Burness Paull

From Introvert to Extrovert:

Welcoming pensions to the party

A refreshing approach to an established institution

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GLOSSARY

AI	*Artificial Intelligence*
Consolidator Funds	*Vehicles being brought to market that aim to group together several corporate pension schemes*
DB	*Defined benefit*
DC	*Defined contribution*
DWP	*Department of Work and Pensions*
Regulator	*The Pensions Regulator*
PPF	*The Pension Protection Fund*

CONTENTS

"If employees can't afford to retire and make way for new talent, what is the knock-on effect on a business and its bottom line?"

WE GATHERED SENIOR BUSINESS LEADERS FROM SECTORS INCLUDING: FINANCIAL SERVICES, ENGINEERING, OIL & GAS, CONSULTANCY, LEGAL, FAMILY BUSINESS, TECHNOLOGY, INSURANCE, ACCOUNTANCY, MANUFACTURING, AND RETAIL TO SHARE THEIR INSIGHTS INTO ACHIEVING A POSITIVE FUTURE FOR PENSIONS. WE WOULD ALSO LIKE TO THANK IONA BAIN, INDEPENDENT FINANCIAL WRITER, BLOGGER, BROADCASTER AND FOUNDER OF THE AWARD-WINNING YOUNG MONEY BLOG FOR HER CONTRIBUTION TO THIS PAPER.

Executive Summary

A PROBLEM SHARED

Corporates have always been reluctant to invite pensions, the introvert, to the party: an approach that has only been exacerbated by the pandemic. The issues are often complex and challenging, particularly in difficult economic times, but it needn't be that way. We gathered insights and observations from a wide range of business leaders to help change your mind and shine a light on the life and soul of best practice.

Pension contributions can be a costly drain on the corporate purse and are increasingly cited as an important ethical responsibility for businesses to ensure that workers can afford to retire.

Legacy defined benefit pension funding is a liability that often competes for available funding with future investment. And the tension is twofold. The sustainability of a business is compromised if it isn't making sufficient forward facing investment. Yet if employees can't afford to retire, businesses are not in a position to invest in new talent to shape the future.

To compound this, the regulatory framework is complex and businesses can often feel hedged in.

The purpose of this paper is to challenge these obstacles and underscore the importance of corporates having a plan. Aligning pensions and profits is perfectly possible if engagement and technology are used to develop a sustainable and dynamic pensions strategy for both corporates and their employees. There are creative options open to agile businesses and we highlight these.

WE EXPLORE HOW YOU CAN:

- **Manage the dynamics between defined benefit (DB) and defined contribution (DC) schemes positively.**
- **Embrace rather than fear pensions in dealmaking.**
- **Participate in auto-enrolment responsibly.**
- **Shape meaningful pension provision for the next generation.**
- **Address the gender pensions gap.**

We hope you enjoy this paper and look forward to discussing how your business is managing these issues and what we can do to help.

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"...rather perversely the lack of appetite to become associated with DB pensions was recognised as an opportunity..."

Part 1

OVERCOMING TODAY'S CHALLENGES - ALIGNING PROFIT & PENSIONS

From regulation to defined benefit scheme deficits - while the obstacles can feel daunting, there are ways to align profit and pensions and navigate to a safe and positive outcome. We urge you to be the business with a creative and sustainable plan.

Why business doesn't need to run scared of defined benefit pension schemes

Innovative funding structures, restructuring, and a transfer to consolidator vehicles are all realistic options available to businesses to help mitigate the costs of pension liabilities.

There is a reason why in 2020, of those DB schemes that haven't already wound up, only 10% were open to new members and future accrual. The costs are volatile and make any sort of long term investment planning difficult. Those businesses that have a credible plan to manage liabilities and balance that with investment in the wider business will be those that succeed in attracting investment too.

Business leaders agreed that for corporates with DB schemes, the rewards will come if companies are bullish and take the funding battle directly to stakeholders to agree strategies to deal with liabilities now and get them off the balance sheet. Of course for trustees to be comfortable with creative solutions, the Regulator needs to be supportive.

One idea that merits consideration is pension schemes taking equity stakes in employers' businesses. This already occurs in insolvency and restructuring scenarios. Therefore, one would hope that the Regulator could get comfortable with the concept in the context of a healthy solvent business. This would require legislative change, but the idea is sound.

This form of holding by a pension scheme would align interests between the scheme and the employer and should encourage collaboration with a view to improving balance sheets and the health of the schemes.

Consolidate to accumulate

DB schemes can be a savvy investment opportunity for those who ask all the right questions, understand the potential risks and are brave enough to seize opportunities. And that is what consolidator funds are hoping to do. Consolidator funds are a variation on pension scheme mergers but with a more ruthless commercial driver. They offer economies of scale and are attractive because they remove the DB scheme from the balance sheet of the corporate sponsor for a price lower than buy-out.

Consolidator solutions are entering the market in the form of either a segregated bridge to buy-out (Clara Pensions) or a single merged super pension scheme (the Pension SuperFund). Other innovative investment solutions are also coming on line and more are likely to follow. The sales pitch for these new vehicles promises additional security for members; the jury is out on that and companies will need to tread carefully. And our participants warned that consolidator structures need to be cognisant of the importance of the personal touch from pension scheme trustees who have often been former colleagues and friends of scheme members.

Legacy schemes - an opportunity for savvy listed & private equity investors

We explored a number of investment options:

LARGER/PUBLICLY-LISTED COMPANIES

Participants felt that legacy schemes can be far from an insurmountable stumbling block for larger/publicly-listed companies looking to complete deals, not least because many still have legacy DB schemes of their own. Albeit there was recognition that recent cases like BHS, Tata Steel and Carillion will be likely to make buyers rather more cautious.

PRIVATE EQUITY INVESTORS

Private equity investors are naturally cautious about investing in businesses with DB schemes. However, given the potential to restructure and work with trustees to improve schemes, there is definitely scope for private equity investors to achieve value through investing in and improving the position for companies with DB schemes.

Our participants discussed the possibility of schemes being permitted to take equity stakes in businesses. This merits particular consideration in a private equity context: a scheme could take a minority stake as a co-investor to a private equity investor. Legislative change will be required to allow this, but it would support alignment between the scheme and the investor and encourage positive engagement with a view to reducing DB scheme liabilities.

AVOIDING LIABILITIES - ASSET VS SHARE SALE

Participants noted that businesses can also free up cash to invest by structuring their deal as an asset rather than a share sale - allowing purchasers to buy the operational side of a business without taking on its pension scheme and associated liabilities.

However, purchasers are still looking for some guarantee that future liabilities will be eliminated even if a DB scheme is removed from the balance sheet. They often ask if it is possible to buy warranty and indemnity insurance to cover liabilities that might surface at a later date.

It will be interesting to watch this market and the success of product development that can give purchasers the reassurance they seek.

DEAL-BREAKER FOR SOME FOREIGN INVESTORS & BANKS

Some foreign investors (having witnessed Lehman Brothers being burned by the Regulator's ever-expanding powers) and smaller companies view potential DB liabilities as a deal-breaker.

There is a fear that, if banks are fully informed about the financial position and nuances of a DB pension scheme, they may be reluctant to approve lending to companies that sponsor such schemes. The problem is further compounded by a concern that banks lack an understanding of DB pension schemes. So how can we have honest conversations without people overreacting?

FEAR OF LIABILITY TRANSFER

Our business leaders also noted a wariness of bidding for second-generation contracts outsourced from the public sector. These present the threat of inheriting former public sector employees' complicated pension rights, and the potential ensuing liabilities create difficulties in subsequent contract transfers.

OPTIMISM FOR THE SAVVY INVESTOR

So while this might seem in part a gloomy picture, rather perversely the lack of appetite in the market to become associated with DB pensions was recognised by participants in our discussions as an opportunity for savvy UK and international investors with sufficiently deep pockets.

“Conversations need to be more transparent and these need to start early and be framed positively.”

Part 2

BUILDING A BRIGHTER FUTURE - ENGAGEMENT & TECHNOLOGY

A sustainable pensions strategy for businesses and their employees is within reach, but it demands better engagement, communication and technology. The dynamic between employers and their employees is complex but, if managed carefully, the future of pensions is bright.

The bottom line is the pension savings of many individuals will simply not be sufficient to retire on. Do employers have an ethical responsibility to reverse that? Should they be paying higher contributions? And should they play their part in better educating employees about their long-term financial well-being and the place that pension savings have within that? The answer is that there certainly has to be better engagement. Conversations need to be more transparent and these need to start early and be framed positively.

Engagement

Participants acknowledged that employees value transparency and fairness and that's why it is important that employees are given the complete picture of the dynamic between legacy and current pension schemes. Clarity of communication is critical. There was genuine concern expressed among our participants about the perceived lack of engagement in pensions by younger generations (and not just millennials). Even those close to retirement aren't taking pensions seriously enough if the recent increase in pension scams is anything to go by.

It was agreed that businesses must play their part in improving this engagement, not just with employees but with all stakeholders, including funders, politicians and the regulatory authorities.

Employees need to hear both sides of the story

Employers face a real threat to the sustainability of their business if the workforce can't afford to retire to make way for the next generation of talent.

An increasingly intergenerational workforce presents further complications – some employees will have DB schemes while younger generations and even their parents have never known one. And disparity of pension provision within an organisation can lead to resentment among employees.

Legacy pension arrangements are often cited as the key reason employers can't afford to pay higher contributions into the pension arrangements of younger generations. And although closing a DB scheme - as many employers have already done – might seem like the most straightforward solution to spiralling liabilities, it doesn't remove the liability; it just helps manage its growth.

The real difficulty in closing a scheme lies in 'selling' this to the workforce and busting many of the media-perpetrated myths around employees' entitlement to DB schemes and employers "pulling a fast one".

Ensuring employees receive a good replacement DC offering will also be pivotal to achieving employee buy-in. Employers need to set the record straight on DB closures: they aren't breaking a promise to their workforce; they are simply trying to protect employee benefits and the future growth of the business.

Auto-enrolment: job done?

The inadequacy of retirement savings is not a new topic. People have said for many years that we are not saving enough for the future. Auto-enrolment was introduced to address this. So, job done? Our participants agreed it is not, and this is an unhelpful (and incorrect) assumption.

Any obligation on employers and employees to make contributions to a pension scheme is positive; but this is not the whole story. Some of our participants voiced concerns that young people and employers are being lulled into a false sense of security with auto-enrolment and do not appreciate what the level of contributions being paid actually means for the financial future of employees.

Contributions need to be realistic

Many employers with DC-only benefits, and even some who have switched to DC, feel no sense of obligation to ensure their employees' twilight years are taken care of – they pay the auto-enrolment minimum, or feel pleased about matching up to 5% of salary. The combined 8% employer and employee contribution ought to be twice that.

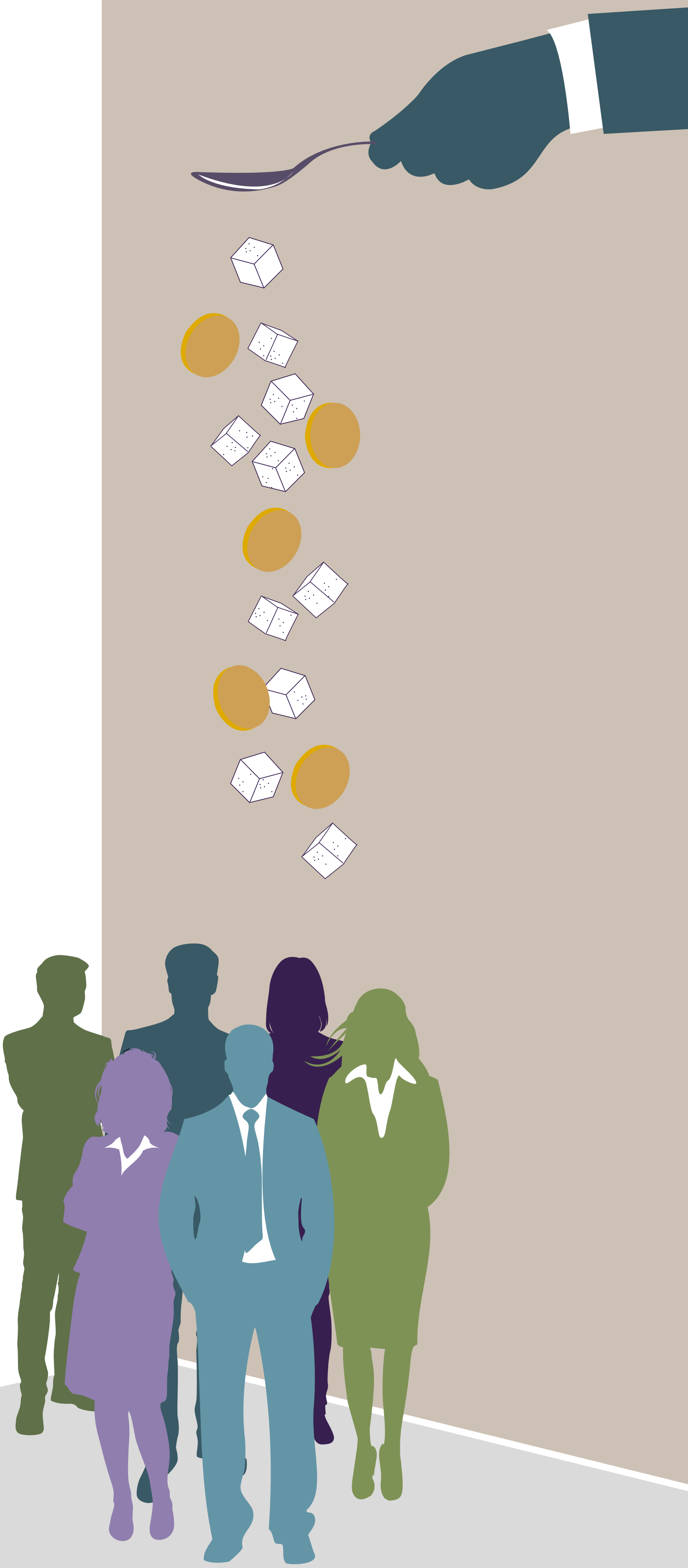
In order to have a comfortable retirement, a rule of thumb is that when you start saving for your pension, you'll need to contribute a % of salary equal to half your age, and keep paying at that rate until you retire. Auto-enrolment has been in place since 2012. Initially the combined employer / employee contribution requirement was 3% of salary. According to that generally accepted rule, workers would have had to start contributing at age six!

Sweeten the deal

To encourage employees to increase their contributions, do employers simply need to sweeten the deal and pay larger matching contributions? While that would help, some are suspicious of how affordable or sustainable that might be; but this mindset needs to change.

Participants agreed that by far the most powerful tool to change behaviour would be realistic illustrations for individuals of what a pension pot might achieve at retirement age. Pension pot valuations are pretty meaningless without the stark reality of what that will mean in everyday life.

Furthermore, communication needs to feel bespoke and personal. Only then will employees sit-up and take notice. The question is: how do we make this part and parcel of employee pension planning?



Doing the right thing for the next generation

There was sympathy for the significant competing financial pressures facing the next generation. For younger generations, pensions and savings are not a priority, with student loans, rent payments and saving to buy a home taking precedence. This raises concerns about the level of savings the next generation will have by the time they retire. Add to this the fact that people are living longer, the increase in age related degenerative disease and the requirement to build care needs into financial planning, and we begin to comprehend the scale of the problem that is emerging. How do we address the tension between the need for flexibility and the public policy need for those who can to fund their own retirement?

The consensus around the table was that younger generations are no longer being looked after as they once were. There are reasons for this, including a more mobile and less loyal workforce, as well as the cost of pension provision, but employers need to engage and do the right thing for their employees and, in turn, the business.

IONA BAIN | YOUNG MONEY

"Most young people prioritise saving for their first home above everything else – pension included.

The average millennial sees most of their wages eaten up by housing costs and many understand that, in most cases, renting rather than owning will be more expensive over time. Plus, they will need a far bigger pension pot just to maintain their standard of living in retirement if they continue renting. So saving for home ownership can actually be critical for a young person's retirement prospects. But a young person also needs to ensure they have short-term savings for emergencies and will often be paying off expensive debt long-term. Employers and the pensions world need to acknowledge these pressures and provide well-rounded advice in the workplace – only then can we guarantee that a young person will be secure enough to commit to their pension."

"Only a minority of millennials are knowledgeable about their workplace pension.

Few are confident it will be sufficient or are taking outside steps to compensate – such as opening a private pension or Lifetime ISA. Low opt-outs are not necessarily a sign that auto-enrolment is working. In my experience, young people either feel it's too much of a hassle to opt out (which is true) or they aren't fully aware they're opted in. This lack of positive engagement wouldn't necessarily be a problem if we could guarantee that current contribution rates and default investment strategies are going to be adequate for future generations. The evidence suggests this is far from certain."

Be creative with DC contributions

Industry leaders pointed to innovative moves on the part of a number of US companies that link contributions to employee retirement funds to those employees' repayments on their student loans. If employers could pay DC scheme contributions to match student loan repayments - and this be made tax advantageous - it could change young people's saving habits.

Education

State pension provision simply won't be enough to fund retirement, and business leaders accept they have a responsibility to educate employees on the importance of longer-term financial planning.

Education also needs to address the short-sightedness of employees across every generation who opt out of auto-enrolment and choose to get their hands on more disposable income now rather than save for the future.

Businesses must stop looking at auto-enrolment as a hidden cost or burden. And the scope of education needs to go beyond the reasons why saving for retirement is important. It ought to focus more broadly on investments and the choice of funds (particularly ethical and ESG funds) – even those working in the pensions industry often select the default fund because the other choices available are so daunting. If employees had to face making contributions of 10-15% of their salaries, they might be a lot more interested in how their investments are being made and want to be more involved in the process.

Mind the gender pensions gap

The gender pensions gap hasn't been far from recent media headlines. While businesses have been grappling with the requirement to produce and publish their gender pay gap reports, how do we address the gender pensions gap to ensure women have a sustainable pensions future? This is particularly so in light of data that shows that the pandemic of 2020/21 has impacted particularly on women in the workplace.

More women than men leave the workforce to have children or care for ageing parents, and often return to lower paid part-time roles with inferior pension benefits - an issue that has been highlighted by the state pension fight of 1950s women.

Women have tended to have lower salaries and their contribution history is shorter, so their pension savings at the point of retirement are lower and cannot provide as much of an income. Businesses that champion gender equality will help shift this dial.

IONA BAIN | YOUNG MONEY

> In an ideal world, we would completely break with the term 'pensions' because they refer to a life pattern and financial model that is unrecognisable in the 21st century.

"Pensions are too rigid, top-down and inimical to flexible working patterns to keep pace with modern life and ensure true equality between the sexes. We will need far more flexible, dynamic and self-managed solutions in the future – and I would definitely be in favour of a simpler name like 'future fund'."

There is little evidence on how much young people value employers' pension contributions compared to other benefits.

As awareness of auto-enrolment grows, I think millennials will increasingly understand that higher levels of contribution rates offered by employers will make a vast difference to their long-term prospects. The delay and likely diminution of the state pension, twinned with the demise of defined benefit schemes, is already giving rise to a debate around 'fairness' – and millennials dealing with student debt, starter salaries and high housing costs will expect a better deal. They may even decide that upping their own contribution, or at least maintaining it, will be worthwhile if the employer contributions going into their pension pot are far more meaningful."

Now it is a legal requirement to enrol most employees into a pension, and it's actually very difficult for them to leave, there is a moral duty to educate millennials about their long-term savings.

But since it is an obligation that has been forced on employers, there ought to be greater tax breaks available for employers who educate young people about their finances – and not just their pensions."

Technology

Technology has an important role to play in effective engagement as part of a sustainable pension strategy, but it has to feel human.

We live in an 'always on' culture, with consumer demand for instant information, products and services. The pensions industry needs to capitalise on that and use it to develop a meaningful exchange on pension savings. The correct digital platforms will have a key role to play in communicating and engaging effectively, especially among younger workers. But participants concluded that even more important than getting the technology right was investing the time and effort in getting the content right.

Discussion centred on the use of phone apps and interactive technologies to encourage better engagement and outcomes. There were differing views as to whether it is helpful to monitor pension savings so closely. Some raised concerns about viewing information too frequently; after all, pensions are long-term investments and seeing their value rise and fall day-by-day might not encourage savings. Others disagreed and felt it might help to 'gamify' pensions and offer 'reward' or 'treat' based interactions for effective saving.

AI needs to feel emotionally intelligent

If members could compare their pots with anonymised averages within their own age group and see an indication of the likely income their level of pot would generate, they might be more inclined to engage and win the game.

Everyone is time poor so how do we best get information through to those who need it? There was a suggestion that the pensions industry should mimic other sector communication strategies and push out tech enabled notifications to workers at optimal times of day to better grab attention.

And would adoption of more interactive technologies encourage better engagement and outcomes?

Pensions dashboard – still not enough?

"Pot follows member" is a concept that has been discussed for some time as the nature of work has changed and we move jobs more regularly than ever before. Why should individuals need to keep track of multiple small pension pots when they could be consolidated into one larger pot? There were differing views from our participants on the usefulness of such an approach.

However, it was generally accepted that as a result of the change in the nature of work, and auto-enrolment, we need a solution for orphan pension pots without identifiable owners.

The Government is pushing forward with its long-promised pensions dashboard. Assuming it works as intended, the dashboard should allow members to view all of their pensions savings through one online portal. There has been resistance within the industry to this, largely related to reliability and consistency of the information that will be included, but it is a no-brainer for engagement.

The hope is that it will increase awareness and therefore engagement amongst pension savers. But simply seeing the amount of their pension saving will not be enough; pension scheme members need to be given clear illustrations of what these savings will mean in financial terms for their retirement.

“Employers need to engage and do the right thing for their employees and, in turn, the business.”

Conclusion

TAKEAWAYS FOR CORPORATE BOARDS

What should be on your board's agenda?

Pensions have always felt like the wallflower at the party, complicated and misunderstood, but times are changing, and pensions are now enjoying much more of the limelight as a positive and sustainable business force.

So what should corporate boards take from this paper?

Be a business with a plan - *positive engagement with stakeholders will be the key to dealing with legacy pension liabilities, increasing regulation and the demands of auto-enrolment.*

Be confident that smart pensions planning will align with sustainable profit - *where employees can afford to retire and businesses can afford to bring through new talent and invest for the long term.*

Don't run scared of legacy pension schemes in dealmaking - *they can present exciting opportunities for savvy investors.*

Be bold and explore innovative funding structures *to help deal with liabilities and create funds for future investment.*

Embrace the ethical responsibility to educate employees *on long term financial planning as a sound business investment.*

Keep engagement relevant; *embrace technology but keep it human.*

Be sensitive to the different issues and aspirations *across an inter-generational workforce and be flexible in tailoring your engagement and pension provision.*

We're here to help.

We look forward to feedback on this paper and exploring how these positive strategies might work for you.

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