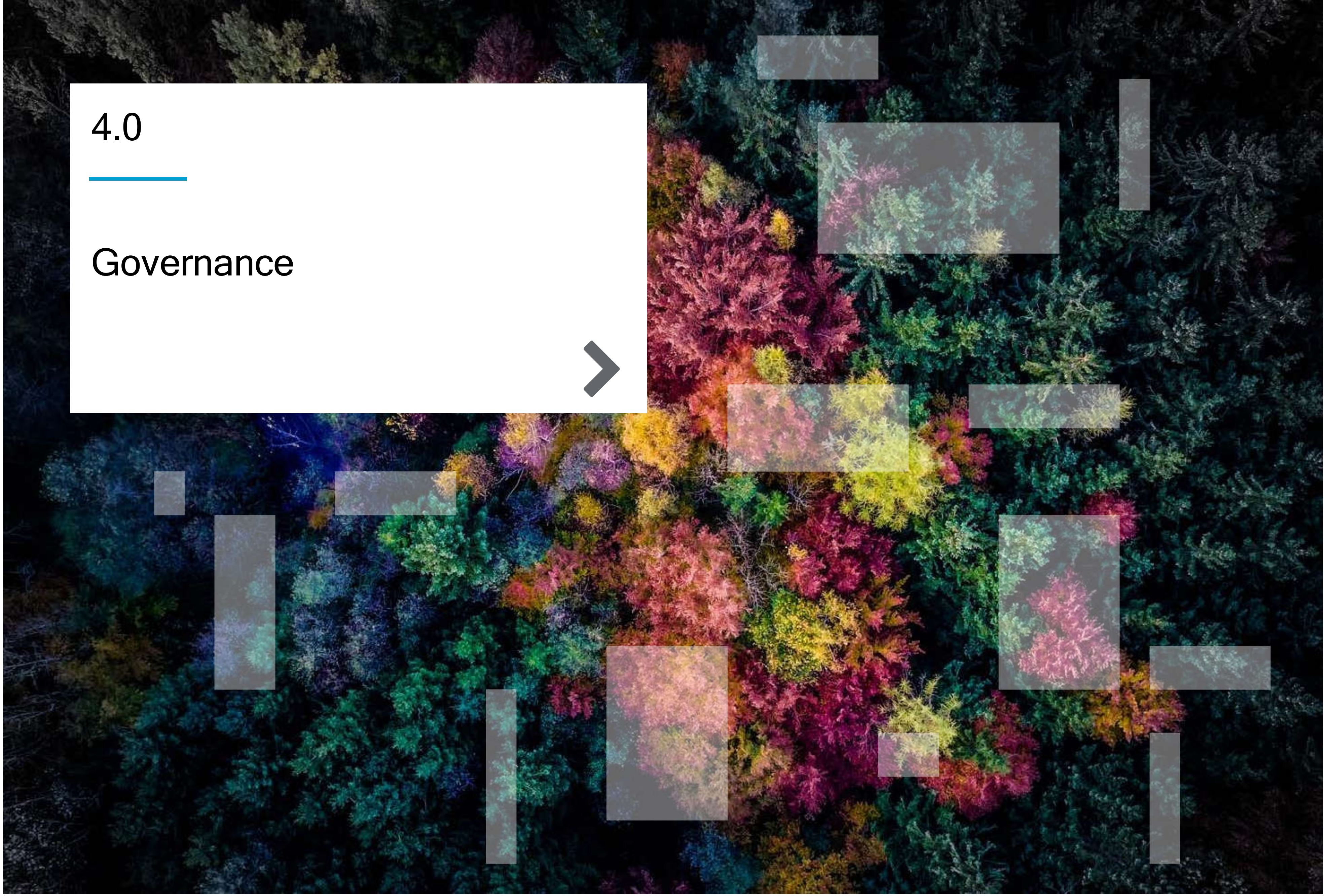
After 28 years of uncertainty, the Lloyds judgment on 26 October 2018 confirmed that schemes must equalise benefits between men and women where differences arise from the statutory calculation of Guaranteed Minimum Pensions (GMPs). This is a major undertaking.

Perhaps for a variety of reasons – the immediate demands of the pandemic, the scale of the task, the wait for government guidance and legal clarity – 55% now expect to complete the bulk of 'GMP equalisation' later than they did 12 months ago. But schemes are looking to make significant progress. As we saw in Figure 1, more respondents named 'GMP equalisation' as their top priority for the next 12 months than cited any other issue.

In Figure 7 we can see that the majority are looking for the bulk of the preparatory work to be completed by 2021 and almost three quarters expect back payments to pensioners to have been completed by 2022. In some cases, these may prove ambitious targets, but schemes are looking to drive forward and start to draw a line under the issue.

Additionally, 53% of respondents said they were likely to equalise by converting GMPs into scheme benefits, with only 20% expecting to maintain dual male and female records (the remainder were unsure).

These percentages might change: in our experience, as schemes have explored 'GMP equalisation' in more detail, some schemes who started off expecting to convert have concluded that this is more difficult, and dual record keeping less difficult, than they first assumed.



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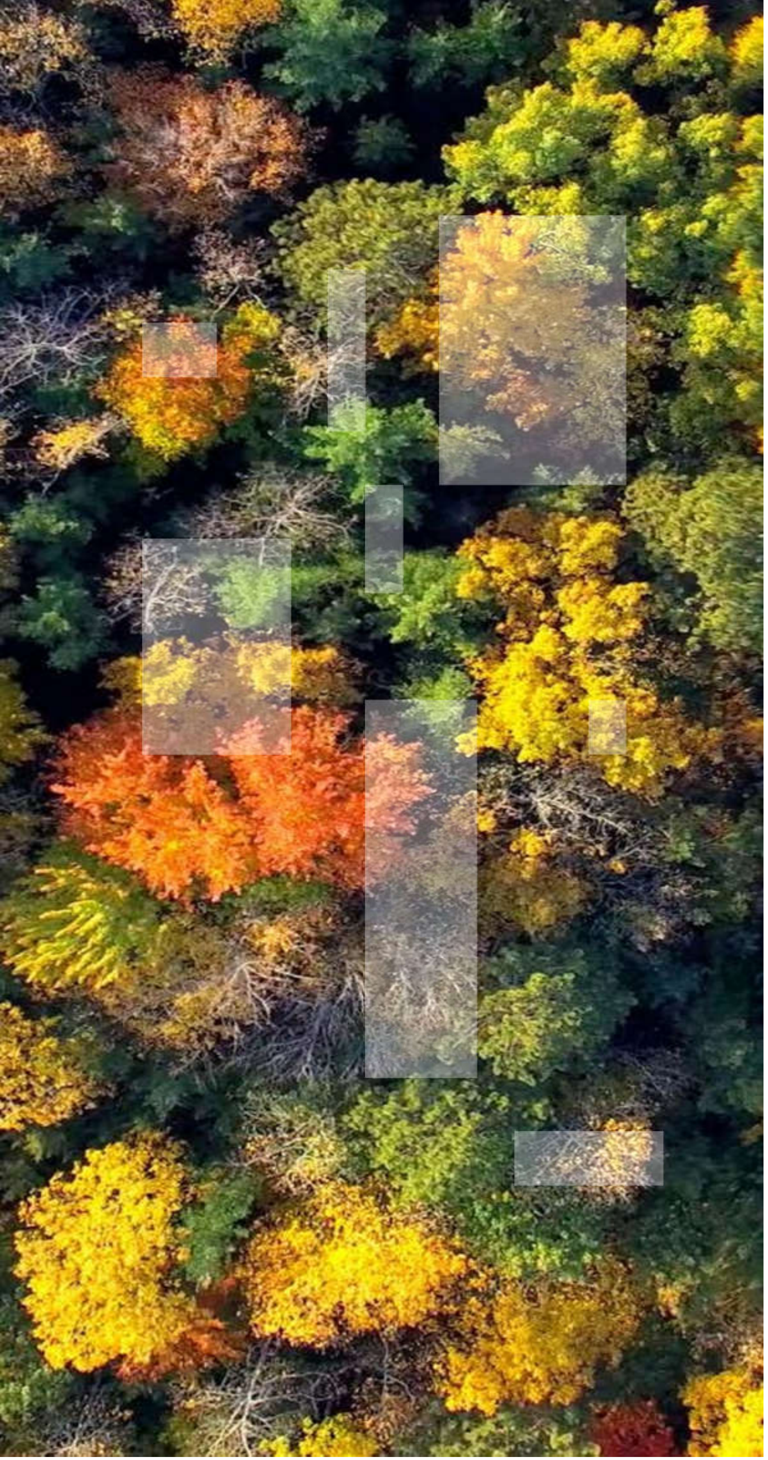
Governance



Governance during the pandemic

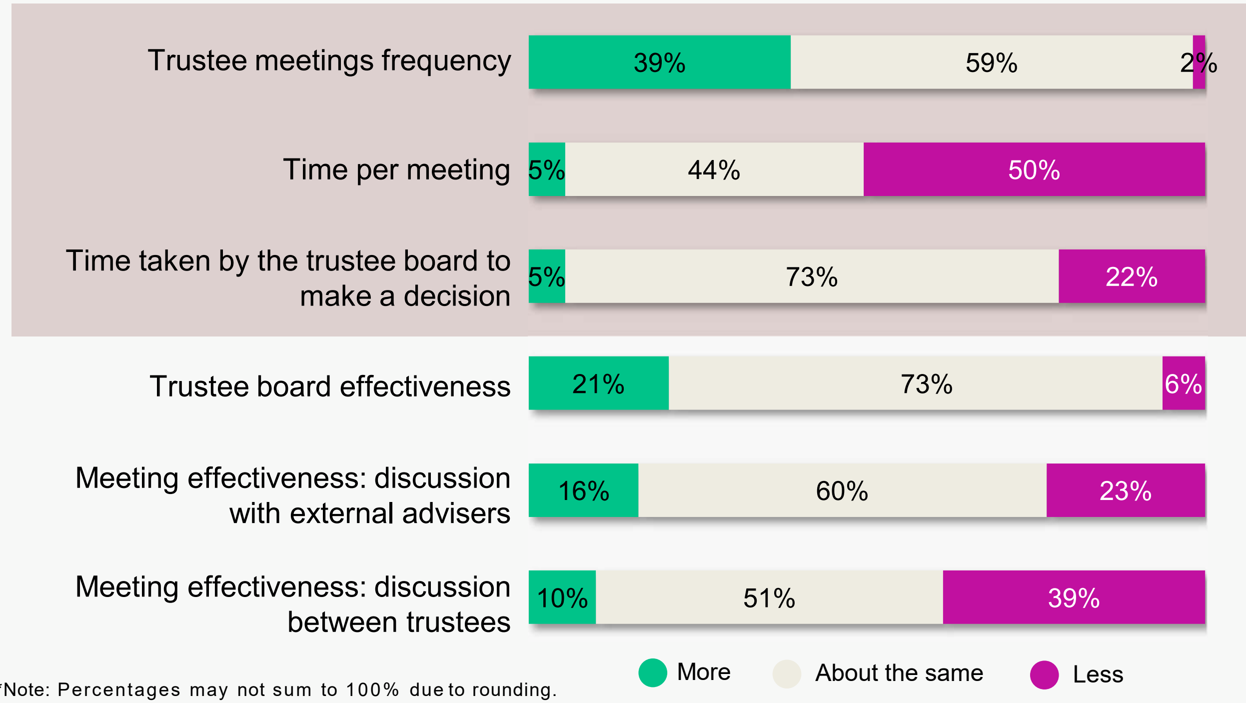
During 2020 the move to remote working, precipitated by national lockdown, has fundamentally altered the way DB pensions schemes have been run. Traditional face-to-face meetings have been replaced by shorter, more frequent online meetings (Figure 8).

How has remote working affected Trustees' effectiveness? In Figure 8, we can see that they are most likely to say things have not significantly changed, for better or worse. Trustees are more likely to say that, overall, the trustee board has become more effective than that it has become less effective. More also think decision making is now faster than say it has become bogged down.

However, many trustees report that discussion between the trustee group is less effective (39%); likewise, discussion with advisers (23%).

If the move to more online meetings becomes permanent, then Trustee

Figure 8: How would you say the move to virtual meetings during the COVID-19 pandemic has affected the governance of your scheme?



*Note: Percentages may not sum to 100% due to rounding.
Sample: Trustee focussed respondents.

groups may need to adjust their approaches to, once again, facilitate more discussion and debate.

Future trends in governance

In Figure 9, we report the expected major trends in governance of DB schemes expected over the next three years. An increase in the role of professional trustees and greater outsourcing of functions/services are the foremost expectations of survey participants.

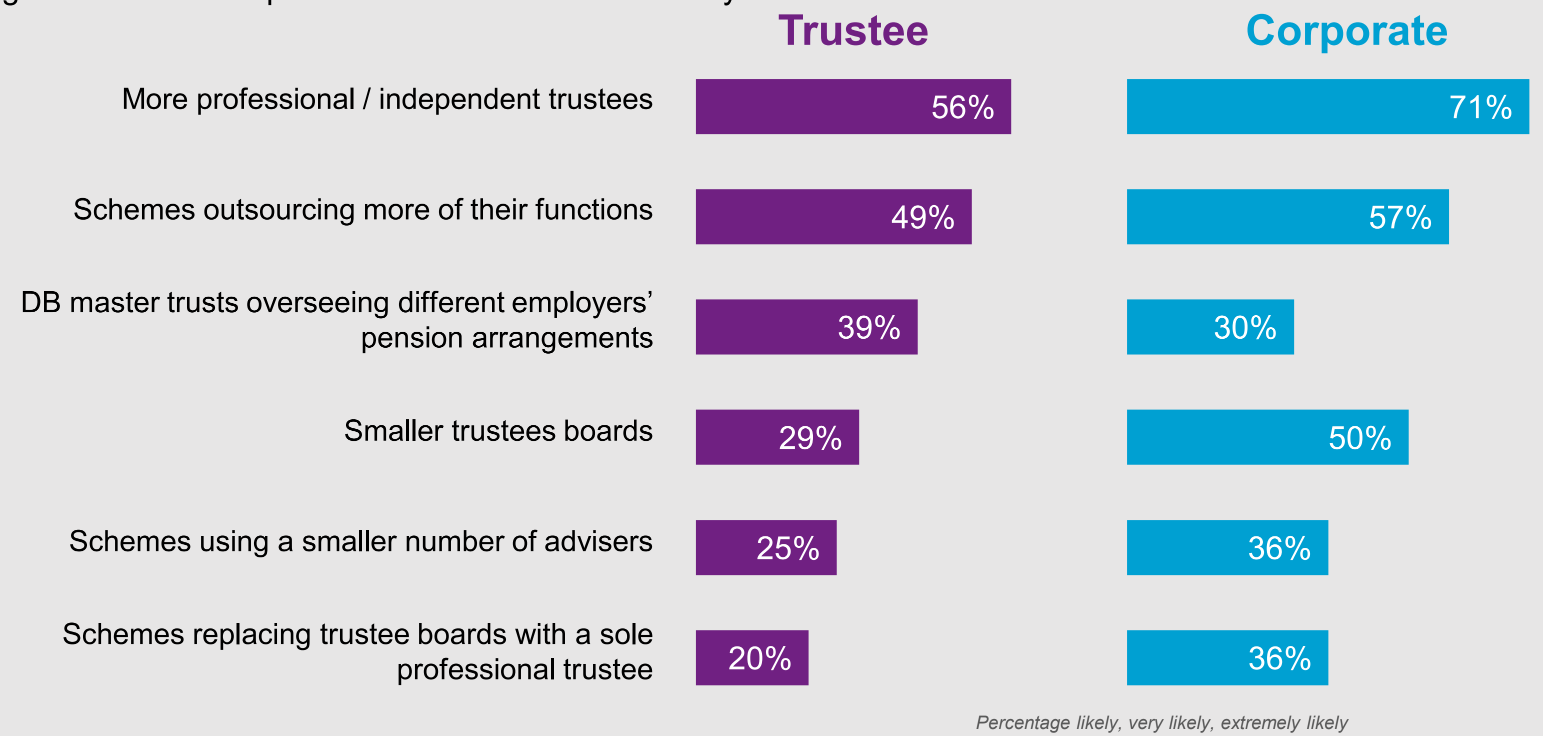
56% of trustee and 71% of corporate respondents expect a growth in independent professional trustees, while over half of both corporate and trustee participants expect an increase in schemes outsourcing.

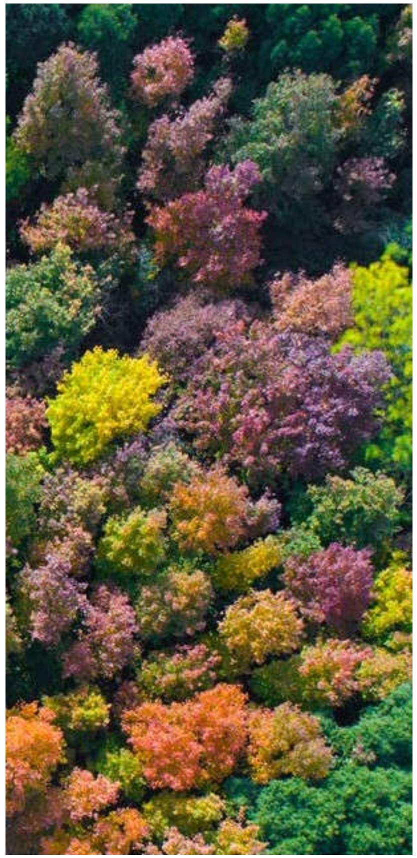
In terms of key new developments in governance: over a third of respondents expect DB master trusts to grow materially in the next three years (39% of Trustee and 30% of Corporate responses).

However, we do see some differences between corporate and trustee responses, with regards the potential for future governance arrangements to shrink the trustee board:

- 50% of corporate and 29% of trustee respondents see smaller trust boards as a likely outcome
- 36% of corporate and 20% of trustee respondents see use of sole trustees growing materially over the next three years.

Figure 9: How likely do you think it is that the following will be major trends in the governance of DB pensions schemes in the next 3 years?





The role of independent professional trustees

The last decade has seen a large growth in the role of independent professional trustees. In Figure 10 we examine what contribution pension professionals think this has made to improving scheme governance.

Some 76% of trustees report independent professional trustees have significantly enhanced the governance of their scheme overall, with the chief advantages seen to be their knowledge of market practice (89%) and specialist expertise (87%).

7 in 10 trustees feel that professional trustees have contributed to more effective decision making (71%) and more than half think they have provided greater independence from the sponsor (54%).

By contrast, only a minority feel that professional trustees have helped schemes improve their relationship with the sponsor or the Regulator.

Figure 10: On the following scale, to what extent do you think the independent trustee(s) has enhanced your trust board's …

Sample: All respondents (excluding professional trustees), whose trustee board contains an independent professional trustee.

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