

ALLEN & OVERY

PENSION RISK – PROVIDING SOLUTIONS

Flight paths

Reducing pension risk is an ever-higher priority for UK companies. Life expectancy is increasing, markets are volatile and funding deficits can be a drag on business investment and growth. We have experience in helping sponsoring employers and trustees find the right solutions to reduce pension risk. Allen & Overy's Pension Risk group has the full range of expertise on all types of de-risking solutions, and experience of leading innovation in the market.

Your destination and how to reach it

Many defined benefit schemes have already closed to new entrants and/or to future accrual as a first step towards managing risk issues. Around half of all schemes, regardless of size, are reported to be considering pension risk reduction activity in the next couple of years, using one or more of an increasingly well-established range of de-risking tools. Constructive risk management requires a strategic approach, sometimes called a *flight path*.

The idea is to set out your ultimate target – for example, deficit recovery, scheme self-sufficiency or wind-up – and the deadline by which you want to meet it. Working back from that, you can identify the steps you need to take to reach that target.

For example, an innovative approach to funding or investment strategy, or to mitigating investment risk, may provide capacity to look at other risk reduction options. Identifying segments of risk which can be secured within or outside the scheme ultimately ensures that members' benefits are safe and reduces pension liabilities on the company balance sheet.

Mapping the route

Setting a strategy requires sponsoring employers and trustees to consider investment and available funding options in combination with the commercial reality of the employer's business strategy. The key is to identify the level of risk you are happy to carry, and the timescale for each step.

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Each flight path is unique. It will start from the current position of the scheme and sponsoring employer and will be designed around your membership profile and your risk management priorities, taking into account your investment profile (for example, is the scheme holding gilts which could be traded to offset scheme risks?). It could include a number of stages, such as:

- a funding and investment strategy agreement including a contingent asset or escrow arrangement
- scheme design changes to limit future liability growth
- asset and liability management solutions using swaps or insurance to hedge longevity, inflation and interest rate risks
- investment in a buy-in contract for core liabilities and removing other segments of risk via transfers or insurance.

Your flight path will need monitoring and adjustment along the way, in response to external events and market movements. For example, strong employer performance could lead to a reassessment of your timescale or funding options. Market movements could open a window for de-risking or changes in investment or funding arrangements.

Smart preparation

Whatever steps you plan to take, smart preparation will give you the flexibility to take opportunities as they arise. For example, pressures on the bond market and changes in capital adequacy requirements for banks may affect the range of available providers in the future. Provider capacity will be snapped up by transaction-ready schemes that are able to move quickly to lock into favourable deals created by movements in gilt prices. Investing time in preparations now could win you early mover advantage, keeping your options open. There are two key preparatory steps:

- Clarity over member data can slow down or derail a de-risking project. It's also key to good scheme governance. The best deal terms go to schemes with good data, so investing in a data cleansing exercise now could pay dividends later.
- You need to audit the benefits being provided and deal with any sex equalisation issues. Documenting discretionary powers and practices is crucial preparation for future pricing negotiations. A legal review of your scheme documents and history can help you sort out problem areas ahead of time.

To design a flight path and implement its strategies quickly and well, you need a team of experienced advisers on board. Allen & Overy's Pension Risk group is here to help you get the best results for your specific circumstances, with an integrated team delivering a seamless and efficient service, covering all aspects of your de-risking journey.

“Its cross-disciplinary approach provides clients with an impressively broad service, allowing them access to banking, restructuring, derivatives and regulatory and corporate expertise.”

Chambers UK 2010, Pensions

