

Feeling pained about paying to reduce risk? There's a cure for that

Aon senior partner Martin Bird shares some of the findings of the company's research into trustees' and sponsors' behavioural biases

People do not like to spend money. We experience the pain of paying and the more difficult or unpleasant an activity is, the less likely we are to do it. Think about the way many of us behave in our personal lives, such as putting off certain financial tasks like paying down debt, saving for retirement, or saving towards a goal. Apply this to pensions, and there is a wealth of cognitive biases that are likely to trip up both sponsoring employers and trustees alike! To help trustees and employers, Aon commissioned research with behavioural insight agency Behave London. It investigated the behavioural biases that can get in the way of making decisions around reducing longevity risk in pension schemes.

You can get a copy of the full research by emailing talktous@aon.com. Here we share some of what we found.

Paying now vs paying later

When you buy house insurance you do not hope to burst a pipe. You pay an insurance premium now to save you from unpredictable potential pain in the future. You take the trade-off between paying a small sum now to protect yourself from a loss later. It is all about protecting yourself from the downside. You will not be hoping to suffer from a burst pipe. In a pensions context, nor do you want to face the consequences of members' lifespans increasing hugely and springing a leak in your pension scheme's finances.

Protecting a scheme against longevity and demographic risks is a prudent move, so what gets in the way?

Where employers and trustees are feeling the pain

- The sponsoring employer does not want to take the 'pain of paying' now – even though reducing risk is likely to save them money over the long term.
- The time cost is in the present
- Trustees and sponsoring employers tend to underestimate the ongoing costs of servicing their scheme. Paying a premium now to transfer those ongoing costs may make financial sense.

'Do I have to do it NOW?'

The problem comes when your average human has to think about events far in the future. The further away the outcome, the harder it is for us to think about it. This tendency to overweight our present concerns and underweight those that are far off is called 'present bias'. If we did not have this bias, we would be eating salads every day and everyone would be saving for their pensions without prompting!

Now, imagine I have asked you to pay me upfront for 30 years of burst-pipe protection. It may seem like a very large amount to pay now, to protect you for a very long time. You are likely therefore to experience the 'pain of paying' now – and as behavioural science shows, we would rather take that hit in the future.

What about present bias and

the pain of paying in the context of pension risk?

Trustees and sponsoring employers, being human, are likely to feel uncomfortable paying money out of the scheme now in order to protect their scheme in the present, against the future. It is a perfectly normal reaction, but it stands in the way of good long-term decisions for the scheme.

How to reduce pain

You need to be comfortable with your choices, and when it comes to reducing risk in your schemes, comfort starts from gaining an understanding of the whole process. As a trustee or sponsoring employer, you want to know that you can take the right actions – and not suffer regret at missing the opportunity to reduce longevity risk at a time when prices were good, when you could have secured a deal which spared the scheme and the sponsor from future financial leaks.

Understanding the process helps everyone make better decisions

When it comes to making decisions, Aon wants to help trustees and sponsoring employers to remove longevity risk where appropriate. As a result of the research, we felt we could make the process more transparent and easy to understand. To help trustees and sponsoring employers painlessly understand what is involved at each stage, we have mapped out the process over four stages: Deciding strategy – should you reduce or remove longevity risk?; Engaging with the market to obtain pricing; Selecting



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a provider; Completing your transaction.

You can learn the behavioural biases that can trip up trustees and sponsoring employers alike, and discover how to navigate through these to make good, confident decisions about your scheme. □

Interested in finding out more?
You can receive Aon's step-by-step guide direct to your inbox. Get your copy before anyone else by emailing talktous@aon.com



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