FTSE 350
DB Pension Scheme Report 2022

Defined benefit pension schemes and
their impact on company accounts at 31 December 2021

May 2022

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Executive summary

Welcome to the eleventh WTW report discussing the impact of defined benefit (DB) pension schemes on FTSE 350 company accounts.

Accounting positions – Improved accounting positions		
1	94% of companies have improved their accounting position	An improvement in funding positions was seen widely across the FTSE 350 in 2021, and the percentage of companies reporting a surplus on an accounting basis increased from 38% to 62%.
2	From £5bn deficit at end of 2020 to £32bn surplus at end of 2021	The end of 2021 saw the highest accounting surplus in the last decade. This surplus continued to grow in the first half of 2022, almost doubling in the first five months of 2022.
Assumptions – Increases in discount rates and inflation, small reduction in life expectancy		
1	+51bps increase in discount rates	Discount rate assumptions have fallen sharply over the last three years, In 2021 we saw a reversal of this trend and average discount rate assumptions rose from 1.37% p.a. to 1.88% p.a.
2	+45bps move in RPI	The end of 2021 saw a sharp upward movement in short- and medium-term inflation expectations and this was reflected in accounting assumptions.
3	Life expectancy assumptions at lowest in a decade	Life expectancies disclosed for scheme members peaked in 2014 and have trended steadily downwards since that time, reaching a decade low. However, there does not seem to be any material pandemic effect yet.
Key trends – DB closure and de-risking continues, dividends return		
1	35% of companies reported DB plans open to future accrual	2021 saw DB closure activity continue, but we may be now be reaching a point where closure slows, with many employers not seeing the current environment as a time to make changes.
2	£43bn of de-risking transactions in 2021	After consecutive record years for the bulk annuity and longevity hedging market, levels of activity in 2021 dipped slightly but still remained the third highest on record.
3	81% of companies paid more in dividends than deficit contributions	With many pandemic-driven dividend cuts reversed, but little change in deficit reduction contributions (DRCs) in 2021, the number of companies paying more in dividends than DRCs increased drastically over the year (from 57% in 2020).

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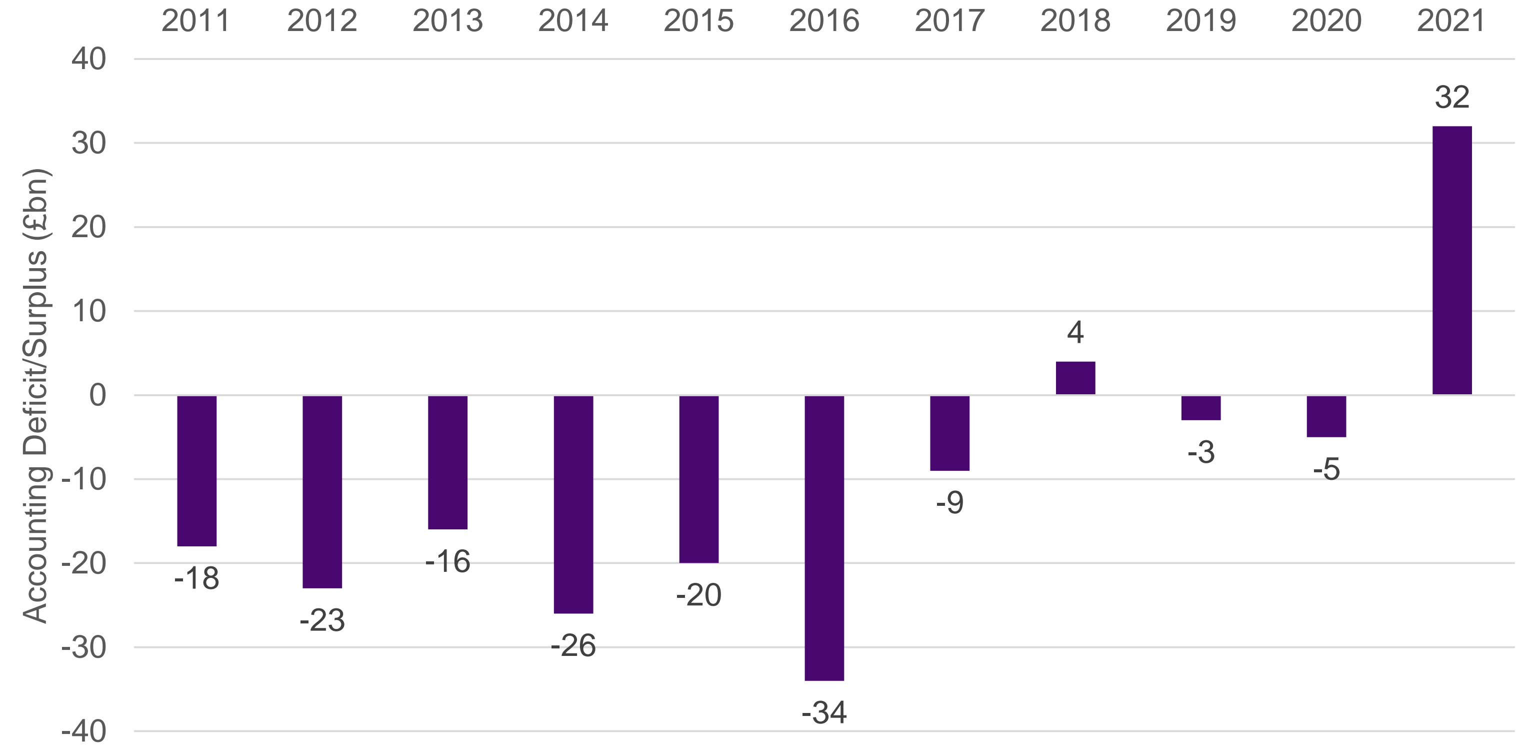
Balance sheet positions

The start of 2021 was overshadowed by the ongoing impact of COVID-19 and, with it, renewed economic uncertainty. However, the next few months saw a steady flow of positive news on the vaccine rollout, which led to improvements in asset markets that boosted funding positions. Throughout the remainder of 2021, the more positive outlook continued and by the end of 2021 accounting positions were displaying a strength not seen for over a decade, with an aggregate surplus of £32bn.

As a result, the percentage of FTSE 350 companies reporting a surplus on an accounting basis increased from 38% 2020 to 62% in 2021 and 94% had improved their accounting position over the year.

With surpluses now more common than deficits (on an accounting basis), the focus of many companies is likely to shift towards other liability measures, such as cash funding or buyout, as schemes continue to progress towards their long-term objectives.



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2021 saw an almost universal improvement in funding positions with 94% of reporting Companies seeing an improvement in their balance sheet position. Changes in financial markets – increasing bond yields against a backdrop of positive returns in most major equity markets – drove this improvement albeit offset, in part, by increasing actual and expected price inflation.

Charles Rodgers, Senior Director, Retirement

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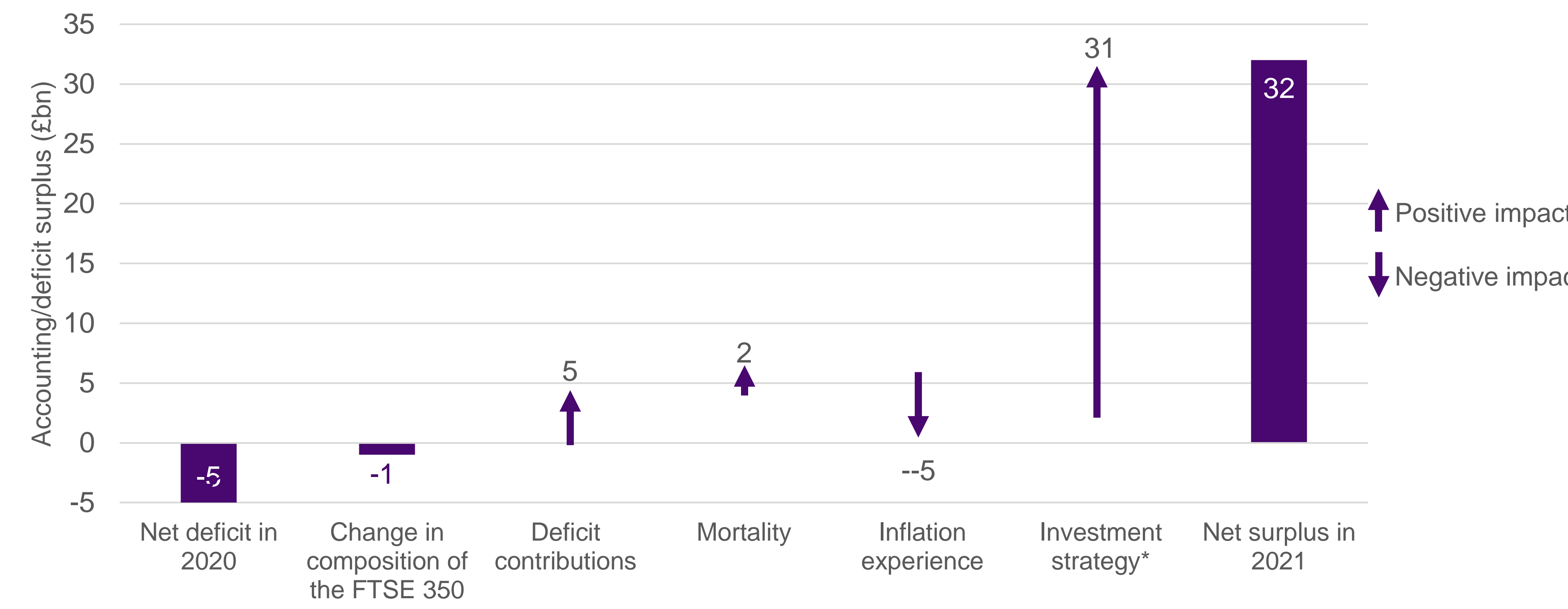
Balance sheet positions

The change in accounting position was primarily due to a mismatch between the performance of scheme assets and changes in the corporate bond yields used to calculate pension liabilities: rising corporate bond yields reduced liabilities by more than the falls seen in government bonds on the asset side for those schemes who had largely hedged their position. For those schemes who were 'on risk', with sizeable equity allocations, rising equity values over 2021 will have led to even greater outperformance.

Increases to RPI assumptions, and higher than expected inflation over the year, increased liabilities (a negative impact on the accounting position, although this will have been largely hedged in many cases). Whilst, despite the pandemic, there was only a slight impact from mortality assumptions on accounting positions.

The change in accounting position: 2020 to 2021



* Investment strategy represents the asset gain / loss less impact of assumption changes on DBO

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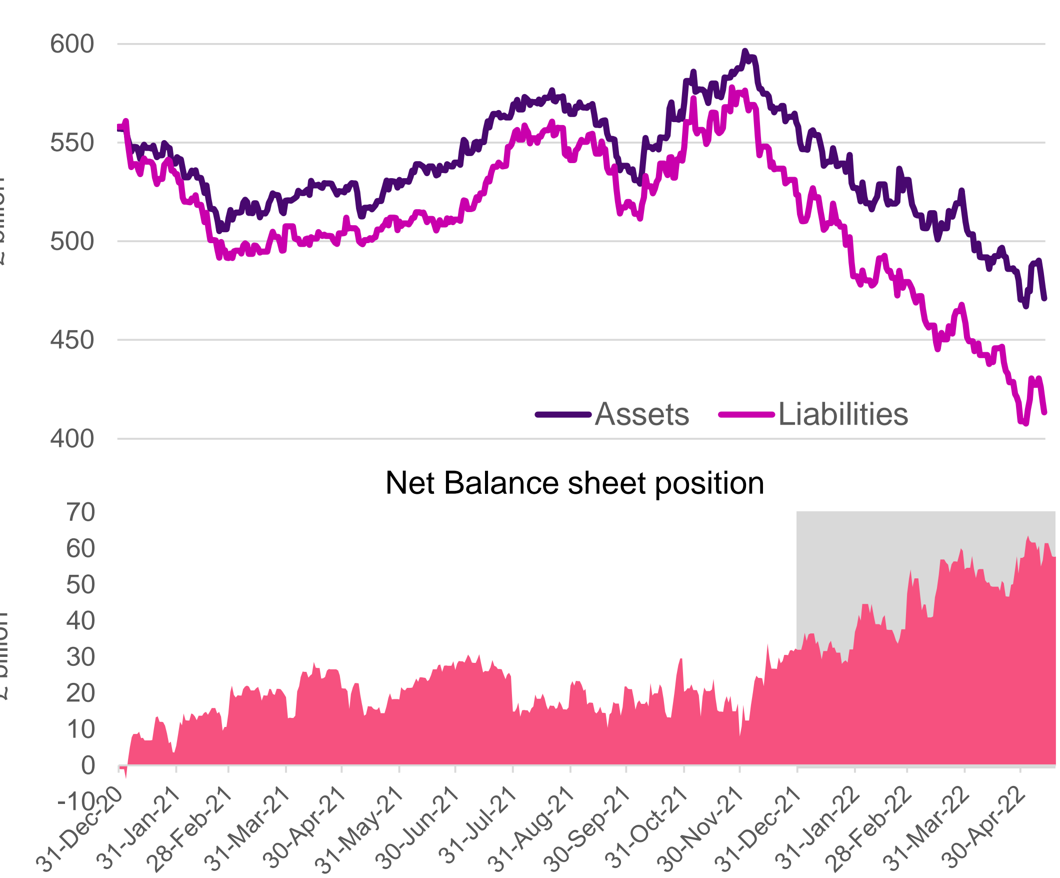
Balance sheet positions

FTSE 350 – Estimated position

Data represents FTSE 350 companies with a 31 December year end reporting in 2021



It would have been difficult to forecast the improvement in accounting positions over 2021 a year and a half ago.

The start of 2021 was overshadowed by the ongoing impact of COVID-19, with a new lockdown announced in the first few days and, with it, renewed economic uncertainty. Assets and liabilities fell in value, although the latter by more and the aggregate funding position moved into surplus early in the year.

The next few months saw a steady flow of positive news and improvements in asset markets, boosting funding positions to a position of surplus that remained for the rest of the year.

By late 2021, inflation had started to rise, related to pandemic-related supply issues and energy price rises. However, this was accompanied by a step up in yields and so we saw further improvements to the aggregate funding position, ending the year in a healthy surplus position (£32bn).

The first quarter of 2022 saw expectations of inflation continue to tick upwards. In February 2022, Russia invaded Ukraine and with it came a dramatic increase in economic uncertainty (initially at least). This placed further pressure on inflation and saw the Bank of England raising interest rates. So, despite the negative movements in assets and liabilities, this increase in bond yields led to a further improvement in accounting positions (projected to be £54bn by late May).

Looking ahead, heightened inflationary pressures will only partly be felt in increases in scheme liabilities, with most DB benefits having capped inflationary increases. A period of inflation may then further strengthen the health of schemes, though pose significant challenges for members.

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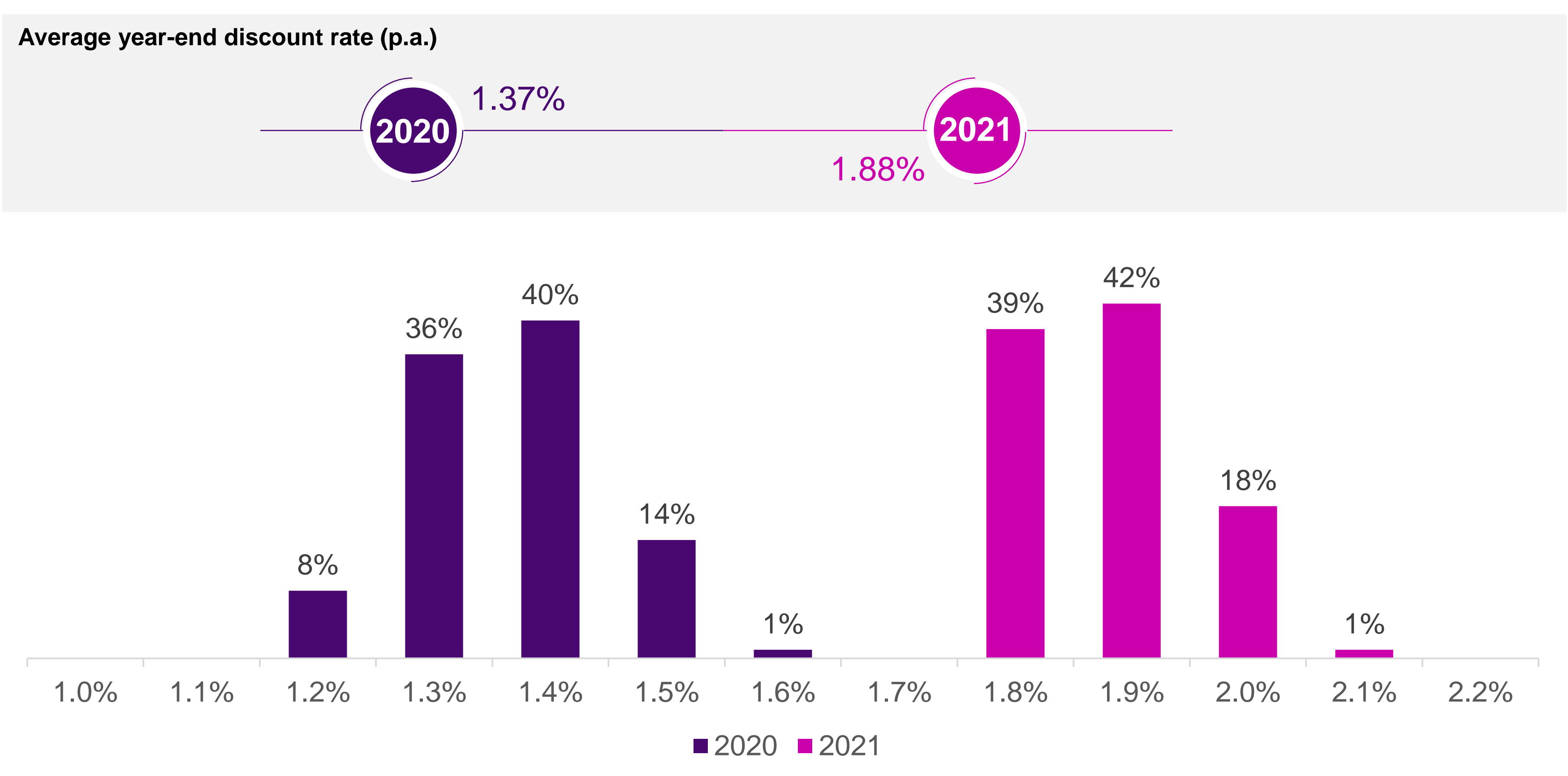
Discount rates move higher

Discount rate



Discount rate assumptions had fallen sharply over the previous three years: from an average of 2.81% in 2018, to 2.03% in 2019, to 1.37% in 2020.

In 2021 we saw a reversal of this trend and average discount rate assumptions rose to 1.88%.

This would typically reduce pension liabilities by around 9% and contributed to the improved accounting positions of FTSE 350 companies.

In the first quarter of 2022 corporate bond yields (which shape the discount rate assumption) rose sharply again, with yields back at levels last seen at the end of 2018.

Hence, the upward pressure on liabilities seen from the end of 2018 to the end of 2020, receded in 2021, with a further weakening in 2022.

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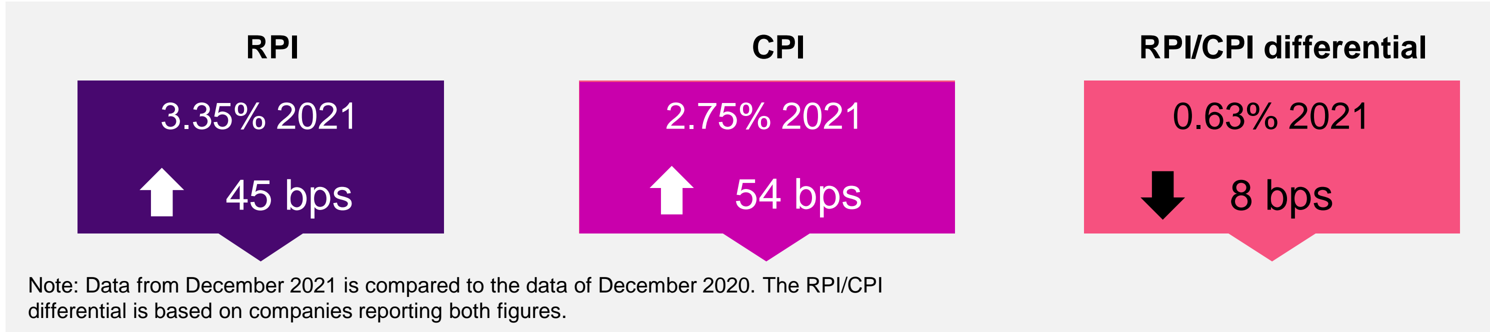
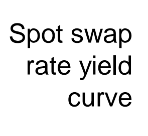
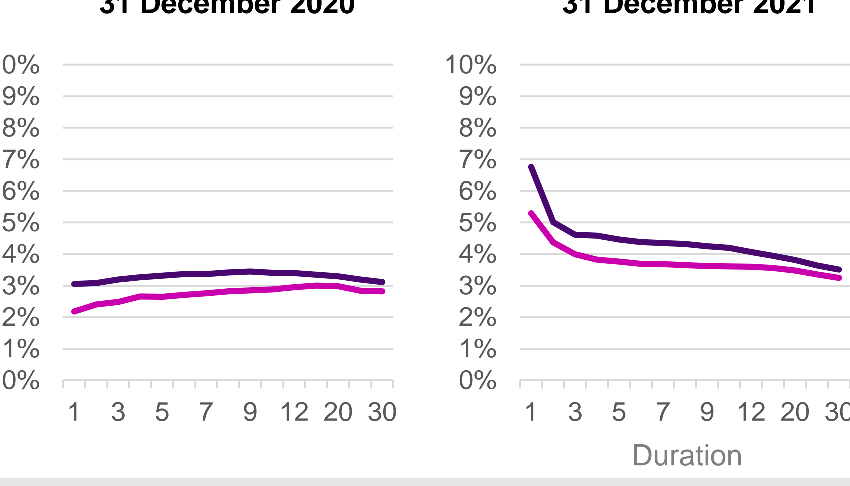
Inflation assumptions rise

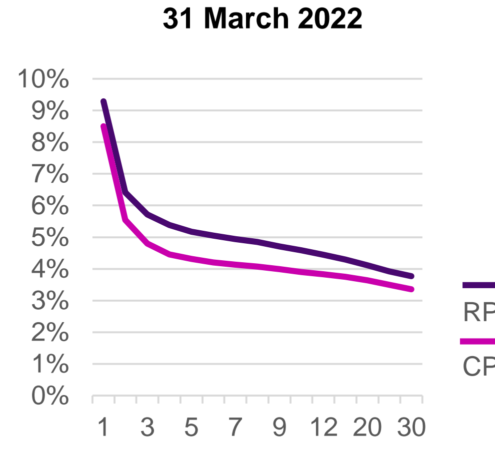
Average assumptions



The story of 2021: Rising inflation expectations







2021 marked the return of significantly above-target inflation to the UK. In December 2021 annual CPI inflation was recorded at 5.4%, the highest figure since early 1992. Mostly this was seen as a short-term phenomenon, but even medium-term inflation expectations (as reflected in swap market rates) have moved upwards.

Given these shifts the average RPI assumptions rose by 0.45% to 3.35%, while CPI assumptions rose even more, by 0.54% to 2.75%.

We may see a further revision to these assumptions at the end of 2022 if the heightened rates of inflation seen so far in 2022 continue. By April 2022, annual RPI inflation had reached 11% and CPI inflation was up to 9%, the highest figures seen since the early 1980s.

The average wedge between RPI and CPI assumptions fell from 0.91% to 0.71% between 2019 and 2020 and fell to 0.63% in 2021.

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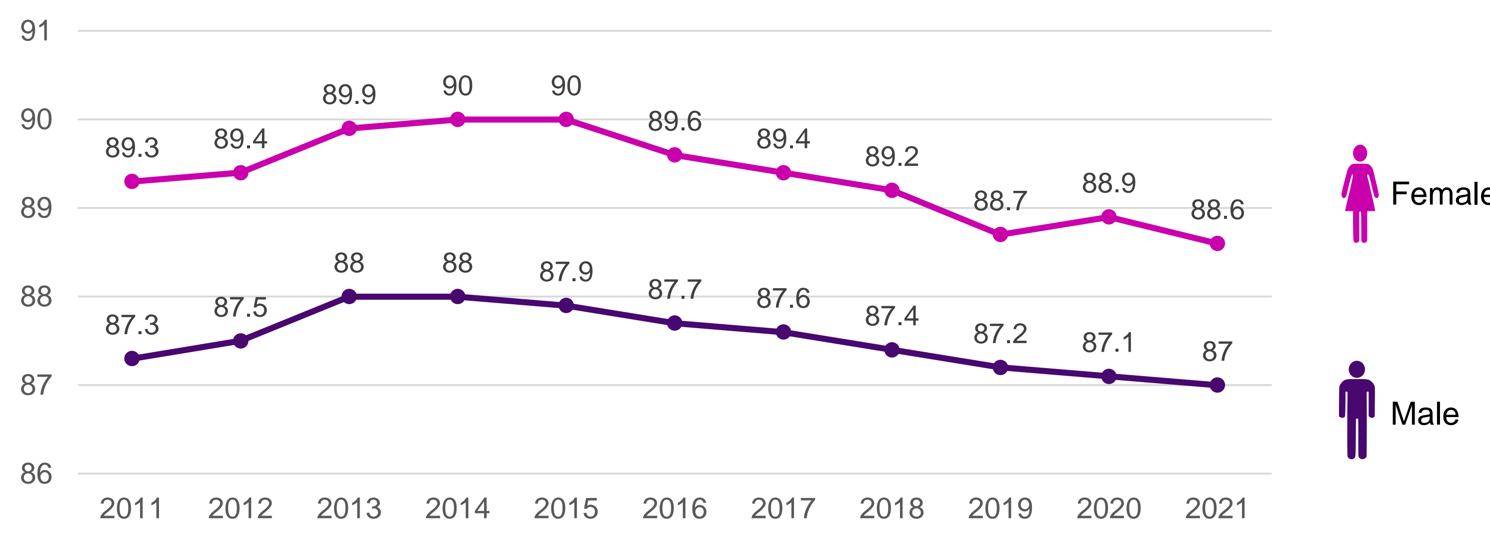
Life expectancy assumptions continue their downward trend

Average life expectancy for members aged 65 (years)



Life expectancies disclosed for scheme members peaked in 2014 (88.0 for men reaching the age of 65, 90.0 for women) and since that time have trended steadily downwards.

2021 saw further moderate reductions in life expectancy. Life expectancy assumptions are now lower than at any point in the past ten years, as companies revise their assumptions in the face of more negative mortality experience than expected.

The decline in assumed life expectancy since the 2014 peak (c 1-year) equates to around a 3-4% reduction in liabilities. And that is with little impact felt from COVID to date.

The impact of COVID-19

Sadly, by early May 2022 around 119,300 more people were estimated to have lost their lives in the UK than would have been expected without COVID 19 (Continuous Mortality Investigation).

Despite the severe impact on the country as a whole, this is likely to have had a relatively muted impact on pension scheme liabilities. COVID-19 has mainly affected the oldest in society for whom life expectancy is already relatively short and the additional deaths typically only account for 0.1-0.2% of a pension scheme's liabilities.

However, the deeper question is whether the aftermath of the pandemic leads to more long-term changes to life-expectancy assumptions.

Will the longer term effects of the coronavirus ("long COVID") or the backlog of untreated illnesses facing the NHS lead to further reductions in longevity? Or will changes to hygiene practices and the advent of new mRNA technologies bring society back onto the upward path of rising life expectancy?

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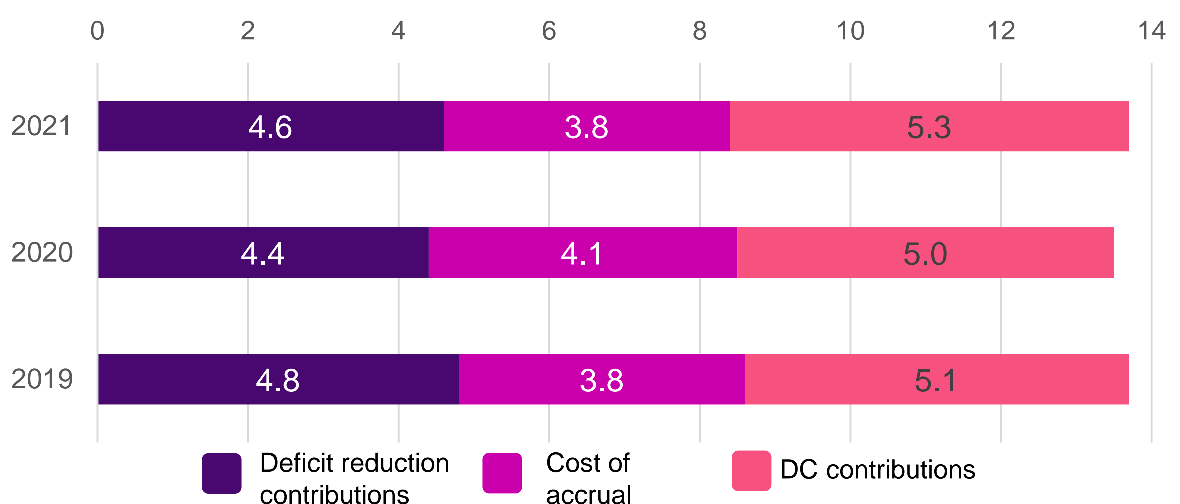
Deficit reduction contributions increase

Aggregate company contributions (£bn)

Data represents FTSE 350 companies with a 31 December year end reporting in 2021



Change in 2021

- 77% of companies made deficit contributions in 2021, compared to 76% in 2020.
- Median deficit reduction contributions increased from £15.3 million to £16 million
- Median future accrual contributions decreased by 22%
- Median DC contributions rose by 14%

Note:
* Cost of accrual has been estimated based on the service cost for companies that still have future accruals
* Not all companies disclose how much they pay in deficit contributions, but we derive an estimate by deducting service cost from total contributions to DB plans.

Most companies had continued to make deficit contributions during the pandemic, with only a small number of employers negotiating contribution holidays (delaying or reducing pension scheme payments due to financial pressures). In 2021, some of these cases have been reversed and some 77% of companies made deficit contributions in 2021, compared to 76% in 2020. There was also an increase in aggregate deficit contributions (£4.6bn in 2021 compared to £4.4bn in 2020).

The cost of accrual fell from £4.1bn to £3.8bn, despite the fact that we would expect a rise given economic conditions. This is explained by a small number of large schemes closing to future accruals and the more general decline in the number of employees still accruing DB benefits.

Contributions to defined contribution (DC) plans continued their long-term movement upwards and totalled £5.3bn in 2021, accounting for 39% of all pension spend (up from 37% in 2020).

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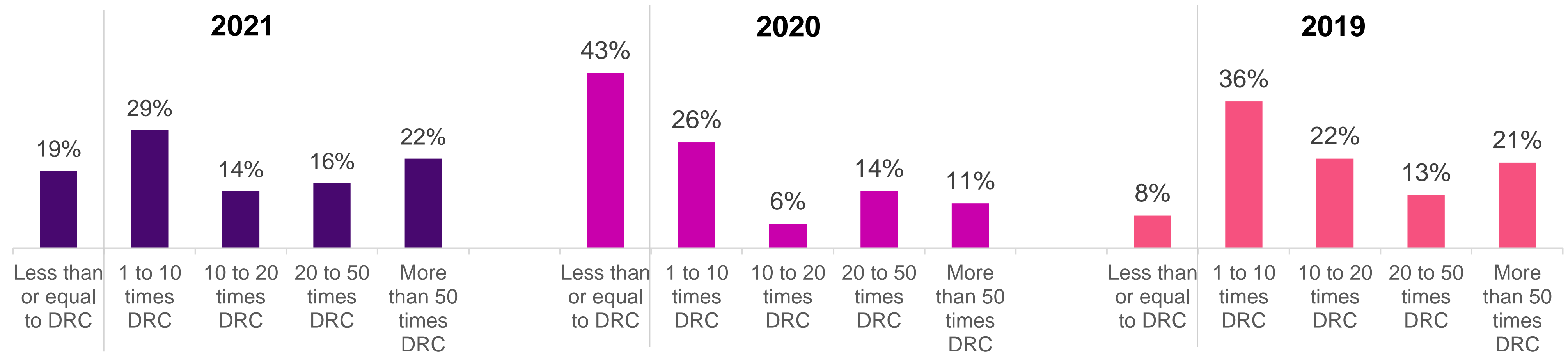
Dividends vs deficit contributions – dividend cuts reversed

Dividends as a multiple of deficit reduction contributions (DRCs)



During 2020 over half of companies in the FTSE 350 curtailed shareholder distributions (cancelled, cut or suspended dividends). By contrast, the Pensions Regulator reported that less than 5% of DB scheme sponsors (not just those in the FTSE 350) agreed a suspension of deficit contributions with scheme trustees. For most, contributions were not interrupted.

As a result, in 2020 we saw a large shift in the balance of company payments to shareholders (dividends) relative to the pension scheme (in terms of DRCs). In 2020, more than 4 in 10 companies paid dividends less than or equal to DRCs (after only 1 in 10 doing so in 2019).

In 2021, with a return to more normal economic conditions, dividend payments have resumed and consequently, the balance between pension contributions and dividends has shifted back, though it still lags a little behind the figure in 2019, with 2 in 10 paying dividends less than or equal to DRCs, highlighting that some employers may still be struggling with the effects of the pandemic.

There is likely to be a further shift in this figure in 2022, as more companies resume dividend payments and indeed with a more positive outlook for pension scheme funding, DRCs may fall.

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2021 saw an improvement in economic conditions and a return to normality on dividends for many employers. We therefore saw the ratio of dividends to deficit reduction contributions move back to levels more commonly seen pre-pandemic after 2020’s dip.

However, the recovery from the pandemic has not been uniform, with some industries taking longer to recover. We therefore expect this ratio to increase further over 2022.

Edd Collins, Senior Director, Retirement

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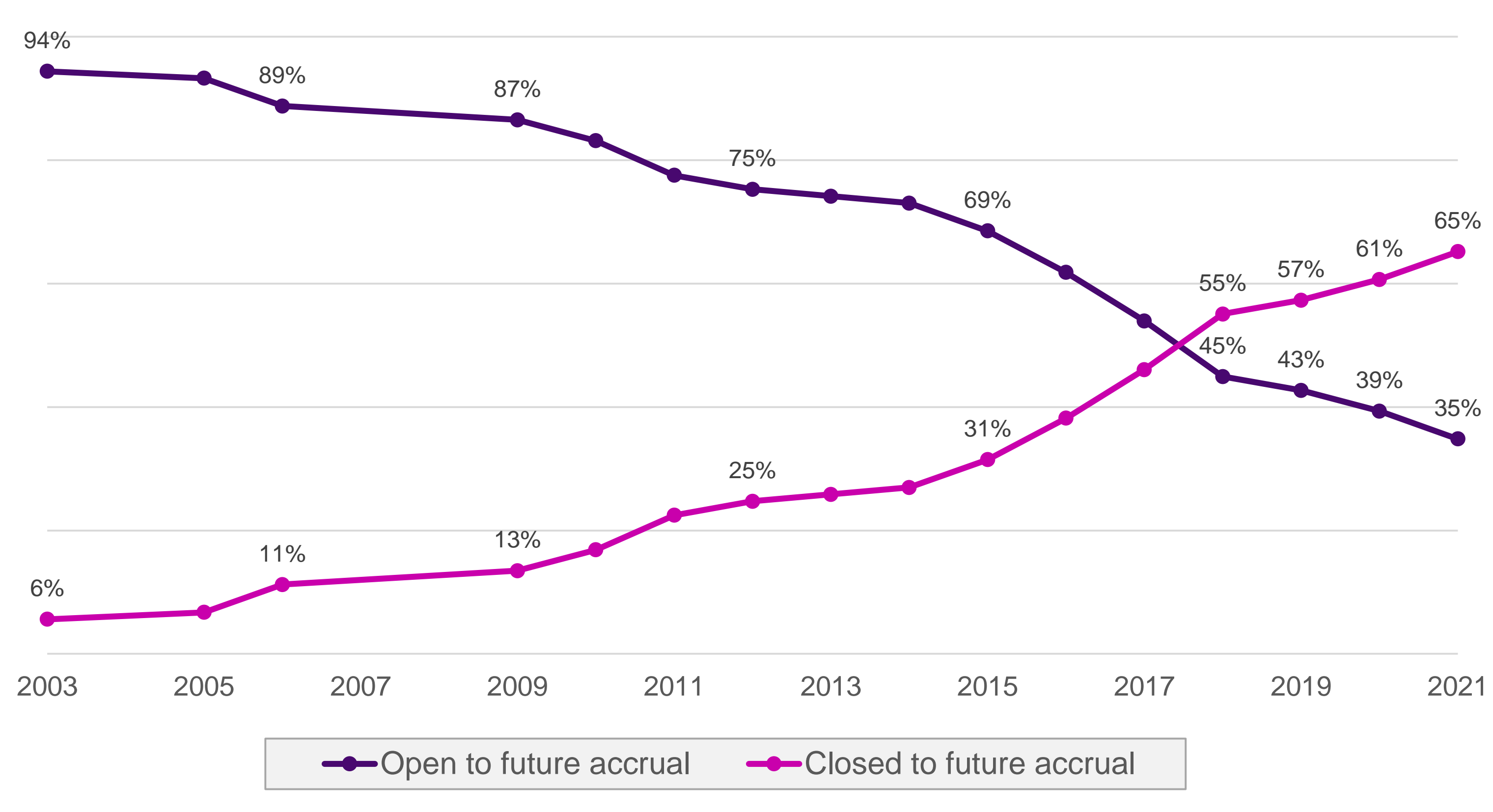
Trend for DB closure continues in 2021

DB plan closure

Data represents FTSE 350 companies with a 31 December year end reporting in 2021.



The proportion of defined benefit plans still open to future accrual declined further in 2021, falling from 39% to 35%. As recently as 2015, over two-thirds had (some) members still accruing DB pension benefits, today it stands at roughly one-third.

Nevertheless, we may be now be reaching a point where this trend slows, with a group of companies for whom DB schemes are difficult to close (due to the cost and difficulty of change) and there may be a weariness to attempt to close schemes in the face of a cost-of-living crisis and stiff opposition from unions to change at the current time.

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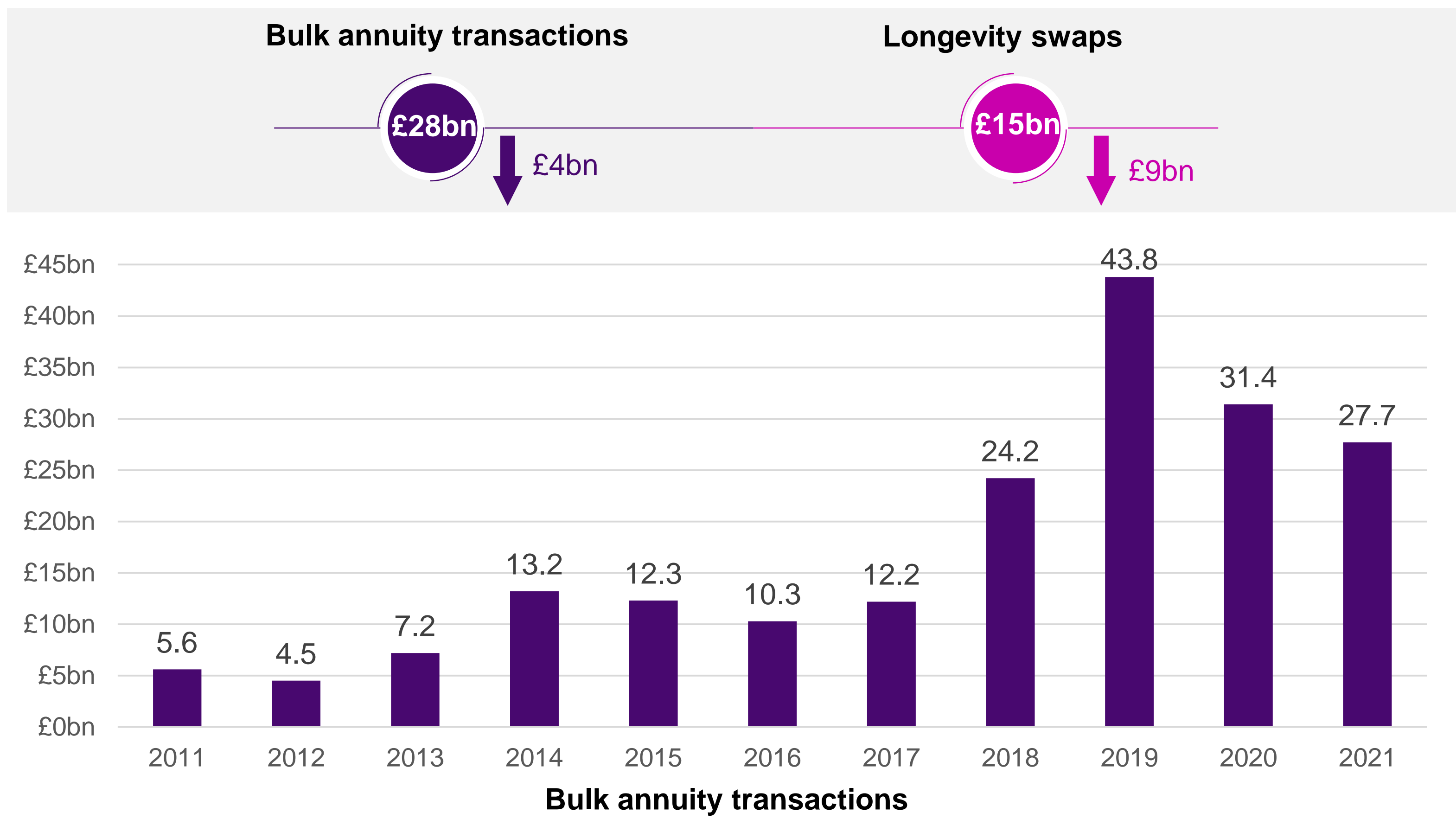
Pension risk transfer transactions remain high

2021 Volume of business (£bn)



* These data include all scheme transactions, not just the FTSE 350

2019 was a record year for bulk annuity transactions with £44bn of pension liabilities secured. 2020 was then, whilst down on the previous year, at £31 billion the second largest year on record.

This was though counterbalanced by record levels of activity in the market for longevity swaps. And the total amount of liabilities subject to longevity swaps in 2020 (£24bn) doubled that seen in 2019 (£12bn).

In 2021, activity was relatively quiet in the first half of the year, but busier in the second half and while levels of activity dipped slightly overall from 2020, bulk annuity transactions were the third biggest on record, at £28bn. Longevity swaps transactions amounted to some £15bn and included the first deferred longevity swap.

2022 has so far seen another quiet start to the year, but again a busy second half is expected, with pricing expected to be attractive (relative to gilt yields) on both buy-ins and longevity swaps.

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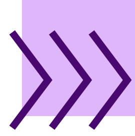
Prospects for 2022 and beyond

Healthy balance sheets

- Focus likely to shift away from accounting measures and onto funding or even buyout
- Deficit reduction contributions are likely to diminish in importance

Investment strategy in focus



- Economic uncertainty continues with increased volatility and the likelihood of further interest rate rises. This may result in unexpected movements in funding positions as hedging strategies are put to the test
- Continued focus on resilience to climate change and other ESG factors

Inflation

- High inflation to continue to be a major factor in the short-term
- May trigger pressure for discretionary increases from members if it persists throughout 2022

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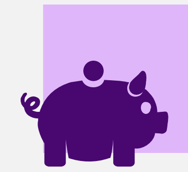
About the survey

FTSE 350 DB Pension Scheme Survey

	FTSE 350	with December 31 2021 year ends
	155 Companies with DB pension liabilities	**89** Companies with DB pension liabilities
		
Market cap	**£1.9 trillion**	**£1.4 trillion**
DB liabilities	**£655billon**	**£531 billion**

Further information

If you would like to discuss the content of the survey please contact your usual WTW consultant or:

Edd Collins
Senior Director, Retirement
edd.collins@willistowerswatson.com

Charles Rodgers
Senior Director, Retirement
charles.rodgers@willistowerswatson.com

This report is based on the published disclosures of 89 FTSE 350 companies with defined benefit pension liabilities reporting at 31 December 2021.

These companies comprise around 81% of all FTSE 350 DB pension obligations.

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