



Playing to win: how should DB trustees plan for the endgame?

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Soon, Defined Benefit (DB) trustees will be obliged to set an endgame strategy to get to a long-term objective – whether low dependency on the employer covenant, buy-out with an insurer, or consolidation with a DB superfund. The Pensions Regulator (TPR) will expect trustees to aim for low dependency by the time schemes are significantly mature. How should trustees play this daunting game?

Imagine a boardgame, like the Game of Life but for DB pension schemes. This game is so complicated that the board is three-dimensional. A trustee is a player and the playing piece is a DB scheme, representing the retirements of perhaps hundreds or thousands of people – so the stakes are incredibly high.

There are many paths the scheme might take around the board:

- The scheme might be supported by its sponsoring employer to maturity – maybe reaching low dependency
- Perhaps the scheme will end up within the 'schemes without a substantive sponsor' regime for Pension Protection Fund (PPF) levies
- Perhaps the employer or trustee will pursue consolidation with a DB superfund model
- Maybe the scheme will reach buy-out with an insurer
- Possibly the scheme could enter PPF assessment because of employer insolvency (by accident or design)

- Perhaps there will be some combination of the above. For instance, a capital-backed journey plan could lead through low dependency to buy-out, some superfunds aim for buy-out, some schemes (or corresponding phoenix schemes) survive PPF assessment, or a DB superfund might end up in the PPF.

The rules of this game are too lengthy to be written on the back of the box - there's a weighty manual.

Which endgame options are on the table depends upon events that can be hard to predict. But that's how games are played: with an element of chance. The skill is in making sure that with each turn, the best choices are made - choices that permit an optimum outcome while managing risks of the worst-case scenario, not forgetting what other players may do and the strength of their hands.

In short, this is a highly complex game. And describing this as a game isn't about trivialising it - the stakes are incredibly high for members, employers and trustees alike. Trustees are playing this game whether they like (or know) it or not. Opting out of the game is just missing a turn.

Who are the other players?

The regulators:

The Pensions Regulator (TPR) regulates schemes that rely on their original employers as well as schemes without substantive sponsors and DB superfunds. Pending a new legislative framework for DB superfunds, TPR has established new regulatory policies. The Prudential Regulation Authority supervises the insurers that buy out pension scheme liabilities. The statutory safety nets are the Pension Protection Fund (PPF) for eligible schemes and the Financial Services Compensation Scheme (FSCS) for insurance buy-out. The PPF is often also a player in its own right.

The sponsoring employers:

Most endgame strategies require the cooperation of employers, who will normally share the desire for good member outcomes but will be concerned about costs given competing demands.

And employer insolvency can tip a scheme into PPF assessment, potentially derailing any endgame strategy.

Insurers and providers of DB superfunds or capital-backed journey plans:

The market is developing an increasingly diverse array of innovative endgame options for DB schemes. Some share risks with other schemes, some target buy-out, some keep the employer, others sever the link, and each comes with its own weighty rule book that must be examined to understand the implications for members.

What are the rules?

Fiduciary duties

In brief, and paraphrased from the leading textbook on the subject, pension scheme trustees must act in the way they consider, in good faith, would be

most likely to provide beneficiaries' stated and accrued benefits. Trustees are also bound by scheme rules, which set the balance of power with employers, and so the strength of their hands.

Statutory funding duties

Trustees have specific duties under the legislative funding framework, which will be augmented by the Pension Schemes Bill, expected regulations and TPR's Code (TPR is consulting on the framework). TPR has various powers to penalise trustees for non-compliance or to impose its own funding measures. TPR also has governance powers, including the ability to replace trustees.

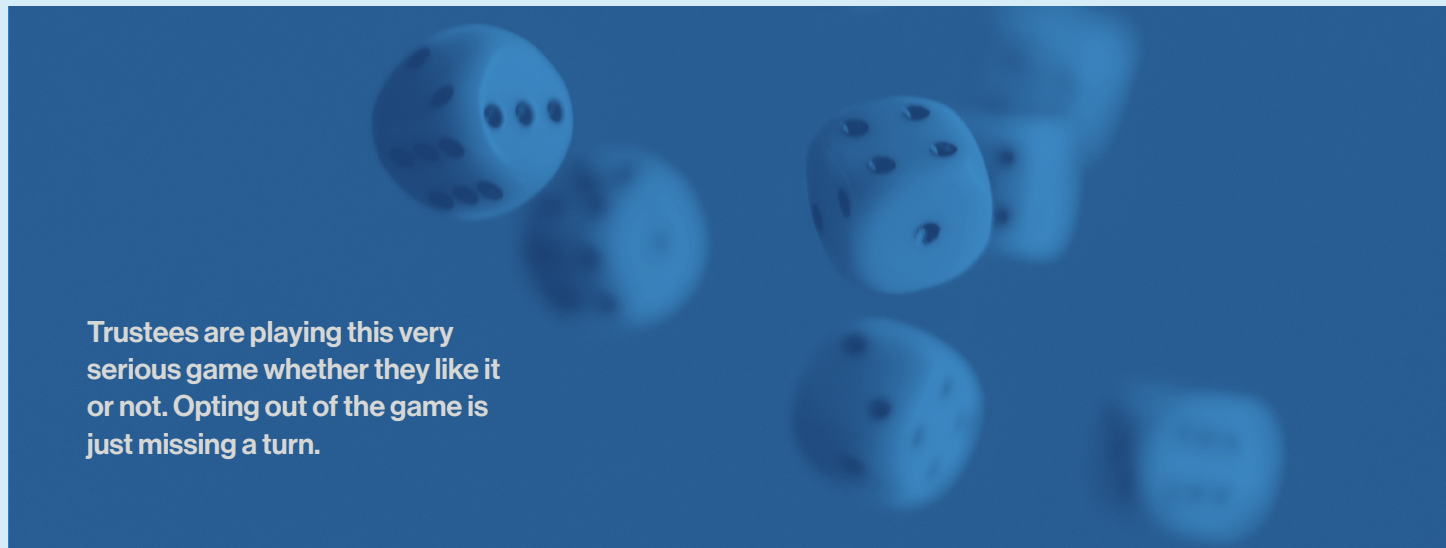
What are the key elements of chance?

Many factors affect which endgame strategies are possible and appropriate for DB schemes. The employer is usually crucial; its attitude, financial strength and legal obligations to the scheme, and its future (including insolvency risk, which may be greater than many trustees imagine – particularly over the medium to longer term). Other factors include the scheme's maturity profile, funding levels and investment strategy.

These shifting elements make setting an endgame strategy a dynamic process - not something that trustees can do once and forget about. The game continues until it's over.

The end of the game

Trustees cannot eliminate chance, but they can plan for it. Outcomes are rarely guaranteed. Nevertheless, when the game is over, TPR, and indeed members, may compare the trustees' stated goal with the actual outcome and ask for an explanation. Trustees will need to have a good story to tell, to justify every turn that they either took or missed.



Trustees are playing this very serious game whether they like it or not. Opting out of the game is just missing a turn.