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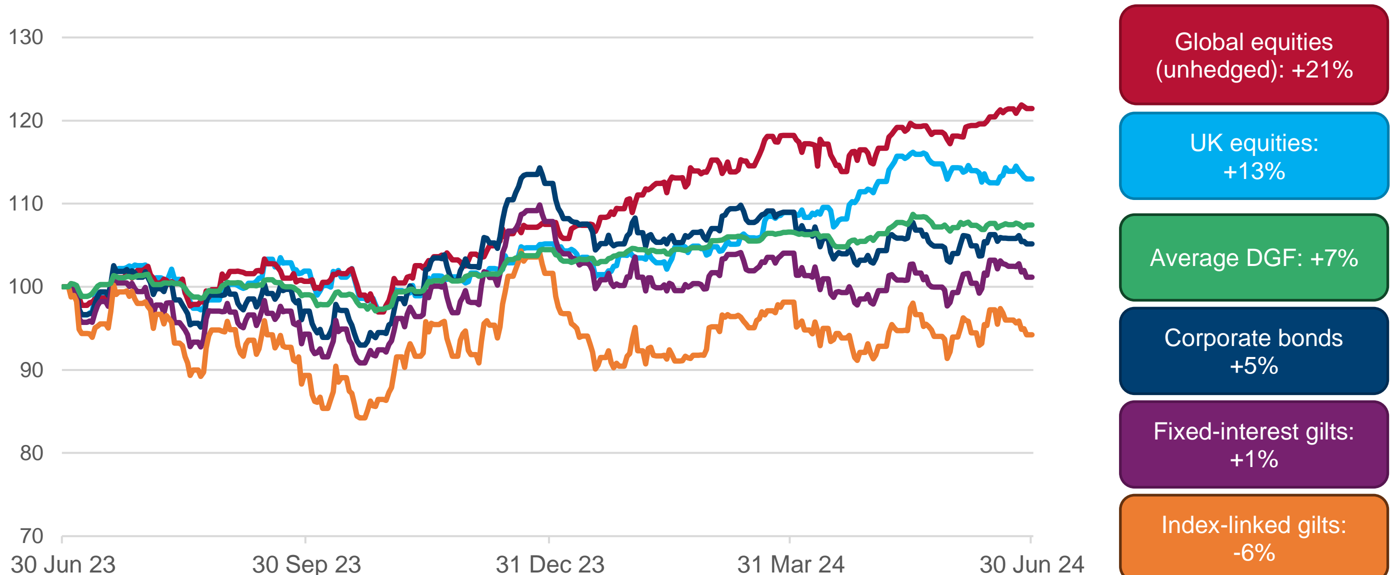
Employer pension briefing, Quarter 3 2024

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. We also discuss broader developments in the pensions industry and how employers should be planning.

Changes in financial markets

Global equities are again the standout performer – with returns of 3% over the quarter contributing to overall growth of 21% over the past 12 months. UK equities lagged behind slightly, returning 13% over the year to 30 June 2024.

Corporate bonds and fixed-interest gilts have seen returns of 5% and 1% respectively over the year, while index-linked gilts didn't fare quite so well – with losses of around 6% for the year.



Changes to scheme liabilities

It may seem obvious, but scheme asset performance should not be considered in isolation. Changes in scheme funding levels will reflect movements in both assets and liabilities.

Bond yields

Corporate bond yields, used to set the discount rate for your accounting liabilities, have ended the year broadly where they started.

Gilt yields, which tend to drive cash funding, low dependency and buy-out discount rates, fell at shorter durations but increased at longer durations. The overall impact will depend on your scheme's liability profile, but for most schemes we might expect a small reduction in those liability values that are linked to gilt yields.

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Inflation

Following a prolonged period of high inflation, the headline rate has finally fallen back to the Bank of England's target of 2% pa. Over the longer term, however, gilt market investors seem to expect that inflation will rise again, with market-implied inflation remaining above 2.75% pa on average for the next 40 years.

The extent of any change in your scheme's liabilities due to actual inflation and changes in expectations of future inflation will depend on the profile of the scheme and the caps and floors that apply to any inflationary increases.

Summary

The table below shows how key financial assumptions have changed over the year:

	30 June 2023	30 June 2024	Impact on the liabilities of an average[1] scheme
Corporate bond yield[2]	5.1% pa	5.1% pa	0%
Gilt yield[3]	4.5% pa	4.6% pa	-2%
Market-implied inflation[4]	3.6% pa	3.5% pa	-1%
Actual inflation (year to June 2024)	RPI: 2.9% CPI: 2.0%		*Scheme-dependent*

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?

The impact on each scheme and liability measure will vary, but it's likely that any changes in liability values over the last 12 months will have been much smaller than those seen over the preceding year. Your funding or balance sheet position will also depend on asset performance, which will vary significantly depending on scheme-specific investment strategies.

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 Defined Benefit pension scheme actuarial valuations as at 30 June 2024** useful. Ask your First Actuarial contact or request a copy.

The new Government's pension priorities

They say things don't move quickly in pensions, but we've had a new pensions minister, a surprise Pension Schemes Bill promised, and a large-scale pension review launched in a matter of days.

Emma Reynolds MP, the newly appointed pensions minister, is the first to have a joint ministerial role, spanning both the DWP and HM Treasury, perhaps suggesting a new era of joined-up pensions policy across those departments.

Key issues that the new Government is looking to tackle include lost pots for Defined Contribution (DC) members, introducing a value-for-money framework for DC schemes and improving options for consolidating Defined Benefit (DB) schemes. They will also be considering how to unlock the investment potential of the £360bn Local Government Pension Scheme, suggesting that the Mansion House reforms remain a focus.

Bulk annuity market update

More schemes than ever are in a position to secure benefits with an insurer, with record volumes of risk transfer business being written. But with demand outstripping supply, we are seeing capacity issues.

However, these concerns are now balanced by optimism regarding recent new entrants M&G and Royal London. Utmost and Brookfield are also expected to officially enter the UK bulk annuity market in the coming months.

Is buy-out the only answer?

There has been much noise in the industry about *run-on* as an alternative to buy-out. This is the novel idea of running a scheme on with the intention of paying benefits as and when they fall due. (As readers over the age of 30 may recall, this is how schemes used to operate.)

The key difference is that the majority of schemes are now closed to the future build-up of benefits. The focus now, therefore, is whether schemes can be run-on to build up a surplus – with the economic benefits of doing so potentially being shared between employers and members.

Run-on will not be the right answer for all schemes, and it is not a risk-free solution. It is, however, an option that should be considered alongside the usual insurance solutions (or, to use the pension industry's jargon of choice – *end-game solutions*). For more on the pros and cons of run-on, **read Pension scheme run-on – Gimmick or game changer?** by Vicky Greenwood.

Can you CDC into the future?

It has been a long time coming, but Royal Mail Group has confirmed that the UK's first Collective Defined Contribution (CDC) scheme will launch on 7 October 2024.

This is an exciting development for UK pensions. CDC bridges the gap between DB and DC pensions, offering members an income for life without the risk of funding shortfalls for sponsoring employers. While few employers have the scale required to set up their own CDC scheme at this early stage, we're hopeful that the launch of the Royal Mail plan will pave the way for multi-employer CDC schemes in future.

For more information about CDC and First Actuarial's pioneering role in the design of the Royal Mail plan, **read our case study**.

BREAKING NEWS: Virgin Media v NTL

The Court of Appeal has upheld the High Court's ruling in the Virgin Media Ltd vs NTL Pension Trustees case. The judgement opens up the possibility that many DB schemes may have made benefit changes that could be deemed invalid if the required actuarial certification was not provided at the time. This will be the case even if those benefit changes would have met the conditions required for certification.

There is some hope that DWP may step in with legislation allowing benefit changes to be certified retrospectively, but at this stage this is far from certain. As a result, many trustees may continue to take a wait and see approach (unless they are approaching a buy-out or buy-in). One potential problem is whether auditors will want potential additional liabilities to be quantified for pension cost accounting disclosures – something for employers with a year-end in the coming months to be aware of.

BREAKING NEWS II: The new DB funding code

It's been a long time coming, but the final draft of The Pensions Regulator's DB funding code has finally been laid before parliament.

The current funding code was published in 2014, replacing the first version published in 2006. The Government describes the need for a new code as:

> *The existing regime sets out how schemes should set their liabilities in a prudent way, but was conceived when most schemes were open, and in steady state. The DB landscape has changed, and most schemes are now closed and maturing. The new arrangements for the first time explicitly require schemes to have a Funding and Investment Strategy setting how they will fund members' benefits over the long term. This is based on the principle that investment risk should be supportable, and that when a scheme is significantly mature, it should not plan to need further support from the sponsoring employer.*

The new code will be effective for schemes with valuation dates on or after 22 September 2024 and, with little time between release and implementation, there have thankfully been only a few changes made to the draft code released earlier this year. The headline changes include:

- Schemes will be deemed to be 'significantly mature' once they have reached a duration of 10 years or less (previously 12 years). Duration calculations will be based on financial conditions as at 31 March 2023.
- Open schemes can allow for new members and future accrual of benefits when determining the future maturity of the scheme, essentially giving more flexibility for open schemes to set their funding and investment strategies.
- The 'broadly matched' principle has been removed to provide clarity on the level of flexibility provided in the low dependency investment allocation (LDIA).
- The final draft has clarified that the LDIA is a notional investment allocation from which a low-dependency funding basis can be derived. The code sets an expectation that, for most schemes, investing in line with the LDIA at significant maturity is in the best interests of members. However, it recognises this will not be the case for all schemes.
- A requirement for trustees to consider the impact of the recovery plan on the employer's sustainable growth has been added.

Watch this space for further information about the new code and what it means for employers that support a DB scheme.

Get in touch with our experts

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

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