

Expert investor series

DB run-on: skills for success in the decumulation phase

UK defined benefit (DB) schemes are entering a new phase marked by improved funding levels yet increasingly negative cash flows as they shift from accumulation to decumulation. This shift presents a new set of investment and operational challenges.

In this new phase, the key to a successful outcome lies in forward planning, simplifying asset allocations, and greater integration across investments and operations to ensure a stable and well-managed transition, supported by the right internal skillsets.

DB schemes have long focused on capital growth and diversification. In recent years, this has led to a build out of private markets programmes. Attractive prospective returns have meant that effective deployment of capital has, understandably, been a priority.

With the rapid normalisation of interest rates, schemes' attention has necessarily turned to managing liquidity and balancing exposures, with portfolios facing a significant denominator effect. The allocation to illiquids has, as a result, become one of the top concerns for Trustee Boards. Exiting or reducing a portfolio of illiquid investments, to address these concerns, is complex, expensive and not always practical. Too great a focus on asset allocation targets, expressed in percentage terms, can lead schemes to become forced sellers and create value leakage.

In reality, the illiquid allocation hasn't changed size in cash terms and a different conclusion could be reached taking a more pragmatic approach with a cash flow focus.

For instance, these assets and / or their underlying cashflows can be reshaped to better fit schemes' evolving needs and produce a better outcome. Such an exercise, however, requires an evolution of internal processes and portfolio management capabilities towards an approach which better integrates across cash outflows, investments and operations.

We believe that illiquids play an important part of the toolkit in a run-on solution, and along with other key variables for a run on environment, including covenant strength and the potential for surplus extraction, must receive appropriate focus.

Looking ahead and as schemes enter their decumulation phase, liquidity is no longer an episodic issue; it now becomes a key challenge and focus as pension outgoes (plus other cash needs such as LDI derivative P&L among others) need to be met through income and asset realisations. Incorporating illiquids into a decumulating portfolio requires a lot more forward planning.

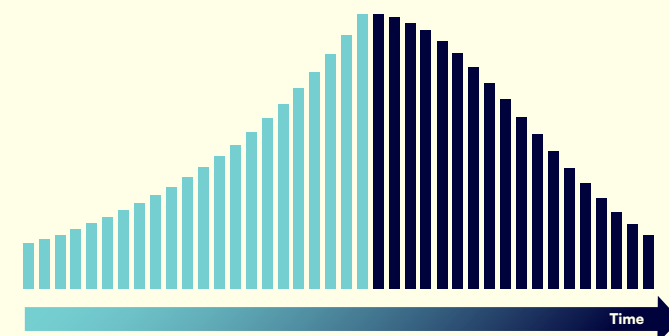
We find that in-house pension team capabilities, let alone the wider industry that has evolved to support DB schemes, have generally been structured to support the accumulation phase. As the balance of investment origination and effective asset management shifts towards decumulation, schemes will need new skillsets to their portfolio management teams.











Arek Zawada

Head of Solutions, Brightwell

Total scheme assets



	<div> Risk</div> <div> Return</div>
	<div></div> <div>Accumulating investor</div>
Objectives	Asset growth
Cash flow needs	Low; returns reinvested
Portfolio focus	Growth, diversification, deployment

	<div> Risk</div> <div> Liquidity</div> <div> Income</div> <div> Return</div>
	<div></div> <div>Decumulating investor</div>
Objectives	Asset growth, hedging & income
Cash flow needs	High; Income paid out and assets sold
Portfolio focus	Rationalisation; cash flow optimisation

Three critical challenges lie ahead:

- **Resource strain:** managing a decumulating portfolio presents a different set of challenges to the investment team than they might have dealt with to date. One of those challenges is the management of illiquid exposure. Reshaping and unwinding illiquid portfolios is complex and resource-intensive. Material operational, legal and tax capabilities are required to support the front office. Strong communication and coordination across these functions is critical. These operationally heavy processes, combined with a more limited capital to deploy into new investments, can have a knock-on effect on job satisfaction of the in-house team. The repercussions of capital constraints on new allocations extend to relationships with incumbent and new managers. That is at the time when schemes, perhaps more so than ever, must ensure that they nurture manager relationships for continuity, transparency and alignment of interests. Whether it is to maintain, evolve or dispose of assets, having the manager on your side can make or break those processes.
- **Implementation model:** decumulation favours investors who take a more integrated, forward-thinking approach to portfolio management. This phase is about balancing the, sometimes conflicting, needs of the scheme in a most cost-effective way. Those needs cannot be addressed through a top-down strategy, single allocation bucket or an individual mandate. A portfolio-wide coordination is required with all assets working towards a single goal and a clearly understood and articulated trade-off framework. For instance, the LDI / CDI portfolio might take on additional objective of supporting illiquid holdings until such holdings can be sold at fair value. Simplification to the portfolio structure is key in this phase — fewer asset buckets should be the focus, with overarching objectives permeating across all activities.
- **Portfolio planning:** decumulation requires extensive planning over multiple periods. Without it, schemes risk making short-term decisions that could undermine their long-term objectives and aspirations. Short term cash forecasts need to be supplemented by medium- and long-term planning, further supported via scenario analysis and stress testing. The cashflow position needs to be modelled alongside exposures; the timing and certainty of cashflows must take centre stage. Effective portfolio management at this stage requires investment in robust analytical systems and data.

As UK DB pension schemes enter this new phase, the focus must shift towards cash flow optimisation, managing illiquid assets, and enhancing operational efficiency. By adopting a more holistic and solutions-driven approach to portfolio management, and ensuring that the right skillsets are in place, schemes can successfully navigate the challenges of decumulation. The key to success lies in forward planning, simplifying asset allocations, and building strong relationships with stakeholders to ensure a stable and well-managed transition, supported by the right internal skillsets.

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