HYMANS ROBERTSON

The future of funding: on demand valuations and on demand cashflows

Meeting the changing needs of pension scheme management

We believe 21st century pension scheme management looks very different to the traditional model and what others currently offer. From a funding and investment perspective, the traditional triennial valuation cycle, based on historic data, no longer meets the needs of today's DB pension schemes.

With today's fleeting opportunities, schemes tell us they want a more dynamic, precise and responsive approach to managing funding and cashflows. That's what our new on demand valuations offer; a transformational approach to valuations based on accurate, bang up to date data.

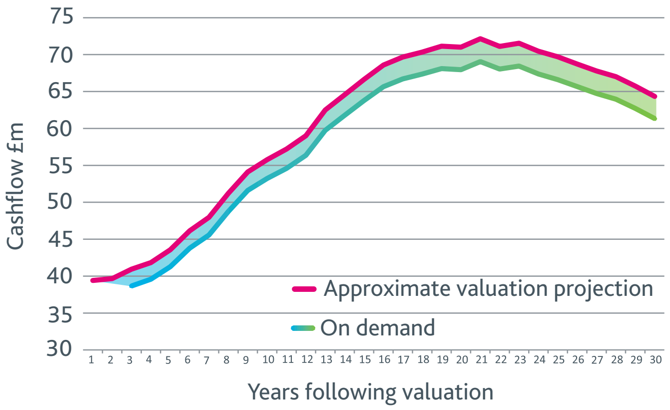
Whilst change is becoming a constant in the world of pensions, the scale and pace of it in recent years has felt unprecedented. For example, last year's Freedom and Choice offers DB members new levels of freedom over their retirement decisions; and a secondary annuity market is just around the corner. All this will make it more likely that your members' benefits will be fully settled earlier.
If your valuation data is not kept up to date by reflecting these settlements as they happen, then your cashflow forecasts will be overstated.

Living with uncertainty

Coupled with other member movements, this can result in 'cashflow drift' – the difference between expected cashflows based on up to date information and industry standard cashflow projections based on data that is up to three years old. This 'cashflow drift' can undermine the effectiveness of any LDI or longevity protection programme or cashflow matching investment strategy. It is illustrated in the chart below.

The pink line shows expected cashflows based on data at the valuation date, whereas the blue line shows what this would look like based on up to date membership data. Given assets are selected to back cashflows, 'cashflow drift' introduces unnecessary frictional costs and unintended risks to your scheme's investment strategy. Reducing these costs and risks means more money to pay pensions, with more certainty.

Cashflow drift in action



Currently, approximations made in traditional funding updates, coupled with the impact of member data changes (which will become increasingly material as "Freedom and choice" gathers momentum) results in "valuation drift" which mean that trustees often either lack the confidence to make important funding and investment decisions or are doing so based on potentially misleading funding and risk data.

2%

potential 'valuation drift' p.a.

6%

potential 'valuation drift' over triennial cycle

£6m

per £100m of liabilities

The cost of over or underestimating based on the traditional approach can be significant.

What might this mean for your scheme?

Based on Hymans Robertson market analysis April 2016

So how are we transforming valuations?

Responding to the changing pensions landscape, we are delighted to be able to provide our clients with updated liability, cashflow and risk information, based on up to date member data "on demand". As a matter of course, every quarter, we'll run full member by member liability calculations to ensure funding and risk information is fully up to date. In fact, the timing and delivery schedule can be adjusted to meet the needs of your scheme, which your consultant can discuss with you in more detail.

There are many benefits of this new approach, but in particular:

- Investment and funding strategy discussions can take place at any time, safely in the knowledge of the scheme's true funding position and the impact different decisions will have. You'll no longer experience the planning blight that so often occurs in waiting for the formal valuation.
- You can monitor (and act on) de-risking triggers without the risk of mismeasuring the scheme's liabilites. You'll no longer take action, fearing that more accurate analysis will subsequently show it to be inappropriate.
- LDI portfolios can be updated regularly to ensure there's no drift away from the scheme's actual liability exposures. You'll no longer have to worry that your liability protection is out of date.
- You'll be able to assess the impact of a buy-in or member option exercises quickly, on a member by member basis.
- From an investment strategy perspective, it will help ensure that assets selected to back your cashflow needs, (e.g. protection or income assets) are more appropriate, effective and efficient – helping avoid forced asset sales and saving transaction costs.

It will also mean timely, accurate and more efficient production of other analysis if and when you need it, for example:

- Bulk transfer values (i.e. for all members) as part of any liability management exercise or on-going freedom and choice communications.
- Production of adhoc s179 valuations.
- Calculation of s75 debts that may arise.

Finally, when it comes to the triennial valuation process, there will be no need to wait for the results. The weeks (and even months) of down time will be removed. Discussions can begin immediately (and even in advance), minimising the distraction of if and how to allow for changes since the valuation date.

We'll generally look to implement this at no extra cost for our clients. Given all schemes are different, your consultant will be able to discuss the specifics of implementing this for your scheme.

Committed to effective pension scheme risk management

Managing risk in DB pension schemes is no easy task. As schemes mature and the landscape continually evolves, keeping on top of pension scheme risk management is an ongoing challenge. With this, the role of trustees and sponsors has also evolved – effectively turning them into risk managers – drastically changing the tools and approaches they need to fulfil their roles.

We've developed our 'on demand' approach to demonstrate our commitment to doing what is right for our clients. To enhance both the quality of information they receive and to help them do their jobs better. No longer do schemes need to hope for the best. Through on demand valuations – with precise, accurate, bang up to date data - schemes can make better decisions and achieve more certainty over the future. Whether that's more stability of cash contributions for sponsors, or enhancing security of members' benefits.

To find out how your scheme can benefit from this ground breaking new approach, please give me a call or speak to a member of your Hymans Robertson team.

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