

Defined Benefit pension funding in the charitable sector

August 2023



Summary

The last few years have been tough for charities. The rising cost of living has resulted in new calls for support in many areas, as well as continued strains on fundraising. Many charities are also experiencing wage pressure from high inflation as well as recovering from other recent challenges, including Covid-19 and the ongoing Russia-Ukraine war.

Alongside this tough environment, DB pension schemes sponsored by charities continue to require substantial funding. The funding levels of these pension schemes have been impacted by recent market volatility which has both presented challenges and brought opportunities.

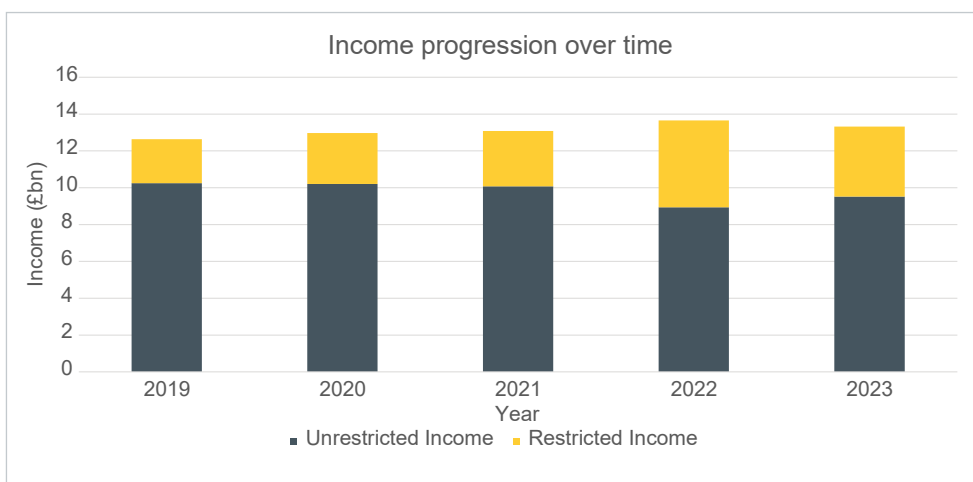
Charities need to continually refine the delicate balance between ensuring stability of charitable support and funding pension deficits.

We've analysed the DB pension exposures of the largest 39 charities in England & Wales by income to assess the issues and how charities should respond. These charities have a combined £48.5bn of reserves.

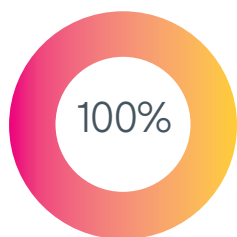
This has increased from £39bn last year largely due to strong investment performances.

Aggregate DB liabilities have increased to £9.7bn. Despite this, we have seen around a 7% rise in average funding level, primarily driven by positive return on pension scheme assets.

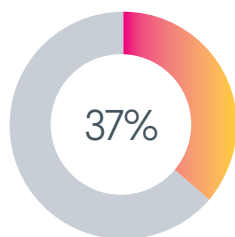
This year's charity income is £13.5bn, which is down slightly from last year. A less significant portion of this is restricted income, in yellow below (such as that earmarked for Covid-19 relief funding). Underlying income from fundraising and charitable activities (in grey below) is slightly up from last year, however has not yet reached pre-Covid-19 levels.



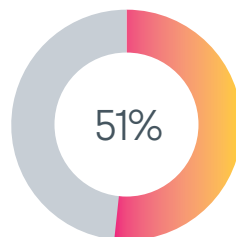
Key findings - 8 figures



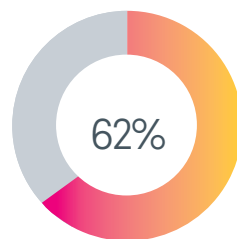
Average FRS102 funding level



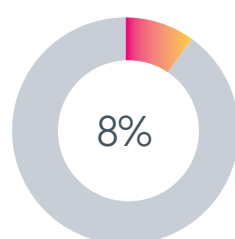
Average allocation to growth assets



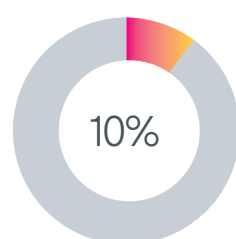
53% of charities have a FRS102 pension surplus



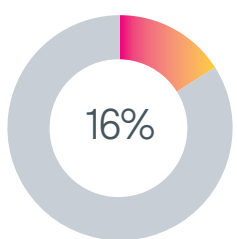
62% of charities have closed their DB scheme to accrual



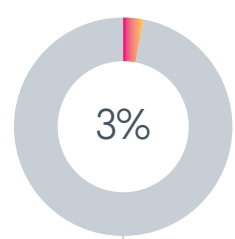
8% of charities have granted security to their DB scheme



The average FRS102 pension deficit is 10% of unrestricted reserves



The average FRS102 pension deficit is 16% of annual net unrestricted income



The average charity pays 3% of net unrestricted income into its pension scheme

How should charities respond?

1 Consider risk transfer options

2022 brought unparalleled market volatility for pension schemes. This meant plenty of challenges for pension scheme trustees, particularly with regards to ensuring Liability Driven Investment (LDI) strategies remained resilient. However, the risk transfer market remained buoyant.

The market volatility led to some excellent pricing opportunities for schemes already in the market, and, for other schemes, significant improvements in their funding position such that their long-term goal to buy-out is now a more viable target in the short term.

We expect 2023 is going to be a very busy year in the risk transfer market as many schemes re-assess their end game journey plans and seek quotations. It's now more important than ever for schemes to ensure that their broking process is appropriate and that they're transaction-ready from a governance, investment, and data/ benefits perspective if they want insurers to view their pension scheme as a high priority case in 2023 and beyond.

Many charity DB schemes may now be in a position to seriously consider risk transfer options, possibly for the first time. Charities should engage with their pension scheme trustees to ensure they're aligned on the long-term objective for the scheme and are considering current pricing opportunities in a timely manner.

You can read more in our [2023 Risk Transfer Report](#) and [Journey to buy-out guide](#).

2 Consider the impact of high inflation

Inflation over the year to March 2023 was 10% for Consumer Price Index (CPI) and 13.5% for Retail Price Index (RPI). This cost-of-living crisis is putting a strain on charitable expenditure as well as causing upwards pressure on salaries across the industry.

Most trustee boards will have, or plan to, seek the Charity's view on paying discretionary pension increases, over and above the capped RPI or CPI increases specified in the scheme rules. Given the current economic uncertainties, we would anticipate that most charities will not want to contemplate agreeing to anything other than guaranteed pension increases.

However, the impact of the increase in inflation has been offset by the rise in gilts yields. For those charity schemes that remain open to accrual of benefits (40% of the top 40), the cost of accruing pension has in fact fallen compared to the cost of living. This means that, for the first time in years, material DB accrual could be a cost pressure release value.

Since April 2021, there's been a 17% increase in the cost of living compared with a 42% decrease in the cost of DB pension accruing.

Charities should engage with pension scheme trustees to understand the impact of inflation on their scheme, and consider the cost of benefits accruing in the wider scheme funding plan.

The reporting dates for the charities' FRS102 disclosures used for this report span the period March 2021 – August 2022, with the majority in December 2021 and March 2022. They will therefore not reflect the full impact of the extreme market fluctuations seen over 2022.

DB Funding Code of Practice

The Pension Regulator's (TPR's) draft DB funding code is now expected to come into force for valuations from 1 April 2024.

The code sets out how pension schemes should de-risk towards a low-dependency funding basis and investment allocation by the time of 'significant maturity'. It takes into account scheme maturity, the pace of funding, investment risk and covenant reliability.

Employer covenant is essential for meeting the requirements in the code. The covenant must support investment risk within the pension scheme and will also affect the route to compliance with the code.

Covenant strength of charities can be hard to measure and quantify. Charities should engage with their pension scheme trustees now to ensure they are prepared for the new code. In particular, charities need to understand their covenant requirements with a focus on the cashflow reliability period and maximum affordability.

The code includes a 'Fast Track' route to compliance that enables TPR to automatically filter out valuations that require no further scrutiny. Charities and their pension scheme trustees should consider what to do if meeting the Fast Track filter isn't viable and how you might use the 'Bespoke' route to compliance.

You can read more on this in our recent [case study](#) that shows what the new DB funding code means in practice.

Charity analysis

Introduction

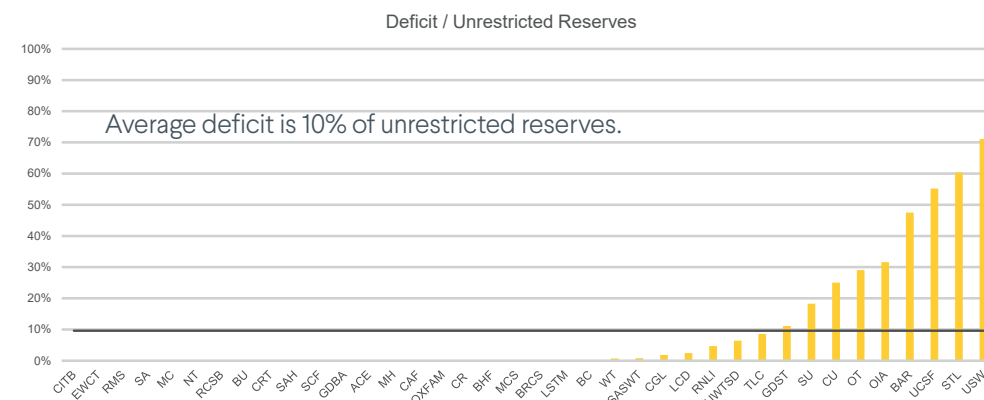
The ability of a charity to support its DB obligations is more important than the size of the liabilities or deficit in isolation. Our analysis focuses primarily on the size of the pension scheme relative to the size of the charity by considering the following measures. The pension deficit in these measures is the FRS102 deficit as reported in charity accounts.

Measure	What it shows
Deficit/unrestricted reserves	The level of charity assets available to potentially support the pension scheme (restricted assets and endowments are excluded as they're typically not accessible by the pension scheme). Charities which are in surplus have been excluded from the average deficit figure.
Deficit/net unrestricted income	The level of charity income available to potentially fund the pension scheme (restricted income is excluded, and the cost of generating the unrestricted income has been removed to leave a net amount of income that could be spent on charitable activities or to fund the pension scheme). Charities which are in surplus have been excluded from the average deficit figure.
DB pension contributions/net unrestricted income	The proportion of net unrestricted income that is paid into the pension scheme.

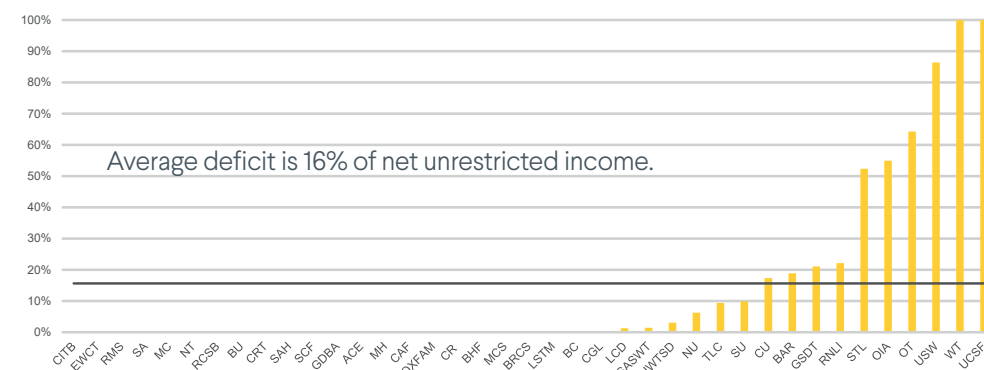
Results

The charts below show the distribution of results on each of these measures.

Deficit/unrestricted reserves

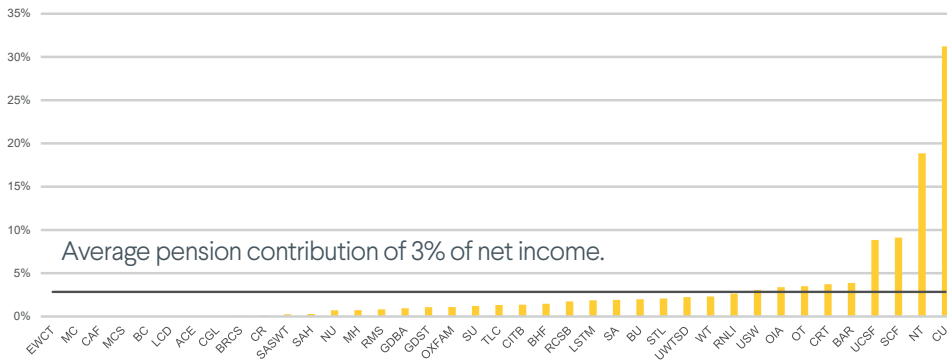


Deficit/net unrestricted income



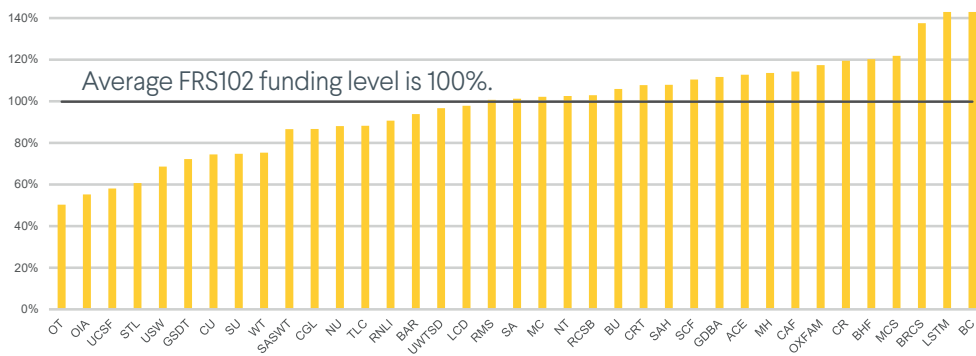
2 charities have a deficit that exceeds unrestricted income compared to 1 last year.

DB contributions/net unrestricted income



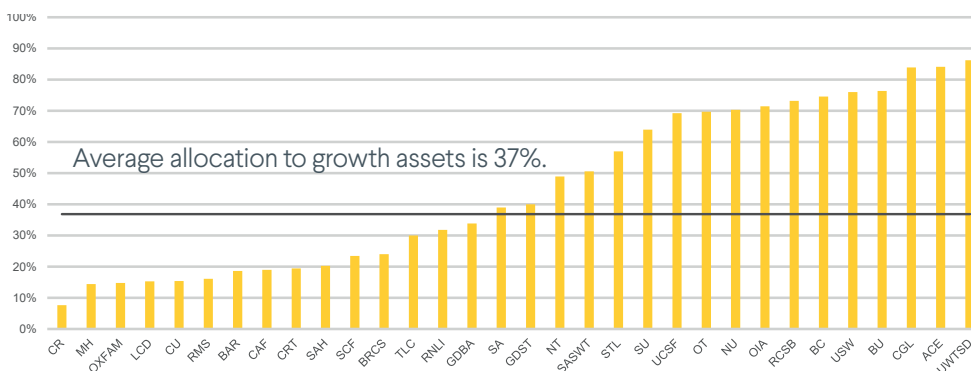
The wellbeing of the pension scheme also provides valuable insights. The charts below show the distributions of funding level and allocations to growth assets.

Funding level



20 charities have a surplus.

Growth asset proportion



Charities taking a lower level of investment risk are exposed to less deficit volatility and can arguably fund deficits over a longer period of time.

The average allocation to growth assets has reduced from 60% to 37% over the past 7 years. We expect this is a result of investment risk being taken off as funding levels improve. Importantly this starts to reduce the risk of pension funding falling behind plan, and means the scheme is more resilient to market shocks, like we've seen with market volatility in late 2022.

A number of charities have not disclosed an asset allocation; resulting in fewer charities being represented in the above chart.

Code	Charity	Code	Charity	Code	Charity
ACE	The Arts Council of England	GDBA	The Guide dogs for the Blind Association	SA	The Salvation Army
BAR	Barnardo's	LSTM	Liverpool School of Tropical Medicine	SAH	St Andrew's Healthcare
BC	The British Council	MC	Marie Curie Cancer Care	SASWT	The Salvation Army Social Work Trust
BHF	British Heart Foundation	MCS	MacMillan Cancer Support	SCF	The Save the Children Fund
BRCS	The British Red Cross Society	MH	Methodist Homes	STL	The Shaw Trust Limited
BU	Bangor University	NU	Nuffield Health	TLC	Trustees of the London Clinic
CAF	The Charities Aid Foundation	NT	The National Trust for Places of Historic Interest or Natural Beauty	SU	Swansea University
CGL	Change Grow Live	OIA	Oasis International Association	UCSF	United Church Schools Foundation Ltd
CR	Cancer Research UK	OT	Ormiston Trust	USW	University of South Wales/ Prifysgol de Cymru
CRT	Canal & River Trust	OXF	Oxfam	UWTSD	University of Wales Trinity Saint David
CU	Cardiff University	RCSB	Royal Commonwealth Society for the Blind	WT	Wellcome Trust
CITB	CITB	RMS	Royal Mencap Society		
EWCT	The Eric Wright Charitable Trust	RNLI	The Royal National Lifeboat Institution		
GDST	The Girls' Day School Trust				
LCD	Leonard Cheshire Disability				

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