Aon
Retirement and Investment Solutions

Health-check, Operational Efficiency

This article is the first in a series which explores some of the findings from newly released independent research into the challenges defined benefit schemes pose to finance directors.

The research surveyed the views of nearly 80 individuals in finance director (or similar) roles, through a combination of an online survey and telephone interviews.

The participants

Almost three-quarters of survey respondents identified themselves as either a finance director, CFO, treasurer or financial controller, with 50% working for a business with turnover in excess of £100m pa. By coincidence, half of the respondents also sponsored a defined benefit (DB) scheme with assets of £100m or more.

Reflecting these roles, the primary responsibility for those surveyed related to group accounting and corporate financial reporting, but oversight of pensions also featured heavily - over half of our respondents had day-to-day oversight of their company's DB scheme.

The results

When asked "What one issue related to your role is most likely to keep you awake at night?" over 80% of respondents cited issues that either directly or indirectly related to their pension scheme. Examples included funding valuations and contribution increases, control over advisory costs, de-risking investments and financial reporting.

Given this, one might expect FDs to be spending lots of time on pensions matters, but in fact 83% of individuals reported spending less than half a day per week on pensions. Further, the survey found that delegating responsibility to others was rarely practised, and over three-quarters reported discussing pensions matters with the CEO either quarterly or less frequently.

We conclude that while pensions matters are high on the corporate agenda, those who have responsibility for them are struggling to find the time or resources to adequately deal with the risks and opportunities that exist.

A possible solution

There is a potential solution to free up management time and improve operational efficiency. In the real case study below, we look at the motivations for considering a scheme merger, and share some practical tips for a successful exercise.

Consolidation of DB schemes is a hot topic in the pensions industry, receiving a significant amount of attention in the Government's Green and White Papers. The potential benefits of consolidation are widely acknowledged, such as lower administration costs, greater investment power and improved governance standards. This will come as no surprise to many companies who have already addressed concerns about operational inefficiency by undertaking a scheme merger.

Empower Results®

In our experience, such concerns typically focus on the costs of running a scheme, which may be explicit (PPF levies or advisor fees), or more subtle (the cost of missing an investment or de-risking opportunity). The latter could be symptomatic of wider governance concerns such as the speed or efficacy of decision-making.

For those readers who do not sponsor multiple schemes, it is worth noting that the growth of DB mastertrust arrangements and incipient development of commercial consolidation vehicles may also deliver some or all of the benefits described.

A case study

The engineering company in our case study sponsored four schemes with total assets in excess of £10Bn and multiple advisors. Achieving efficiencies in running costs and streamlining governance were the key motivations behind the decision to explore a merger - significant potential savings were identified beyond the costs of the exercise.

At first glance, funding levels differed materially between the schemes, even when using a consistent discount rate. This is not uncommon, and proceeding via a sectionalised merger in such cases can still enable some of the benefits to be realised. However, in this case Aon carried out informal valuations of the schemes, and then tracked the funding positions using our funding and risk monitoring tool, Risk Analyzer. Monitoring the schemes on an agreed equal footing (except where justified by differing demographics) showed that funding levels were much more closely aligned than had initially appeared, aiding discussions and ultimately supporting the trustees' agreement to a full merger.

This unusual step – effectively bringing forward the first valuation of the merged scheme - also meant that the trustees were able to consider the merger based on up to date information rather than relying on historic valuations. This avoided any surprises at the formal valuation date, and also helped the sponsor to reach agreement for deficit contributions to one scheme to cease, since it was no longer underfunded on the like-for-like basis.

Thinking beyond the more mechanical aspects of a scheme merger, such exercises also present a good opportunity to 'tidy up' schemes by equalising powers, benefits and discretionary practices; and to run other associated exercises. In our case, this included making minor benefit changes, formalising a discretionary pension increase, and the use of a separate DC scheme to receive AVC benefits from all merging DB schemes, relieving the burden of DC governance in the future.

We also carried out a Winding-Up Lump Sum exercise in the transferring schemes, granting additional flexibility to over 5,000 eligible members, while further simplifying administration and making marginal funding and risk improvements. A take-up rate of 66% was achieved.

A more significant commitment as part of the merger agreement was the introduction of a rule in the merged scheme offering members paid for IFA advice upon retirement (facilitated by the Aon Retirement Options Modeller) which has seen 55% of members electing to transfer. Members were balloted on the changes and this benefit improvement was considered a significant positive by union representatives.

The ultimate results of this exercise were materially reduced running costs, streamlined governance, risk reduction, and a helpful precedent set for future valuations.

TOP TIPS:

- Consider the feasibility and benefits of consolidation. While the largest efficiencies are likely to be reserved for companies with multiple schemes, single scheme sponsors could still benefit from consolidation via fiduciary investment platforms or mastertrust arrangements. The choice of receiving scheme is important, and the obvious choice may not always be the most appropriate.
- Scheme mergers can be significant standalone exercises requiring input from multiple stakeholders and advisors, often with differing interests. It is common for potential 'banana-skins' to arise, so in addition to technical scheme merger experience, appointing an advisor with specialist project management expertise is recommended to ensure successful delivery.
- Consider where you can realise additional value from your merger exercise - does your advisor have the technology and expertise to add value through a joined-up approach to funding, investment, covenant assessment, alternative financing, and running member options exercises.
- Do not underestimate emotional resistance to change and the importance of managing expectations – for example, on the composition of the post-merger trustee board. Engage with trustees early, agree a business case for the merger from the outset, and stick to it.

Aon are currently offering **free pensions health checks** to give organisations a greater understanding of their scheme's ailments and how they might be addressed. If you'd like to discuss how your operational efficiency could be improved, or you would like to receive a copy of the full survey, **click here**.

Joe Moore is a principal consultant at Aon, where he leads its Scheme Mergers specialist team.

Joe Moore
Principal Consultant

+44 (0) 117 945 3512
joe.moore@aon.com

About Aon

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