Pension scheme funding: benchmarking analysis

Analysis of 'tranche 15' valuations submitted in the period up to 21 June 2022

September 2022

Welcome to our 2022 benchmarking analysis

Welcome to Hymans Robertson's fourth annual benchmarking report analysing pension scheme funding trends. Looking across the latest tranche of valuation submissions received by the Pensions Regulator we explore reported assumptions, funding targets and recovery plans, as well as the impact of scheme characteristics such as maturity and sponsor covenant.

As the first tranche of submissions to be impacted by the COVID-19 pandemic, perhaps unsurprisingly, we saw more schemes (45%) needing to lengthen their recovery plan end dates than the year before (35%). Although markets quickly reversed out the damage done by the pandemic, challenges were evident across many businesses. Nevertheless, average recovery plan lengths are around six years. However, as well as continuing post-COVID recovery, the analysis pre-dates recent rises in gilt yields which are likely to have brought some good news for schemes with less hedging in place – usually those with larger deficits that are further behind in their de-risking journeys. Overall the health of schemes has been increasing and we expect this to be reflected in an improved picture in future reporting.

At a time when the DB funding regime is under review, this evolving view of the DB universe makes for interesting consideration. I hope you find this report interesting and informative.

Laura McLaren
Partner and Funding & IRM Specialist
Laura.McLaren@hymans.co.uk
0141 566 7914

HYMANS ROBERTSON

Guide to benchmarking analysis

The enclosed analysis summarises information published by The Pensions Regulator (TPR) on pension scheme funding on 28 July 2022.

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 2022 Annual Funding Statement and covers ‘tranche 15’ schemes with effective valuation dates falling from 22 September 2019 to 21 September 2020 submitting information in the period up to 21 June 2022.

Using the analysis

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.

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

Monitor emerging clarity on new funding code

With the DB funding regime under review, benchmarking also offers valuable insight into where TPR might ultimately set the 'Fast Track' parameters and whether a scheme might prefer the 'Fast Track' or 'Bespoke' route.

The second consultation due later this year will bring more clarity on the exact form the new framework will take.

Understand segmented expectations

Whilst consultation on changes is ongoing, trustees and sponsors are directed to this year's Annual Funding Statement.

TPR is again segmenting schemes by funding strength, covenant and scheme maturity. Benchmarking helps schemes understand which segment is most relevant and the key actions to take on covenant, investment and funding in response.

At a glance…

1,713 valuations analysed

73% of schemes in deficit

Around 42% of schemes have **> 50%** pensioner liabilities

6.4 years average recovery plan length for schemes in deficit

5.4 years median recovery plan length for schemes in deficit

89% is the average ratio of assets to technical provisions

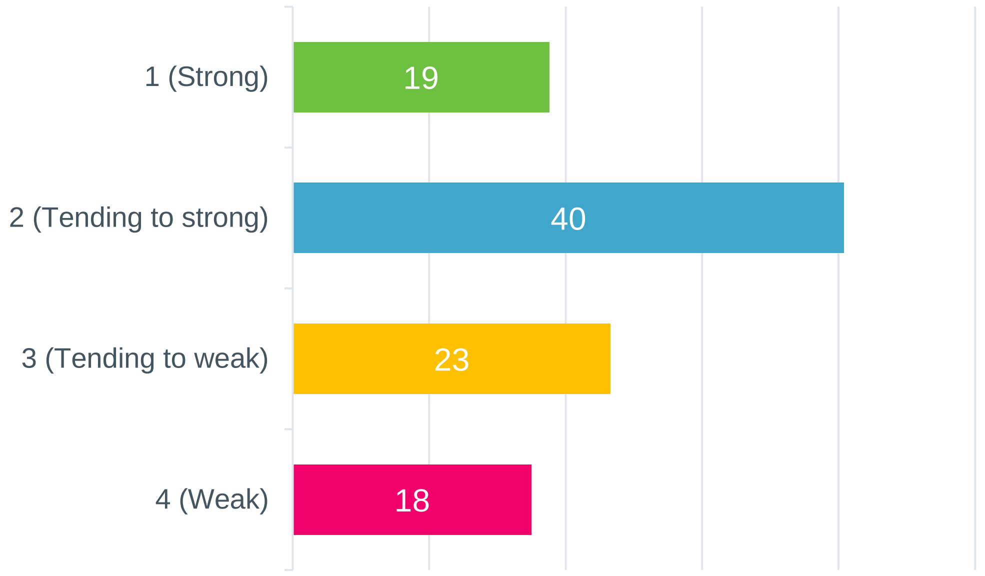
82% for schemes in deficit

On average technical provisions were **77%** of buy-out liabilities

0.88% is the average single equivalent discount rate outperformance in excess of gilts

Analysis of covenant strength

% breakdown of schemes* by covenant band



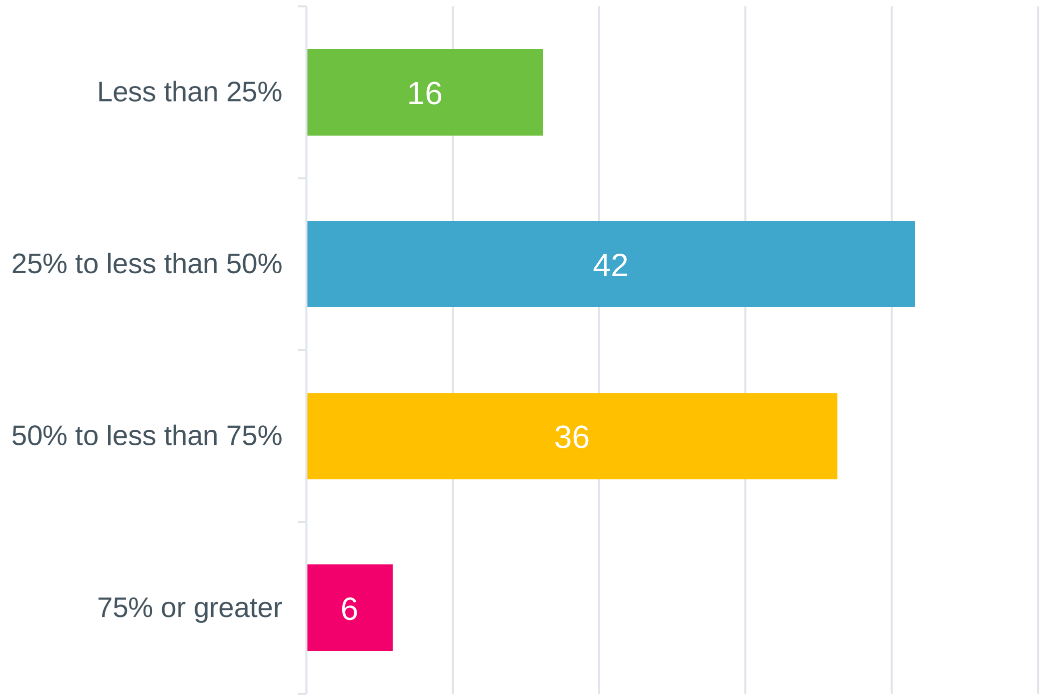
** Schemes in deficit only*

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

Percentage of total liabilities that relate to pensioners:



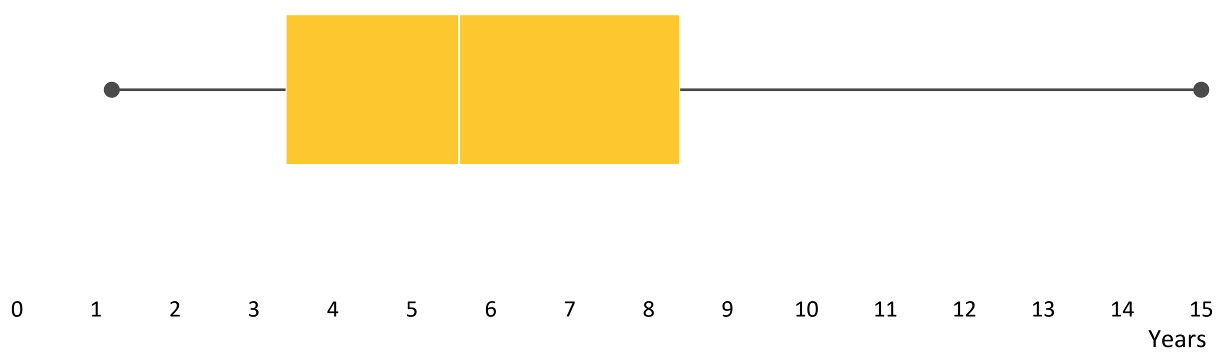
One way scheme maturity can be measured is by looking at the percentage of total liabilities that relate to pensioners.

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 = 5.4 years (6.4 years average)

50% of schemes have plans between 8.2 and 3.2 years

5% of schemes have plans longer than 14.8 years

5% of schemes have plans shorter than 12 months

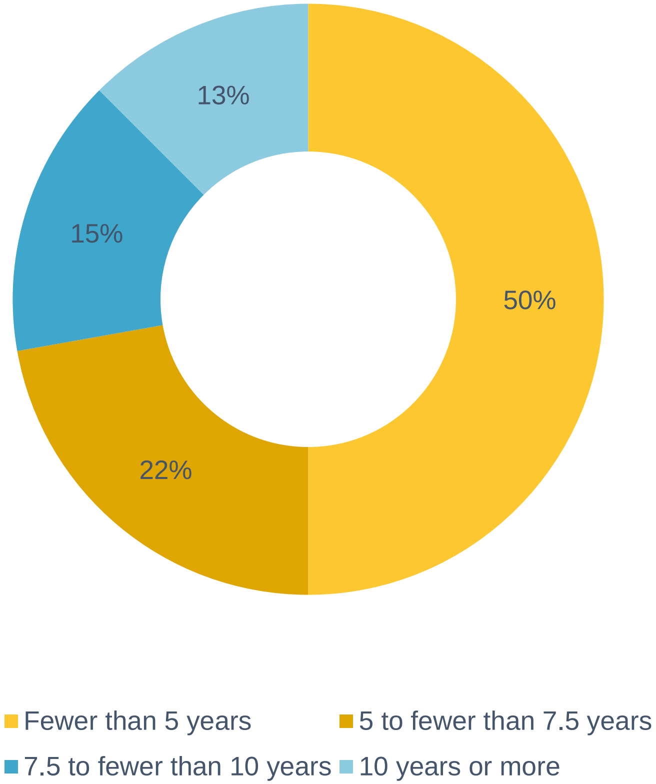
75% of schemes in covenant group 1 (strong) have recovery plans of less than 6.2 years increasing to 11.5 years in covenant group 4 (weak)

Average recovery plan length by scheme characteristics

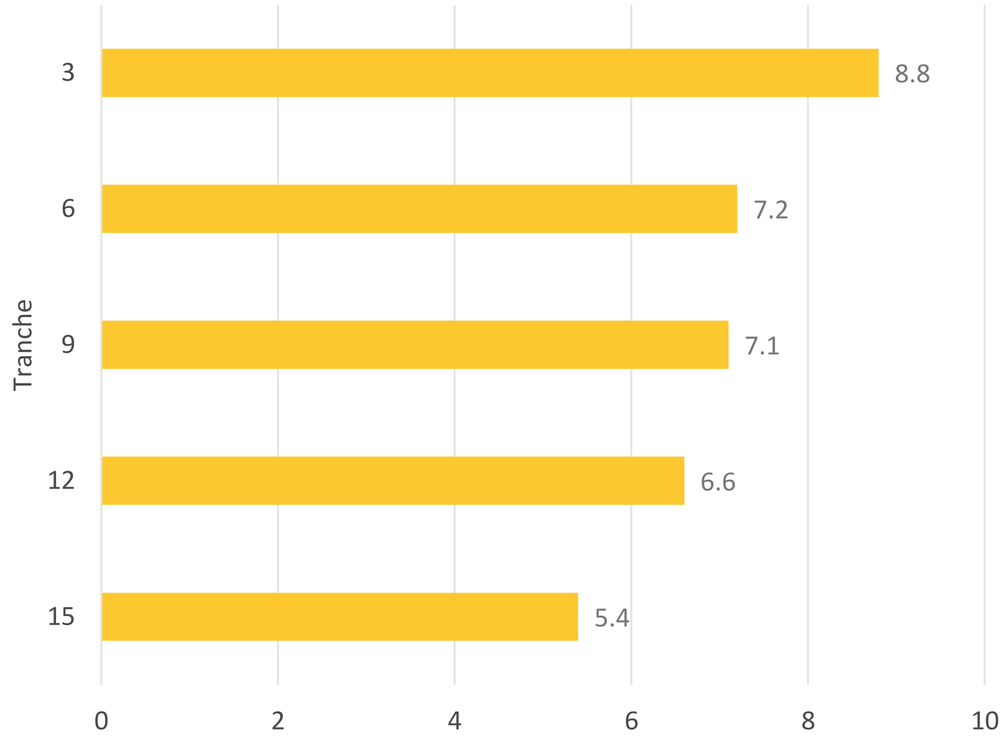
Maturity		Covenant group		Contingent assets	
< 25%	5.9 years	1 (Strong)	5.0 years	No contingent assets	6.4 years
25% to 50%	6.7 years	2	5.3 years		
50% to 75%	6.2 years	3	7.2 years	At least one contingent asset	6.3 years
75% +	6.1 years	4 (Weak)	9.1 years		

Analysis of recovery plan length ctd.

% breakdown of schemes by recovery plan length



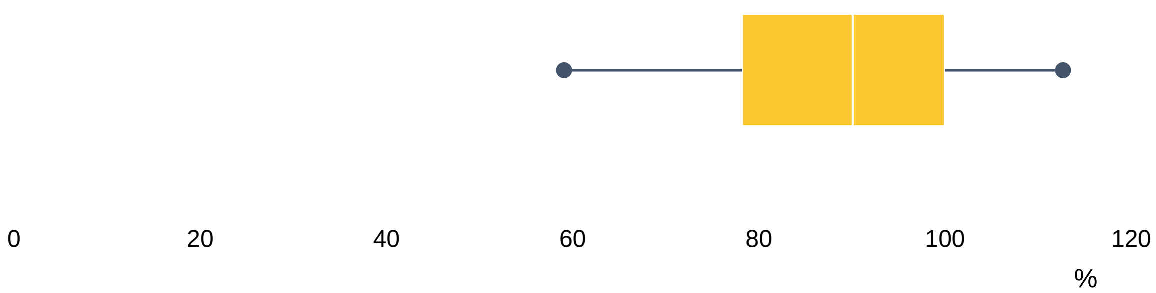
Trend of recovery plan length over time (median)



Typically schemes in tranche 15 had valuations in tranches 12,9,6 and 3. 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

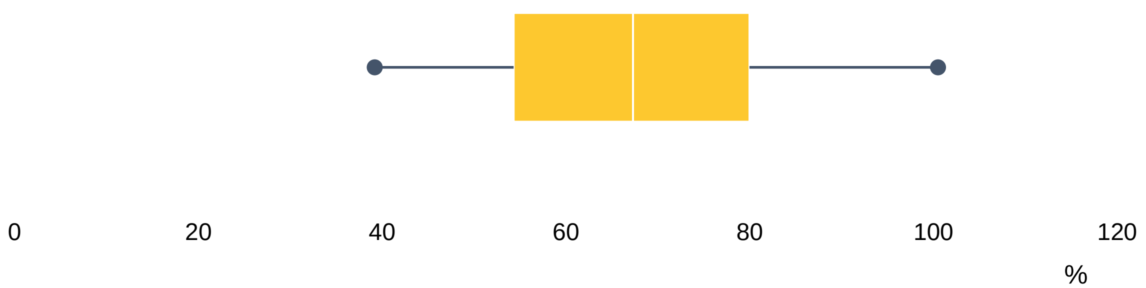
Distribution of technical provisions funding ratio



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

Median funding level 90%

Distribution of buy-out liabilities funding ratio

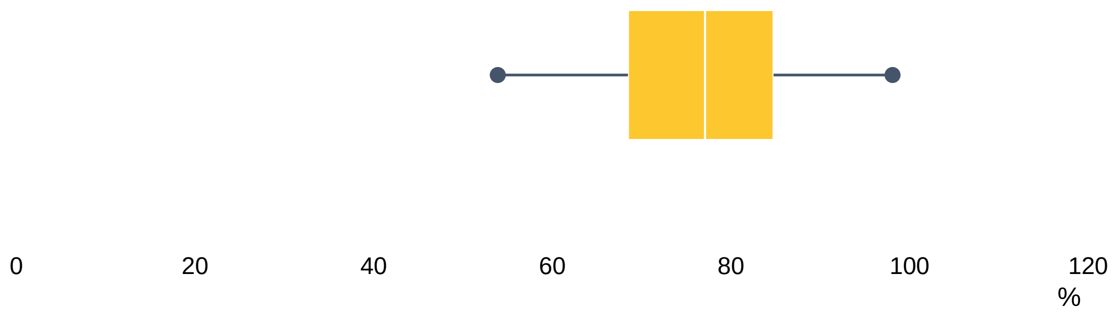


Equal to the assets divided by the buy-out liabilities in % terms.

Median funding level 67%

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 = 77%

5% of schemes fall below 53.9%

50% of schemes fall on or between 68.5% and 84.8%

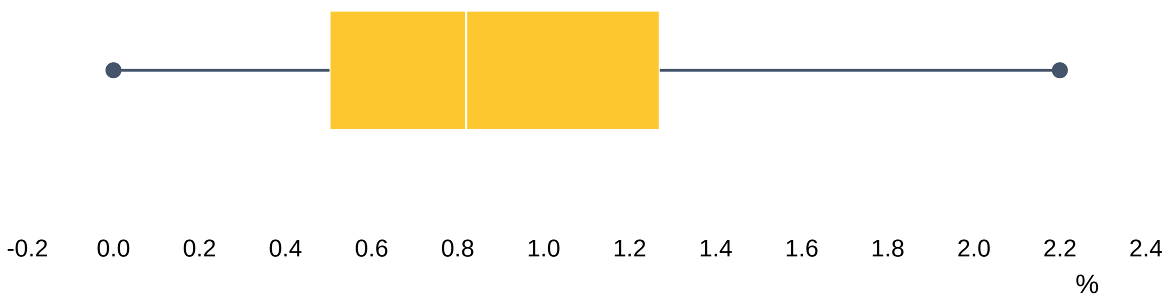
5% of schemes are above 98.1%

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

<table>
<tr><th colspan="2">Maturity</th><th colspan="2">Covenant group</th><th colspan="2">Contingent assets</th></tr>
<tr><td>< 25%</td><td>72.8%</td><td>1 (Strong)</td><td>74.7%</td><td rowspan="2">No contingent assets</td><td rowspan="2">76.7%</td></tr>
<tr><td>25% to 50%</td><td>74.1%</td><td>2</td><td>74.7%</td></tr>
<tr><td>50% to 75%</td><td>79.6%</td><td>3</td><td>75.3%</td><td rowspan="2">At least one contingent asset</td><td rowspan="2">76.0%</td></tr>
<tr><td>75% +</td><td>86.2%</td><td>4 (Weak)</td><td>75.2%</td></tr>
</table>

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 = 0.82%

50% of schemes fall on or between 0.45% and 1.27%

5% of schemes are above 2.20%

Average assumed discount rate outperformance by scheme characteristics

Maturity		Covenant group		Contingent assets	
< 25%	0.976%	1 (Strong)	0.889%	No contingent assets	0.88%
25% to 50%	0.926%	2	0.890%		
50% to 75%	0.789%	3	0.827%	At least one contingent asset	0.89%
75% +	0.972%	4 (Weak)	0.886%		

Some other useful statistics

Recovery plan end dates vs previous valuation:

55%

unchanged or shortened,

21%

extended by more than 3 years

Investment strategy:

24% <20% growth

30% 20-40% growth

31% 40-60% growth

15% >60% growth

19%

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

(83% of these are guarantees)

As a proportion of liabilities, average annual DRCs are

1.9%,

Average life expectancy improvements ***reduced*** between valuations

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

87.1 years

80%

of schemes assume a long-term longevity rate of improvement/underpin of **1.5% p.a.** or higher with **5%** assuming a rate of **2%** or higher

Comparison with last year's report

Headline statistics	Tranche 14 (22 Sept 2018 to 21 Sept 2019)	Tranche 15 (22 Sept 2019 to 21 Sept 2020)	
% of schemes in deficit	**69%**	**73%**	↑
% of schemes with >50% pensioners	**39%**	**42%**	↑
Recovery plan lengths	**5.9** years (median: **5** years)	**6.4** years (median: **5.4** years)	↑
Changes to recovery plans	**65%** unchanged or shortened **35%** extended (15% extended by more than 3 years)	**55%** unchanged or shortened **45%** extended (21% extended by more than 3 years)	↓ ↑
Average ratio of assets to technical provisions (all)	**91%** (median: 93%)	**89%** (median: **90%**)	↓
Average ratio of assets to technical provisions (schemes in deficit)	**84%** (median: 87%)	**82%** (median: **85%**)	↓
Average single equivalent discount rate outperformance in excess of gilts	**0.74%**	**0.88%**	↑

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 of 'Tranche 14' schemes published in May 2019.
Current segmentation of scheme universe may be different given this is based on historic assessments of employer covenant.

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	6.2 – 7.2 years	Relatively short recovery plan compared to other schemes like this.
Funding target	TPs are 85% of buy-out	75 - 80%	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 2022 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 upcoming valuations.

New DB funding code

You can find updates on the new DB code of practice with more detail on the upcoming changes, what to watch out for and how you can get prepared on our website. Read our latest briefing on the **DWP’s consultation** and **sign up** to receive our regular insights as we help guide you through these changes.

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.

Get in touch

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

Laura McLaren
Partner and Funding & IRM Specialist
Laura.McLaren@hymans.co.uk
0141 566 7914

Alistair Russell-Smith
Partner and Head of Corporate Consulting
Alistair.Russell-Smith@hymans.co.uk
020 7082 6222

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

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 15’ schemes with effective valuation dates falling from 22 September 2019 to 21 September 2020 submitting information in the period up to December 2021. This analysis was published on 28 July 2022. For more information visit: https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/scheme-funding-analysis-2022