

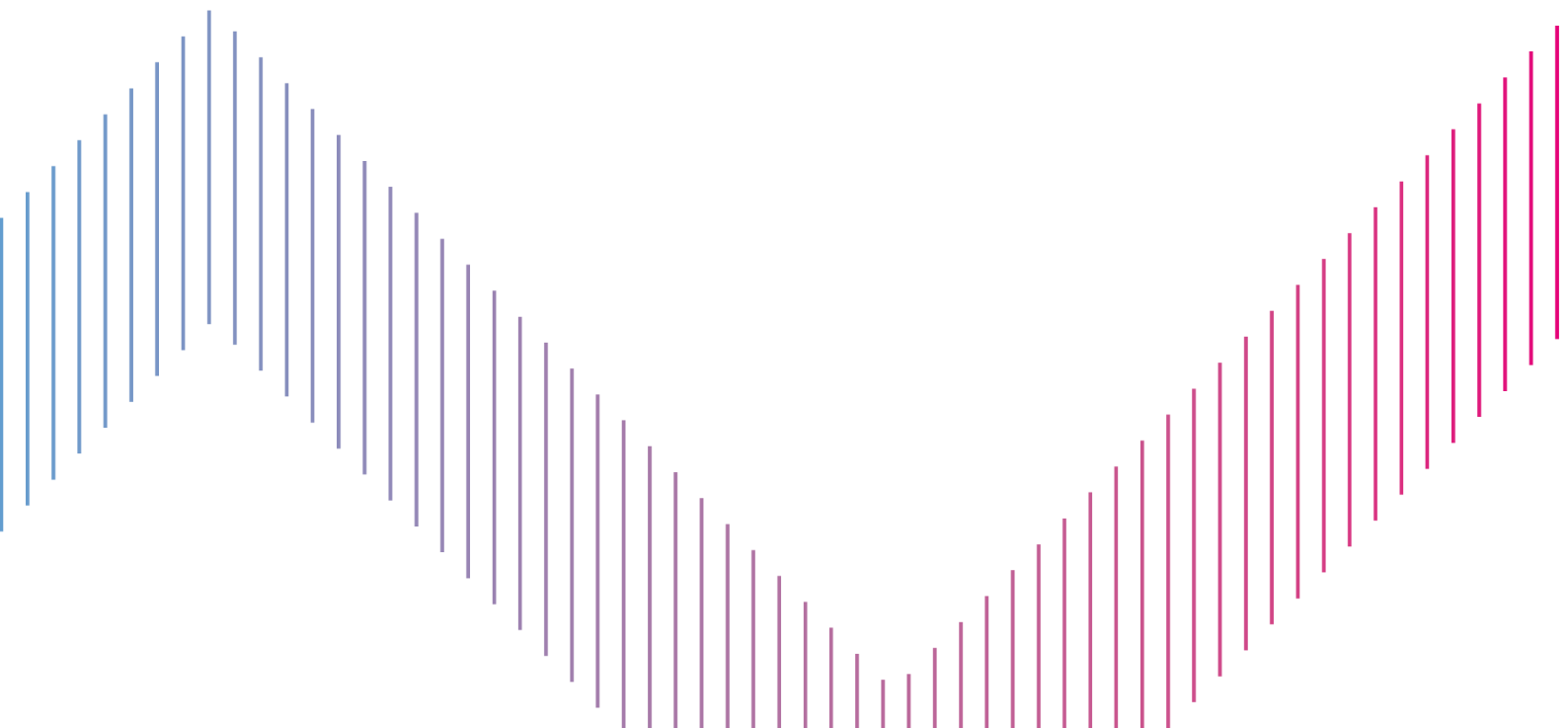
Approaching your 2023 valuation

Our guide to the key issues facing those with 2023 valuations

Valuations in 2023 will be set against a backdrop of high inflation, high interest rates and slow economic growth – all of which may affect pension scheme funding and employer covenant. Longevity uncertainty and changing regulation throw up other challenges, giving you plenty to think about.

Your triennial valuation remains one of your most important risk management exercises. It is an opportunity to reassess if funding and investment plans are appropriate, and make sure effective monitoring and contingency mechanisms are in place. Now more than ever trustees need long-term journey plans that align funding, covenant and investment decisions with activities such as data cleansing, and insurance strategies.

The route map sets out how to get the most from your 2023 valuation.



1.

Plan and prioritise

The focus for this valuation may be different

To make the best use of your time and effort, you need to plan your valuation thoroughly. A lot has happened since 2020, so it's likely you're in quite a different position three years on. If ever there was a time to take stock and plan the journey ahead, it is now.

Significant rises in gilt yields and favourable investment conditions over the past three years have improved many schemes' funding positions. Your focus may therefore be on long-term plans and contingencies rather than repaying deficits. You may be closer to buy-out than you think.

Your plan should be based on an updated assessment of your position. But you also need to agree on priorities so that everyone's energy is channelled in the same direction.

2.

Catch up on regulatory developments

Assess the impact of the Pensions Regulator's new funding code of practice

The pensions landscape has changed a lot in three years, and more change lies ahead. Discussions should cover the implications of the Pensions Regulator's new funding code of practice. Although it won't apply to valuations until after 1 October 2023 (at the earliest), the Regulator's view of good practice is still relevant.

If your valuation is earlier in 2023, it makes little sense to agree a funding framework without an eye on how it's likely to work with the new code.

While you wait for the final details, you could assess how your plans stack up against the latest proposals. How far is your scheme from significant maturity and how should the journey plan to get there look? Mature schemes are encouraged to focus on their shorter time horizon for improving funding and reducing risk.

The new DB funding code

In a nutshell, schemes will be required to:

- Formalise a long-term 'low-dependency objective' for funding and investments.
- Set a journey plan for how to manage risk to meet the objective, with the technical provisions target and investment strategy converging to low dependency as the scheme matures.
- Either meet the 'Fast Track' tests or go down a 'Bespoke' route to compliance. Fast Track will in effect act as a filter, and the Regulator is unlikely to scrutinise a valuation further if the strategy meets specified parameters. These require a plan to be fully funded on a gilts + 0.5% pa basis (or stronger) by the time duration falls to 12 years, a technical provisions recovery plan of 6 years or less, and investment risk below specified limits.

Read more on the proposals in our [Sixty second summary](#).

3. Think about the long term

Ensure decisions are made in support of long-term goals

Long-term funding and investment strategy has never been more important, whether driven by an improved funding position or upcoming regulatory change.

Think about how appropriate a long-term target is, or consider putting one in place. At the heart of this assessment is the final plan for discharging a scheme's liabilities. Whether the scheme is ultimately targeting buy-out or run-off, reviewing arrangements with a clear objective in mind can ensure any changes support that objective.

Ensure your technical provisions, funding and investment plans are suitably strong and aligned with your long-term goal.

4. Review employer covenant

Probe the effects of macroeconomic uncertainty on your sponsor

Some employers may be struggling with ongoing affordability, especially those that can't easily pass increased costs on to customers. Consider how you'll approach a covenant review, what information you need and whether to expand your assessment. The new DB funding code will require you to look specifically at visibility, reliability and longevity. It may also be helpful to explore how things might change over your covenant reliability period.

Trustees should be vigilant to any corporate activity (such as mergers and acquisitions, refinancing or reorganisation) and other value leakage to ensure fair treatment for the scheme. For trustees who consider their sponsor to be at particular risk, the valuation is a good opportunity to seek extra protections. You should carefully consider requests for a temporary reduction or easement in contributions.

Watch for more guidance on assessing and monitoring covenant later in the year.

5.

Refresh valuation assumptions

Longevity assumptions are of particular interest

Consider what assumptions to update in the light of changes since the last valuation, especially investment and covenant changes. As funding levels improve and focus switches to low dependency, it may be worth reviewing how expenses are funded.

Longevity assumptions need particular attention following the Covid-19 pandemic. Its long-term impact on mortality trends is still uncertain. However, the pandemic, pressures on the NHS and the cost-of-living crisis all suggest that mortality rates are unlikely to revert to pre-pandemic levels in the short term.

Indeed, 2022 has been another heavy year for UK mortality, with excess deaths relative to pre-pandemic levels. The CMI believes mortality in 2022 may be more indicative of future rates than the exceptional years of 2020 and 2021 were. Reductions in longevity are likely to come through once the CMI2022 tables are published in June 2023.

6.

Adjust your funding and investment strategy

Balance changes to contributions, investments and covenant by looking at these together

Combine funding and investment strategy in a way that gives you the best chance of paying the benefits you have promised to members at a reasonable cost and risk to you.

Schemes with LDI will need to reposition portfolios to have enough liquidity to support reduced leverage and more prudent management frameworks. Funding improvements may present an opportunity to accelerate de-risking plans for some schemes, which might even think about getting strategies buy-out ready. Other schemes will have to choose between less hedging or lower returns. Horizons for illiquid assets will be important to consider.

If in a technical provisions deficit, you'll need to assess your recovery plan, making changes to balance risk, affordability and other protections. **The average recovery plan is now less than six years, and longer plans are likely to attract attention.** Reducing deficit contributions is unlikely to be acceptable without a strong affordability argument.

Escrow, guarantees or other non-cash options remain useful tools for taking more risk, and help to reduce the risk of the scheme generating a surplus that the company can't get back. They could have a role in managing the path to buy-out.

7.

Plan for what could happen post-valuation

Test, monitor and have robust contingency plans

As economic uncertainty continues, you should test assets, liabilities and covenant against several future scenarios to inform decisions, assess risks and implement meaningful contingency plans.

The past few years remind us that things can change quickly. Robust contingency planning prepares you for the inevitable changes along your scheme's journey. A framework with ongoing monitoring, triggers and agreed actions lets you act swiftly when opportunities or risks arise.

Contingency plans could cover covenant deterioration, sharing in future successes (eg through dividend-sharing mechanisms) or accelerating de-risking. Mechanisms to switch contributions back on if funding deteriorates help keep plans on track without needing to wait until the next valuation.

Consider whether you need to allow for changes between the valuation date and signing off plans.

8.

Start to get buy-out ready

Optimise your scheme's journey to buy-out through careful preparation

Improved funding and insurer pricing means that many schemes may find buy-out affordability much closer than expected. If insurance is your goal, the sooner you start planning for buy-out, the better.

A triennial funding valuation is an opportune time to develop or refine your endgame plan. As well as looking to lock in gains, think about scheduling other buy-out readiness actions, including data cleansing and GMP equalisation. It's also a good time to make sure you understand the position and powers in relation to eventual buy-out and surplus refunds.

We expect the risk transfer market to stay busy, so planning ahead will help you get the best deal.

Expert strategic planning should take all the different activities and turn them into a cohesive plan. Even if buy-out isn't a medium-term goal, optimising the scheduling of operational projects makes sense.

A quick guide to your priorities



Well funded, de-risked and planning for insurance

Know when buy-out might be affordable – you may be closer than you think. Start planning now.



Fully funded on a technical provisions basis, or close to it

Agree whether you're ultimately targeting buy-out or run-off and develop long-term plans with suitable contingencies. For example, if funding deteriorates, contingent contributions will help get plans back on track before the next valuation.



Strong sponsor but weak funding or funding plans off track

Strengthen your funding target, increase deficit reduction contributions and shorten your recovery plan. Test plans against the new funding code to see how big any gap is.



Strained sponsor

Focus on fair treatment against other stakeholders and mitigating against further covenant weakening through non-cash or wider group support.

Want to find out more?

To find out how we can help with your 2023 valuation, please get in touch with your usual Hymans Robertson contact or one of our experts:



Laura McLaren

Partner and Head of Scheme Actuary Services
laura.mclaren@hymans.co.uk
0141 566 7914



Lisa Deas

Scheme Actuary
lisa.deas@hymans.co.uk
0141 566 7619



Amy Walker

Actuarial Consultant
amy.walker@hymans.co.uk
0141 566 7761