HYMANS ROBERTSON

Pension scheme funding: benchmarking analysis

August 2019

Guide to benchmarking analysis

The enclosed analysis summarises information published by The Pensions Regulator (TPR) on pension scheme funding.

The underlying data is sourced from valuations and recovery plans submitted to TPR by schemes with deficit positions, and from annual scheme returns for schemes with surplus positions. The latest available update was published by TPR in conjunction with the 2019 Annual Funding Statement and covers ‘tranche 12’ schemes with effective valuation dates falling from 22 September 2016 to 21 September 2017 submitting information in the period up to 31 January 2019.

At a glance

1,880 valuations analysed

77% of schemes in deficit

One third of schemes have > 50% pensioner liabilities

6.5 years average recovery plan length for schemes in deficit

7.3 years median recovery plan length for schemes in deficit

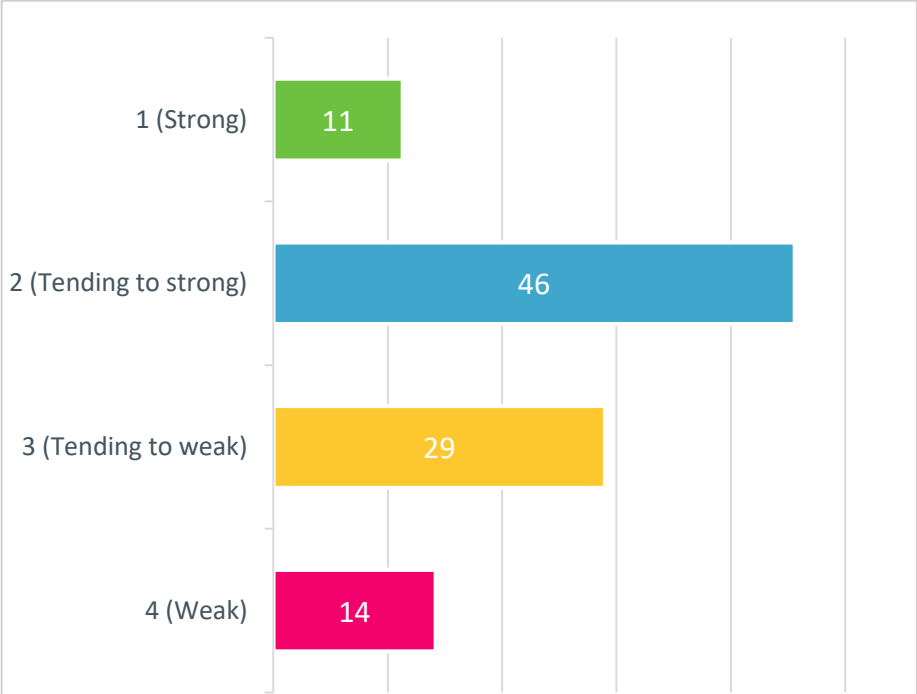
89% is the average ratio of assets to technical provisions

69% is the average ratio of technical provisions to buy-out liabilities

0.87% is the average single equivalent discount rate outperformance in excess of gilts

Analysis of covenant strength

% breakdown of schemes* by covenant band

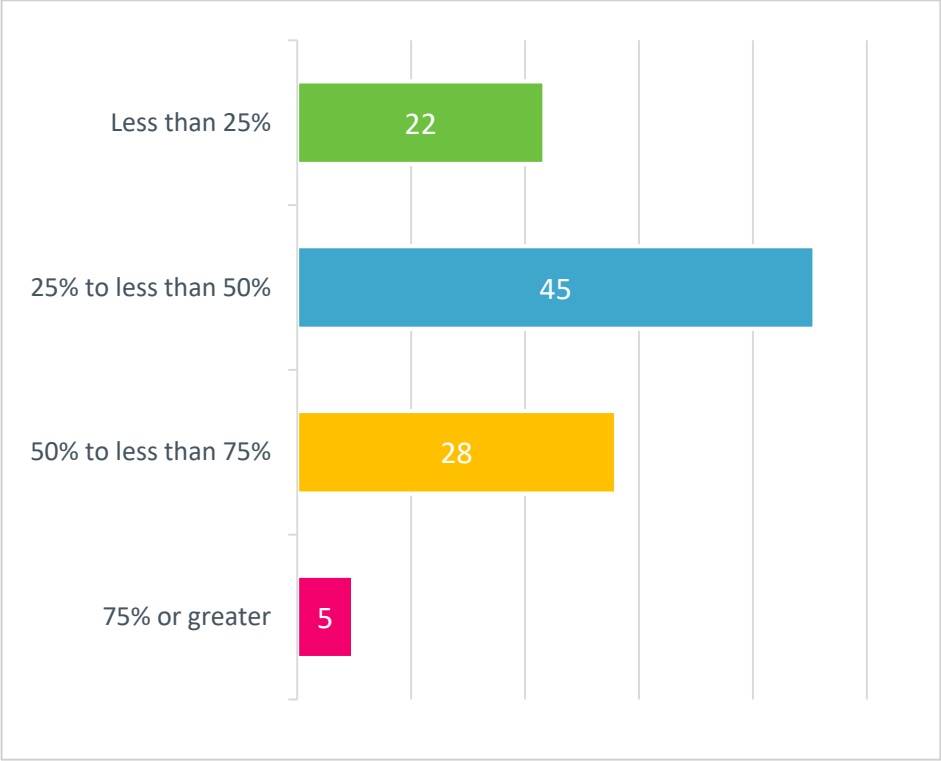


** Schemes in deficit only*

1. **Strong**: The sponsor's outlook is positive. There's a relatively low risk of it not being able to support the scheme in the short to medium term.
2. **Tending to strong**: The sponsor's outlook is generally positive. There's a relatively low risk of it not being able to support the scheme in the short term but beyond this less visibility and certainty.
3. **Tending to weak**: Whilst there is no immediate concern over insolvency, there are some concerns over employer strength and possible signs of decline.
4. **Weak**: The sponsor is unable to support the scheme. There may be an immediate concern over insolvency.

Analysis of scheme maturity

% breakdown of schemes by maturity



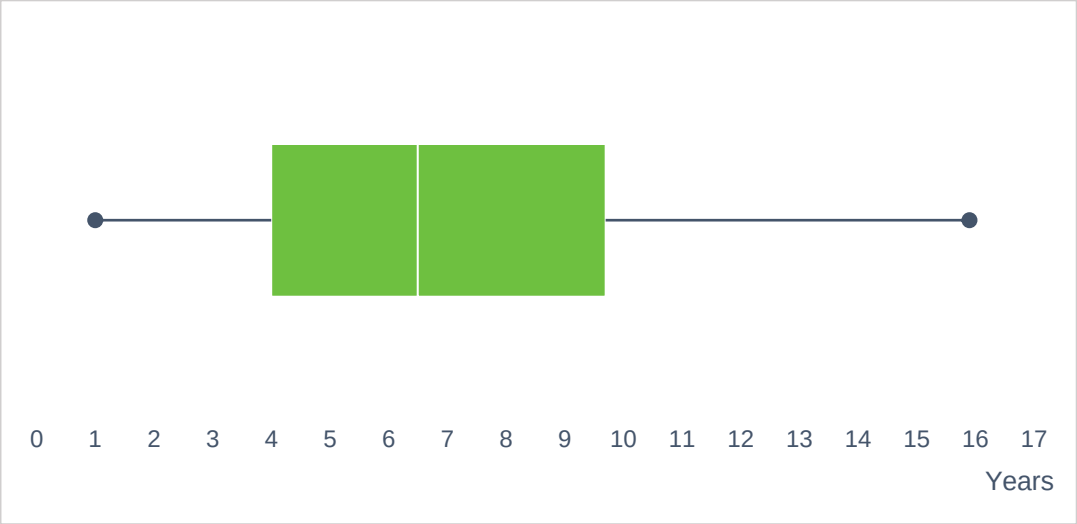
Scheme maturity can be measured by looking at the percentage of total liabilities that relate to pensioners.

The higher the percentage, the higher the proportion of members who have retired.

Once schemes are closed to new members or further benefit accrual, scheme maturity will increase year-on-year.

Analysis of recovery plan length

Distribution of recovery plan length



Median = 6.5 years (7.3 years average)

50% of schemes have plans between 9.7 and 4 years

5% of schemes have plans longer than 15.9 years

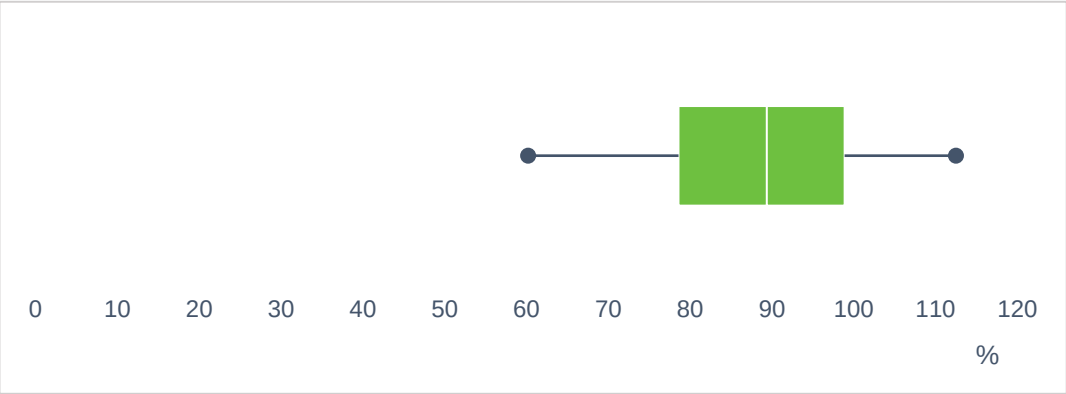
5% of schemes have plans shorter than 1 year

Average recovery plan length by scheme characteristics

Maturity		Covenant group		Contingent assets	
< 25%	7.1 years	1 (Strong)	5.4 years	No contingent assets	7.2 years
25% to 50%	7.6 years	2	6.6 years		
50% to 75%	7.0 years	3	7.9 years	At least one contingent asset	7.5 years
75% +	6.3 years	4 (Weak)	10.0 years		

Analysis of funding targets

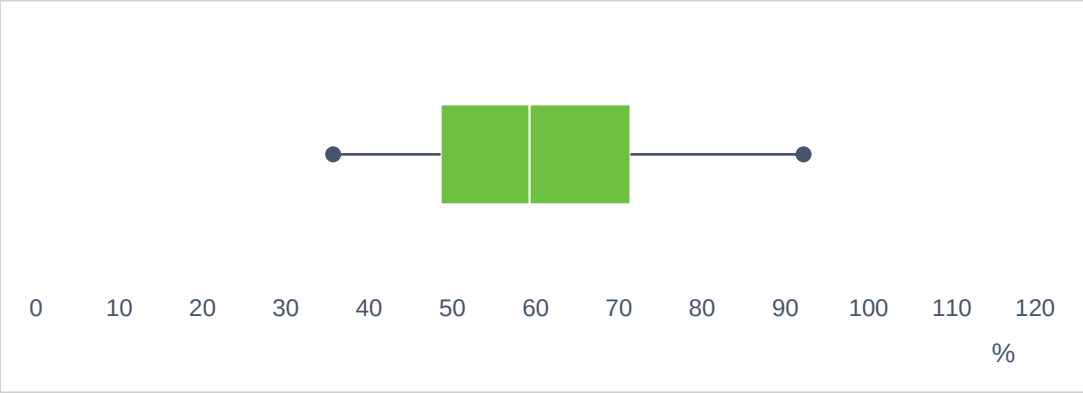
Distribution of technical provisions funding ratio



Equal to the assets divided by the technical provisions liabilities in % terms.

Median funding level 89%

Distribution of buy-out liabilities funding ratio

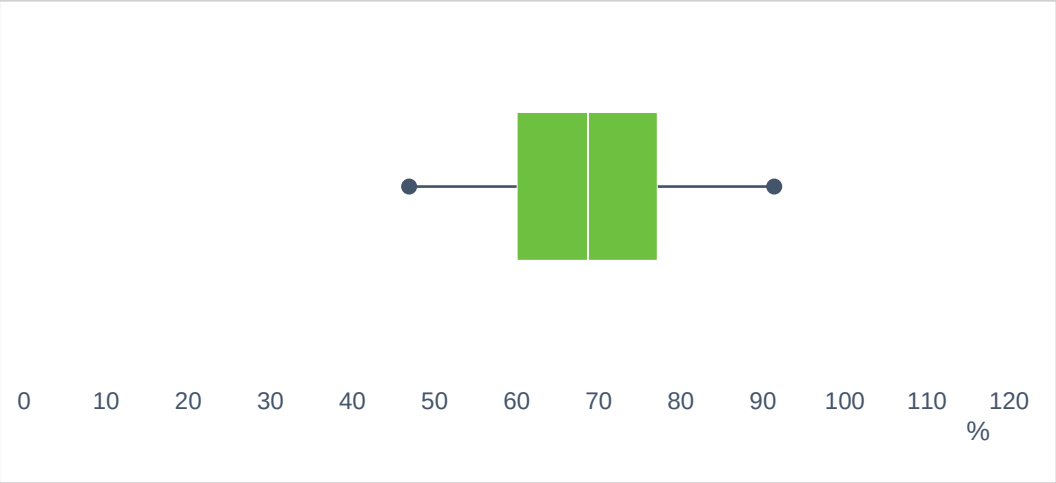


Equal to the assets divided by the buy-out liabilities in % terms.

Median funding level 59%

Analysis of funding targets ctd.

Distribution of ratio of technical provisions to buy-out liabilities



The ratio of technical provisions to buy-out liabilities can be used as a measure of how "strong" a funding target is. The higher the ratio the closer the funding target is to the current cost of securing all members pensions with annuities.

Median = 69%

5% of schemes fall below 46.9%

50% of schemes fall on or between 60% and 77.2%

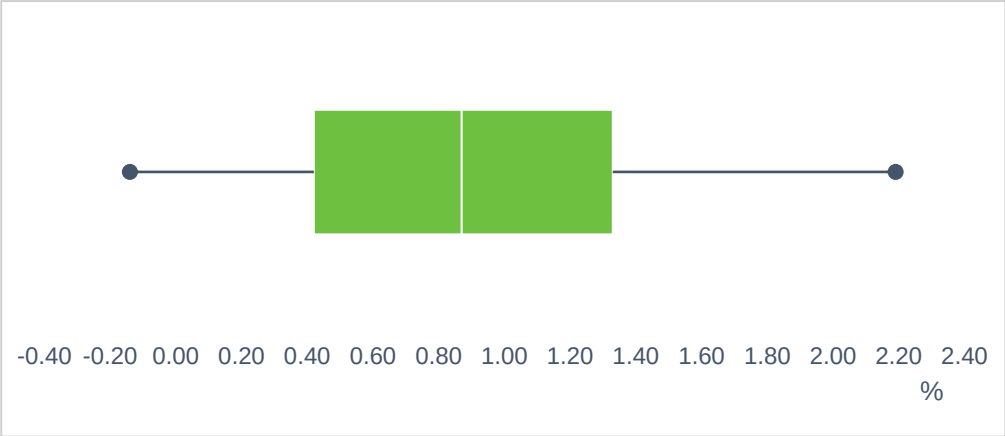
5% of schemes are above 91.4%

Average ratio of technical provisions to buy-out liabilities by scheme characteristics

Maturity		Covenant group		Contingent assets	
< 25%	65.7%	1 (Strong)	68.7%	No contingent assets	69.1%
25% to 50%	66.6%	2	67.7%		
50% to 75%	73.6%	3	67.4%	At least one contingent asset	69.5%
75% +	82.2%	4 (Weak)	68.5%		

Analysis of discount rates

Distribution of assumed discount rate outperformance



Discount rate assumptions are typically reported as a single investment return, or as different returns pre-retirement and post-retirement or over time. For the purposes of comparison, a single equivalent discount rate (SEDR) can be calculated to approximate outperformance over nominal 20 year spot rate on UK gilts.

The single equivalent discount rate (SEDR) provides a measure of how conservative the assumptions for investment returns are. The higher the outperformance in excess of gilt yields of the SEDR, the higher the assumed returns and lower the liabilities.

Median = 0.87%

50% of schemes fall on or between 0.42% and 1.33%

5% of schemes are above 2.19%

Average assumed discount rate outperformance by scheme characteristics

Maturity		Covenant group		Contingent assets	
< 25%	0.83%	1 (Strong)	0.90%	No contingent assets	0.91%
25% to 50%	1.01%	2	0.97%		
50% to 75%	0.83%	3	0.93%	At least one contingent asset	0.89%
75% +	0.68%	4 (Weak)	0.84%		

Some other useful statistics

Recovery plan end dates vs previous valuation:

50%

unchanged or shortened,

10%

extended by more than 6 years

Investment strategy:

13% <20% growth

24% 20-40% growth

39% 40-60% growth

24% >60% growth

17%

of schemes have a contingent asset

(70% of these are guarantees)

Over 1 in 5 trustees ***have or expect to*** experience regulatory intervention before their next valuation*

41% of trustees would value more clarity on 'prudence', 'affordability' and/or when TPR will intervene*

Average life expectancy improvements *reduced* between valuations for the first time

The average assumed life expectancy for a current male pensioner aged 65 is

87.6 years

83%

of schemes assume a long-term longevity rate of improvement/underpin of 1.5% p.a. or higher with 7% assuming a rate of 2% or higher

**Hymans Robertson 2019 research*

Interpreting the analysis

TPR's latest Annual Funding Statement sets out what's expected from trustees and sponsors by grouping schemes into segments A to E using three criteria: **covenant strength, recovery plan length,** and **strength of funding target**. A fourth criteria – **maturity** – creates a further overlay with the bar typically set higher for more mature schemes.

Here "short", "long", "strong", "weak", "mature" and "immature" can be interpreted with reference to the enclosed benchmarking analysis of schemes.

Segment*	Covenant strength		Recovery plan length		Funding target			% schemes**
A	Strong Tending to strong	+	Short	+	Strong	=	**Strong employer + strong funding position**	**50%**
B	Strong Tending to strong	+	Long	+/or	Weak	=	**Strong employer + weak technical provisions and/or long recovery plan**	**9%**
C	Tending to weak	+	Short	+	Strong	=	**Weaker employer + funding on track and strong technical provisions**	**20%**
D	Tending to weak	+	Long	+/or	Weak	=	**Weaker employer + weak technical provisions and/or long recovery plan**	**18%**
E	Weak					=	**Weak employer + stressed scheme**	**3%**

* Maturity creates a further layer of segmentation – 1 being immature, 2 being mature.
** Based on TPR's analysis into defined benefit schemes with valuation dates between September 2018 and September 2019 ('Tranche 14').

Case study 1

Criteria	Scheme	Average	Benchmarking comments
Covenant strength	Strong	Tending to strong +	Covenant is stronger than most. The sponsor's outlook is positive with a relatively low risk of it not being able to support the scheme in the short to medium term.
Recovery plan length	9.2 years	5.4 – 7.6 years	The scheme has a recovery plan longer than average for schemes like this. TPR is likely to engage with schemes where they consider recovery plans to be too long.
Funding target	TPs are 59% of buy-out	67-69%	The scheme has a funding target lower than average for schemes like this. The higher the ratio the closer the funding target is to the current cost of securing all members pensions with annuities.
Maturity	31% pensioners	<50%	Scheme is relatively immature. Nevertheless, this may change in the future. Once schemes are closed to new members or to further benefit accrual, scheme maturity issues are likely to assume greater significance for setting funding and investment strategies.

This Scheme is most likely to fall into category B1

The covenant is relatively strong however it appears the technical provisions are relatively weak and the recovery plan is longer than average. The scheme should focus on strengthening technical provisions, increasing deficit reduction contributions and shortening the recovery plan.

Case study 2

Criteria	Scheme	Average	Benchmarking comments
Covenant strength	Tending to weak	Tending to strong +	Covenant is weaker than most. There are some concerns over employer strength and possible signs of decline.
Recovery plan length	4.0 years	6.3 – 7.9 years	The scheme has a relatively short recovery plan compared to other schemes like this.
Funding target	TPs are 90% of buy-out	67-82%	The scheme has a funding target higher than the average for schemes like this. The higher the ratio the closer the funding target is to the current cost of securing all members pensions with annuities.
Maturity	76% pensioners	<50%	Scheme is relatively mature – less than 5% of schemes have more than 75% of liabilities in respect of pensioners. Maturity can amplify risks.

This Scheme is most likely to fall into category C2

The covenant is tending to weak and the scheme is more mature than most, however the scheme's technical provisions are relatively strong and recovery plan shorter than average. The scheme should focus on improving security to mitigate against further covenant weakening – prioritise the scheme against other stakeholders and look for non-cash or wider group support. Ensure there is an appropriate long-term objective, technical provisions are suitably aligned and there is a clear plan for reaching this long-term goal within a realistic timescale. As a mature scheme this time horizon is shorter than for many.

Want to know more?

Segment identifier tool

In just five simple steps, our segment identifier tool can tell you which of TPR's segments is most relevant to your scheme and the key actions you should be taking on covenant, investment and funding in response.

Click here to find out what segment TPR thinks you're in.

Guide to the new DB funding code

You can also download our quick guide to the new DB code of practice with more detail on what we know, what to watch out for and how you can get prepared.

Or get in touch…

If you have any questions about anything covered in this report, please don't hesitate to ask.

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Hymans Robertson has relied on external sources of information in compiling this report. Whilst every effort has been made to ensure the accuracy of the data, Hymans Robertson cannot verify the accuracy of such data.

The material and charts included herewith are provided as background information. They are not a definitive analysis of the subjects covered. While average rates are informative they do not tell the whole story. The position of individual schemes will vary depending on a number of individual factors. The analysis needs to be used with care for such reasons. You should not act upon the information contained in this publication without obtaining specific advice.

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