BROADSTONE™

A NEW APPROACH TO FUNDING

WHAT IS INTEGRATED FUNDING?

The recent Pension Regulator's new Code of Practice on defined benefit pension scheme funding is based on a central theme of three pillars that, taken together, form the basis of the Code.

The Code, like a building, recognises that the three pillars need to be well placed, proportionate and accepts the inter-dependancy that exists between the three pillars if they are to provide a firm stable structure. The creation of the Code recognises that these three pillars have not always been in place meaning that many schemes are not as structurally sound as they could be.

The three pillars within the Code are:

1. Integrated Funding
2. Assessment of the Employer Covenant
3. Investment Risk Management.

Previously we have issued a guide to the Code of Practice that can be downloaded here: **www.broadstoneltd.co.uk/page.aspx/Pension-Scheme-Funding-New-Code-of-Practice**.

Over the next two issues we will explore the remaining pillars of the Code but in this guide we are focusing on the first pillar of the Code – Integrated Funding.

We explore the key tenets of this part of the Code and what Integrated Funding means to the Regulator.

In turn the Regulator's view will impact on Trustees relationships with the Employer and the Trustees adviser, and, on the existing Investment Strategy and Governance and funding agreements.

WHAT DOES INTEGRATED FUNDING MEAN TO THE REGULATOR?

RELATIONSHIP WITH YOUR ADVISERS

Having a good open and collaborative working relationship with your advisers will achieve better results and your Scheme Actuary is fundamental to achieving an appropriate funding plan for your scheme.

Having a Scheme Actuary that is able and willing to break away from the herd will ensure you get the best possible advice and outcomes appropriate for your specific set of circumstances. Being able to discuss the views of the Trustees, and the employer, with your Scheme Actuary, together with the clear findings of the employer covenant review and the positioning of the investments will give the Scheme Actuary the information they need to give you the right advice that is appropriate for your unique circumstances.

RELATIONSHIP WITH THE EMPLOYER

This is an important relationship and there are two drivers that will play a key part in your discussions with the employer.

Covenant – The strength of the employer covenant and ability to pay will inform the Trustees' and Scheme Actuary's view on the level of risk that the scheme can take and the amount of pressure on timing to meet the ongoing costs of the scheme. This will have a key influence on the assumptions that you may wish to make.

Aims of the employer – Aside from the employer covenant, there should be a conversation with the employer about their attitude to risk, long-term aims and objectives for the scheme, and other drivers or constraints.

For example:

Objective for employer A – get to buy-out as soon as possible. The employer and Trustees need to acknowledge the employer has the right to target this and work together to get there.

Objective for employer B – happy to be paying the annual contributions, don't want any nasty surprises or bumps along the way.

Only by having a good relationship with the employer will the Trustees and Scheme Actuary understand the views of the employer. As importantly, the employer will then be clear about the implications of any path chosen.

We will revisit this in next month's briefing when we discuss the second pillar of the Code covering the Employer Covenant.

RELATIONSHIP WITH INVESTMENT STRATEGY

This is a crucial relationship as it relates to the level of risk inherent in the assets used and the understanding of possible impacts on funding of periods of under-performance. This in turn relates to the views, prospects and strength of the employer in underwriting these risks and should be reflected in the assumptions of the Scheme Actuary.

Specialist independent investment advice is essential to make sure you understand the investment risks you are taking and also that you are using the most appropriate and efficient tools to deliver your aims with the lowest risk.

We will examine this relationship more closely when we consider the Investment Risk Management pillar.

RELATIONSHIP WITH GOVERNANCE & FUNDING AGREEMENTS

Most schemes will be underfunded and so will need to negotiate how the deficit is met by the employer.

This relationship feeds off the discussions the Trustees will have had to date with the employer and their advisers. From this they will be able to take the appropriate action to structure the recovery plan mindful of the employer's position and scheme's objectives.

A Governance Framework of risk assessments and controls needs to be in place to monitor the balance of the positions of the employer as the scheme's assets and liabilities change over time.

DON'T ALL SCHEMES ALREADY TAKE THIS APPROACH?

The short answer to this is no.

Surprisingly many schemes have a relationship with both advisors and employers that is too passive and lacks the level of engagement required to address these key issues head-on. Many schemes lack a clear investment strategy or have one that is too generic and not designed around their individual needs.

For many schemes, especially at the smaller to mid-level size, the level of engagement between the scheme, its advisors and the employer will need to increase to ensure that a collaborative approach is taken to achieve a higher level of understanding of the competing priorities of the scheme and the employer.

The advisor will need to be much more skilled and pro-active in facilitating this engagement and tailoring their advice accordingly. Advisors will need to recognise the days of applying a 'one size fits all' approach to their portfolio of clients has gone.

FOUR ACTIONS YOU CAN TAKE NOW

1. Clarify the nature of your relationship with your advisers. If these are not suitable to meet the need of a full collaborative approach, then seriously consider replacing your advisers.
2. Ensure that the Trustees understand the objectives of the sponsoring employer - be this to remove the pension scheme risk from their books entirely (via buy-out) or control the deficit contributions. What can the sponsoring employer afford?
3. Do you have specialist independent investment advice? Is your investment strategy aligned with the funding assumptions and the employer's strength and objectives?
4. If you do not have an investment consultant appoint one now.

HOW CAN WE HELP?

At BROADSTONE:

- We recognise that many schemes (and their advisors) will need to raise their level of focus. We can provide a bespoke service and work with you to achieve the Pensions Regulator's aims for good scheme funding
- We will facilitate a collaborative engagement between the Trustees and employer rather than perpetuate a disjointed and passive approach experienced by many schemes in the past
- We can introduce a closer relationship with your investment advisers to achieve the investment structure you need
- We can provide assistance with the governance structure so that the process is handled in a timely manner so all sides consider and respond appropriately.
- We work openly and pragmatically with the employer so the position of the employer and objectives of the scheme are aligned.

CONTACT US

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SEPTEMBER 2014