UK defined benefit pensions

Long-term funding targets: 2022 survey results
July 2022

Executive summary

Our survey is based on data collected from defined benefit pension schemes during June 2022.

We received responses from schemes with assets of around £600 billion which is approximately 40% of all UK defined benefit pension schemes by asset value.

Headline results from the survey are as follows:

- **80%** of schemes surveyed have already set a long-term funding target (see page 5);
- **60%** have a long-term funding target referencing a ‘gilts’ based measure of the liabilities (see page 5);
- **2/3rds** are either explicitly or implicity targeting a level of funding that would allow the scheme to be bought-out with an insurer (see page 5);
- **80%** expect to reach their long-term target within the next 9 years (see page 6);
- **over 90%** of schemes will rely on assets returns, either partially or fully, to increase funding levels towards the long-term target (see page 7).

The Pensions Schemes Act 2021 requires all defined benefit pension schemes to have a *‘long-term funding and investment strategy’* - our survey suggests that many pension schemes are already ‘ahead of the game’ and well prepared for these requirements.

UK defined benefit pension scheme funding levels have improved dramatically during 2022 (see page 4). We believe that these improvements present a number of opportunities for sponsors and trustees to re-assess progress towards their long-term target.

With funding levels improving and a majority of pension schemes targeting a ‘buy-out’ level of funding, capacity in the insurance markets could become a limiting factor over the next decade - we encourage schemes that are thinking of buying-out to start the process of getting trade ready.

I look forward to discussing the results of the survey with you in more detail.

John Dunn
Head of Pension Scheme Funding and Transformation at PwC

Our survey covers approximately 40% of all defined benefit pension schemes in the UK

Our survey covers UK defined benefit schemes with total assets under management of around

£600bn

UK market coverage by asset size

40%

The survey was conducted during June 2022 and the responses received by size of scheme were as follows:

- 45% from smaller schemes with assets of less than £300 million

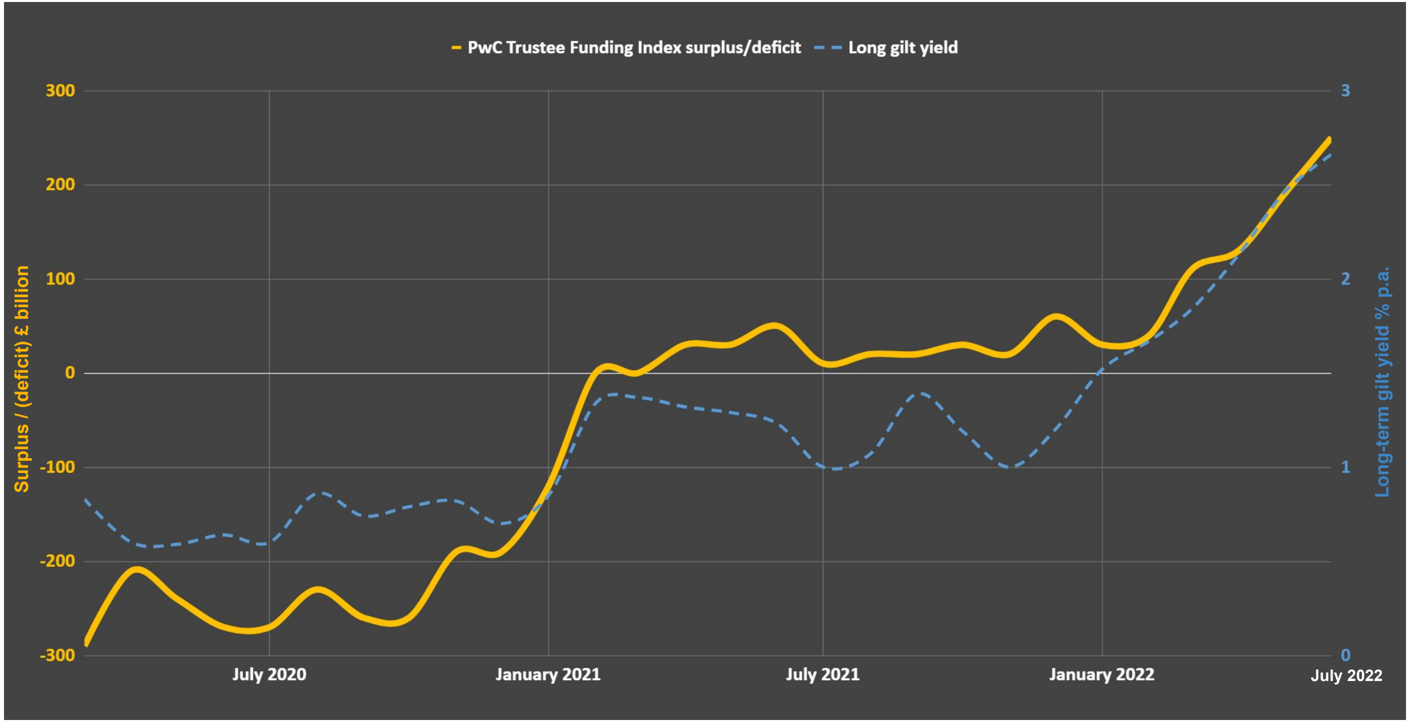
- 45% from mid-sized schemes; and

- 10% from large schemes will assets of greater than £5 billion.

Responses came from professional independent trustees, individual trustees, pensions managers and other individuals with responsibility for the pension scheme - we received the greatest number of responses from professional independent trustees.

Therefore, the survey is more representative of behaviour in pension schemes with a particular type of governance model i.e. there is a bias towards schemes with a professional independent trustee.

Rising long-term interest rates have reduced pension scheme liabilities by £540bn since the start of the COVID-19 pandemic



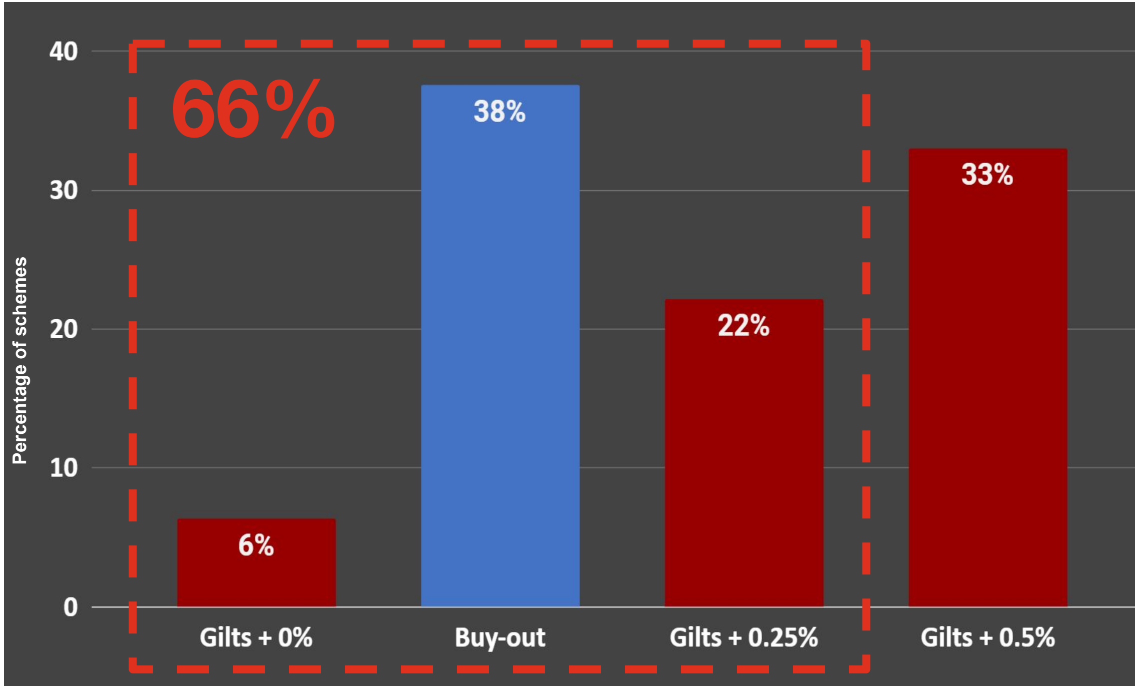
This chart shows the estimated improvement in the technical provisions funding position of all 5,000 plus UK DB schemes as measured by PwC's monthly trustee funding index. We contrast this against the rise in long-term gilt yields over the same period.

Funding levels are estimated to have improved from 85% to 119% and a combined deficit of £290 billion has flipped to become a surplus of £250 billion.

This dramatic improvement in funding levels is largely driven by a fall in the assessed value of liabilities due to rising gilt yields (gilt yields are typically used by actuaries to set discount rates in pension scheme liability calculations).

Rising funding levels present a number of opportunities for sponsors and trustees, for example: reviewing investment and hedging strategies; accelerating trade ready activities; and considering how surplus is allocated within the pension scheme between sponsor and members.

80% of schemes in our survey have already set a long-term funding target. Targets are prudent - 2/3rds of schemes are effectively targeting a buy-out level of funding



What about expenses?

Just over 50% of schemes surveyed include a reserve for expenses within the long-term target.

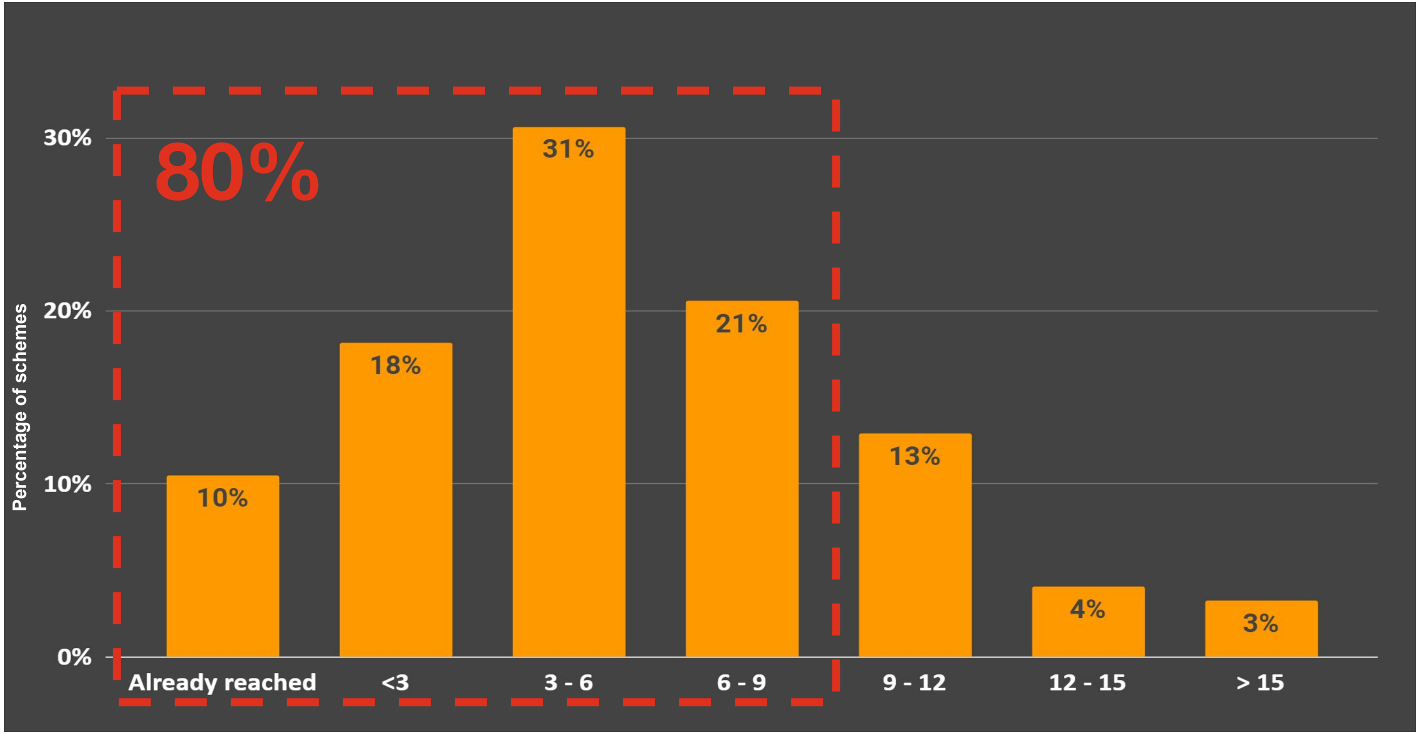
60% of schemes in the survey adopt a 'gilts' based long-term funding target i.e the discount rate in the calculation of the target value of the liabilities is based on the yield on UK government bonds or 'gilts'.

Whilst 38% of schemes have an explicit target of buy-out, in reality 2/3rds of the schemes surveyed are targeting a buy-out level of funding - the price of a full scheme buy-out for a population of 50% deferreds and 50% pensioners is usually somewhere between the gilts plus zero and gilts plus 0.25% value of the liabilities.

In its March 2020 consultation on scheme funding, the Pensions Regulator stated that it was minded to set the Fast Track long-term funding target 'at a point in the range gilts plus 0.25% to gilts plus 0.5%'.

Overall schemes in our survey are already setting long-term funding targets that are at least as prudent as the upper end of the Regulator's range (note that this range may now be subject to change).

80% of schemes expect to reach their long-term target within the next 9 years

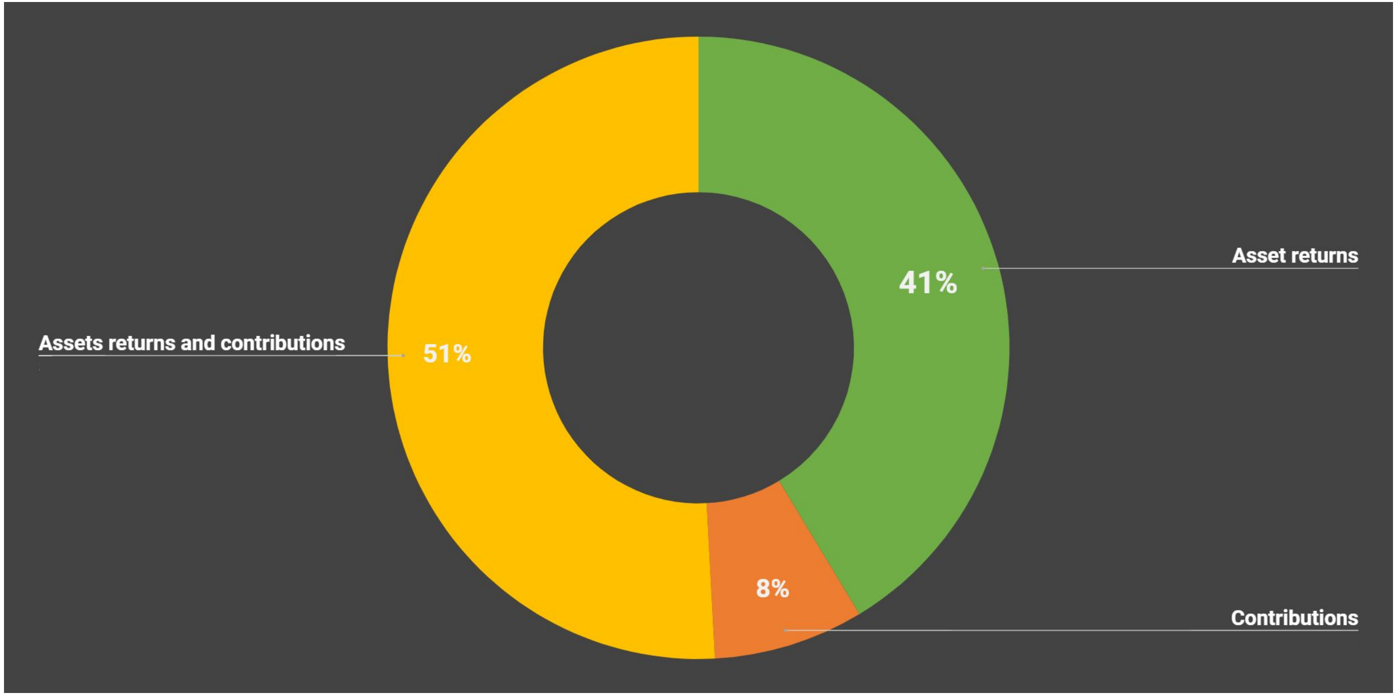


80% of schemes surveyed expect to reach their long-term funding target within the next 9 years and 97% within the next 15 years. With the significant improvement in funding levels during 2022 these expected timescales are now likely to be shorter.

We would encourage sponsors and trustees to reassess funding levels in their pension schemes if they have not already done so - improving funding levels may mean that exit plans and plans to de-risk investment strategies could be brought forward.

One interesting feature of the data is that the smallest schemes with assets of less than £300 million and the larger schemes with assets of £5 billion plus are the most confident about reaching their long-term funding target within nine years; nearly 85% of those schemes believe they will reach the target within nine years, whereas only 75% of the medium size schemes expect to reach their target within this time scale.

How will schemes increase funding levels to reach the long-term target?



Asset returns will be a key component of trustees and sponsors' strategy to reach their long-term funding target. Over 40% of schemes surveyed plan to reach their long-term funding target using asset returns alone. In total, over 90% of schemes surveyed said that they would rely in whole or in part on assets returns.

Less than 10% of schemes surveyed appear to have locked down all investment risks and are relying on sponsor returns alone to reach their long-term funding target.

We see a trend towards more schemes only relying on asset returns i.e. we would expect to see the percentage of schemes relying on assets returns alone (currently just over 40%) to increase in future surveys.

Schemes adopt a variety of approaches to documenting long-term funding targets

Embedded within Technical Provisions i.e the discount rate trends down to equal the long-term target

38%

Separate agreement, e.g. MOU or long-term funding deed

25%

As a secondary target described in the Statement of Funding Principles

37%

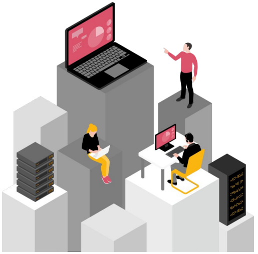
The way trustees and sponsors are documenting long-term funding targets varies.

Nearly 40% are embedding the target within their technical provisions calculations. This echoes what the Pensions Regulator said in the first consultation on scheme funding; technical provisions should be the '*milestones along the journey'* to the long-term funding target.

The remainder use a variety of methods to document the long-term funding target: long-term funding deeds; memoranda of understanding; or describe the long-term funding target within the Statement of Funding Principles.

The Pensions Schemes Act 2021 will require schemes to document their 'long-term funding and investment strategy'. We expect that the documentation requirements will be set out in the detailed funding regulations due to be issued shortly by the DWP and then in the Pensions Regulator's second consultation on its new funding code of practice.

Few schemes have made the long-term target an obligation that the sponsor will have to fund no matter what



The sponsor has a contractual obligation to fund the scheme to the long-term target level by an agreed point in time

17%

The sponsor has a contractual obligation to fund the scheme to the long-term target level eventually (the time frame can flex)

33%

The trustees and sponsor have agreed (or are in the process of agreeing) that this is an appropriate target but have not formalised how it will be reached or by when

50%

Half the schemes in our survey have agreed with the sponsor that it will provide additional funding (if necessary) to reach the long-term funding target. But only a third of these schemes have agreed with the sponsor that the long-term target must be reached by a fixed point in time.

The other 50% of schemes surveyed have agreed (or are agreeing) the target level of funding with the sponsor but have not made the either the timescale or levels of additional funding a contractual requirement. May of these schemes will be relying on asset returns alone to improve funding levels.

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