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Valuation themes 2025

Preparing for the first valuation under the new code can be an opportunity to review where the scheme is after an eventful few years for pensions. Sustained funding improvements have put many schemes in a good place to meet the requirements of the new code. However, trustees and sponsors should come together to engage meaningfully on the big-picture, long-term issues.

The range of strategic options is expanding, and regulatory thinking is shifting, so it's a great time to develop your plans.

Manage compliance with the funding code

The big theme for DB schemes with a valuation in 2025 will be the Pensions Regulator's (TPR's) new DB funding code of practice, which came into force last year. It applies to valuations after 22 September 2024, so any scheme with a valuation in 2025 will have its first valuation that must comply with the new code.

In a nutshell, the code requires trustees to do several things:

- **Formalise a long-term 'low-dependency objective' for funding and investment.** This means the scheme must be funded in a low-risk way, so no more employer contributions are expected under reasonable circumstances.
- **Set a journey plan to get to the objective by the time the scheme is 'significantly mature'.** The scheme can take managed risks that reflect covenant strength and scheme maturity.
- **Integrate long-term objectives and journey plans into valuations.** The technical provisions target and investment strategy should converge to low dependency as the scheme matures. Plans should seek to recover any deficit as soon as the sponsor can reasonably afford.
- **Summarise plans as part of the valuation.** Submitting this 'statement of strategy' may be the biggest change to the valuation process, as schemes have to write up and evidence plans in a specific format.

One of the main tasks for trustees is picking their route to compliance with the code. 'Fast Track' is a streamlined route, and TPR is unlikely to scrutinise a valuation further if the strategy meets certain tests. These typically require a plan to be fully funded on a gilts + 0.5% basis (or stronger) by the time the scheme's duration is 10 years, a technical provisions recovery plan of six years or less, and investment risk below specified limits. However, Fast Track won't be the right approach for all schemes. The Bespoke route offers more scheme-specific flexibility.

ACTION

Trustees should consider training to bring them up to speed with the code's requirements and how to meet them. They should also build in time and potentially advisory cost for the extra work that might be needed. Don't underestimate getting to grips with the detail. Good advice will manage compliance proportionately and keep focus on strategic issues. To find out more about the requirements and how to prepare, read our briefing note or visit our dedicated funding code hub.

Build plans for endgame targets

Long-term strategy has never been more important.

The funding code requires trustees and sponsors to set down how they intend to provide benefits over the long term. The requirement is a good opportunity to review any long-term objectives already in place and see if they're still fit for purpose. Even if the conclusion is to maintain flexibility and keep options open for now.

Things have changed quickly over the past few years for DB schemes. As gilt yields rose sharply, many schemes found themselves much better funded than they expected. Against this backdrop, the well established bulk annuity market continues to go from strength to strength.

Government consultations have explored making it easier for schemes to run on. Recent statements have confirmed the government will announce changes that increase the flexibility around DB surplus in the spring. Some schemes may be thinking about creating surplus and sharing it with the employer or members, instead of insuring benefits as soon as affordable.

The alternative risk transfer market is growing and developing. In 2024 Clara-Pensions completed its second and third transactions. As superfunds move from being a concept to a proven endgame, more sponsors and trustees could consider this route if they felt it were right for their scheme. As superfund transactions are gathering pace, innovation and appetite for other capital-backed risk transfer or consolidation arrangements may grow. See our Risk Transfer Report 2025 for our latest market insights.

ACTION

As the risk transfer and provider markets expand, and the government makes it easier to access surplus. Anyone managing DB schemes should take stock and consider all their options. Purposely running on to create and share value works best if the trustee and sponsor have a shared vision. Getting upfront agreement on the principles avoids wasted effort and focuses detailed analysis. For more information on how to set and implement an endgame strategy, visit our Excellence in Endgames hub.

ADD VALUE

If you're considering running on your DB scheme to create and share value, we can help you set the right strategy for success.

A strategic approach to run-on

Align

Purposely running on to create and share value works best if the trustee and sponsor have a shared vision, so start by discussing it in principle.

Define

Map a detailed plan for whom you'd share value with, when and how – and build in contingencies.

Deliver

Put the strategy into motion, and work with all stakeholders to monitor performance and keep members engaged.

Review and align investment strategy

The code requires that by the time a scheme reaches 'significant maturity', it needs to be targeting a low-dependency investment strategy that is 'highly resilient' to adverse market movements and 'sufficiently liquid'.

Trustees must plan how they intend the scheme to reach its low-dependency target from the current strategy. However, there might be more flexibility than you think. The regulations and code imply significant matching assets and hedging, but they're clear that there's scope to invest a meaningful allocation to growth assets for schemes that want to. Schemes also have flexibility with surplus.

The investment landscape poses its own challenges. Despite inflation slowing significantly, gilt yields and interest rates remain high. The US dominance of equity markets shows no sign of diminishing, and credit spreads are at historically tight levels. Although funding positions for DB schemes are healthier than in previous years, market conditions in 2025 will require careful navigation.

ACTION

DB schemes should reassess their investment strategies, bearing in mind the requirements of the funding code and the wider investment landscape. Review your journey plan, your liquidity position and how you stack up against the code's requirements now.

Plan sponsor input and engagement carefully

The funding code requires a more detailed covenant assessment. Trustees need to give more consideration to factors affecting the employer's future capacity to support the scheme. In general, a scheme can take on more risk if the covenant is strong and the employer can afford to make good any downside risk. In most cases the sponsor needs to bolster its information flows.

Trustees should also look at any contingent assets carefully. TPR has tightened its expectations, so it's worth checking how current arrangements stack up, and what you need to change. You should also consider using a covenant adviser.

Trustee and sponsors need to agree aspects of the long-term strategy that may not have been discussed or formalised. It's worth opening dialogue early to align expectations.

Using the Fast Track route strengthens funding packages for some schemes; but schemes with strong long-term plans could come under pressure to 'level down' to reduce the sponsor support they need. Some herding is inevitable, but it would be disappointing if Fast Track became widely regarded as the default approach at the expense of well planned scheme-specific approaches.

ACTION

Trustees need to engage meaningfully with the sponsoring employer if they are to comply with the scheme funding requirements.

Be clear on the actuarial assumptions that are likely to need most discussion

Your technical provisions **valuation target** should align with your chosen objective and with your strategy to get there. Both 'gilts plus' and 'dynamic discount rate' approaches are possible. If you're targeting buy-out, consider aligning your discount rate with how insurers measure liabilities.

Scheme-specific **mortality** analysis can help to reduce the risk of mortality diverging a lot from your assumptions. Schemes continue to face challenges when setting **longevity improvement assumptions**, because of the uncertainty surrounding the long-term effects of the pandemic. The uncertainty is partly due to the ever-evolving CMI model and how much weight to give recent data. The proposed changes to CMI_2024 represent an overhaul of the model.

The code encourages scheme-specific analysis of other **demographic assumptions** – for example, the likelihood of a dependants' pension being paid. Some trustees could find that they need more analysis of their schemes' demographic data to justify assumptions.

Assumed **commutation** factors should be no lower than current or agreed factors. Recent gilt yield rises mean it could be worthwhile reviewing factors to build changes into valuations.

Another requirement is to consider reserving for **expenses** in long-term targets. Schemes should include an expense reserve in their low-dependency target unless the sponsor has a legal obligation to meet expenses (though a reserve is still encouraged). Trustees should consult their rules to understand the position, and consider an appropriate reserve aligned with their long-term strategy.

ACTION

Trustees should ensure they choose assumptions prudently, and that they comply with the principles in the code. Identify what assumptions might need particular attention, and consider any specific analysis required.

Things have changed quickly for DB schemes in recent years, and schemes must review the latest situation ahead of their 2025 valuations. The triennial valuation is an opportunity for schemes to stop, take stock and look at their long-term ambitions, against a backdrop of political and regulatory change. As always, the key is early planning and being on the front foot.

If you have any questions on anything covered in this publication, or would like to discuss further, please get in touch.

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