Emerging Trends in DB

Key messages from our 2023 survey

A shift in focus

The last three year has seen a major shift in the outlook for Defined Benefit (DB) pension schemes: from a world of low interest rates and often a focus on repairing deficits, to one where interest rates have risen sharply and funding levels are typically much improved. Indeed, many schemes are now left pondering how to use their new-found surpluses. Alongside that, the regulatory pendulum seems to be swinging away from a regime that encouraged de-risking towards one that is trying to encourage more productive investment.

With all that change, the focus of UK DB pension schemes has unsurprisingly shifted. In the 2023 edition of our Emerging Trends in DB survey we track how schemes are reacting and responding to the new challenges and opportunities these circumstances present, covering a wide range of topics such as views on the Mansion House reforms, developments in the settlement market, and Pensions Dashboards.

In Figure 1 we can see the evolution of priorities for DB pension schemes since 2020.

Figure 1. **Most important issues for your scheme.**

This year

Year of survey	2020	2021	2022	2023
#1	'GMP equalisation' 55%	'GMP equalisation' 59%	'GMP equalisation' 64%	'GMP equalisation' 60%
#2	Long-term journey planning 36%	Long-term journey planning 37%	Long-term journey planning 37%	Investment strategy 40%
#3	Investment strategy 36%	Funding negotiations 36%	Pension dashboards 36%	Long-term journey planning 37%
#4	Funding negotiations 33%	Investment strategy 31%	Investment strategy 33%	Member experience 29%
#5	Sponsor covenant 30%	Scheme governance 22%	Settlement 30%	Settlement 27%

The next three years

Year of survey	2020	2021	2022	2023
#1	Long-term journey planning 60%	Long-term journey planning 56%	Long-term journey planning 47%	Settlement 48%
#2	Investment strategy 36%	'GMP equalisation' 33%	'GMP equalisation' 47%	Long-term journey planning 42%
#3	Settlement 34%	Investment strategy 31%	Settlement 37%	Pension dashboards 40%
#4	'GMP equalisation' 30%	Settlement 29%	Investment strategy 31%	'GMP equalisation' 30%
#5	Sponsor covenant 26%	Dealing with climate change 29%	Pension dashboards 31%	Investment strategy 29%

Note: Up to four options could be chosen. Settlement includes: Buy-ins, buyouts and longevity swaps
Source: 2020-2023 Emerging Trends in DB Pensions Survey

Whilst ‘GMP equalisation’ remains the most pressing issues schemes face in the short-term (the year ahead), increasingly this is seen as an issue that will be resolved soon – with its prominence dropping sharply when schemes look three years hence. In the immediate aftermath of the Lloyds judgment there was some optimism around the ability of the schemes to address the issue relatively quickly. Whilst such optimism proved unfounded and the reality of ‘GMP equalisation’ being a longer-term area of focus seemed to dawn in 2021 and 2022, 2023 suggests schemes might be turning a corner.

Since 2021, one of the key developments in UK DB pensions has been the improvements seen in scheme funding. This has shifted priorities in two ways: in the short-term (the one-year view) funding negotiations have become less important and in the medium term (three-year) the view has clearly shifted towards settlement (buy-ins, buyouts, longevity swaps, etc).

Over half of schemes (55%) report buyout represents the long-term target for the DB scheme and nearly 3 in 5 of these (59%), so just under a third of all schemes (32%), are looking to buyout their liabilities in the next five years and are accelerating their preparations for buyout now.

Few see significant barriers to future buyout transactions due to limited market capacity. Indeed, this may reflect a number of steps seen to increase market capacity towards the end of 2023. In September 2023, M&G re-entered the bulk annuity market. While in November 2023, the first superfund deal was announced by Clara, providing an alternative to traditional buyout, especially for schemes where the covenant is not certain. We are aware of other interested parties exploring entry to the bulk annuity market.

The shift in focus to settlement may also explain the increased short-term focus on investment, with schemes potentially seeking to address the presence of illiquid assets prior to buyout, adding to a broader sell-off of these assets in the aftermath of the LDI crisis. In the medium term, however, investment issues are felt to be less of a pressing issue.

Finally, the Pensions Dashboards programme has dropped significantly down the immediate agenda.

With the delay to the programme’s connection deadline from August 2023 (for first movers) to October 2026 we can see a shift in the time horizons for dealing with this, from a one-year priority in 2022 to a three-year priority in 2023.

Views on regulation and the Mansion House reforms

In recent years there has been a number of voices suggesting that regulation of defined benefit pension schemes has become too stringent, forcing schemes to be overly conservative in their investment strategies and leading them away from productive investment in new companies, towards "unproductive" investment in government bonds to the detriment of the UK economy. With increased scheme funding levels these views have grown in prominence.

The Government has been keen for DB schemes to invest in productive asset classes – without jeopardising members' benefits – and has looked enviously at other countries experiences, where schemes appear more likely to invest in infrastructure projects and start-up companies. In the summer of 2023, the Chancellor used his Mansion House speech to announce plans to get UK pension funds investing in high growth UK companies and other productive asset classes. These plans were built upon with the announcements in the recent Autumn Statement.

We examined both of these premises in our survey, testing trustee and corporate views on the following:

1. Whether regulation has encouraged excessive de-risking.
2. Whether investment in productive asset classes by UK pension schemes has been insufficient.

In Figure 2 we can see that most trustees (just over half) think that regulation was broadly appropriate (i.e., led schemes to de-risk about the right amount). Just under half of corporate respondents also share this view.

However, nearly 4 in 10 trustees and just over half of corporates feel that schemes have de-risked too much in response to regulation.

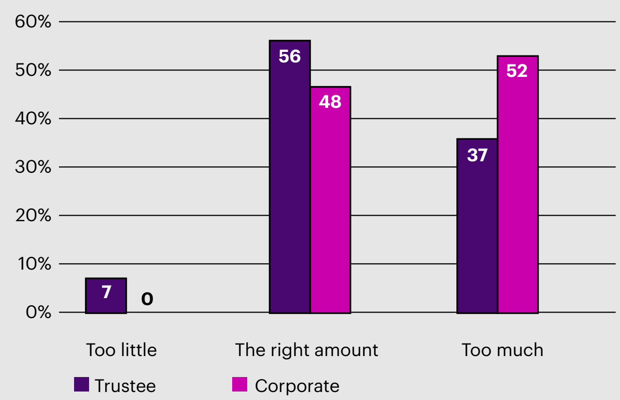
A very small group (less than 1 in 10 trustees and no corporates in this sample) think regulation was too light.

There is therefore significant (but not necessarily majority) support for the view that the last decade has seen an excessive focus on de-risking. We expect the government's recently announced plans alongside the Autumn Statement to make "changes to the DB funding code of practice to support a less risk-averse approach to encourage scheme investment in productive finance" should therefore find support.

There is also more significant support for the notion that regulation should have a wider focus: 78% of respondents report that regulation of DB schemes should focus more on better outcomes for members, while just over half (51%) suggest regulation should take account of the wider impact of pension schemes on the UK economy. Alongside a desire for greater focus on outcomes of members, two-thirds (67%) agree regulation should make it easier to return surplus to members. It would seem there is a desire for regulation to be more holistically member-focussed rather than narrowly focused on the security of accrued benefits.

There is also a recognition that if the government wishes to foster more investment in growth assets it may need to make it easier to share surplus more broadly, with 63% of respondents agreeing that sponsors would be more willing to take risk in this instance. Once again, this would appear to suggest there is broad support for the government's plans (announced in its response to its call for evidence on Options for Defined Benefit schemes) to make "surplus extraction easier" and "introduce measures to ensure surplus can be shared with scheme members", alongside appropriate safeguards.

Figure 2: **Current regulation led schemes to de-risk:**



Source: 2023 Emerging Trends in DB Pensions Survey

On the level of UK pensions investments in productive assets, one of the underlying premises of the Mansion House reforms is that this is suboptimal today. What are trustee and corporate reactions to these views? In Figure 3, we can see that only a minority believe schemes do not currently invest enough in these assets (20%). Correspondingly, only 1 in 5 see it as a likely trend emerging in the future.

Hence, there is a challenge. Whilst many are supportive of a regulatory environment with broader ambitions and many agree regulation has been excessive, few perceive there has been a failure amongst pension schemes to invest in productive assets. Perhaps this simply reflects the fact that, until now, few trustees or corporates have seen value in investing in productive assets given the regulatory framework? Could the Government's plans to make surplus extraction easier, and less penal from a tax perspective, change this view? Actions over 2024 will tell, as DB schemes react to an ever-evolving landscape.

Figure 3. **Schemes' investments in Alternative assets.**

Insufficient investment | **Increasing in the future**

Schemes do not currently invest enough in them

Schemes investing more in these assets will be a significant trend in the next 3 years

Q: How strongly do you agree or disagree with the following statements on pension schemes investments in the UK?
Note: Percentages indicate 'agree' or 'strongly agree'. Don't know ranges from 3% to 9%.
Alternative assets investments refers to start-ups, infrastructure and private equity.
Source: 2023 Emerging Trends in DB Pensions Survey

About the survey

Our sixth annual survey examining emerging trends in Defined Benefit pensions examines the changing priorities for pension schemes in the aftermath of the LDI crisis, rising interest rates and improved pension scheme funding and against a backdrop of government moves to encourage schemes to invest more in productive finance assets. This year's survey was completed in September and October 2023 and contains responses from 89 trustees and pension scheme managers.

Contact us to find out more about the survey results.