Running on – considering alternatives to buy-out

Prepared for ACA & APL

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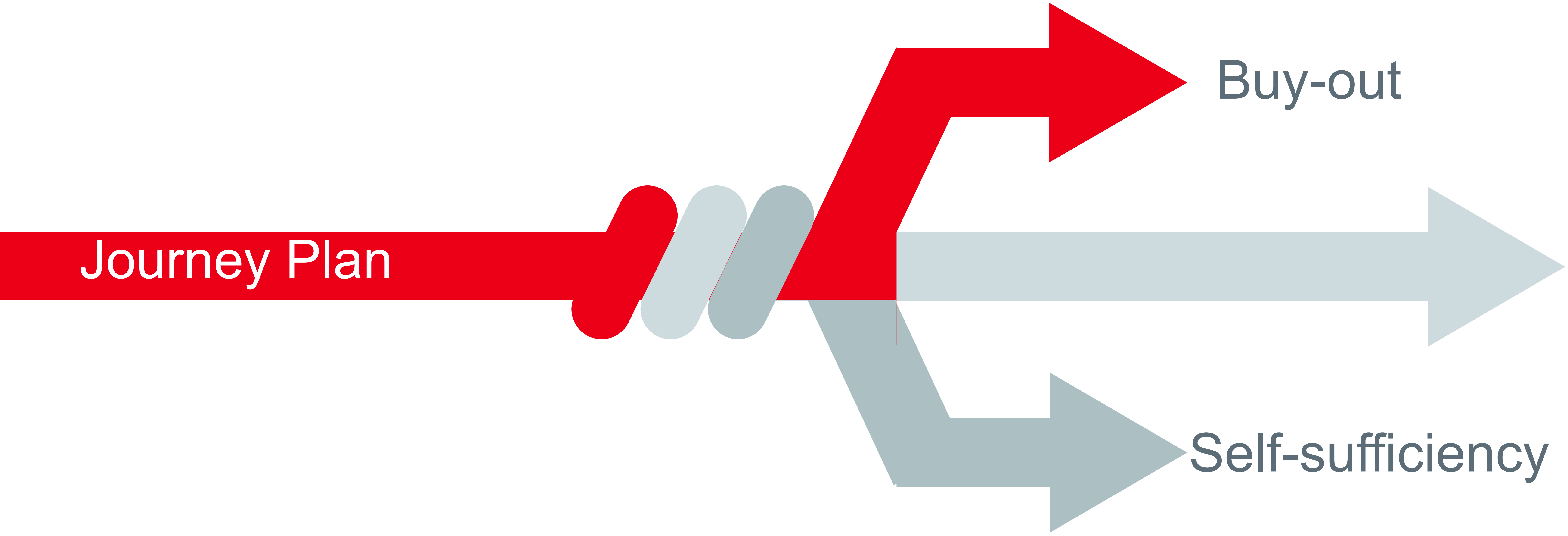
Endgames – changing landscape in UK



Settlement

- Traditional buy-out
- Consolidator buy-out

Hybrid

- Captive buy-out
- Short-term active run-on

Low dependency run-off

- Long-term active run on
- “Self-sufficiency”

Active run-on

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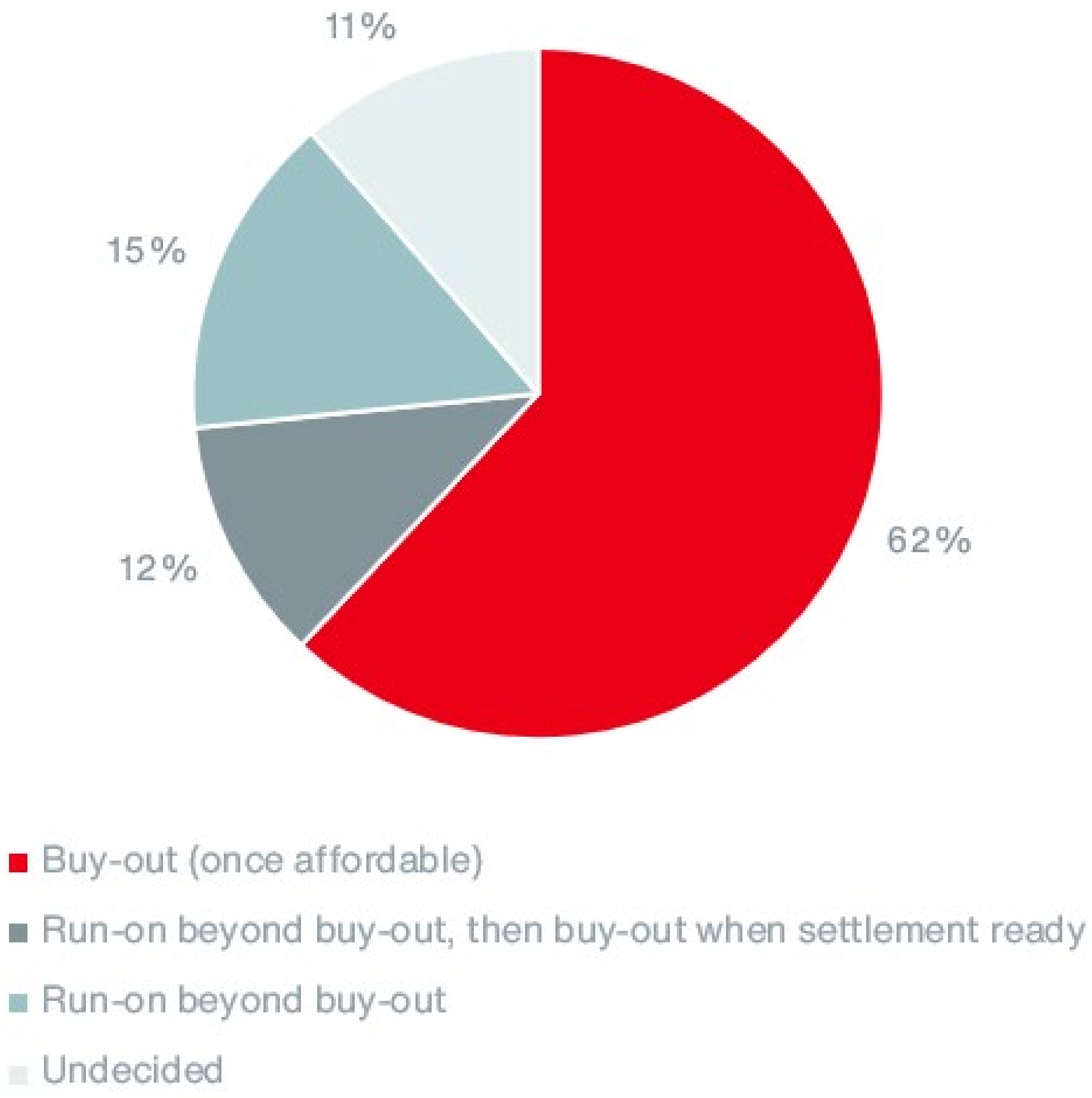
Long-term strategy / endgame

What is the planned long-term strategy / endgame of surveyed schemes?



- **62%** of schemes have an objective to **buy-out**, once this becomes affordable.
- **27%** of schemes plan to **run-on** beyond buy-out funding in some capacity**:**
  - **15%** aiming to actively **run-on** past when they can feasibly buy-out
  - **12%** aiming to **run on until they are ready to settle**
- **11%** of schemes are **still to decide** on the long-term strategy/endgame

Key statistics

- c150 schemes from Aon advised clients
- ~ 30/70 corporate/trustee
- Wide spread of scheme size and endgame journey
  - 30% less than £100M, 22% £1bn+
  - c. 40% already sufficiently funded or 1-2 years away

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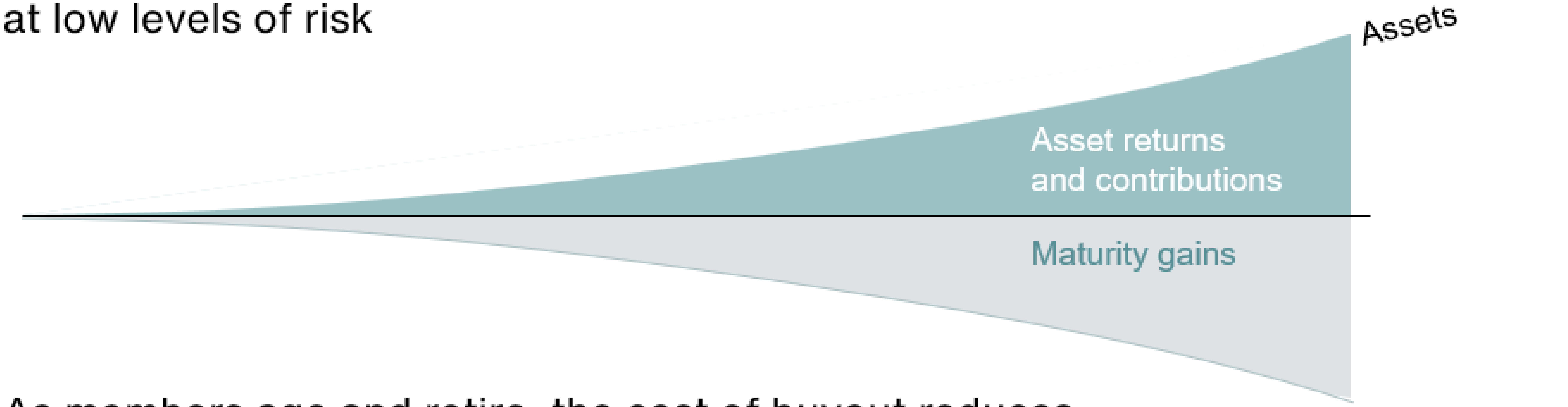
Generating value: Where does the value come from?

Targeting returns above gilts is achievable at low levels of risk



As members age and retire, the cost of buyout reduces relative to a gilt-based measure

Rule of thumb: up to £2M p.a. surplus per £100M of pension liability*

*Based on a model scheme fully-funded on solvency, targeting returns of gilts + 1% to 1.5%

Suitability

Which schemes are appropriate for active run on?

Well-funded schemes

At least 90%+ of solvency

"Mid to large" size

Surplus generation must comfortably cover expenses, unless running on for paternalistic reasons

Good covenant

Adequate and decent visibility

Active run on is not a once and for all decision

Insurance buyout may be better solution for many schemes or where sponsor wants to transfer risk.

After a short or long period of run on most schemes will still buy out.

Current legal position

Can schemes run on?

Who decides?

Who owns surplus?

Scheme Rules

Overriding fiduciary duties

Conflicting case law?

A framework for considering run on

Stable, buyout-aware investments

- Low investment volatility versus buyout
- Conscious outperformance to deliver value

Multi-layer protection

- Strong contributing employer
- Regular covenant monitoring
- Funding buffer and/or security against default

Member benefit

- Maintain member support, options and factors
- Potential for future discretionary increases

Sponsor payback

- Rewarded for ongoing risk
- Expect c2% pa surplus generation

>99.5%*

accrued benefit payout

110%**

15-20%*

20 year value released

10-14%**

Average proportion of benefits paid/insured, based on a BBB employer, £1Bn scheme 100% solvency funded with a 20-year core run on parameters.

* 100% of solvency surplus released to the employer.
**1/3rd surplus distributed to members

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Refunds and benefit improvements

Why run on?

Uses for surplus:

- Refunds to employer
- Funding DC contributions
  - In the scheme
  - Transfers out
  - Commercial master trusts?
- Using surplus round a group
- Additional member benefits
  - Pre-97 increases
  - Other benefit augmentations

Problem areas

Crimes and fines

- Must the employer "pay" contributions?
  - AE duties
- Sections 58B and 58D PA 2004
  - Conduct risking accrued scheme benefits?
- Disguised dividends and returns of capital
  - Transferring assets at an undervalue?

Changing legal position

Government consultation and beyond!

- Tax neutral
- Statutory override
- Contributions and transfers
- Member protection
- Regulatory guidance

Discussion