

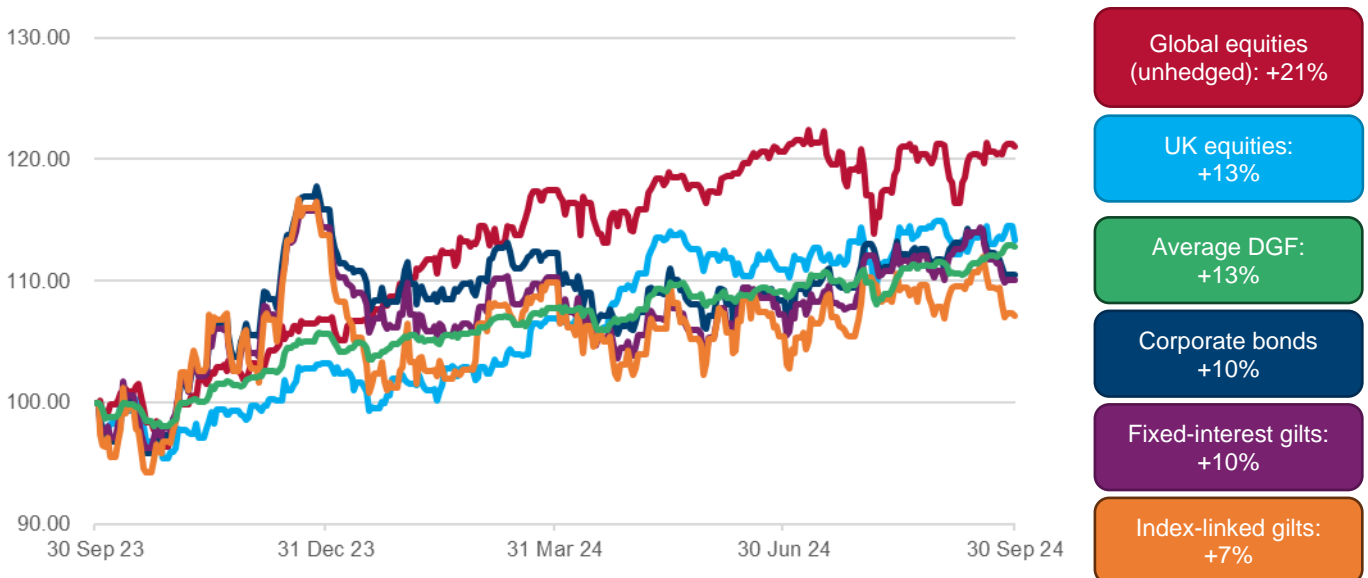
## Employer pension briefing, Quarter 4 2024

In this briefing, we highlight key pension issues for employers. We look at 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

The 12 months to 30 September 2024 saw positive returns across all major asset classes. Once again, global equities were the standout performer, returning 21% over the year to 30 September 2024 (despite a volatile final quarter).

Bond returns didn't hit those heady heights, but still ended the year up by around 10%. Diversified growth funds (DGF), perhaps unsurprisingly, finished the year between the two, with an average return of 13%.



### Changes to scheme liabilities

It may seem obvious, but DB 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 fallen over the year. All else being equal, this will increase the value of accounting liabilities. For employers with schemes which are open to accrual, we also expect next year's service costs to be higher.

We've also seen a decrease in gilt yields, which tend to drive cash funding, low dependency and buy-out discount rates. The overall impact will depend on your scheme's liability profile, but for most schemes we would expect a small increase in those liability values that are linked to gilt yields.

### Inflation

Following a prolonged period of high inflation, the headline rate has finally fallen back to more typical levels, with CPI inflation for the year to September dropping below the Bank of England target of 2% pa. Over the longer term, however, gilt market investors seem to expect inflation to rise again, and market-implied inflation to remain above the 2% target 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 September 2023	30 September 2024	Impact on the liabilities of an average <sup>1</sup> scheme
Corporate bond yield <sup>2</sup>	5.4% pa	5.1% pa	5%
Gilt yield <sup>3</sup>	4.8% pa	4.4% pa	6%
Market-implied inflation <sup>4</sup>	3.7% pa	3.4% pa	-3%
Actual inflation (year to September 2024)	RPI: 2.7% CPI: 1.7%		Scheme-dependent

<sup>1</sup> An average scheme is taken to have a duration of 15 years and around 75% of liabilities linked to inflation

<sup>2</sup> Yield on the iBoxx over 15-year AA-rated corporate bond index

<sup>3</sup> Bank of England nominal gilt curve over a duration of 15 years

<sup>4</sup> 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?

It's impossible to say how individual schemes have fared. Liabilities are likely to be higher than at the same time last year, but positive assets returns will have offset to varying degrees.

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 September 2024** useful. Ask your First Actuarial contact or [request a copy](#).

### New Defined Benefit funding code finally in place

The world of pensions is littered with dates to remember: 17 May 1990 (the 'Barber' judgment), 6 April 1997 (introduction of statutory pension increases), 6 April 2006 (A-Day 'pension simplification') to name just a few. And now we have a new one: 22 September 2024 – the date The Pension Regulator's (TPR) new Defined Benefit (DB) funding code was finally introduced.

Many DB sponsoring employers will be worried about the potential cost implications of the new code on ongoing and deficit contributions as well as on adviser expenses.

Here are some key points we feel employers should bear in mind:

1. For most schemes, the trustees will be required to **agree the funding plan** with the employer, and in all cases, to at least consult. Trustees are likely to err on the side of prudence, so employers may want to take independent advice on any proposed funding approach.
2. The code sets out TPR's idea of **best practice in relation to covenant assessment, investment advice and funding approaches** – but also stresses that a more proportionate approach may be acceptable in some circumstances. This may be the case for well-funded schemes, so it's probably worth waiting for indicative results before incurring significant professional fees.

The central tenet of the new code is for schemes to set a **long-term objective and design a journey plan** towards it. Employers should play a key role in these discussions and avoid getting railroaded into agreeing

an overly prudent objective, which could eventually drive cash funding requirements. There have been some industry suggestions that buy-out is the only real long-term option for smaller schemes. However, we would beg to differ. Run-on can, and will, work for schemes of all sizes provided they have the covenant visibility and complementary objectives to support it.

3. Employers should give their journey plan careful consideration, ensuring any **plans to de-risk the investment strategy in future do not place excessive burden on their finances**. There is flexibility within the code for employers and trustees to reach a sensible outcome.
4. The concept that **scheme contributions should remain “reasonably affordable”** remains in the code, with explicit acknowledgement from TPR that investing in sustainable growth is a valid use of the employer’s cash. Employers should agree to a level of scheme contributions that does not threaten their long-term viability.

### How does the member journey fit into your journey plan?

With schemes being actively encouraged to set a plan for their ‘end game’, now is a good time for both sponsors and trustees to consider how member options fit into the journey. This can be a win-win for all parties involved – introducing or improving awareness of member options can reduce risk and cost for sponsors, while increasing choice and enhancing outcomes for members.

Pensions are, by and large, poorly understood. A refreshed member options strategy can improve awareness and appreciation of existing benefit packages. And importantly, it can also give members access to greater support at key points in their retirement journey.

Importantly, the approach you decide to take may depend on your chosen end-game strategy and journey plan. Taking an integrated approach to planning now will lead to better outcomes for all.

For more insights into the member journey, and the critical role it can play in a scheme’s journey plan, read our recent blog post – [Putting members first in the ‘new world’ of Defined Benefit pensions](#).

### This year’s bee in your auditor’s bonnet

Another year, another legal judgement complicating year-end pension cost accounting disclosures. (Yes, we’re still bitter about the GMP equalisation ruling six weeks before the end of 2018!)

This year, it’s the Virgin Media v NTL Pension Trustees case that’s getting auditors hot under the collar. The High Court gave its initial ruling last year, and an appeal was heard in late summer this year.

As a reminder, the original judgement (upheld in the Court of Appeal) determined that past changes to the rules of contracted-out DB schemes may be deemed invalid if there is no evidence that the required actuarial confirmation was received at the time.

The case has attracted a great deal of industry commentary and many still hope that the Department for Work and Pensions will step in with legalisation to allow changes to be certified retrospectively.

Many trustee boards will still be taking a ‘wait and see’ approach, which seems perfectly reasonable given the lingering uncertainty. Unfortunately, this might not be sufficient for your pension cost accounting disclosures. We therefore recommend engaging with your auditors sooner rather than later to agree an approach ahead of your year-end.

### Royal Mail delivers the UK’s first CDC scheme

The Royal Mail Collective Pension Plan, the UK’s first-ever Collective Defined Contribution (CDC) scheme, officially launched on 7 October 2024.

First Actuarial originally proposed the idea of CDC to Royal Mail and played an instrumental role in the successful negotiations that followed. We are delighted that the scheme – which will provide pensions to more than 100,000 Royal Mail employees – has launched.

The scheme will pay a retirement income for life, along the lines of a DB scheme but without the cost uncertainty. The compromise with CDC is that the target level of pension is not guaranteed – pensions can go down as well up.

### What's next for CDC?

The Government recently opened its consultation on extending CDC to multiple unconnected employers. This raises the possibility of smaller employers being able to offer master-trust type CDC schemes to their employees.

First Actuarial is offering a complimentary training session to any organisation interested in what CDC can offer. We'll take you through the basics and give you ample opportunity to discuss how it could work for your organisation or scheme. To book a training session, please email [cdc@firstactuarial.co.uk](mailto:cdc@firstactuarial.co.uk).

### Autumn Budget

In the weeks preceding the autumn Budget, the pensions rumour mill was well and truly churning. Rumours persisted about changes to the limits on tax-free cash, employer National Insurance being payable on pension contributions and, as always, more fundamental reform of pension tax relief.

In the end, these rumours proved to be unfounded, and pensions escaped largely unscathed.

The headline change was the increase in employer National Insurance contributions, which may make salary sacrifice for pension contributions more attractive to employers. There's always a pension angle!

[Read our autumn Budget briefing.](#)

### 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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