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Pension scheme funding: benchmarking analysis

Analysis of the Pensions Regulator's 2023 annual funding statistics for UK defined benefit (DB) and hybrid schemes

October 2023

Welcome to our 2023 benchmarking analysis

Welcome to Hymans Robertson's fifth annual benchmarking report analysing pension scheme funding trends. Looking across the latest tranche of valuation submissions received by the Pensions Regulator we explore funding trends in the context of the market conditions and scheme characteristics (such as maturity and sponsor covenant) that impact on valuations.

The Regulator's 2023 analysis is based on tranche 16 schemes with typical valuation dates of 31 December 2020 and 31 March 2021. Unsurprisingly, with markets bouncing back quickly from the initial impact of the COVID-19 pandemic, the analysis shows an improved picture compared with last year's report. The number of schemes in surplus has increased on the previous year (from 27% to 39%), recovery plans continue to shorten (now on average less than 6 years) and funding bases strengthen. And there's more improvement to watch out for in more recent valuation submissions – increases in funding positions over the last eighteen months from rising gilts yields and strong asset returns won't filter through to the Regulator's statistics for another two years. The Regulator has released analysis that estimates that over 75% of tranche 18 schemes (generally schemes with valuation dates of 31 December 2022 and 31 March 2023) will be in surplus. Overall, the health of UK DB schemes is materially improved.

As the industry awaits the Regulator's final DB funding code, this evolving view of the DB universe makes for interesting consideration. I hope you find this report interesting and informative.

Laura McLaren
Partner and Head of Scheme Actuary Services

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The enclosed analysis summarises information published by The Pensions Regulator (TPR) on pension scheme funding on 17 August 2023.

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 2023 Annual Funding Statement and covers 'tranche 16' schemes with effective valuation dates falling from 22 September 2020 to 21 September 2021.

We also refer to TPR's indicative forecasts in relation to 'tranche 18' schemes with effective valuation dates falling from 22 September 2022 to 21 September 2023.

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Using the analysis in this report

Understand how your scheme plans compare and where action may be required

Compare your current approach

This latest scheme funding analysis lets schemes benchmark current funding plans against what other similar schemes are doing and how this is changing over time.

Identify whether the scheme might be at risk of attracting regulatory scrutiny.

Monitor emerging clarity on new funding code

As the industry awaits the Regulator's final DB funding code, benchmarking also offers valuable insight into how the Regulator might ultimately finalise the detail and set the 'Fast Track' parameters.

The code is due to come into force on 1 April 2024.

Understand segmented expectations

Benchmarking helps schemes understand the key actions to take on covenant, investment and funding.

TPR is again segmenting schemes by funding strength, covenant and scheme maturity to set out expectations on recovering deficits and long-term planning.

Tranche 16 valuations at a glance…

1,712 valuations analysed

61% of schemes in deficit

Around 43% of schemes have **> 50%** pensioner liabilities

5.7 years average recovery plan length for schemes in deficit

5.0 years median recovery plan length for schemes in deficit

94% is the (unweighted) average ratio of assets to technical provisions for schemes in surplus and deficit

On average technical provisions were **79%** of buy-out liabilities

0.67% is the average single equivalent discount rate outperformance in excess of gilts

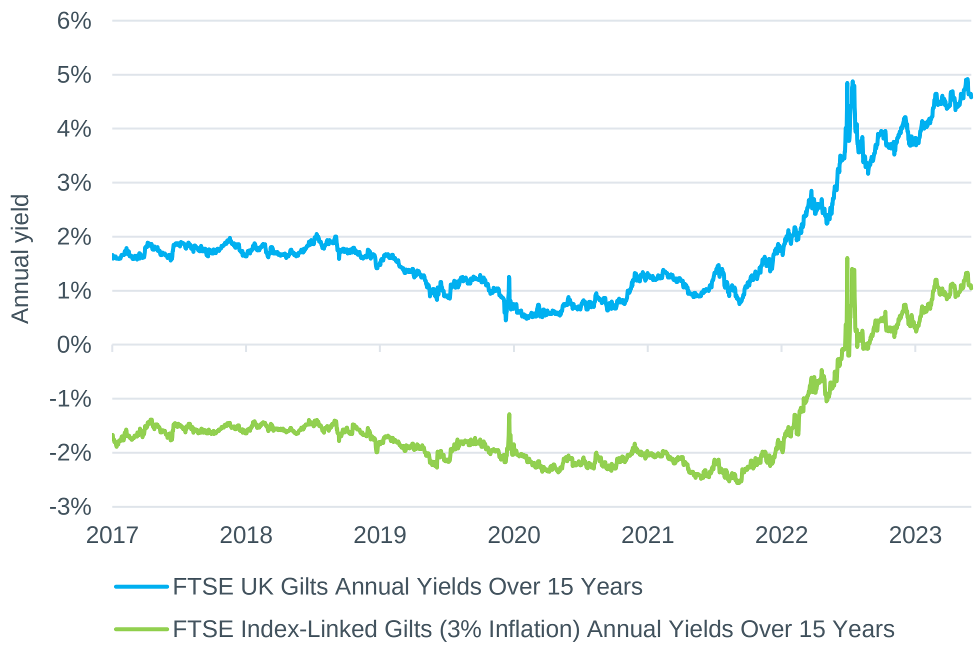
Comparison with last year's report

Overall, the latest statistics show an improving picture for T16 valuations across funding, recovering deficits and assumptions

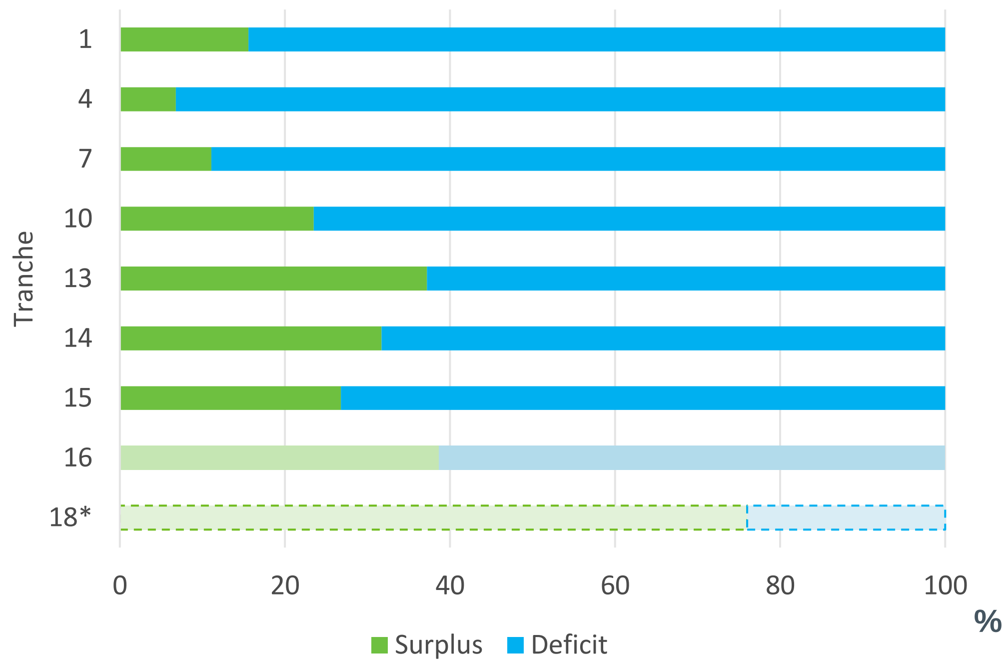
Headline statistics	Tranche 15 (22 Sept 2019 to 21 Sept 2020)	Tranche 16 (22 Sept 2020 to 21 Sept 2021)	
% of schemes in deficit	**73%**	**61%**	⇩
% of schemes with >50% pensioners	**43%**	**43%**	⇨
Recovery plan lengths	**5.9** years (median: **5.0** years)	**5.7** years (median: **5.0** years)	⇩
Changes to recovery plans	**55%** unchanged or shortened **45%** extended (21% extended by more than 3 years)	**61%** unchanged or shortened **39%** extended (17% extended by more than 3 years)	⇧ ⇩
Average ratio of assets to technical provisions	**89%** (median: **90%**)	**94%** (median: **95%**)	⇧
Average ratio of assets to buy-out	**68%** (median: **67%**)	**75%** (median: **74%**)	⇧
Average single equivalent discount rate outperformance in excess of gilts	**0.88%**	**0.67%**	⇩

Looking ahead

Very different market environment for valuations in 2022/23 (T18 valuations) than 2020/21 (T16 valuations). Analysis suggests that T18 schemes will generally be better funded, with the dramatic rise in government bond yields a key factor as well as slowing longevity improvements and positive asset returns. Overall, the position of the UK DB pension universe is expected to be much improved – only 25% of schemes expected to have a funding deficit.



% of schemes in surplus / deficit (technical provisions basis)



*Estimated by TPR

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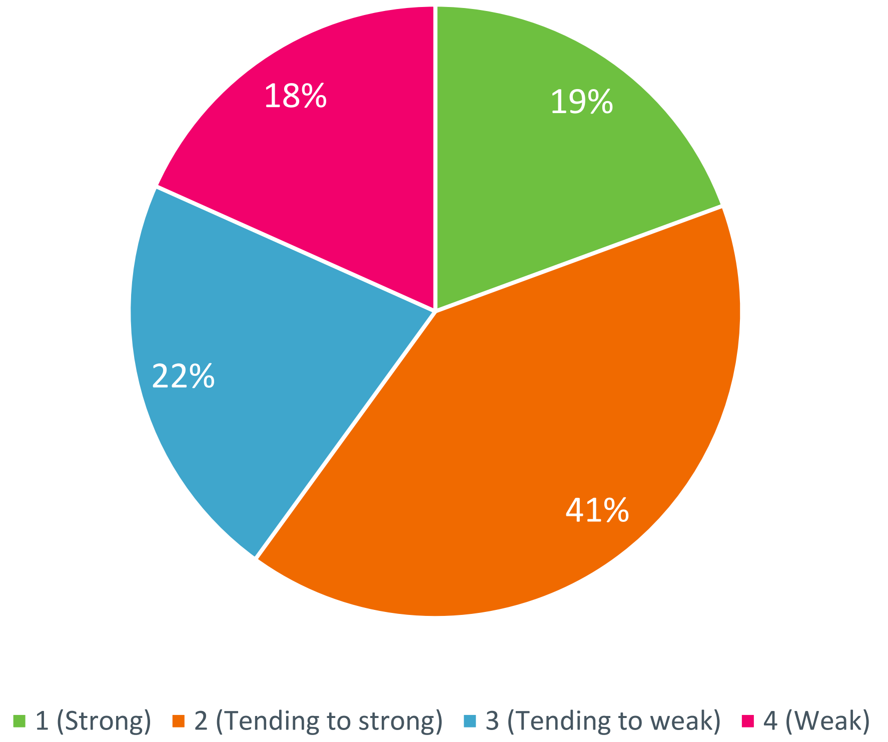
Analysis of covenant strength and maturity

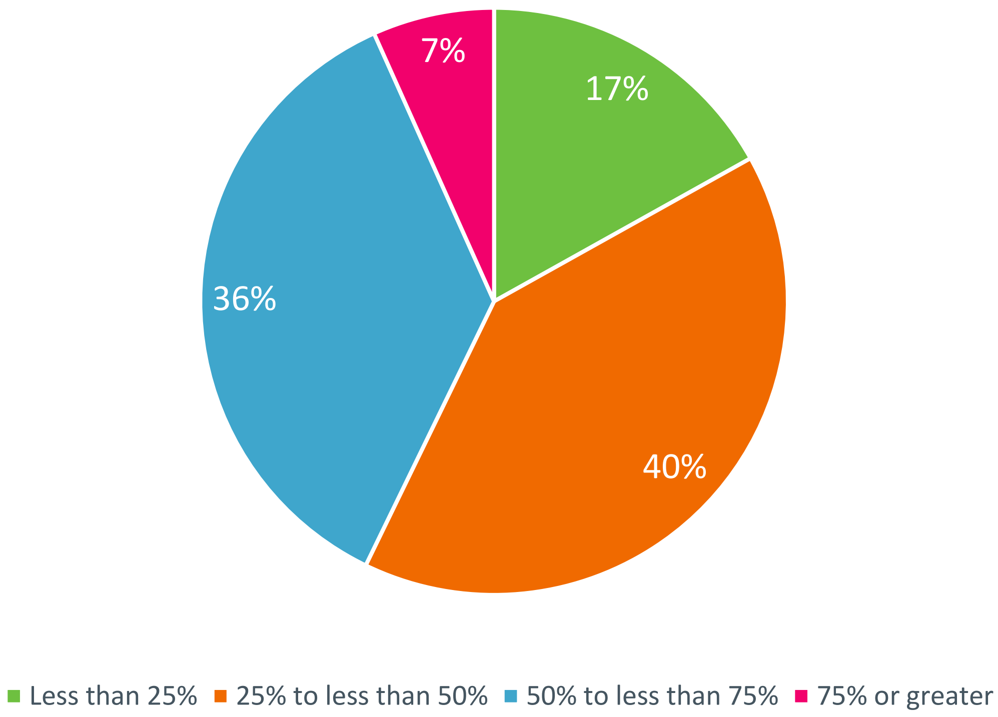
% breakdown of schemes* by covenant band

** Schemes in deficit only*



% breakdown of schemes by maturity

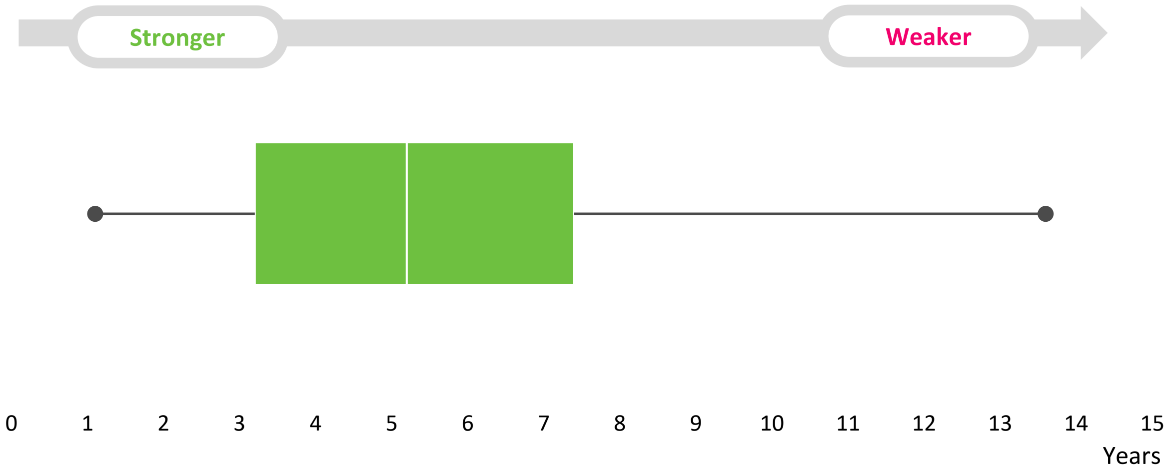
Percentage of total labilities that relate to pensioners:



Analysis of recovery plan length

Analysis shows recovery plans continue to shorten: Median plan = 5.0 years (vs. 5.3 years 2022)

Distribution of recovery plan length



Median = 5.0 years (5.7 years average)

50% of schemes have plans between 7.2 and 3.0 years

5% of schemes have plans longer than 13.4 years

5% of schemes have plans shorter than 0.9 years

75% of schemes in covenant group 1 (strong) have recovery plans of 6 years or less increasing to 10 years in covenant group 4 (weak)

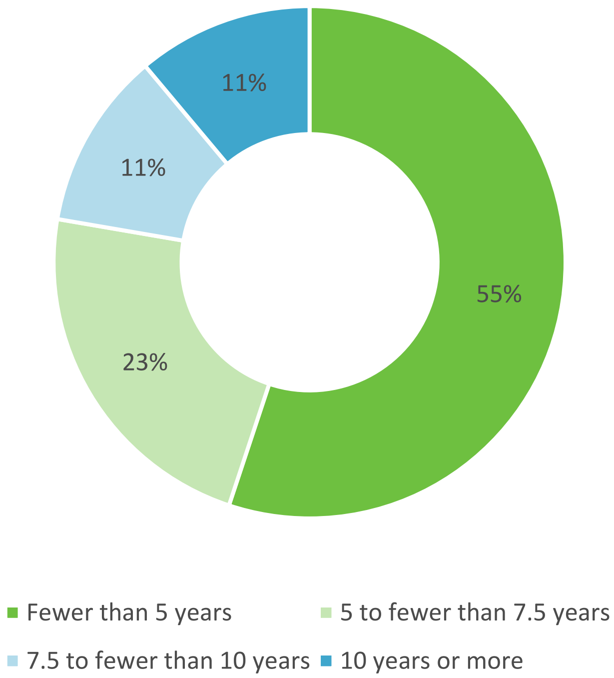
Average recovery plan length by scheme characteristics

Maturity		Covenant group		Contingent assets	
< 25%	5.9 years	1 (Strong)	4.6 years	No contingent assets	5.5 years
25% to 50%	5.6 years	2	4.7 years		
50% to 75%	5.8 years	3	6.6 years	At least one contingent asset	6.3 years
75% +	5.7 years	4 (Weak)	7.7 years		

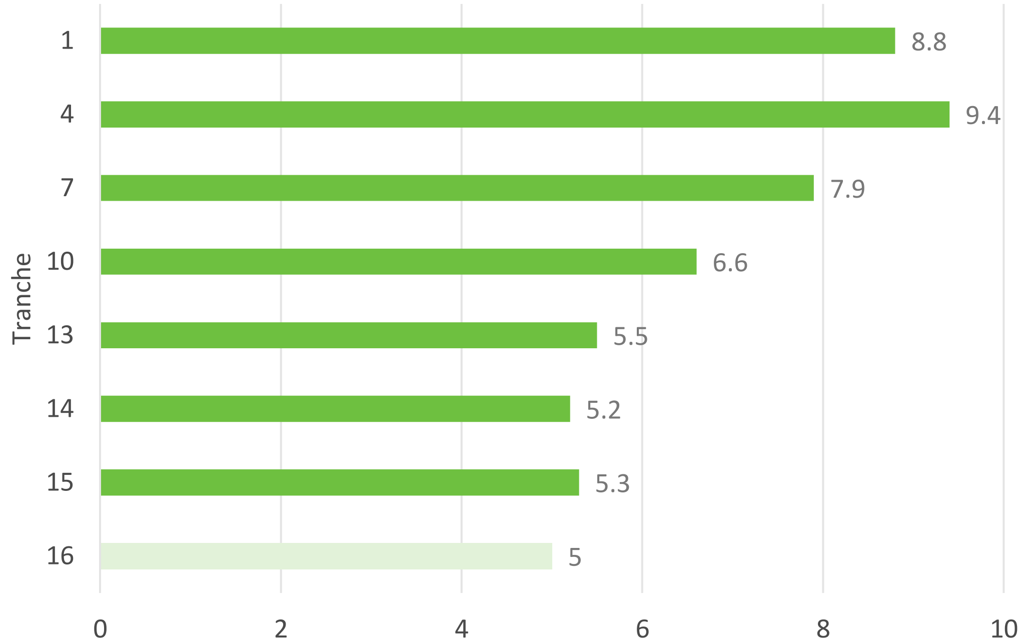
Analysis of recovery plan length ctd.

Recovery plan end dates vs previous valuation: 61% unchanged or shortened, 17% extended by more than 3 years. 55% of recovery plans for schemes in deficit less than 5 years, 78% less than 7.5 years.

% breakdown of schemes by recovery plan length



Trend of recovery plan length over time (median)*

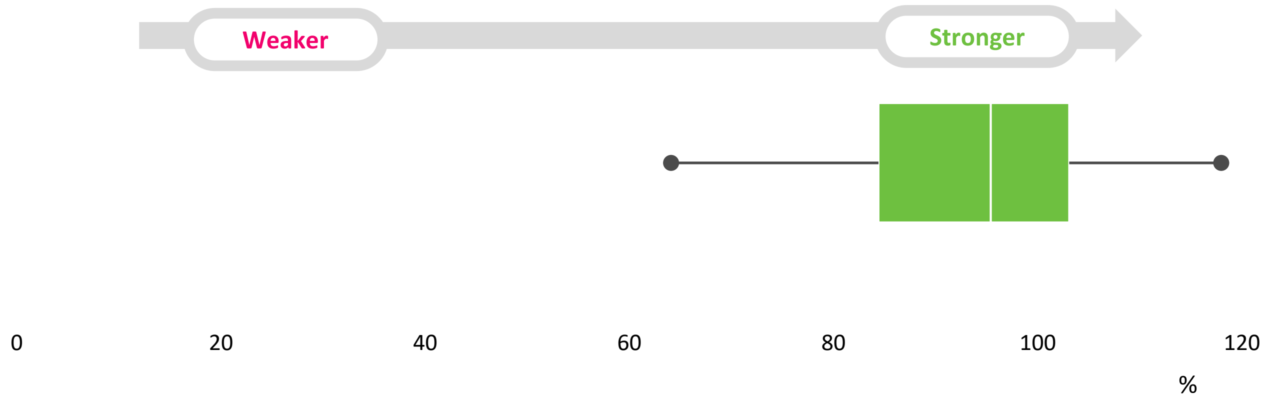


*Typically schemes in tranche 16 had valuations in tranches 13,10,7,4 and 1. However, these do not constitute a perfect cohort given some schemes may have had their most recent valuation less than three years since their previous valuation, others may have moved from deficit into surplus, some may have wound up etc.

Analysis of funding targets

Analysis shows funding improving: Median technical provisions funding ratio = 95% (vs. 90% 2022)

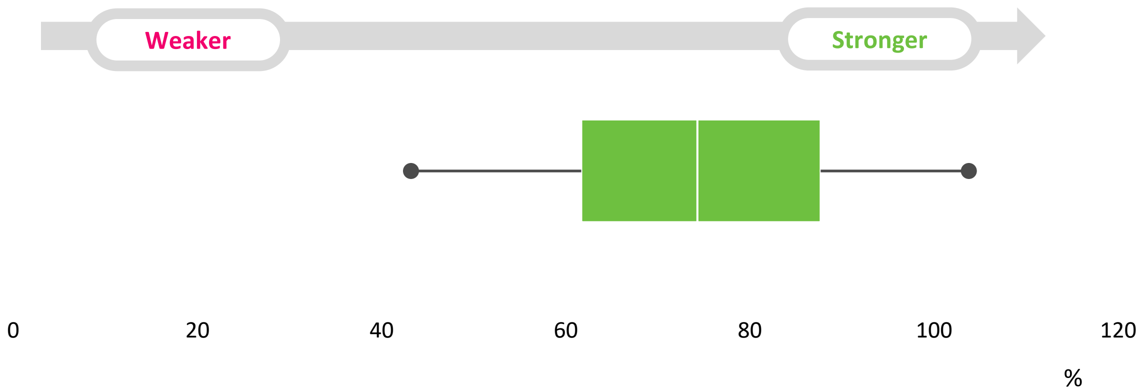
Distribution of technical provisions funding ratio



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

Median funding level 95%

Distribution of buy-out liabilities funding ratio



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

Median funding level 74%

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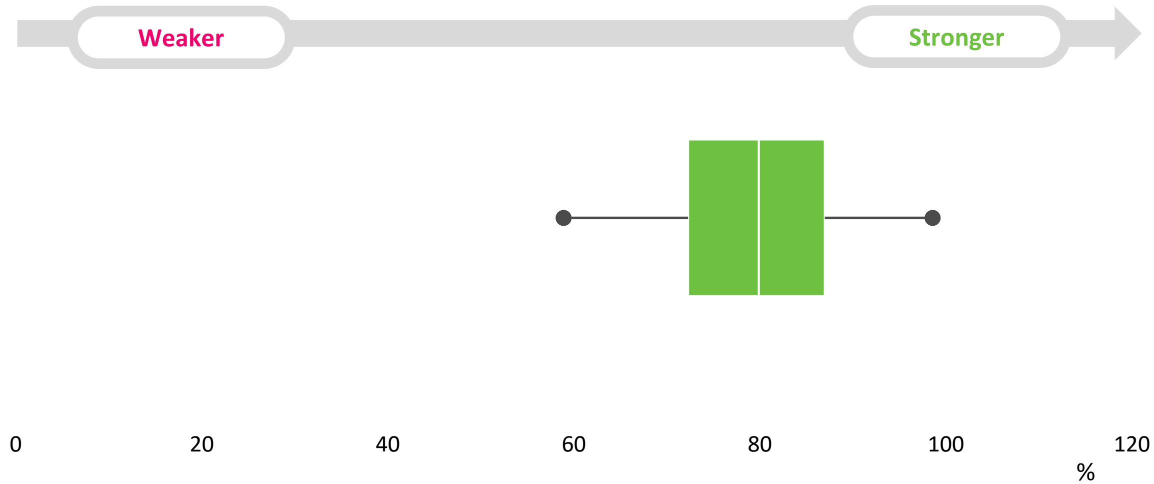
Analysis of funding targets ctd.

Analysis shows technical provisions moving towards buy-out: Median ratio = 80% (vs. 77% 2022)

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 = 80%

5% of schemes fall below 58.9%

50% of schemes fall on or between 72.3% and 87.0%

5% of schemes are above 98.6%

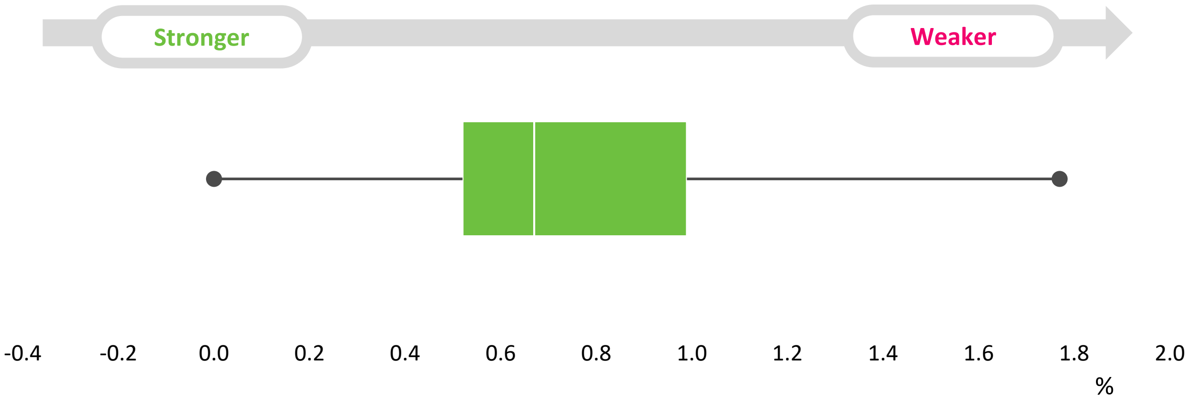
Average ratio of technical provisions to buy-out liabilities by scheme characteristics

Maturity		Covenant group		Contingent assets	
< 25%	73.7%	1 (Strong)	76.8%	No contingent assets	80.2%
25% to 50%	76.9%	2	77.4%		
50% to 75%	83.3%	3	77.5%	At least one contingent asset	77.3%
75% +	91.6%	4 (Weak)	77.1%		

Analysis of discount rates

Analysis shows assumed returns falling: Median outperformance = 0.67% (vs. 0.82% 2022)

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 = 0.67%

50% of schemes fall on or between 0.52% and 0.99%

5% of schemes are above 1.77%

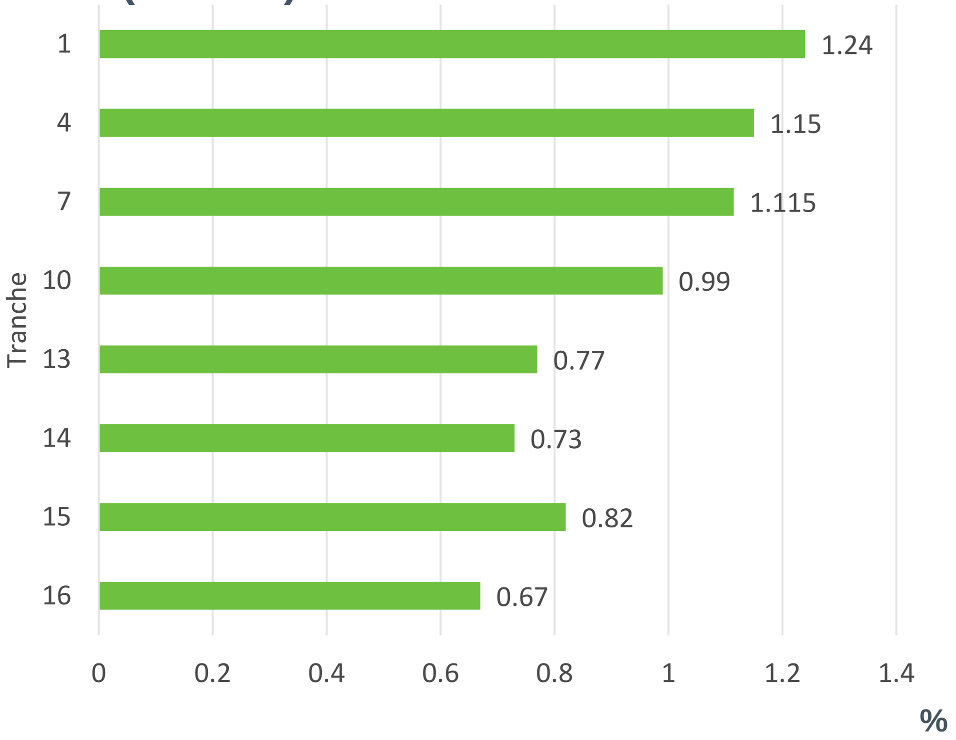
Average assumed discount rate outperformance by scheme characteristics

Maturity		Covenant group		Contingent assets	
< 25%	0.891%	1 (Strong)	0.676%	No contingent assets	0.66%
25% to 50%	0.743%	2	0.701%		
50% to 75%	0.532%	3	0.476%	At least one contingent asset	0.71%
75% +	0.459%	4 (Weak)	0.680%		

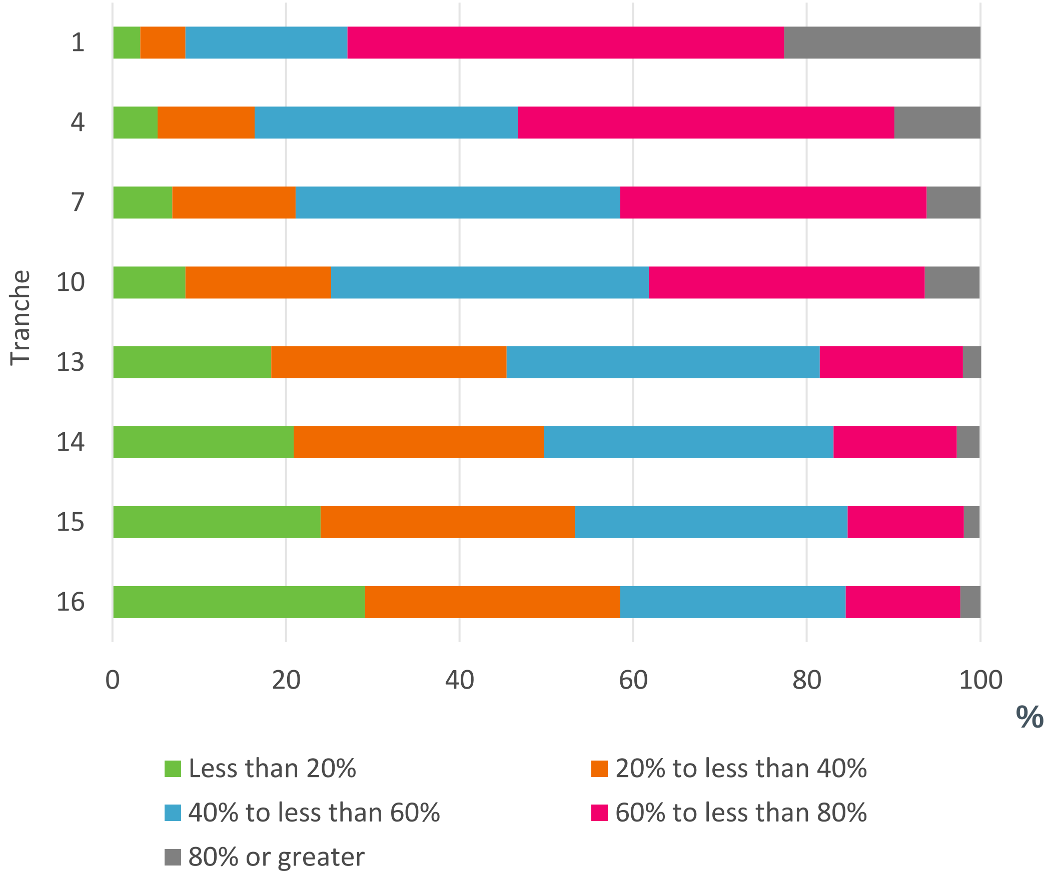
Analysis of discount rates ctd.

Analysis shows assumed discount rate outperformance falling over time along with % of return seeking assets

Trend of SEDR outperformance over time (median)



Trend of return seeking assets over time



Some other useful statistics

15%
of schemes have additional security in the form of one or more contingent assets

As a proportion of liabilities, average annual DRCs are
2.1%

Average life expectancy improvements ***stayed the same*** between valuations

The median assumed life expectancy for a current male pensioner **aged 65** is
87.1 years

82%
of schemes assume a long-term longevity rate of improvement/underpin of **1.5% p.a.** or higher with **6.2%** assuming a rate of **2%** or higher

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 and associated averages.

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

* Maturity creates a further layer of segmentation – 1 being immature, 2 being mature.

Case study

Criteria	Scheme	Average	Benchmarking comments
Covenant strength	Tending to weak	Tending to strong +	Covenant is weaker than most. There are some concerns over sponsor strength and possible signs of decline.
Recovery plan length	4.0 years	5.8 – 6.6 years	Relatively short recovery plan compared to other schemes like this.
Funding target	TPs are 85% of buy-out	77 - 83%	Funding target relatively strong – closer to the current cost of securing all pensions with annuities.
Maturity	65% pensioners	<50%	Scheme is relatively mature – around 40% of schemes have more than 50% pensioner liabilities.

This Scheme is most likely to fall into category C2

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 other 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. Scheme maturity makes this time horizon shorter than for many.

Visit our segment identifier tool to find out which of TPR's segments is most relevant to your scheme.

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.

TPR's 2023 Annual Funding Statement

Listen to our webinar to hear our expert panel provide an overview of this year's Statement and discuss what this means for 2023 valuations. Your triennial valuation remains one of your most important risk management exercises – use our **route map** to help you get the most out of this.

New DB funding code hub

Our dedicated hub includes a number of resources to help you plot a route through the regulatory changes, including our **case study** which shows what the code could mean for various schemes, and some of the unintended consequences that could arise.

Fast track tool

Our interactive fast track tool can quickly identify whether your current strategy is more suited to the 'Fast Track' or 'Bespoke' route from TPR's new DB Funding Code of Practice. **Click here** to discover which route is better suited for you.

Planning your journey to buy-out

Over 75% of DB pension schemes are now targeting buy-out and around 40% of those schemes expect to fully insure within the next five years*. Buy-out is a complex stage in a pension scheme's evolution, with a clear need for a cohesive and integrated journey plan.

Our analysis shows that not having a journey to buy-out plan in place could lead to unnecessary costs of between £20-30m for a typical scheme, as well as impacting on member confidence in the scheme more generally. Planning your journey to buy-out sooner rather than later is paramount.

That's why we've developed a **guide** - to help trustees and sponsors agree on a comprehensive plan, covering strategy and actions to help your scheme reach buy-out confidently and efficiently.

**Hymans Robertson 2023 Risk Transfer Report*

Get in touch

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

Laura McLaren
Partner and Head of Scheme Actuary Services
Laura.McLaren@hymans.co.uk
0141 566 7914

Amy Walker
Actuarial Consultant
Amy.Walker@hymans.co.uk
0141 566 7761

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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.

The underlying data is sourced from valuations and recovery plans (RPs) submitted to TPR by schemes with deficit positions, and from annual scheme returns for schemes with surplus positions. The latest available update covers 'tranche 16' schemes with effective valuation dates falling from 22 September 2020 to 21 September 2021 submitting information in the period up to December 2022. This analysis was published on 17 August 2023. For more information visit: *https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/scheme-funding-analysis-2023*

In addition, this report makes reference to TPR's analysis of the expected positions of 'tranche 18' schemes with effective valuation dates between 22 September 2022 and 21 September 2023. This analysis was published on 13 June 2023. For more information visit: *https://www.thepensionsregulator.gov.uk/en/document-library/statements/annual-funding-statement-analysis-2023*