Aon Global Pension Risk Survey: DB schemes speed to buyout

Matthew Arends discusses the UK results of Aon's latest pension risk survey

With over a decade's worth of survey data trends to draw on, *Aon's Global Pension Risk Survey* is an accurate barometer of long-term risk trends in UK pensions.

Our 2021/22 findings shine a spotlight both on the short-term impact of the Covid-19 pandemic for pension schemes' risk priorities, and more crucially on long-term trends and future actions for UK defined benefit (DB) schemes.

We asked trustees, pensions managers and sponsors from DB schemes of all sizes about their long-term targets, how they manage benefits and liabilities, and the way in which their investment strategy is changing. We also asked how they are addressing hot topics such as cyber risk and GMP equalisation.

The findings give a clear signal about schemes' long-term goals. Appetite for endgame planning and the number of schemes now aiming for buyout has continued to accelerate at pace. Over the last eight years it has more than doubled from just 20% in our 2013 survey, to almost half (47%) in this year's figures. Buyout is now the leading long-term target for DB schemes in the UK.

The length of time schemes expect to need to reach that goal is also reducing steadily. Our 2021/22 report found that the average time is now 8.8 years, compared to 9.4 years in the 2019 research.

If this trend continues, by the end of the 2020s the average DB scheme will have achieved its long-term target, and the volume of buyouts will cause a significant reshaping and resizing of the DB market. Could this decade bring a sea change to the nature of DB pensions in the UK?

Interest rate, inflation and equity risk remain priorities for schemes. In line with their long-term aim of buyout, schemes have increased their focus on de-risking within their investment strategy. Allocations to LDI and credit have increased, and more than half of respondents said that they had reduced their equity allocation.

The large market crash of 2020, followed by an even stronger recovery, had a varied impact on schemes' funding levels, often depending on the level of hedging that the scheme had in place. Over the last two years, hedging ratios for both interest rates and inflation have been put under scrutiny, and almost a third of schemes are now fully hedged. Nearly three-quarters (74%) say their interest rate hedge ratio is over 80%. In comparison, just 45% had this level of hedging in place in 2019.

This year's survey also saw a very clear trend towards embedding ESG principles in investment strategies. New regulations relating to schemes' Statement of Investment Principles, Implementation Statements and the Task Force on Climate-related Financial Disclosures (TCFD) contributed to schemes' increased

> **'Buyout is now the leading long-term target'**
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emphasis on ESG. More than nine out of ten (92%) schemes now say they have considered their ESG policies, and a fifth (20%) have made investment changes as a result. We would expect this second figure to significantly increase in the future as trustees look to put their policies into practice.

Schemes are also starting to see other types of risk rising up the agenda. Data, governance and cyber risks are all becoming priorities for trustee boards and sponsors as other risks are managed down and new threats to the safety of members' pensions emerge.

Strategies to deal with risk now embrace projects such as data cleansing, member options exercises and GMP equalisation. More schemes have also been faced with the realities of cyber-attacks, with the number experiencing cyber incidents doubling from 3% in 2019 to 7% in 2021.

The last year will have forced all trustees and sponsors to reflect on their scheme's governance, asset and liability priorities and risk practices. There have inevitably been temporary disruptions caused by the pandemic, with schemes

pausing large-scale projects and re-assessing the types and severity of risk they face.

Despite the short-term turmoil, the findings of Aon's *Global Pensions Risk Survey 2021/22* reinforce long-term patterns towards de-risking assets, managing broader risks and adopting an end-goal of buyout. The DB landscape is radically and irrevocably changing and schemes' focus is clearly on activities that will prepare them for their long-term destination. The question for many schemes is not if, but how quickly, they will reach buyout.

Matthew Arends, head of UK retirement policy, Aon