A roadmap for success

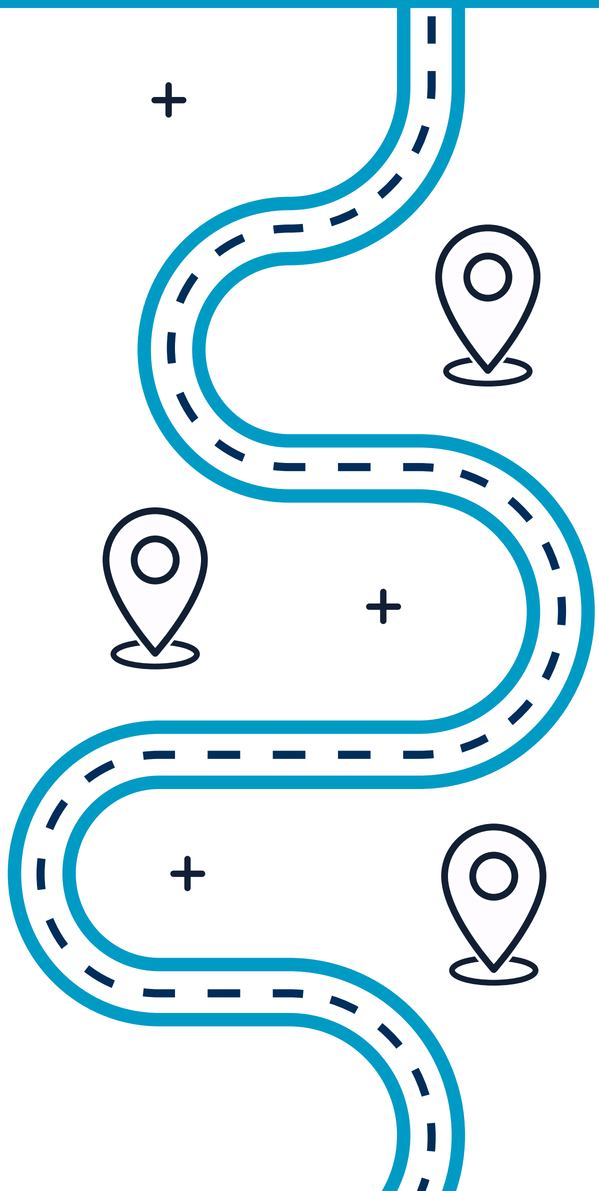
Trustee priorities for 2023 | DB Pension schemes

There's no denying that 2022 was a challenging time for trustees of most DB pension schemes. For many, 2022 was about reacting to soaring inflation and then dealing with the immediate consequences of the unprecedented volatility in the gilt market resulting from the Government's ill-fated mini budget.

However, as the dust settles, most are realising that the road ahead has changed – with many seeing improved funding positions but against a backdrop of an economy in recession, higher gilt yields potentially here to stay and the norms around Liability Driven Investment (LDI) changing.

When combined with the latest expected round of legislative and regulatory changes, it seems certain a busy 2023 lies ahead.

Our roadmap for success is designed to help you prioritise key issues for your DB scheme and give a focused action plan which can help set your agenda for the year ahead.



Reconsider where you are going and how you are going to get there

Strategic Journey Planning

- [ ] Revisit your Journey Plan - LCP's GEARS framework (see p2) can help you do this in a holistic way.

Check under the bonnet

Governance and administration

- [ ] Assess the effects of the current inflationary environment and consider member options in light of the cost of living crisis
- [ ] Consider buy-out preparatory work
- [ ] Prepare for the Pensions Dashboard
- [ ] Progress GMP equalisation

Limit your pollution along the way

Responsible Investment

- [ ] Set stewardship priorities and engage with managers
- [ ] ESG investment considerations

Strategic journey planning

A crucial focus for 2023 is going to be reviewing existing journey plans under a new lens, following the events of 2022. LCP's latest 2022 Chart your own course report introduced a simple five-step framework (GEARS) for successful journey planning. Below we set out some of the key questions and issues trustees should consider, during 2023, under that framework.

Get the right governance structure in place	• **Reflect** on how your governance structure and decision-making processes fared during 2022. Ensure you have the nimbleness to tackle further uncertainty and take opportunities that might arise over 2023. • **The Single Code of Practice** (expected to be finalised in early 2023) will be key to reviewing your trustee board's effectiveness. Our guides provide a helpful overview of the requirements, including establishing an Effective System of Governance (ESOG) and undertaking an Own Risk Assessment (ORA). The Single Code will also set out expectations around diversity, equity and inclusion (DEI). Our guide sets out the importance of this topic in good governance.
Establish your ultimate objective and timescales	• **Long-term objective** – With buy-out funding levels much improved, some schemes previously targeting low-risk self-sufficiency may now see buy-out as a realistic destination. We can give you a realistic estimate of your buy-out funding position. • **Timescale** – Improved funding levels (or the implications of the new funding regime) may mean many schemes will now be expecting to reach long-term targets earlier. This will influence strategic planning, for example the level of risk being run within the investment strategy today.
Analyse what could change your journey	• **Covenant deterioration** – Could the recession impact the sponsor's ability to meet its deficit contributions or its longer-term ability to support the scheme, including the risks associated with the scheme's current investment strategy? • **A changing investment toolkit** – Given the significant changes to LDI fund terms across the industry, is it sensible to review how these funds now fit into your wider investment strategy? Is your revised strategy still expected to provide the long-term returns required? • **New funding regime** – Explore how the revised funding code could influence the scheme's journey plan, including the potentially significant implications for the covenant assessment, suitability of the scheme's investment strategy and the pace of funding. See our news alert for our viewpoint and sign up to attend our 11 January webinar.
Refine the steps you plan to take to reach your goals	• **Hedging** – Do the current target hedging levels remain appropriate in light of revised strategic objectives, and do you have a structure in place to meet future collateral calls on the LDI portfolio? • **Illiquid investments** – do existing illiquid assets still fit with the scheme's journey or might the holdings need to be realised sooner than previously envisaged? Consider making use of secondary markets / building relationships with brokers. • **Funding plan** – How does any change in long-term covenant support or investment strategy interact with the funding plan? Begin open and honest conversations with sponsors now, rather than waiting for the next valuation date.
Steer your journey dynamically and in a joined-up way	• **Monitoring** - It will be more important than ever to monitor your journey and ensure your advisers are working in an integrated way so that nothing falls through the cracks. • **Contingency planning** – Will existing contingency plans still provide adequate protection in the event of covenant or funding deterioration? Conversely, if 2022 has left the scheme ahead of its funding plan, sponsors may be concerned about over funding. LCP's Contingent Funding handbook provides valuable insight into how contingent funding can maintain benefit security whilst efficiently using sponsor resources.

Administration and Governance

Inflation and member options

High inflation over 2022 and continuing into 2023 will continue to have implications for schemes, sponsors and members. Trustees will need to **carefully consider your trustee duties in relation to pension increases (including any discretionary powers)** as well as continuing to **monitor the appropriateness of member option terms**, to ensure members receive fair value.

The cost of living crisis is likely to mean many scheme members would benefit from increased flexibility around the shape of their benefits, and so there may be **increased appetite from members for retirement options** such as early retirement, pension increase exchange or temporary bridging pensions paid until state pension age.

In addition, increased economic uncertainty, coupled with enhanced flexibility, make it increasingly important for members to take advice at retirement. Given the difficulties for members in sourcing good and affordable advice, more schemes and sponsors are using their bulk buying power to **select, implement and monitor an IFA** to support their members. Our on point paper explores these ideas further.

> Trustees should also consider the potential impact of future deflation on the scheme's finances and member benefits as we may be looking at a much-changed inflationary environment by 2024.

Buy-out preparation

Your strategic journey plan review might show that buy-out is now more achievable in the short to medium term than you previously thought. However, many schemes will be finding this, so there is likely to be a significant increase in demand for buy-ins and buy-outs over the coming years. Whilst appetite from insurers is expected to remain strong, operational capacity is likely to be a key challenge in meeting the increased demand, and so we expect to see insurers being increasingly selective.

If your scheme is over 90% buy-out funded, **set a clear plan for positioning your scheme to make it as attractive to insurers as possible** – this should cover data and benefit cleansing (including GMP equalisation), setting up an appropriate governance framework and aligning of investments.

Read our detailed insights on the buy-out market and how it might develop via our 2022 de-risking report and recent 2023 de-risking predictions article. Our recent webinar also provides top tips on preparing to go to market".

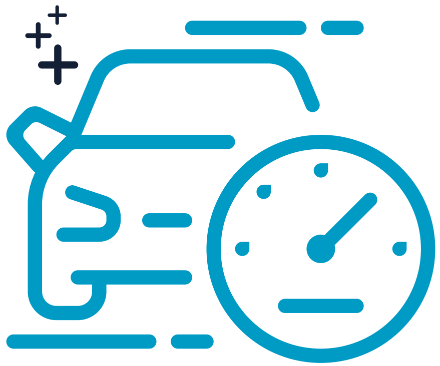
Pensions dashboards

Getting ready to connect to the dashboards ecosystem is no longer a can which may be kicked down the road. A significant number of schemes have a staging date in late 2023 or 2024, and there is plenty of work to do in advance.

It is essential for trustees to ensure that as 2023 progresses they have had the necessary training to understand their responsibilities and have formed a plan of action to get the scheme ready. Our handy guide provides more detail on key steps and how to **develop an appropriate action plan**.

GMPe

We foresee that 2023 will be the year that the majority of schemes make material progress and activity will start to ramp up further. **Keep up to date by regularly checking our** GMP insights hub for fresh content on how trustees should manage this, reflecting experience from our completed



Responsible Investment

Stewardship

Stewardship is fundamentally important to solving issues such as climate change but has often been overlooked. 2023 will continue to see trustees needing to agree on stewardship priorities, in line with DWP's guidance. However, trustees cannot simply state that they have delegated all of their stewardship activity to managers – expectations for trustees have been raised!

Therefore, you should **have a process in place to monitor and engage with your managers' policies and practices,** and to report on the activity arising from this process each year in your implementation statement.

Further detail can be found in LCP's guide. You can read about our own approach to stewardship in our 2022 stewardship report.

ESG investment considerations

Environmental considerations, including TCFD compliance and reporting, will remain a significant consideration for larger schemes, with many producing their TCFD report for the first time and others looking to build on their first report. **Watch our on demand webinar for insight and practical tips.**

In addition, the Single Code of Practice (expected to be finalised in 2023), will bring climate considerations onto the agendas of many sub £1bn schemes for the first time.

There is also an expectation that, particularly for larger schemes, responsible investment considerations over 2023 will begin to move beyond just climate change and measuring carbon emissions to meaningful consideration of other areas of sustainability including: bio-diversity, nature and human rights.

Get insight into the latest developments through our responsible investment and climate change hubs:

Upcoming webinars on the new DB funding code:

The good, the bad and the (potentially) ugly

11 January 2023

A whole new world for covenant advice

26 January 2023

For a framework of priorities for your DC scheme, **click here**

Any questions?

If you would like any assistance or further information on the contents of this update, please contact your usual LCP contact or one of the team below.

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