

Responding to market conditions: Actions for pension scheme sponsors

The cost-of-living crisis and broader economic environment are providing employers with several challenges and pension opportunities.

Businesses and organisations are having to manage the impact of rising costs on their operations and needing to look at interventions to support employees. However, there is one area where there is some good news.

For defined benefit (DB) pension schemes, these market conditions have typically led to meaningful improvements in their funding positions. Most employers have moved from having to manage funding deficits to being close to longer term targets.

As a result, it is now critical that sponsors take action to understand how their pension schemes are affected; look for opportunities to capture these improvements and review what next for their journey plans.

With the Department of Work and Pensions (DWP) consultation on funding and investment strategy giving more clarity on the direction of travel, now is the time for sponsors to take stock of their long-term pension strategy.

**It is helpful to have a clear process to work through when looking at this.
The key steps are to:**

1

**Assess the
impact**

2

**Understand the
opportunities**

3

**Engage with key
stakeholders**

1

Assess the impact

Sponsors can use the checklist below to help you understand how your scheme has been affected by the current market environment.

Funding

Yes

To do

1. Have you got a clear understanding of how current market conditions have affected the funding position of your scheme(s) on the following key measures:

- Technical provisions
- IAS 19
- Self-sufficiency/low dependency
- Buyout

☐☐

2. Do these updated positions allow for high short-term inflation?

☐☐

3. Has an up-to-date analysis been carried out in order to set your demographic assumptions?

☐☐

Covenant

Yes

To do

1. Are you clear on how current market conditions have affected the employer covenant available to your scheme? See our more detailed [checklist on employer covenant](#) for a full list of issues to consider.

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2. Are you looking to refinance? If so, have you considered The Pension Regulator's latest comments on what pensions schemes should look at during a refinancing exercise?

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3. Have you considered whether any alternative / non-cash forms of employer support could help?

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Long-term strategy

Yes

To do

- | | | |
|--|--------------------------|--------------------------|
| 1. Do you have a long-term strategy for your pension scheme? | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Have you reviewed your long-term strategy in light of the impact of current market conditions? | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. Do you know how the DWP's consultation on new regulations for scheme funding and investment might affect your long-term strategy? | <input type="checkbox"/> | <input type="checkbox"/> |

Inflation

Yes

To do

- | | | |
|--|--------------------------|--------------------------|
| 1. Have you considered how you would respond if your trustees wanted to grant a discretionary pension increase to pensions in payment? | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Have the terms for any member options (e.g. early retirement, commutation, pension increase exchange) been reviewed to take into account high short-term inflation? | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. Have you considered what support could be given to your employees to help them deal with the cost-of-living crisis? | <input type="checkbox"/> | <input type="checkbox"/> |

Investment strategy

Yes

To do

- | | | |
|--|--------------------------|--------------------------|
| 1. Has your scheme's hedging strategy been reviewed in light of current market conditions? | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Has your scheme got sufficient liquidity to meet any capital calls from LDI managers and higher benefit payments? | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. Have other investment opportunities been considered in light of current market conditions? | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. Does your scheme's investment strategy align with your corporate ESG objectives? | <input type="checkbox"/> | <input type="checkbox"/> |

Depending on your scheme's funding position, there are a range of opportunities for you to consider when forming a plan of action.

100% funded on buyout

Close to buyout

- Engage with your trustees around strategy for approaching the insurance market
- Consider the accounting implications of different insurance transactions and discuss these with your auditors
- Look at member options exercises to bridge any remaining gap to buyout cost
- Work with your trustees to ensure the scheme's investment strategy matches insurer pricing and there is enough liquidity to allow a transaction to happen at short notice
- Seek to stop any deficit contributions already committed

Buyout deficit

- Actions above will still apply, but will have more time to implement
- Review your current approach to member options exercises (both bulk and at-retirement): a well-designed exercise could reduce the term to reaching full funding against a buyout cost

100% funded on low dependency

Low dependency deficit

- Review investment strategy to ensure the right balance between returns and risk: in particular consider hedging levels in the current economic climate
- Manage cash contributions carefully: consider diverting any future contributions towards an escrow account to mitigate the risk of over-funding

100% funded on technical provisions

Technical provisions deficit

- Monitor funding position going into your next triennial actuarial valuation and think about contingency plans in case the funding position deteriorates
- Review demographic assumptions: do these properly reflect your scheme's characteristics allowing for the impact of the pandemic?
- Is your scheme's investment strategy still appropriate? A review could help reduce risks without sacrificing returns
- Start considering options to manage overfunding if committed contributions are more than is needed

3

Engage with key stakeholders

Once you have a plan of action, you will need to engage with your trustees (and their advisors) and obtain any required corporate approvals.

Trustees are likely to be considering what actions they should be taking in light of current market conditions, so it is important to be proactive to make sure that any actions taken by the trustees align with your own objectives.

Given the volatility of current market conditions, you should look to act quickly to take any steps needed to bank improvements in your scheme's funding position, otherwise there is a risk that conditions change again and any improvements are lost.

About us

XPS Pensions Group is a leading pensions consulting and administration business focussed on UK pension schemes. XPS combines expertise, insight and technology to address the needs of over 1,500 pension schemes and their sponsoring employers on an ongoing and project basis. We undertake pensions administration for over 968,000 members and provide advisory services to schemes and corporate sponsors with schemes of all sizes, including 51 with assets over £1bn.

XPS Corporate Advisory has a long history of helping clients find solutions to their pension and employee benefit problems. We have more than 400 corporate clients who sponsor defined benefit and defined contribution pension schemes in a range of industries and a range of sizes, the largest of which has almost 300,000 members in a defined benefit scheme with more than £50 billion of assets. Our team of over 100 corporate advisory experts provide tailored and personal advice on a range of issues including pension and investment strategy, benefit change, accounting, corporate transactions and insurance solutions.

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