BROADSTONE

## DB & THE BREXIT IMPACT

# (BR)EXCITING TIMES FOR DEFINED BENEFIT PENSIONS?!

On 23 June 2016 British voters voted to leave the EU. In the weeks since we have seen significant market volatility, a downgrade to the UK's credit rating, a change in Prime Minister and ongoing political upheaval.

The Bank of England's decision on 4 August to cut interest rates for the first time since 2009, together with £70 billion of additional Quantitative Easing, added to Sterling's volatility and another fall in gilt yields contributed to further pressure on defined benefit scheme funding.

Trustees need to understand the impact on their schemes by identifying the key risks and agreeing potential ways to mitigate them. The Brexit Scenario, and the corresponding increase in risks, is exactly the type of scenario that the Integrated Risk Management framework, introduced by The Pensions Regulator, seeks to consider.

This note highlights the key issues for trustees and employers to consider within their IRM Framework.

## 1. EMPLOYER COVENANT

Brexit will impact on the UK economy – potentially damaging an employer's ability to support the Scheme.

Trustees should consider the impact on employer profitability, cash-flow generation, recovery-plan affordability, and the risk of insolvency. In particular they should consider:

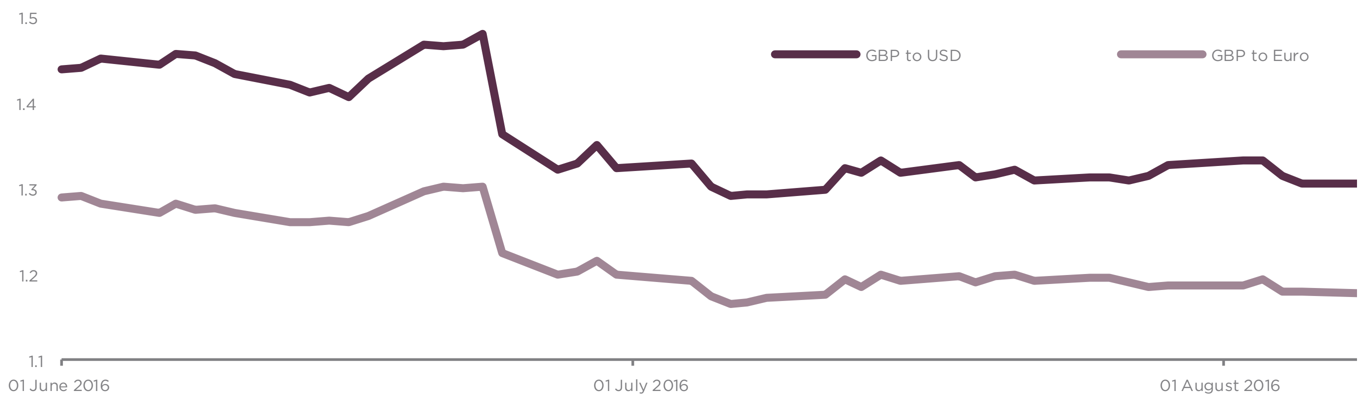
- The impact of a rise in dollar-based costs (e.g. fuel) and interest rate changes
- Whether any key customers are affected? Is the employer at risk of losing business in the EU post Brexit?
- How is group strategy affected? Might the employer consider relocating its operations?
- Is there an opportunity to increase funding to take advantage of a weaker Sterling?

## 2. INVESTMENT

The weeks following the referendum saw increased volatility across markets. Trustees and sponsors should:

- Consider which assets are most affected by volatility and exchange rate changes
- Consider their ability to deal with further shocks (falls in gilt yields, rising inflation, etc) and understand the options for reducing and managing risk
- Review de-risking plans and ensure funding and market triggers remain relevant
- Consider the outlook for UK property and the illiquidity of some property funds
- Consider expected disinvestments and the impact of volatile markets, potential illiquidity and higher trading costs.

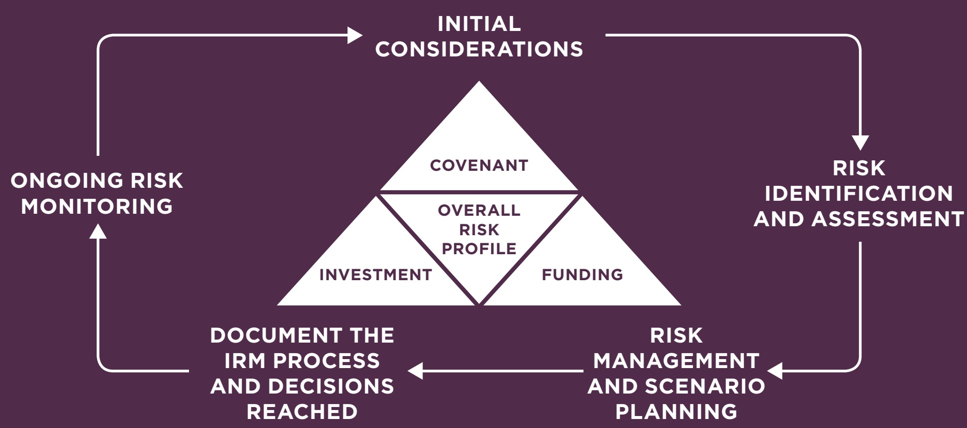
### WEAKER STERLING




Source: fx.sauder.ubc.ca, August 2016

## APPLYING THE IRM FRAMEWORK

Broadstone has taken the key elements of the guidance and incorporated it into the following framework. There are then five main steps in applying the framework.




## 3. SCHEME FUNDING

In response to lower than expected growth the decision to cut interest rates has already impacted on the 20 year gilt yield. On 9 August, 20 year gilts yielded just 1.32% p.a. Put simply, this is bad news for DB schemes and trustees and employers should:

- Prepare for increased deficits and difficult funding negotiations - especially if their valuation date is approaching
- Understand the impact that larger pension deficits and (possible) changes in Experian ratings might have on PPF levies
- Consider reviewing the calculation bases for transfer values, trivial commutation factors and other actuarial assumptions
- Employers should consider their options for reducing and managing DB scheme liabilities.

## 4. CONCLUSION

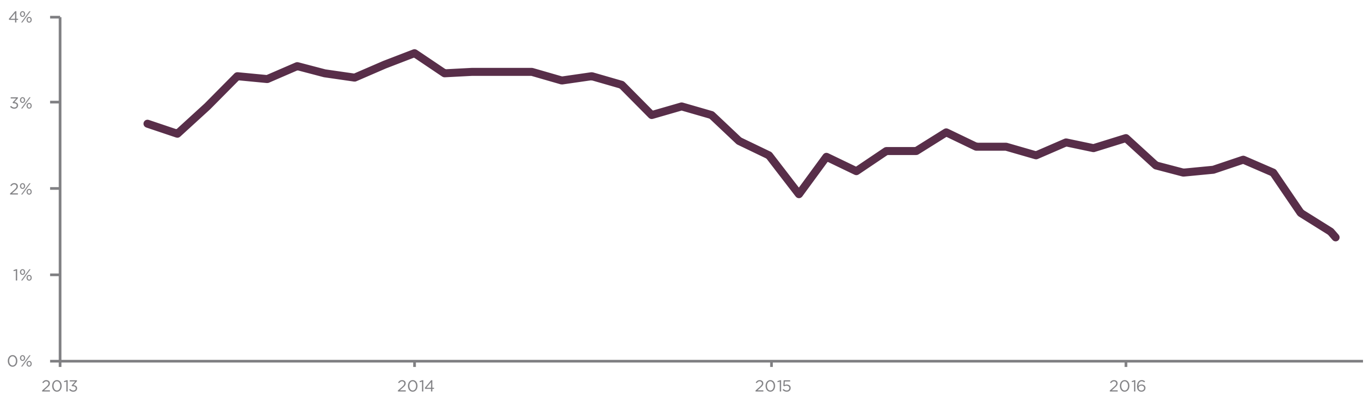
Brexit will impact the real economy, financial markets, DB scheme valuations and the level of support DB employers are able to provide.

It is likely that all the main DB risk areas (covenant, investment and scheme funding) will be affected.

Broadstone does not think a knee jerk reaction is necessary, but recommends that trustees and employers set up a framework for a considered response to the challenges emanating from Brexit.

Broadstone believes the IRM framework can be an important tool in providing practical help and encouraging closer collaboration between trustee and employer and encourages its adoption as a key instrument in improved understanding of risk and how it can be mitigated.

### FALLING GILT YIELDS




Source: FT-SE Actuaries 20 Year Gilt Yield Index - 2013-2016

If you wish to discuss any of the topics raised in this publication further, please contact your existing consultant, or alternatively contact one of the individuals below.

## CONTACT US TODAY

**Oscar Brown**
Actuarial Director
+44 (0)20 3869 6858
oscar.brown@broadstone.co.uk

**Peter Dean**
Investment Consulting Director
+44 (0)20 3869 6853
peter.dean@broadstone.co.uk

**For more information on our wider pension and employee benefit services contact:**

www.broadstone.co.uk
corporate@broadstone.co.uk

55 Baker Street
London
W1U 8EW
United Kingdom

BROADSTONE