Navigating new waters in your pension scheme? Get a map!

Karen Gainsford explores the help available for trustees making decisions regarding their scheme's longevity risk

Do you really know how long your members will live?

How long people live is their 'longevity'. In pension schemes, longevity risk is the risk that members live for longer than expected. That means pensions are paid for longer than expected, which costs more money.

Longevity risk can be significant and is often the key remaining risk in schemes that have taken action to reduce investment risks. Removing longevity risk can be very beneficial, but not all trustees or sponsoring employers explore the options available to them.

Behavioural insights

Aon commissioned research with behavioural insight agency Behave London, to look into the behavioural biases which can get in the way of making decisions around reducing longevity risk in pension schemes. (For more information or to register for your copy please email us at talktous@aon.com.)

Ambiguity. Nobody likes it

One of the core findings of the research was that that there is a real lack of clarity around the end-to-end process of what de-risking involves – what is needed to complete a transaction and who does what? Human beings are prey to a cognitive brain bias called the ambiguity effect, where our decision making is affected by a lack of information, or ambiguity. In essence, we will tend to pick known outcomes over unknown ones.

But what does it mean for schemes?

When trustees start to look at taking longevity risk out of their schemes, it can feel like a huge task as insurance premiums can look expensive and the decisions involved numerous. As with many tasks, the real battle is not in actually what is to be done but in dealing with a process that can feel confusing or overwhelming.

We wanted to improve the way we help trustees look at removing longevity risk and make decisions. The research results showed that we needed to make the process transparent and easy to understand. Trustees needed a map of the whole process, so that they could understand what is involved at each stage and how they can set themselves up to sail through the process to success. After all, if you are setting sail for new waters, you want to know what is ahead.

In practice, the process can be simplified into a number of bite-sized steps with clear decision points to determine whether to proceed to the next stage, or pause until the time is right. For trustees or sponsoring employers at the very start of their journey, this process and the steps needed are not always clear.

Navigating new waters

To help trustees understand what is involved at each step, we have produced a guide that maps out the process over four stages:

- Deciding strategy – should you reduce of remove longevity risk?
- Engaging with the market to obtain pricing

- Selecting a provider
- Completing your transaction

Throughout, we explain the behavioural biases that can trip up both trustees and sponsoring employers and aim to help you to navigate through them to make good, confident decisions for your scheme. The step-by-step practical guide removes the ambiguity from risk reduction and gives trustees a map of what to expect. Aon works with huge numbers of schemes each year; we therefore understand that not every trustee is familiar with all the options available to them. Due to this, as well as outlining the process of reducing longevity risk, we also explain the options available to schemes and trustees. So, whether you are new to trusteeship, or you have set sail many times, we are here to help.

Interested in finding out more?

You can receive Aon's step-by-step guide direct to your inbox. Chapter 1, on deciding your strategy to reducing or removing longevity risk, will be available soon. For more information or to register for your copy please email us at talktous@aon.com.

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