Pensions Strategy Review for DB sponsors: managing key risks and identifying opportunities in a new world

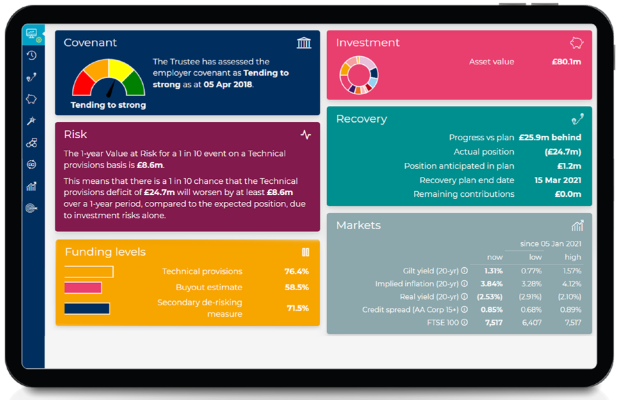
The Pensions Schemes Act 2021 brings in a new requirement for sponsors and trustees to agree on a long-term funding and investment strategy for their Defined Benefit (DB) pension schemes, as well as new tougher powers for The Pensions Regulator (TPR) potentially hitting normal business activity.

Now more than ever, sponsors need to be proactive in driving the pensions strategy and working with trustees to ensure that there is alignment with the wider corporate strategy.

Our Pensions Strategy Review is designed to help sponsors address key questions in relation to their DB scheme, and to prioritise any actions to manage the impact of the scheme on the sponsor's business. This will give the Company board confidence that pension risk is being appropriately managed and opportunities in relation to the scheme are not missed.

The key components of a successful Company pensions strategy include (but aren't limited to):

- **clarity on the scheme's ultimate destination** (eg buyout, run-off or other transaction-based target?);
- **clearly defined timescales** within which this target should be achieved, reflecting the desired balance of investment risk and return versus cash funding to get there;
- **well-defined approach to investment de-risking**, and consideration of the use of tools to manage liability risks (eg member options);
- **effective processes to identify and respond to risks and opportunities** along the way (with early notification for where sponsor input and trustee engagement is required);
- **efficient scheme governance,** including managing advisory and investment costs;
- **management of regulatory requirements** and early warning of events which may fall in scope of the new TPR powers.



Our 'Pensions Strategy Review' focuses on asking key questions of the sponsor in relation to each of these distinct areas. A summary of these key questions is set out overleaf.

We will then work with you to build and document a plan which can be discussed and shared with wider stakeholders in the business (eg the Company board), and with the pension scheme trustees.

Monitoring progress against this plan will then be key, as will having a clear framework for how and when to respond to future opportunities and risks.

LCP's Pensions Strategy Review addresses the following key questions:

1) What is the most effective way to provide Company input on long-term strategy to the trustees?	• Providing clear sponsor input and views on the long-term target (and timescales for reaching this target) is key. • For example, if the sponsor's preference is to run the scheme on (rather than transfer to a 3rd party), trustees need to be made aware of this at an early stage of discussions. • Consider how to present the covenant appropriately to the trustees, and how to make best use of company resources to optimise the covenant afforded to the Scheme.
2) How can the Company ensure that opportunities aren't being missed?	• It will be important to set out the sponsor's pension principles upfront, which will reflect the broader corporate strategy. • The cost and benefits of any opportunities (eg investment de-risking, member options exercises etc) can then be assessed against these principles, and raised with the trustees as appropriate.
3) How should the Company manage the risks of further cash calls and overfunding?	• Proactively engaging with the trustees on the investment strategy and pace of de-risking will help manage the risks of future unexpected cash contribution requirements. • Contingency planning will be key to mitigate the risk for future overfunding – and could involve the use of **security, escrow, or other contingent assets.** • It will also be important to understand how the scheme may stack up against the **new funding code** requirements – or how a bespoke approach may be justified to manage resources efficiently.
4) How are the regulatory risks for the Company and its directors identified and managed?	• The Company will need to be able to identify in advance activities which could potentially fall under the scope of **TPR's new powers** (eg refinancing, dividends, group restructuring). • A process will be needed to then assess the potential impact, and to establish if there is a need to engage with the trustees (or with TPR) and/or to provide mitigation to the scheme.
5) Is the Scheme's governance robust and fit for purpose?	• Effective scheme governance will be important to monitor progress versus the scheme's strategic plan and to also identify scope for potential efficiencies on route to the long-term target (eg via consolidation, outsourcing of scheme management or streamlining of adviser support).
6) How does my scheme stack up?	• Understanding where the scheme stands versus schemes of similar maturity/ schemes of sponsors in the same sector, or with similar covenants, will aid communication with the trustee and Company boards.

> *LCP have been a great help to us as we have developed our pension strategy and take a very commercial approach, enabling us to drive forward our efforts to manage our pension risk.*
>
> **FTSE 100 Finance Director**

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Case Study: 50% reduction in ongoing pensions risk and establishing 'Pensions Principles'

Details of the process:

- Initial pensions strategy workshop held for Treasury Committee and facilitated by LCP
- Further LCP support provided to develop Board papers on pensions risks, and pensions key principles for Board approval
- Board sign-off obtained for Group 'Pension Principles', with long-term Company objectives agreed
- Company was able to provide considered input into Joint journey planning and strategy days with Trustees
- Group viewpoint was already clear for the next triennial valuation and the Company was able to make proactive suggestions to Trustees to utilise positive investment performance and de-risk asset base

Outcomes for the business:

- Value at Risk down by 50%
- Stable (and reduced) cash commitments
- Company now driving pensions matters forward proactively
- Trustees onside and happy that company is engaged
- Systematic build-up of DB risk stopped
- Funding savings as a result of member options projects (which reflect the Group's 'Pension Principles')
- Proactivity means partial buy-ins have been achieved without the need for further contributions

Want to find out more?

At LCP we are ideally placed to help sponsors in this area with our award-winning corporate pensions practice advising schemes of all sizes; our integrated covenant specialist team (hugely important given the new TPR powers); combined with our investment and insurance de-risking expertise which is invaluable as schemes approach their end point.

If you would like further information, please contact your usual LCP adviser or one of the people opposite.

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