HYMANS ROBERTSON

Corporate pensions hot topics H2 2023

Funding and investment strategy

Busy risk transfer market is changing the way schemes engage with insurers

Busyness in the risk transfer market is at an all-time high, with around £25bn of bulk annuity transactions expected to be secured in the first half of 2023. This compares to around £27bn in the whole of 2022. This level of activity means the optimal way to approach the insurance market has changed in 2023. Our experience has been that smaller schemes have been able to achieve attractive pricing using an exclusive process. Each case is different and needs an appropriately considered market approach and excellent pre transaction preparation. You need to show the insurers that you are buy-out ready.

Key takeaway: if risk transfer is your chosen endgame, make sure your plan to approach the market reflects the changing market dynamic in 2023.

Easier access to DB surpluses for employers from the Mansion House reforms?

The Chancellor of the Exchequer, Jeremy Hunt, gave a speech at Mansion House on 10 July 2023 announcing a series of reforms to the pensions market, intended in part to stimulate more investment in the UK from the £1.7trn of assets in DB schemes. A subsequent call for evidence from the DWP focuses heavily on addressing the asymmetric risk for DB sponsors whereby they are on the hook for funding deficits but cannot easily or tax efficiently access surpluses. This is to encourage sponsors to run-on rather than insure, thereby enabling surpluses to flow through to the broader UK economy.

Whilst the details are not defined and subject to further consultation and regulation, these reforms, alongside a busy insurance market that is getting more difficult to access, could mean more sponsors decide to run-on rather than buy-out, in order to access DB surpluses. Removing the 35% tax on surplus refunds and lowering the bar for accessing DB surplus are two examples that would make run-on more compelling for employers.

Key takeaway: keep a watch on emerging government policy, which appears to be shifting towards a more employer friendly regime.

Kickstarting the DB superfund market

Another of the Mansion House reforms is that the DWP has finally reported the outcome of their 2018 consultation on a superfund regime. They are supportive of superfunds, in part to give sponsors more settlement options in light of expected insurer capacity constraints, and in part because superfunds could benefit the UK economy by both freeing employers of legacy DB arrangements and by superfunds themselves investing in 'patient capital' that might stimulate UK growth. TPR issued updated superfund guidance in parallel that lowered the asset level needed in superfund schemes and clarified that profit extraction for investors does not require an insurance buy-out (thereby enabling run-on superfund structures). It is possible that policy decisions in relation to the superfund regime could set precedent for broader policy around employers accessing DB surpluses, and possibly also the Fast Track basis for the new funding regime (see next page for more details).

Key takeaway: consider superfunds if your scheme is struggling to get engagement from the insurance market.

Funding and investment strategy

Delays to the new funding code

The Pensions Regulator (TPR) has announced that its new DB funding code will not apply to valuations with an effective date before 1 April 2024, a delay from the previous implementation date of 1 October 2023. The required regulations and final code are still to be published, so remain subject to further potential change too.

TPR proposes using its so-called Fast Track parameters to consider which funding plans to review further. The key aspects of Fast Track are a plan to be fully funded on a long-term objective with a discount rate of gilts + 0.5% pa (or stronger) by the time duration falls to 12 years, and a technical provisions recovery plan of 6 years or less. Schemes are not required to meet Fast Track thresholds.

As a part of TPR's second consultation in early 2023, they estimated that 51% of schemes were expected to meet these thresholds based on information at March 2021. Following improvements in many schemes' funding levels over the past 12 months, this percentage will have increased meaning it's now likely that meeting Fast Track thresholds will not be a significant issue for many schemes. However, schemes with mature liabilities and significant technical provisions deficits in 2023 are unlikely to meet these thresholds unless their funding strategies are refreshed. Similarly, those schemes open to accrual may find that the thresholds don't reasonably represent their circumstances and so they are unlikely to meet these.

Key takeaway: consider how your current funding and investment strategy (or your proposed strategy for a forthcoming valuation) will work alongside the new funding code.

Mortality assumptions

The long-term impacts of Covid-19 on longevity are still not clear, so mortality assumptions (both for technical provisions and accounting bases) need particular attention. Recent ONS data shows significant excess deaths in 2022 relative to pre-pandemic levels, and there is a growing body of opinion that the pandemic will negatively affect future mortality improvements, resulting in lesser views of future life expectancy.

The newly-released CMI 2022 tables have a core parametrisation with a 25% weighting applied to data from 2022. This reduces projected life expectancy from age 65 by up to 2%. The value of this weighting parameter has a material impact on the final result and is also highly subjective. Given the value of 25% has been stated as the default value, there is a risk of herding in the industry around this number.

Key takeaway: it is important that companies give thought to what allowance for 2022 experience is appropriate and can justify their rationale for the weighting parameter they choose to use.

Other hot topics to consider

Avoiding a funding strain through commutation and early retirement

Most schemes review their commutation factors triennially and then leave them fixed for three years – generally a reasonable approach when gilt yields and interest rates are stable. But yields are much higher than a year ago so you should check your trustees have reduced commutation terms back to market-consistent levels. Otherwise, commutation is likely to cause a funding strain. Most schemes anticipate commutation in their triennial valuation, so reducing commutation terms can immediately improve the funding position.

Similar issues apply to early retirements, although these are not always allowed for in triennial valuations.

Key takeaway: check that the trustees have adjusted commutation and early retirement terms to reflect current level of gilt yields.

New regulatory powers

The Pensions Scheme Act 2021 introduced regulatory powers including:

- two criminal offences that can apply to almost anyone whose actions affect a pension scheme
- discretionary civil penalties up to £1m
- two grounds for issuing contribution notices.

A much stronger regime for notifiable events has still to be introduced. This was due to take effect from April 2022 but has been significantly delayed (it is unclear for how long). The regime is expected to require companies to notify and engage with their scheme trustees and with TPR ahead of specified corporate activity, and submit an 'accompanying statement' to the trustees and TPR that sets out the implications for the scheme of a transaction and how any potential detriment will be mitigated.

Key takeaway: make sure your corporate pension governance processes are appropriate for managing increased regulatory risk. Consider and manage the impact on your DB scheme when planning any significant corporate activity.

DC member engagement and broader financial planning

The current financial downturn, coupled with high inflation and cost-of-living pressures is shining a light on the lack of member engagement with retirement and broader financial planning.

Helping employees with financial planning can mitigate workforce interruption due to employees hitting financial hardship or not being on track to achieve their retirement objectives. Many companies are starting to realise the importance of employee support in this area.

Key takeaway: it is a very good time to review your financial planning support to employees as part of your broader HR and reward strategy

Want to find out more?

To find out how we can help you, please get in touch with your usual Hymans Robertson contact or one of our experts on employer strategy:

Leonard Bowman
Partner
leonard.bowman@hymans.co.uk

Andrew Udale-Smith
Partner
andrew.udale-smith@hymans.co.uk

Sachin Patel
Senior Actuarial Consultant
Sachin.patel@hymans.co.uk

HYMANS ROBERTSON