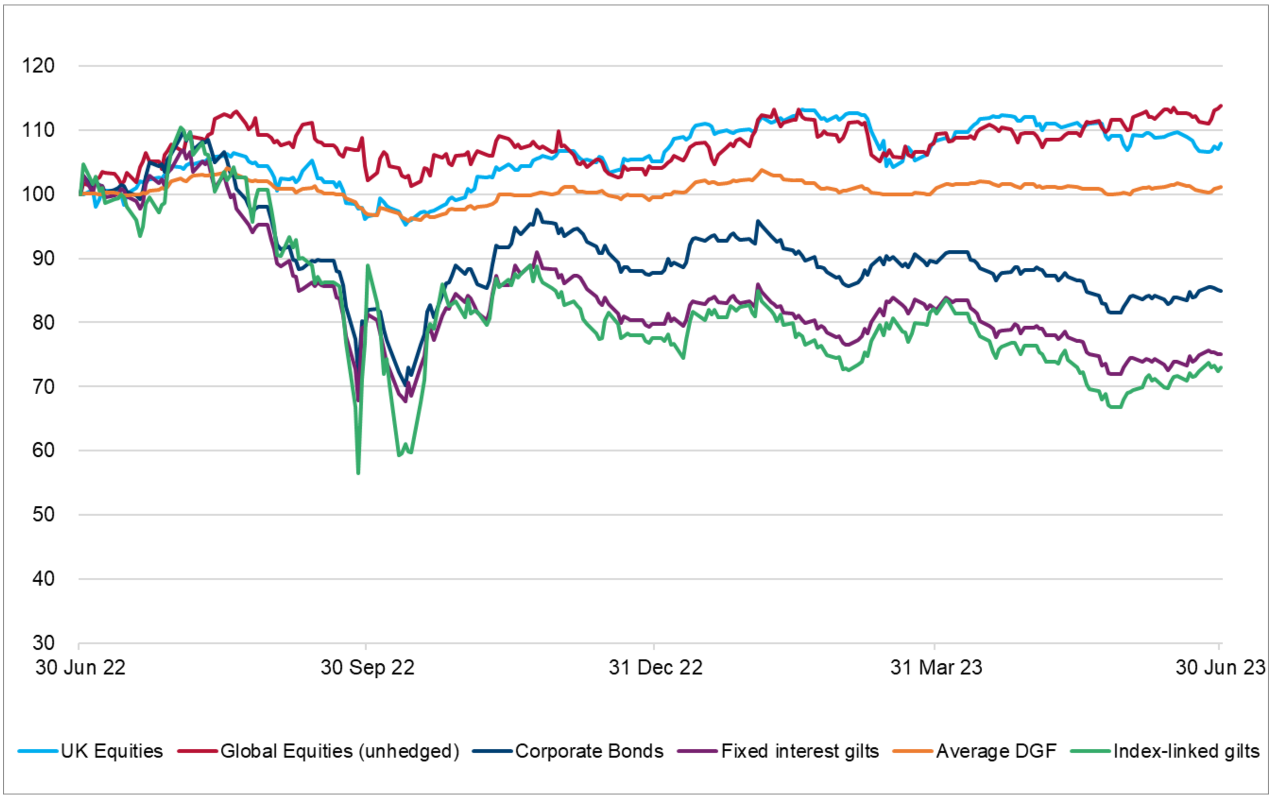
Employer pension briefing, Quarter 3 2023

In this briefing, we highlight key pension issues for employers. We focus on the impact of market movements on pension cost accounting positions and upcoming funding valuations. And we also highlight key developments in the pensions industry.

Changes in financial markets

The second quarter of 2023 saw further falls in the value of corporate and government bonds. While not reaching the lows seen in September 2022, bond values ended the year with losses of 15% (corporates) and 25% (gilts).

Returns on UK equities were flat over Q2. Global equities had a better quarter, returning around 4%, which contributed to an overall return for the year of around 14%.



UK equities: +8%

Global equities (unhedged): +14%

Average DGF: +1%

Corporate bonds -15%

Fixed-interest gilts: -25%

Index-linked gilts: -27%

Changes to pension scheme liabilities

Bond yields

While bond returns over the last 12 months are clearly not good news in isolation, it's important to remember that changes in scheme funding levels will reflect movements in both assets and liabilities.

Falling bond prices mean rising bond yields, and since these yields drive the discount rates for most purposes, this translates to falls in the value of scheme liabilities. Over the course of the last 12 months, the increase in corporate bond yields alone could have reduced accounting liabilities by over 15%. For employers with schemes that are open to accrual, next year's service costs will also be significantly lower.

Inflation

Inflation remains stubbornly high, with efforts from the Bank of England and government having little impact on headline rates. Schemes that provide inflation-linked benefits will continue to see these benefits increase at much higher levels than in previous years.

The extent of any increase in your scheme's liabilities will depend on the profile of the scheme and the caps and floors that apply.

Summary

Overall, this means that despite record levels of inflation, we expect scheme liabilities to have fallen significantly compared with the previous year-end.

	30 June 2022	30 June 2023	Impact on the liabilities of an average[1] scheme
Corporate bond yield[2]	3.8% pa	5.1% pa	-17%
Gilt yield[3]	2.7% pa	4.5% pa	-23%
Market-implied inflation[4]	3.7% pa	3.6% pa	-1%
Actual inflation (year to June 2023)	RPI: 10.7% CPI: 7.9%		Up to +8%

1 An average scheme is taken to have a duration of 15 years and around 75% of liabilities linked to inflation
2 Yield on the iBoxx over 15-year AA-rated corporate bond index
3 Bank of England nominal gilt curve over a duration of 15 years
4 Gilt market-implied inflation at a term of 15 years from the Bank of England implied inflation curve

What does this mean for your scheme?

Many (although certainly not all) schemes will have seen their pension balance sheet positions improve over the year to 30 June 2023. Improvements will have been greatest for schemes that didn't have material levels of liability hedging in place (and so will not have seen such substantial falls in asset values).

For more information on the implication on funding positions – especially if you have an upcoming actuarial valuation date – you might find our *Finance Director's guide to 30 June 2023 actuarial valuations* useful. Ask your First Actuarial contact for a copy if you don't already have one [or request one here](#).

Buy-out market update

The rise in gilt yields over the last 12 months has seen a significant number of scheme funding level increases, to such an extent that schemes can now consider approaching an insurer to secure benefits. However, as with any market, the increase in demand has led to an increase in prices. Bulk annuity transactions exceeded £20bn in the first half of 2023.

The Pensions Regulator publishes its 2023 scheme funding analysis

The improved funding position of many Defined Benefit (DB) schemes was a theme of **The Pension Regulator's 2023 funding analysis**. The analysis covers schemes with a valuation date falling between 22 September 2020 and 21 September 2021. Even before the rise in gilt yields, the analysis reveals that almost two in five schemes (39%) had reported a surplus on the technical provisions funding basis.

Mansion House reforms

In July, Jeremy Hunt delivered his Mansion House speech, setting out a raft of proposed pension reforms aimed at improving outcomes for pension savers and boosting the UK economy.

The measures are likely to have more of an impact on individuals in Defined Contribution (DC) schemes. They propose that some of the larger providers should move part of their default funds into less liquid assets. They also suggest an expansion of the Collective Defined Contribution (CDC) regulations, potentially paving the way for multi-employer CDC schemes.

For DB schemes, the key initiatives are around consolidation as an alternative to buy-out, and increased investment in productive assets. While Mr Hunt appears keen on the idea of UK schemes investing to help the UK economy, this seems slightly at odds with The Pensions Regulator's focus on reducing investment and funding risk. Perhaps we are heading for a further delay in the release of the new funding code?

Legal news: Virgin Media v NTL

A recent high court judgment could cause issues for some DB pension schemes. The judgment in the Virgin Media Ltd v NTL Pension Trustees case ultimately means that benefit changes made after 6 April 1997 could be deemed invalid, if the required actuarial confirmation was not received at the time. This could result in significant additional liabilities for some schemes.

We understand that Virgin Media Ltd is likely to appeal the decision. The DWP may also step in and save the day with retrospective legislation to overrule the judgment. So at this stage, it's a case of wait and see.

Get in touch with our experts

To discuss your scheme, contact your usual First Actuarial consultant or any of our **employer services team**

Sam Mullock
E: sam.mullock@firstactuarial.co.uk
T: 0161 348 7469

John Ingoe
E: john.ingoe@firstactuarial.co.uk
T: 0113 818 7365

Kirk Hinton
E: kirk.hinton@firstactuarial.co.uk
T: 01733 447 642

Marcos Abreu
E: marcos.abreu@firstactuarial.co.uk
T: 01732 207 507

Dale Walmsley
E: dale.walmsley@firstactuarial.co.uk
T: 0161 348 7464

Jennifer Hodgson
E: jennifer.hodgson@firstactuarial.co.uk
T: 0161 348 7435