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XPS Express for Employers

Bringing you the latest pensions news for employers

The landscape for DB schemes after the Mansion House speech

At a glance

In his speech on 10 July, the Chancellor announced a series of consultations to encourage pension scheme investment in UK growth and increase returns for savers. These consultations will close on 5 September, with the outcomes expected to be announced in this year's Autumn Statement

The Government is considering how defined benefit (DB) scheme assets could be used more flexibly, while still protecting accrued benefits. This may create opportunities for employers to access surpluses more easily

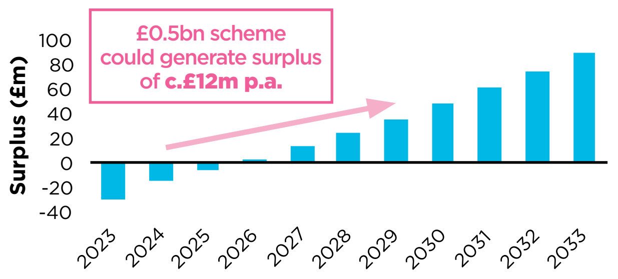
A permanent regulatory regime for superfunds will be introduced, which may allow liabilities to be settled at a lower price versus a traditional buyout

New requirements around trustee skills and training are being considered, which may lead employers to review the make-up of their trustee boards

The speech's policy intention has created uncertainty over the new funding and investment regime. Actions being considered in light of the new regime should be reviewed once the outcomes of the Mansion House speech are clearer

Running schemes on can generate significant surplus

Running a scheme on with a well-managed investment strategy could be preferable to securing benefits with an insurer.



Current tax rules mean the employer could only realise **c.£8m p.a.** of this surplus by taking a refund but the Government are reviewing these rules.

Potential DB scheme endgame options following Mansion House speech

Option	Overview
Run scheme on	• Generate surplus by taking sensible investment risk, to provide discretionary benefits/fund other schemes/be refunded to the employer.
Delayed insurance	• Generate surplus ahead of a future insurance transaction. • Agree framework for when insurance will be considered.
Insurance (buy-in/buyout)	• Typically the most secure form of risk transfer. • Currently very high levels of demand for these transactions.
Superfund/ consolidator	• Potentially most cost-effective way to remove DB scheme from balance sheet. • New regulatory regime may widen circumstances when these transactions may be feasible.

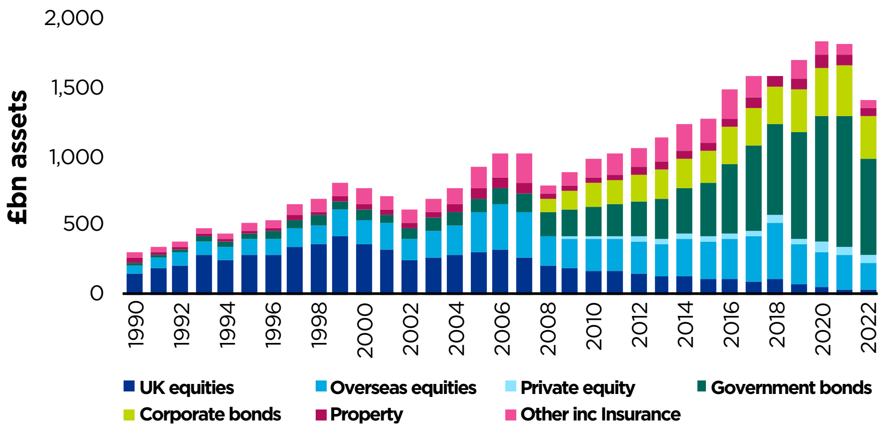
Actions employers can take

1. **Understand:**
   - **how well funded your DB scheme is against a realistic buyout cost;**
   - **when your DB scheme might start to generate a surplus; and**
   - **the potential size of that surplus if the scheme runs on.**
2. **Consider the different endgame options (run on, buyout, superfund etc) and decide which option is best for your DB scheme and your business.**
3. **Engage with your trustees on your preferred endgame option to ensure interests are aligned.**

Why is the Government considering changes?

The Government's intention is to encourage greater investment by pension schemes in UK 'productive finance', i.e. investment that provides equity capital and finance for UK businesses including start-ups, infrastructure and private equity. The charts below show that the allocations to UK equities by DB schemes have fallen significantly over the past 20 years, but that investments by DC schemes are expected to plug the gap left by DB schemes as they continue to de-risk.

UK DB schemes: Historic asset allocation 1990 – 2022



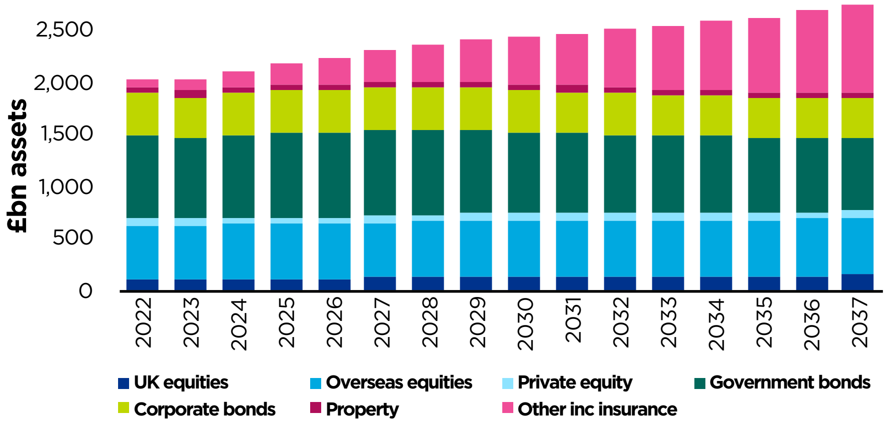
Source: UBS Pension Fund indicators 1990-2007, Purple Book 2008-2022

Over the past 20 years, DB schemes' allocation to UK equities has fallen materially, from around 50% to less than 2%.

Why has this changed?

- **Early 1990s** – DB schemes invested in 'balanced funds' which were roughly 70% UK equities.
- **Late 1990s/early 2000s** – increased diversification into global equity markets (of which UK equities make up only 4% by 2022).
- **2010s onwards** – schemes de-risked away from equities into lower-risk assets, e.g. bonds.

UK combined DB and DC schemes: Projected future asset allocation



Source: XPS calculations, Purple Book 2022, Pension Policy Institute, Corporate Adviser

To support the Government's intentions, nine of the largest DC providers in the UK (representing the majority of the UK's workplace DC pensions market), have committed to allocate 5% of their default funds to unlisted equities by 2030.

This chart allows for this change, and shows the allocations to UK equities across both UK DB and DC pension schemes is expected to remain stable in the future.

While it is helpful that the DC market can provide a source of capital for UK productive finance opportunities, it is unclear whether the Government's intention for DB schemes to also provide this source of capital will be realised. For this to happen, employers will need to explore how the assets held by DB schemes could be deployed to generate surplus, while maintaining the security of accrued benefits so that balance sheet positions remain stable and unwanted deficits do not emerge.

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