

De-risking – building a route map to success

While turbulent investment markets affect pension scheme funding across the UK, there remains a wide choice of de-risking options for trustees to consider

Before embarking on de-risking strategies, it is vital that pension scheme trustees and sponsoring employers agree on their key aims for the scheme. Regardless of the funding position, both parties need to be fully aligned to ensure the most appropriate solutions are implemented effectively and for the right reasons. Of course, both parties are likely to seek independent advice, to help determine the goals, assess key risks, identify appropriate solutions and decide on the most suitable provider.

Analysing the risks

While current economic conditions may make it difficult for some schemes to afford full buyout terms the good news is there are alternative options that trustees can implement to help reduce risk exposure, with varying degrees of affordability. Solutions can target specific areas of risk within the scheme, so it's vital to understand the specific 'hot-spots' within each scheme before determining the solution. This is something that trusted providers such as Prudential can help trustees identify through their advisors. It doesn't necessarily matter which 'standard' mortality table you use to make assumptions, it's more important to understand how well this truly matches the membership of your scheme. Various factors can influence scheme specific risks. For instance, mortality is affected by:

- **Geographic spread** – mortality rates differ greatly depending on location
- **Socio-economic** – lifestyle can be as important as gender when it comes to longevity, yet many schemes do not account for this
- **Risk concentration** – there could be specific

Solution	Focus	Benefits	Risks / Considerations
Buyout	All members and associated liabilities	Secures full benefits via a transfer of all liabilities to insurer	Expensive – particularly for deferred members
Buy-in	Pensioners	Secures cost of future pension payments for selected members, while trustees continue to manage scheme	More affordable than full buyout, although some risks (such as investments and deferred benefits), remain with trustees.
Enhanced Transfers	Deferred Members	Reduces number of deferred members in the scheme. Offers members personal choice whether to remain in DB or take enhanced transfer to a Defined Contribution (DC) alternative	Will be more appropriate to some members than others. Requires robust personalised advice process in line with FSAs 'Treating Customers Fairly' principles.
Annuity Vesting	Future Pensioners (current active & deferred members)	Provides a solution relating to active and deferred members as they approach retirement	Can be implemented in isolation or following completion of a pensioner buy-in

Table 1: derisking solutions

groups of members within your scheme that pose a greater risk, or skew the mortality model, ranging from large portions of pensioners of the same age to a group of younger executives, or skilled staff on high benefits

Really understanding your membership and the significant impact this can have on your scheme costs can help identify the right solutions (see the table above for examples). Applying a combination of these solutions over time can provide trustees with a route-map that presents a more affordable and manageable way of reducing, and ultimately removing, the risks within their scheme.

Investment strategies

Current financial markets will make most schemes re-think their investment strategies. The

key will be to align such strategies to the wider de-risking aims.

Data cleansing

For any scheme looking to de-risk, it will be vital to ensure scheme data is thoroughly cleansed. Having accurate data helps the process for any bulk annuity arrangement, such as buy-in or buyout, both in terms of speeding up the transaction and helping to ensure any quotations provided by insurers accurately reflect the real costs to the scheme.

Assurance of quality and trust.

In times of turbulent markets, the quality of the chosen provider is more important than ever. Pension provision is a long-term commitment, with the livelihood of scheme members at stake – and with it the reputations of trustees and sponsors! De-risking decisions are vital and so too is choosing the right partner with the appropriate financial strength, security, expertise and reputable brand that members trust. ■

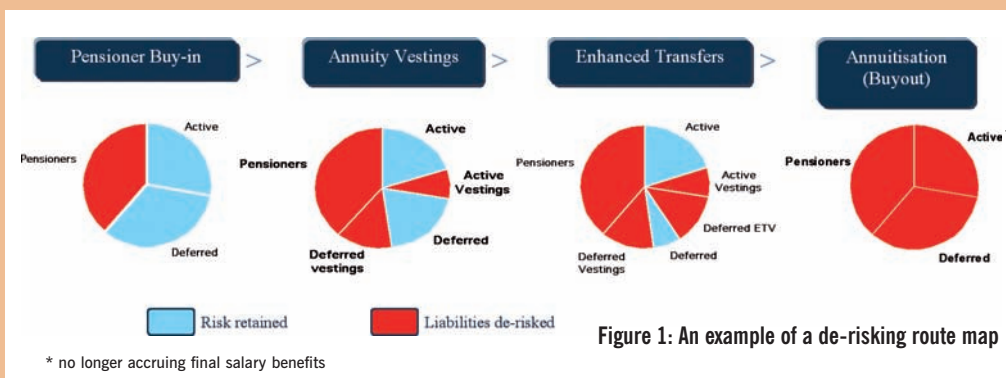


Figure 1: An example of a de-risking route map

Andy Reed, director, defined benefit solutions at Prudential

Retirement has more potential with **PRUDENTIAL**