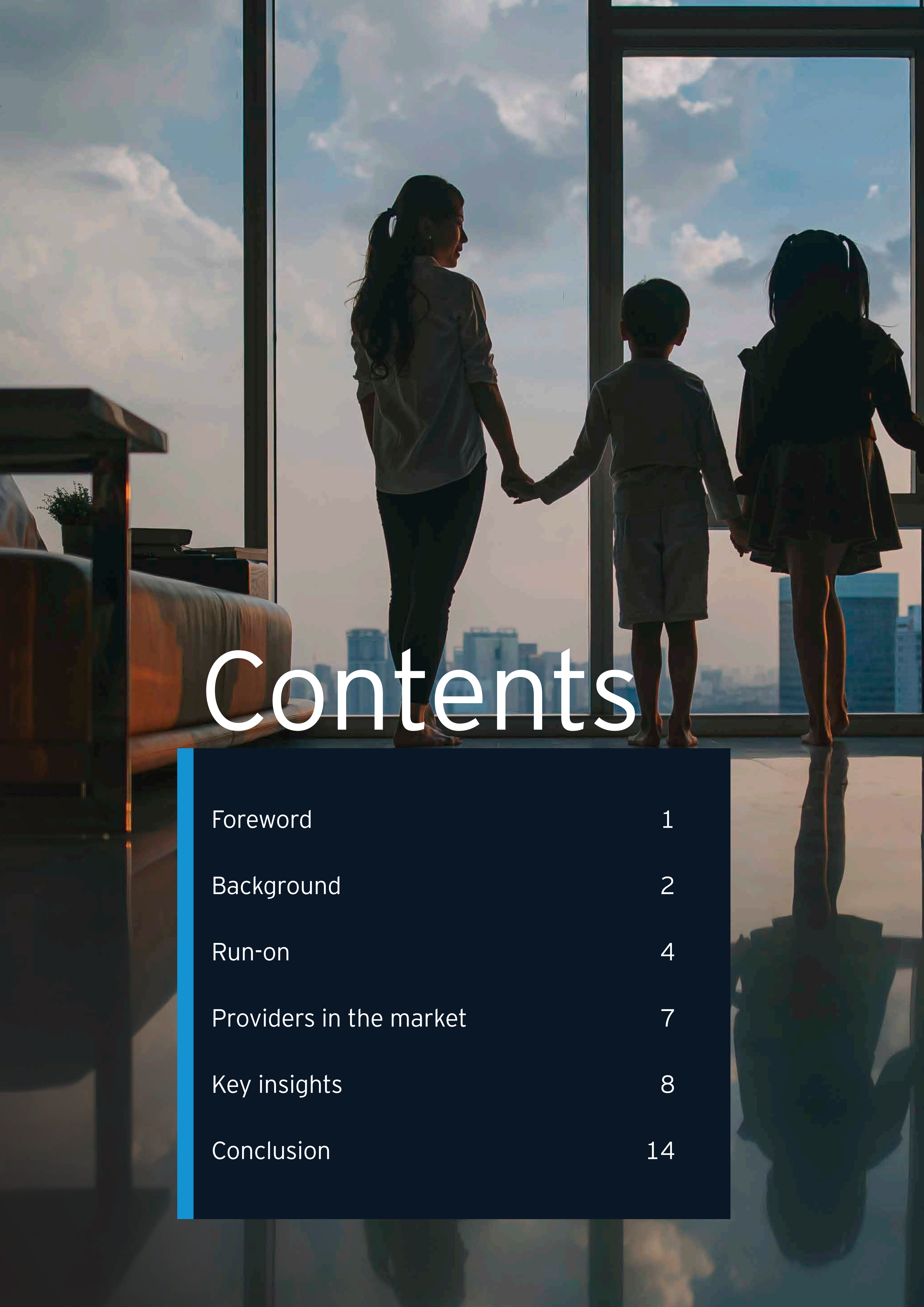
Strategic run-on

EY insights

April 2025

The better the question. The better the answer.
The better the world works.

EY Parthenon
Shape the future with confidence



Contents

Foreword

As the landscape of defined benefit (DB) pension schemes continues to evolve, we are excited to present our insights on "strategic run-on". This paper explores a number of implementation options available for pension schemes that are considering a run-on strategy.

Indeed, with the government's recent announcements on the release of surplus in the past few weeks, there has perhaps never been a more timely moment in the pensions landscape to publish our paper.

Our paper explores the expanding market of providers offering innovative solutions for running on pension schemes, presenting opportunities that may not have been fully leveraged to date. The insights gathered from industry stakeholders indicate a significant shift toward more streamlined and cost-effective approaches, which can ultimately enhance the impact of running-on pension schemes.

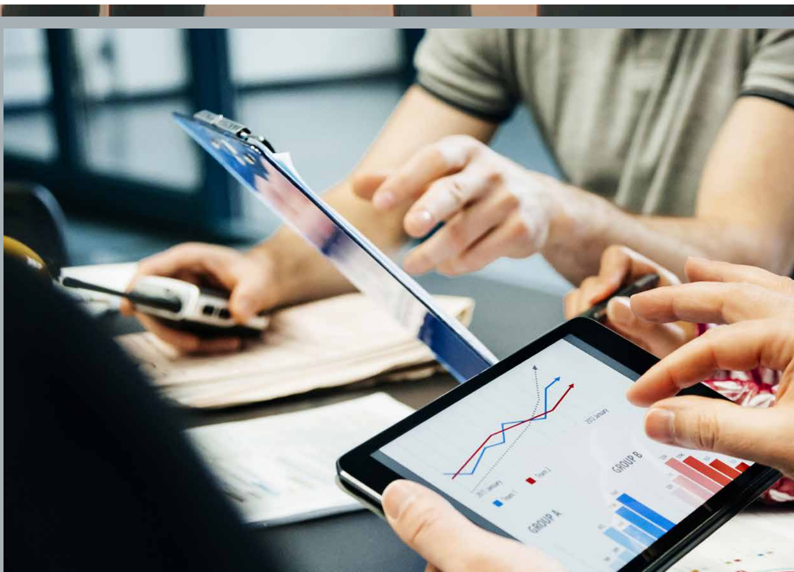
We would like to express our gratitude to all the providers who shared their valuable insights to this paper. Working closely with a range of providers across the industry has been instrumental in painting a comprehensive picture of the range of implementation options at play.

As you explore the findings within this report, we encourage you to consider the implications of these insights for your own pension schemes. Given the government's desire to strategically implement a run-on for pension schemes to release surplus, it is inevitable that more schemes will need to consider the best implementation options for this strategy. The market for run-on providers is clearly expanding, and we anticipate that next year's paper could reveal even more options and innovations that will shape the future of pension scheme management.

Thank you for your interest and support as we navigate this evolving landscape together.

Sincerely,

Paul Kitson
Head of EY UK Pensions Consulting



"Given the government's desire to enable strategic run-on to encourage surplus release, trustees and sponsors will increasingly need to consider their implementation options. There is an expanding market offering increasingly innovative options.

1. Background

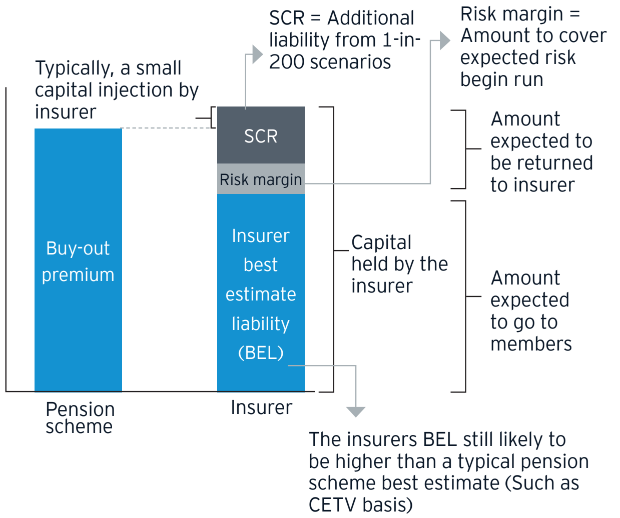
What has got everyone talking about run-on?

1. Schemes in Surplus: One of the outcomes of the September 2022 mini-budget was that the funding levels of many DB pension schemes increased. Many schemes with previous large deficits now find themselves with healthy surpluses. So, "endgame" options that were once considered a future luxury are now a reality.

2. Consultation on Surplus: The Mansion House reforms, supported by a consultation published by the UK government, aim to introduce changes to private sector pensions, potentially making it easier for companies to extract surplus from pension schemes. This could make run-on more attractive in certain circumstances.

3. Evaluation of all options: Buy-out is an irreversible decision, so now that it's a realistic option, trustees and sponsors are looking to test their long-term strategy to ensure it is the correct one for the long-term. Buy-out also involves passing capital to insurers, who seek to be rewarded for the risks they take (see the chart). This is further reinforced by the revised actuarial standard TAS 300 v2, which requires actuaries to consider credible alternatives to buy-out as part of their advisory process.

The Buy-out premium contains capital that will be returned to the insurers' shareholders if benefits emerge in line with the best estimate assumptions.



Note: Simplified examples for illustration purposes only.

Our view on run-on

We don't have a "house view" when it comes to run-on. Having performed a number of evaluations for clients, we have quickly realised that no two clients are the same and that different objectives, different scheme sizes, different company covenants, and even quirks like scheme rules or accounting preferences are leading to very different preferences between run-on and insurance options.

For some schemes, buy-out will still very much be the answer, in most cases this leads to the lowest risk option. For others run-on will be the answer, as the expected surplus generated could benefit both sponsors and members in a safe risk managed way.

The main purpose of this paper is to consider the implementation of a run-on strategy, but an important first step will be to evaluate the relative merits of buy-out and run-on (and the options in between).

2. Run-on

What do we mean by run-on?

Run-on can mean a number of different things such as:

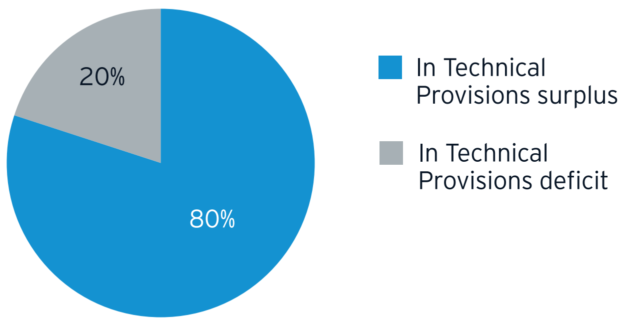
1	Running on out of necessity due to poor funding levels.
2	Running on for a few years whilst illiquid assets are being redeemed or issues such as poor data are corrected ahead of a buy-out.
3	Running on to strategically generate surplus, even where buy-out is already achievable.

In this paper, by 'run-on,' we refer specifically to a **strategic run-on** (i.e., point 3 above). A strategic run-on is a deliberate and proactive decision made by the pension scheme's trustees or sponsor to continue managing and operating the pension scheme over an extended long-term basis, even though they may be fully funded on a buy-out basis. It is important to note that in this context, 'strategic run-on' pertains to schemes that are already or nearly fully funded on a buy-out basis but decide not to proceed with a buy-out.

A strategic run-on may serve various objectives, such as generating surplus for the benefit of members and sponsors or improving the security of benefits overall.

As you can see from the chart, approximately 80% of schemes are now estimated to be in surplus on a Technical Provisions basis and so there are many schemes that could be in a position to consider a strategic run-on.

Percentage of DB schemes



Source: TPR Occupational defined benefit landscape in the UK 2024.

Run-on is not business as usual

We strongly believe that strategic run-on as a longer-term strategy is fundamentally different from "business as usual" and how the Schemes have been run to this point.

EY's five pillars of run-on

We have developed a five pillar structure for the most important considerations when embarking upon a strategic run-on, set out as follows:

EY's five pillars of strategic run-on

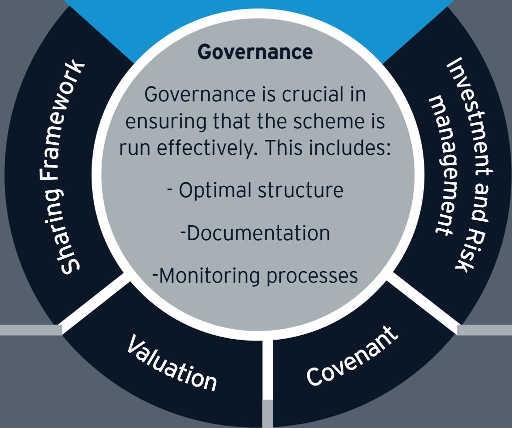
- Designed to help agree on an approach to achieve maximum benefit to members and sponsor with minimum risk
- Up front to avoid future conflicts

Consider distribution of surplus

- Agree stakeholders
- Required buffer
- Agree the order and shares of distribution

Investment framework to generate excess returns

- Set investment strategy to generate excess return
- Cashflow matched
- Agree optimal investment framework



Ensure better alignment between investment and funding strategies

- Refine valuation basis
- Use of Credit Driven Investment (CDI) dynamic basis vs. traditional gilts basis
- Outcome is stability of funding level and recognition of 'true' risks.

Understanding covenant

Understanding strength of covenant is key to ensuring investment strategy is supportable and appropriate buffer is held

- Is there any covenant enhancement required to underpin the desired strategy?
- Retained surplus could provide stability

Rule of thumb

Whilst every scheme is different, broadly we expect a reasonably low-risk strategy to generate around £2m per annum distributable surplus for every £100m of scheme assets.

3. Implementing strategic run-on

In order to implement the five pillars for a strategic run-on, there are a number of services that the scheme and trustees will require. They will want to keep these as streamlined and efficient as possible for successful implementation and to minimise the drag on the surplus generation.

EY insights on strategic run-on providers

The most effective provider solution might be impacted by the size of the pension scheme.

Large schemes (£1bn+)

Large schemes benefit from economies of scale and hence are able to pick the most appropriate provider for each individual service. Although in some cases, this could still lead to the bundling of services.

Large schemes therefore benefit from the most options available to them across all of the traditional and new strategic run-on providers.

Mid-market schemes (<£1bn)

For strategic run-on to work in this market, services provided will need to be extremely efficient, otherwise there is a risk that most of the surplus generated might be spent on ongoing running costs.

In this market there is a huge spectrum of options, starting from providers that will bundle 2 or 3 of these services together through to those that will bundle the entire package.

Small schemes (<£50m?)

Under the current market, while there are providers who can support these schemes, we think it is unlikely to be feasible for the smaller schemes to generate sufficient surplus to cover the expenses of strategic run-on, unless there are a unique set of circumstances.

Insights from providers

The strategic run-on market is in its infancy but is quickly evolving with lots of new innovative structures. To help our clients better understand their options we have spoken to a number of known providers who can support across a spectrum of services. Following these conversations, we have summarised the top 5 insights in the pages that follow.

4. Key insights

Through our meetings with the providers we gained some valuable insights on the strategic run-on market. These were our top 5:

1. There is a **wide range of bundled outsourcing solutions** to help schemes minimise costs and streamline operations
2. All of respondents supported adoption of a **dynamic discount rate approach**
3. There is a **role for existing trustees across all providers**, either as continuing trustees or to provide transitional oversight
4. Providers are continually **innovating** their offerings to pivot to market need
5. **CDI** is at the **heart of investment strategy** for strategic run-on

The rest of this section provides a little more on each of these insights

With thanks to the following providers that input into our insights:

- Blackrock
- Brightwell Pensions
- Dalriada
- Enplan
- GSAM
- IGG
- Insight
- Legal & General
- M&G
- Phoenix
- Schroders
- TPT
- Van Lanschot Kempen

It is important to note that this is not an exhaustive list. We are aware of other providers and actuarial firms who can deliver similar services across the spectrum and we would expect that, as strategic run-on continues to gain attention, additional providers will enter the market and existing providers may change their service offerings.

1 There is a wide range of bundled outsourcing solutions to help mid-market schemes minimise costs and streamline operations

Bigger change

Fully bundled providers → There are a number of fully bundled providers who can offer to provide most, or even all, key services. This would generally be via a multi-trust or master trust arrangement.

Bundled Trustee houses → Some of the Trustee houses are now able to bundle their sole trusteeship with other services such as governance and administration. For most other services they offer a panel of providers for increased efficiency.

Investment houses → Many of the investment houses now offer DC services for strategic run-on. There is an increasing amount of innovation, particualrly in investment products.

Smaller change

No Change? As set out in section 3, the largest schemes may not need to consider bundling services. In addition existing advisors are increasingly thinking about what services they could bundle as a run-on option. All the major actuarial firms either have or are likely to come out with a solution.

The market for run-on providers is rapidly expanding, and we anticipate other variants could shortly be added to the above list.

Case study 1

Midmarket clients

Our insight from the midmarket is that there is an appetite for strategic run-on but a concern that scheme expenses would erode the value. To address this concern, traditional consolidators are building out their run-on capabilities. Master trusts such as TPT or multi-trusts like Enplan (TPT also offer a multi-trust option) are bundling almost all the services that a midmarket client would need.

Case study 2

Large clients

Whilst the midmarket is showing an interest, we still expect the largest schemes to be central to strategic run-on. BT is the largest private DB pension scheme and has been strategically running-on for a number of years already. Brightwell are providing the majority of services to BT and now actively looking to support other large £1bn+ schemes (and currently they would consider schemes upwards of £500m).

2 Run-on providers support adoption of a dynamic discount rate approach

In conversations with providers, they unanimously agreed that for strategic run-on, the funding strategy looks different compared to funding for a buy-out or temporary scheme continuation.

In a buy-out, if a scheme is fully funded, the strategy is to maintain the funding position at gilts+ basis until buy-out completes. In a run-on scenario, the focus shifts towards ensuring the long-term sustainability and solvency of the scheme, which requires a more dynamic and flexible approach to funding. Hence the gilts+ funding approach is no longer fit for purpose under a strategic run-on.

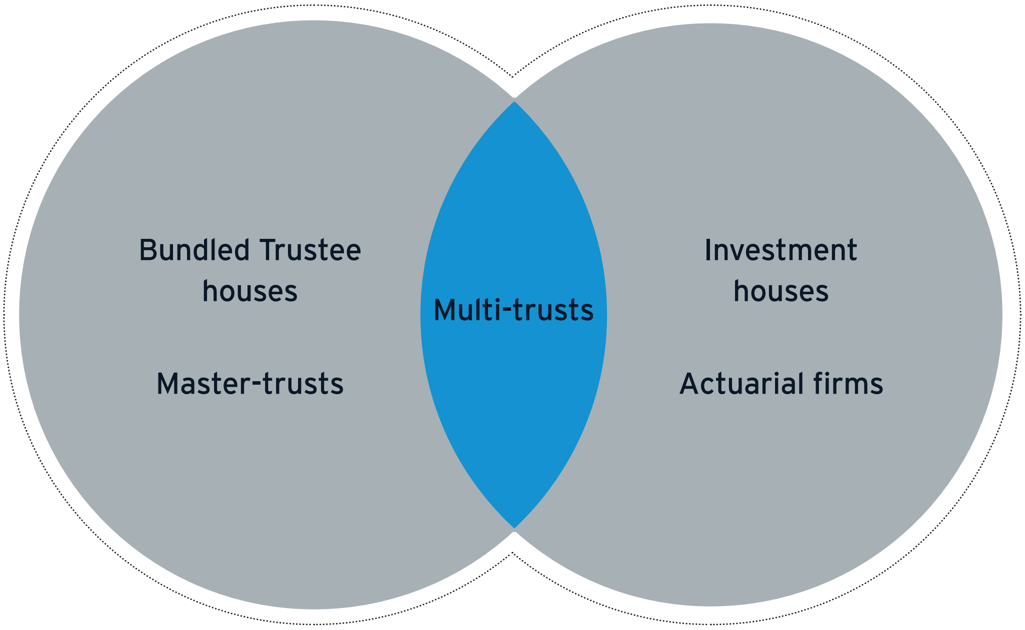
The scheme must balance the need for stability with opportunities for growth, often by maintaining a margin of prudence to cushion against adverse conditions while strategically investing the surplus in higher return assets. Thus, a more appropriate approach for the discount rate is to use the expected return from the assets each year, less an allowance for potential default risks, known as a "dynamic discount rate".

100% of the respondents supported adopting the dynamic discount rate as part of their services

3 There is a role for existing trustees across all providers, either as continuing trustees or to provide transitional oversight

Existing Trustees need to leave role but given a transitional oversight role

Existing Trustees can remain as trustees



Some providers in the market provide a flexible option for schemes to either retain or choose a new trustee, while others require the use of their own trustee services. Even where new trustees are required, every provider confirmed there would at least be a role for existing trustees to support in a transitional capacity for 18 months+.

Case study 3

Bundled services from Trustee houses

Almost all Trustee houses are now willing to offer co-trustee appointments or sole trustee appointments, meaning that the Trustees can decide whether or not they want to continue. Some Trustee firms have taken it further than the sole trustee model by bundling other services such as admin, actuarial or legal either directly themselves or via panels. This might be a viable solution for the Midmarket where there is a requirement to bring down costs. Dalriada Trustees and IGG are examples of this using their Dalriada together and IGGnite offerings.

4 There is an increasing level of innovation

One thing that was particularly prevalent in all of our discussions with providers was the amount of innovation across a number of different aspects. With most providers expecting more innovation within the next 12 months.

Innovation in DC

With an increasing number of schemes looking to use DB surplus to fund their DC schemes there appears to be an increasing focus on the use of DC within all the provider's propositions. Many of the providers, especially the investment houses, can integrate their own DC products into their solution. Others are able to integrate with a range of different DC providers.

All respondents hoped that government would make it easier to move surplus assets into DC arrangements (not necessarily within the same trust).

Innovation in insurance

The providers all agreed that monitoring of insurance pricing will be important to many trustees in strategic run-on, with a desire to maintain enough assets to transact if desired. A range of partnerships and products are developing.

Innovation in covenant

It is important to understand the future ability of an employer to support the scheme under strategic run-on. Where covenant may not be strong enough, there are increasing innovative solutions in the market which provide additional covenant support in the form of external capital or appropriate contingent assets. Some of these solutions remain in their infancy but have potential to open up run-on to a broader range of schemes, if the right protections and the right balance of cost, risk and return for the schemes can be achieved.

These are just three areas where we are seeing increasing innovation, however there is a great deal of innovation across the whole spectrum.

5 CDI is at the heart of investment strategy for strategic run-on

The investment strategy for strategic run-on will differ from traditional approaches, particularly when considering the management of surplus assets. From our discussions with the different providers, it was evident that a CDI approach was at the heart of strategic run-on scenario; with any surplus assets strategically invested in a credit-based portfolio to achieve higher returns. We also discussed how managing credit duration will be key given a credit based portfolio will be sensitive to credit spreads, i.e., minimise exposure to really short dated credit.

When introducing higher return assets, the sponsor should maintain a margin of prudence to cushion the assets and funding position against adverse market conditions and against longevity risks. The remaining surplus could then be allocated to higher return assets depending on the risk appetite, striking a balance between growth potential and risk management. This dual approach allows the scheme to optimise returns while maintaining a safety net to protect against volatility and ensure the long-term security of members' benefits. Any excess return achieved could also be distributed to the sponsor and members. It is critical when operating strategic run-on that the possibility of ever going back into deficit is strongly minimised and mitigated across the investment, funding and surplus distribution frameworks.

For a strategic run-on, a scheme's investment strategy should be based on a CDI approach designed to:

1. Provide cashflows to ensure liabilities can be paid as they fall due.
2. Provide a reasonable investment return as a buffer to demographic changes and to generate sufficient surplus for Sponsor and members.

In establishing our key insights, we spoke to a select number of run-on providers who provide investment only services. However this list is not exhaustive, instead, it is illustrative of the growth and innovation in this space. Importantly we are aware of other investment providers also offering and expanding their services for strategic run-on.

Case study 4

Investment under strategic run-on

Schroders have recently implemented a strategic run-on to their own staff pension scheme and have adopted these investment principles themselves. In their case they are using some of the surplus generated to reduce their annual DC spend. Another example is Insight who have recently published their 'A brief guide to investing for surplus release' paper which sets out many of these same investment principles. These are just two examples, all the other investment houses we spoke to shared similar examples.

Conclusion

The strategic run-on market is at an early stage with only a handful of providers covering all required services, despite an increasing number of investment providers specialising in investment management and solutions. As the concept of strategic run-on gains traction, we expect to see more providers revising their service offerings to include more features. Additionally, they might reconsider their minimum asset size requirements if there is sufficient demand, potentially becoming more selective in their client base.

This snapshot of early 2025 captures just a glimpse of the current services and providers in the market. There is clearly a lot of innovation going on in the market. By year-end, we can expect even more novel services to emerge, with new propositions and players entering the market. The landscape is rapidly evolving, and staying informed about these changes is crucial for getting the best and most competitive services available.

Why EY?

EY is uniquely positioned to advise on whether running-on is right for your scheme. We work with both sponsors and trustees and can help you understand both points of view. When working with sponsors our focus is on aligning pension strategy with corporate strategy by working closely with both finance and pensions teams to understand your objectives. As part of the EY organisation, we offer a full multi-disciplinary service with access to experts in insurance, accounting, and tax.

Please reach out to one of our team if you would like to discuss your specific circumstances further:

Authors

Paul Kitson
Partner, UK Head of Pensions Consulting

+44 20 7806 3388
paul.kitson@uk.ey.com

James Allinson
Director, Head of Corporate Pensions Consulting

+44 11 3236 4481
james.allinson@uk.ey.com

Priya Jassal
Senior Manager, Head of Corporate Pensions Investment Consulting

+44 1132 982 276
priya.jassal@uk.ey.com

Other EY leadership team

Karina Brookes

+44 20 7951 1246
kbrookes@parthenon.ey.com

James Berkley

+44 20 7980 0049
james.berkley@parthenon.ey.com

Swapnil Katkar

+44 20 7197 7271
swapnil.Katkar@uk.ey.com

Russell Laver

+44 20 7022 9153
russell.e.laver@uk.ey.com

Eimear M Kelly

+44 20 3523 4351
eimear.m.kelly@uk.ey.com

EY | Building a better working world

EY is building a better working world by creating new value for clients, people, society and the planet, while building trust in capital markets.

Enabled by data, AI and advanced technology, EY teams help clients shape the future with confidence and develop answers for the most pressing issues of today and tomorrow.

EY teams work across a full spectrum of services in assurance, consulting, tax, strategy and transactions. Fueled by sector insights, a globally connected, multidisciplinary network and diverse ecosystem partners, EY teams can provide services in more than 150 countries and territories.

All in to shape the future with confidence.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

About EY-Parthenon

Our unique combination of transformative strategy, transactions and corporate finance delivers real-world value — solutions that work in practice, not just on paper.

Benefiting from EY's full spectrum of services, we've reimagined strategic consulting to work in a world of increasing complexity. With deep functional and sector expertise, paired with innovative AI-powered technology and an investor mindset, we partner with CEOs, boards, private equity and governments every step of the way — enabling you to shape your future with confidence.

EY-Parthenon is a brand under which a number of EY member firms across the globe provide strategy consulting services. For more information, please visit www.ey.com/parthenon.

EYSCORE 002737-25-UK
ED None

UKC-039037.indd (UK) 04/25. Artwork by Creative UK.

ey.com