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a true partnership approach

Briefing note

# Funding negotiations and valuation support

Barnett Waddingham, the largest independent partnership of actuaries and consultants in the UK, has a specialist team dedicated to advising employers in relation to the investment and funding risks associated with their pension schemes.

In the last three years, we have supported many UK companies, including a number with schemes in excess of £1 billion, through their valuation negotiations. Details of three recent case studies where we have supported companies in achieving optimal outcomes from their latest triennial valuations follow.

## CASE STUDY 1

Our work involved providing support to a multinational company which acquired a UK operation with a large (> £3bn) defined benefit (DB) scheme several years ago through a historic transaction. We provided support to the company in its negotiations with the trustees during the triennial valuation process.

> "The negotiations were challenging as our analysis provided good evidence for the Company to pay reduced contributions."

This involved keeping the management team, based in Europe, up to date with developments in UK pensions, analysing and challenging assumptions and figures prepared by the scheme actuary, exploring alternative scenarios with the company and preparing a counter-proposal and support during meetings with a trustee sub-committee.

As part of the analysis we were able to demonstrate that, under the trustees' proposed funding plan, the scheme could potentially be fully funded on a buy-out basis ahead of the end of the proposed recovery period. As part of the counter-proposal to the trustees we helped develop a framework which could be used to manage the funding level of the scheme towards a buy-out position over a longer time horizon. One of the conclusions reached was that it would be more efficient to target a buy-out once the majority of deferred members have retired, to avoid having to purchase deferred annuities which tend to be much more expensive compared to immediate annuities.

We also worked closely with our investment team, who are also advising the company, in developing the counter-proposal. They used cashflows provided by the scheme actuary to prepare an analysis of the progression of the funding level over time which the company was able to use as part of the counter-proposal. The investment team also carried out an analysis for the company to give them a better understanding of the interest rate, inflation and credit risks inherent in the trustees' investment strategy which highlighted potential areas where further de-risking could be considered.

The negotiations were challenging as our analysis provided good evidence for the company to pay reduced contributions. The strategy adopted by the scheme had served it well over the three years to the valuation date and the position had improved. The trustees were reluctant to accept a reduction to the current level of contributions and the matter was further complicated because the scheme actuary has a role in setting the contribution rate.

The end result was that although the company was unable to secure an extension to the recovery period it was able to negotiate down the deficit and secure a significant reduction in total contributions. The company was also able to secure a cap on future contribution requirements should the deficit increase at the next valuation (which is effectively an undertaking to extend the recovery period in the event of adverse experience).

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**CASE STUDY 2**

Our work involved providing support to a UK subsidiary of a European multinational on its £300m DB scheme. The scheme is relatively immature and is open to accrual. We provided an analysis of the proposals made by the trustees on assumptions for the valuation and the recovery plan and illustrated potential alternatives showing the impact on the funding level and contributions.

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Our analysis indicated that the company could achieve the level of contributions it wanted through other means.

This analysis was used to prepare a response to the trustees with a counter proposal.

At the same time as the valuation negotiations, the company was also looking at putting into place an asset backed funding solution to address the deficit – our analysis indicated that the company could achieve the level of contributions it wanted through other means. The use of the asset backed funding solution carried other benefits for the company so we helped them understand at a high level how the structure of payments under such an arrangement would vary if the trustee could be moved on its proposed assumptions.

The company ultimately decided to put in place the asset-backed funding vehicle. The value of this arrangement was more than enough to cover the deficit. This was done to effectively pre-fund part of the cost of the future accrual of benefits, allowing the company's cash contributions to remain unchanged when otherwise there would have been a significant increase.

**CASE STUDY 3**

Our work involved providing support to a major UK regulated financial services company with a very large (>£8bn) pension scheme. We helped the company in its negotiations with the trustees during the triennial valuation process.

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The outcome was an agreed revised deficit of around £1.1 billion which gave the company an acceptable recovery plan and regulatory capital impact.

We were appointed after the valuation process had begun and the trustees' initial estimate of the deficit was around £2 billion. We were tasked by the company to help it negotiate with the trustees to reduce the headline deficit figure (which was a key determinant of the regulatory capital it had to hold).

Our approach was to work with the trustee and scheme actuary in a collaborative but robust way. In doing this:

- we made sure that the trustee understood the company's commercial and regulatory constraints
- we presented counter-proposals that were fully evidenced and justified (bearing in mind that small changes in assumptions can have big effects on the deficit)
- our strategy centred around removing 'hidden prudence':
  - best estimates (based on experience and future business plans) were proposed for all of the actuarial assumptions except for the discount rates and mortality assumptions where prudence was conceded
  - the company proposed that discretions would no longer be pre-funded but will be funded on a pay-as-you-go basis for future cases
- we were also able to agree an adjustment to the assumptions that reflected that market yields were at historic lows and had improved since the valuation date

The outcome was an agreed revised deficit of around £1.1 billion which gave the company an acceptable recovery plan and regulatory capital impact.

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Barnett Waddingham Illuminate is an online pension scheme valuation tool with a difference. Rather than being a generic tool that has to be translated to specific situations, it is integral to our tailored client advice.

Illuminate does all of the things you would expect from such a tool, allowing trustees and sponsors to keep track of their funding levels (on various bases) from day to day, showing how changing actuarial assumptions affects the scheme's liabilities, and illustrating the risk from the investment strategy.

It includes a module focused on The Pensions Regulator's new Code of Practice on scheme funding; linking together the calculation of the scheme's liabilities with the investment risk, and pulling the funding and investment strategy together to show the reliance on the company covenant.

It is directly integrated with our valuation systems, so it does not incur significant additional costs.

It accesses real-time data, allowing extensive interaction covering a range of scenarios. Once the effects of alternative strategies have been understood, our experts can help guide and implement the chosen path.

The second module focuses more on employers planning liability management exercises. Illuminate allows our clients to input different combinations of such exercises (for example a pension increase exchange offered at retirement, plus a buy in for pensioners aged over 70), and then see the impact of different levels of take up.

- What does this mean for the funding strategy already in place?
- How has the risk profile of the scheme changed?
- When do we now expect to be fully funded?

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It accesses real-time data, allowing extensive interaction covering a range of scenarios.


*i* Visit www.barnett-waddingham.co.uk/illuminate for more information and to register for a demonstration

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# Contact us

### Nick Griggs, Partner and Head of Corporate Consulting

Nick advises a range of UK businesses on DB pension issues including risk reduction exercises, scheme funding, pension benefit design and accounting disclosures. He also acts as Scheme Actuary to a number of clients.

nick.griggs@barnett-waddingham.co.uk

### Andrew Vaughan, Partner

Andrew advises a range of UK and international businesses on DB pension issues including pension scheme funding, risk reduction exercises, pension benefit design, M&A transactions, and accounting disclosures.

andrew.vaughan@barnett-waddingham.co.uk

### Paul Hamilton, Partner

Paul is a Scheme Actuary to a number of pension schemes, and advises a range of UK businesses and trustee bodies on DB pension issues including scheme funding, benefit design, and risk management.

paul.hamilton@barnett-waddingham.co.uk

### Simon Taylor, Partner

Simon advises companies on DB pension issues including liability and risk reduction exercises, scheme funding and financing, exit strategies, benefit changes and accounting disclosures.

simon.taylor@barnett-waddingham.co.uk

Barnett Waddingham LLP is the UK's largest independent firm of actuaries, administrators and consultants with seven offices throughout the UK.

We were founded in 1989 and offer a full range of services to trustees, employers, insurance companies and individuals.

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