



FTSE 350 DB Pension Scheme Report 2024

Defined benefit pension schemes and
their impact on company accounts at 31 December 2023

May 2024

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Executive summary

Welcome to the 13th WTW report discussing the impact of defined benefit (DB) pension schemes on FTSE 350 company accounts, analysing the published disclosures of companies reporting at 31 December 2023..

The story of 2023 – a major turning point for DB pensions in the UK

1	Accounting positions broadly unchanged over 2023	Aggregate funding positions (assets compared to the value of liabilities) remained robust at 109%. This was a small reduction compared to the end-2022 position
2	The cost of pensions dropped significantly	The cost of DB pensions dropped steeply in 2023, reflecting an increase in discount rates from the prior year. Median DB pension contributions fell by a fifth and (in real terms) are the lowest for many years.
3	DC contributions exceed DB contributions for the first time	For the first time, DC contributions exceed those paid into DB plans (in companies where both are present). With much of the difficulties around DB funding seemingly in the rearview mirror, employers may now turn their focus to DC, considering retirement adequacy, choices and support.
4	No DB plan closures for the first time in 20 years	The proportion of employers with defined benefit plans still open to future accrual was unchanged in 2023, at 28%.
5	A record year for de-risking transactions	2023 was the busiest on record for the bulk annuity and longevity hedging market, with £59bn of de-risking transactions. Accounting for rising gilt yields, 2023 would be double the previous 2019 record!
6	Biggest reduction in assumed life expectancy for over a decade	Assumptions for life expectancy fell by around five months for both men and women, to the lowest level for over a decade

Balance sheet positions show a moderate decline

For much of the last decade, pension scheme financing has been characterised by low interest rates, deficits and additional deficit reduction payments from employers.

But the last three years have seen a reversal in that trend. Rising bond yields at a time when equity markets performed strongly alongside reducing life expectancy assumptions have all combined to improve funding positions substantially in 2021 and 2022.

In 2023, accounting positions remained broadly unchanged, with aggregate surplus falling slightly from £39 billion (relative to £348 billion liabilities) to £31 billion (relative to £359 billion liabilities) and aggregate funding ratios were 109% in 2023 (compared to 111% in 2022). The number of FTSE 350 companies reporting a surplus on an accounting basis stood at 62% (up from 38% in 2020, but a small decline from 66% at the end of 2022).

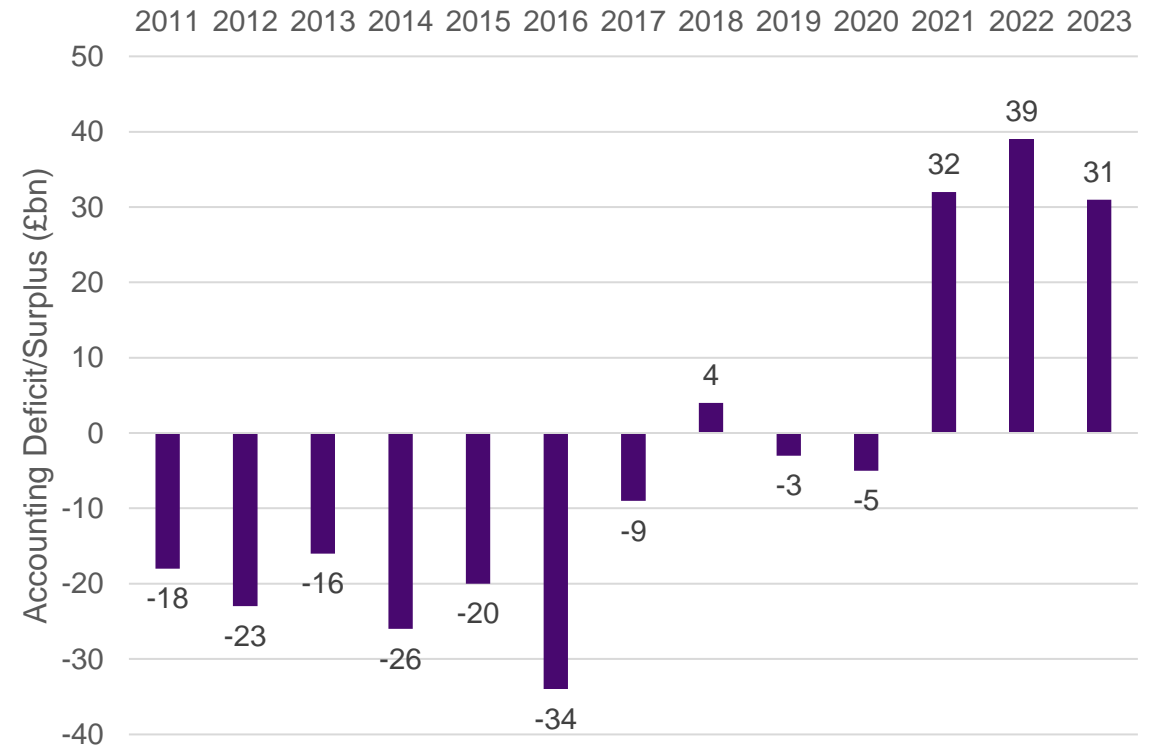
The moderate deterioration in funding positions was largely driven by a fall in discount rates increasing liabilities. Asset values showed a small increase (from £388 to £390 billion), which only partially offset the liability increase.

The focus of many companies is now shifting towards buyout. However, with the Government consultation on access to surplus on an ongoing basis, this may lead some sponsors to revisit their long-term strategic objectives and also consider the various accounting implications. With buyouts in some cases leading to significant losses through Profit & Loss (P&L) accounts, companies could engage with the market and their investors early to explain the wider benefits of buyout and the limited true economic value of the surplus.

Similar considerations also apply to any government proposals to make sharing of surplus with members easier (e.g., through permitting one-off discretionary lump sums). Despite these being provided from surplus assets, they will typically result in losses through P&L. Companies could therefore also consider alternative non-GAAP metrics that better represent the business implications and start informing the market of these.

Accounting deficits/surplus (£bn)

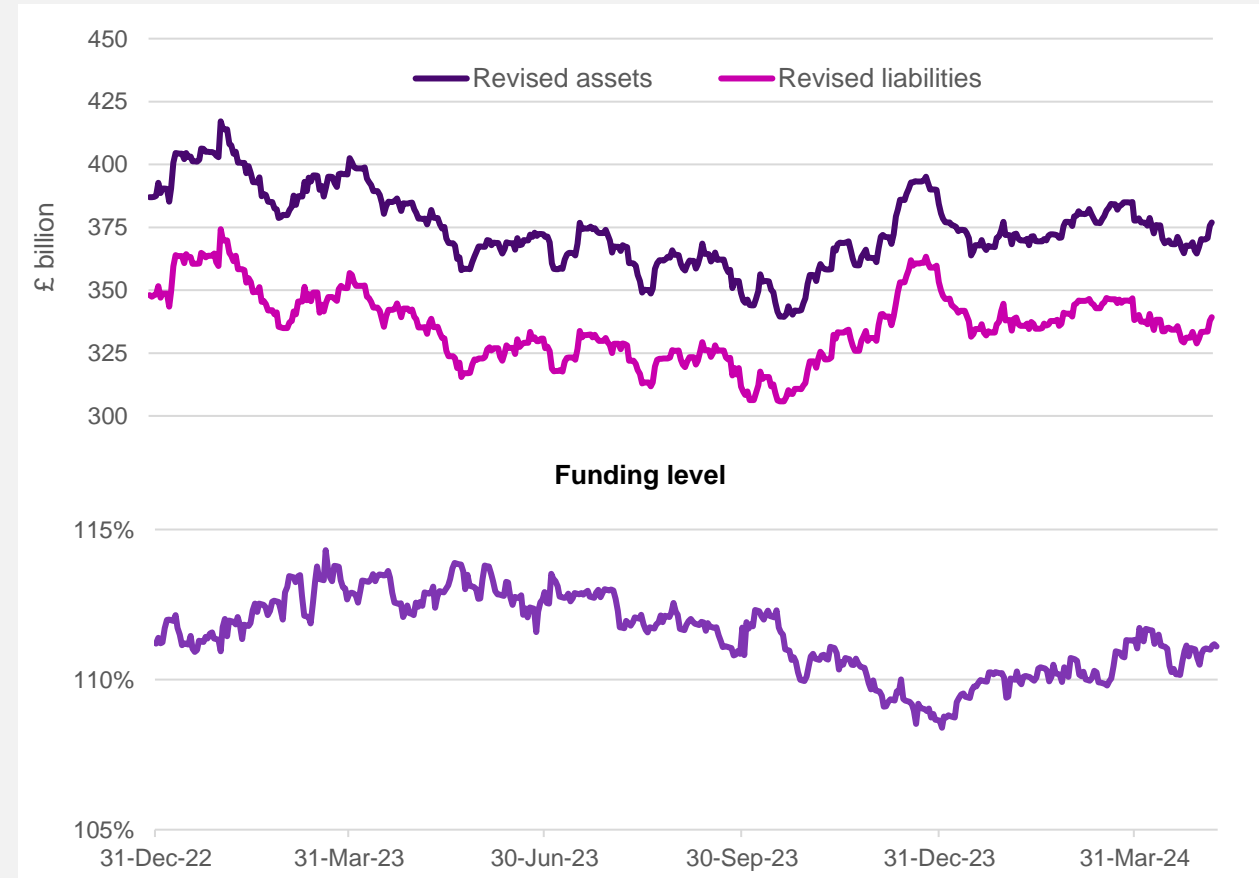
Data represents FTSE 350 companies with a 31 December year-end reporting in that year



Balance sheet positions

FTSE 350 – Estimated position over the year

Data represents FTSE 350 companies with a 31 December year-end reporting in 2023



* iBoxx UK Corporate Bonds AA Over 15 Years

2023 was a relatively benign year for pension scheme funding compared to previous years and funding positions for companies in the FTSE 350 remained relatively unchanged at the year end.

The era of ultra-low interest rates ended at the end of 2021. From the end of 2022 corporate bond yields* rose from 4.8% to peak at 5.8% in October 2023, before falling back to 4.5% in December 2023.

As a result, across 2023 this was the main reason liabilities as a whole grew by 3%, though the upward movement in liabilities due to discount rates was offset somewhat by a reduction in life expectancy assumptions.

Pension scheme investments were characterised by weak returns on their bond investments, with equities growing more strongly, particularly in the US. UK equities grew by 7.9% and overseas equities by 17.6% (FTSE Actuaries Indices).

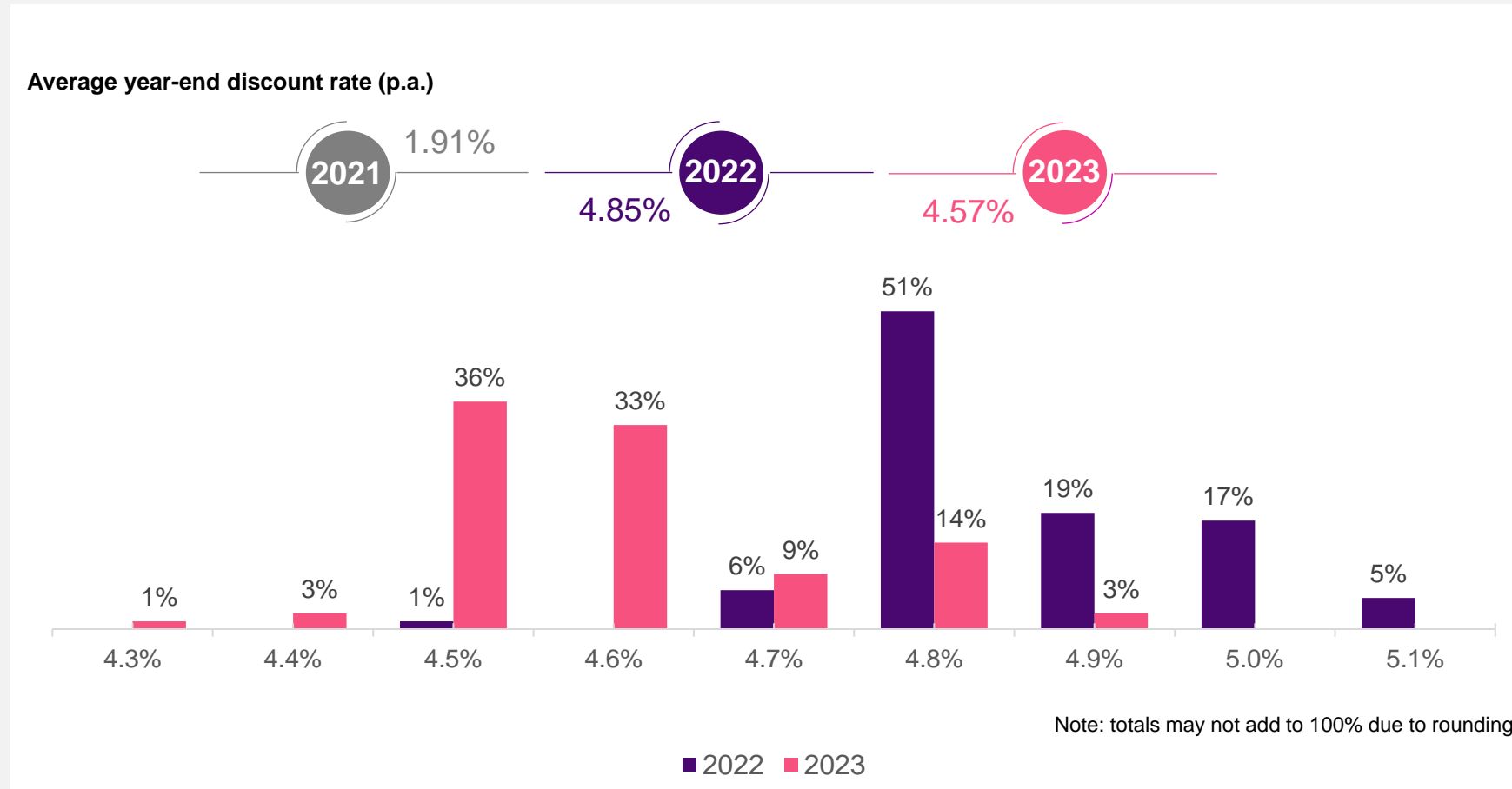
Hence, across 2023, assets increased by 0.6% and the funding position fell from 111% to 109%.

In the first quarter of 2024, equities continued their strong growth with returns in the quarter of 3.6% for UK equities and 9% for overseas equities (FTSE All world, excluding UK, total return). Offsetting this bond prices fell, as yields rose a little. But credit spreads (and liabilities) were little changed over the quarter.

Together this implies that funding positions have improved slightly over the first quarter of 2024.

Discount rates remain high

Discount rate



Discount rate assumptions had fallen gradually from 2018 to 2020 (from an average of 2.81% in 2018 to 1.37% in 2020). 2021 saw the start of a reversal of this trend, with a small increase in the average discount rate assumption.

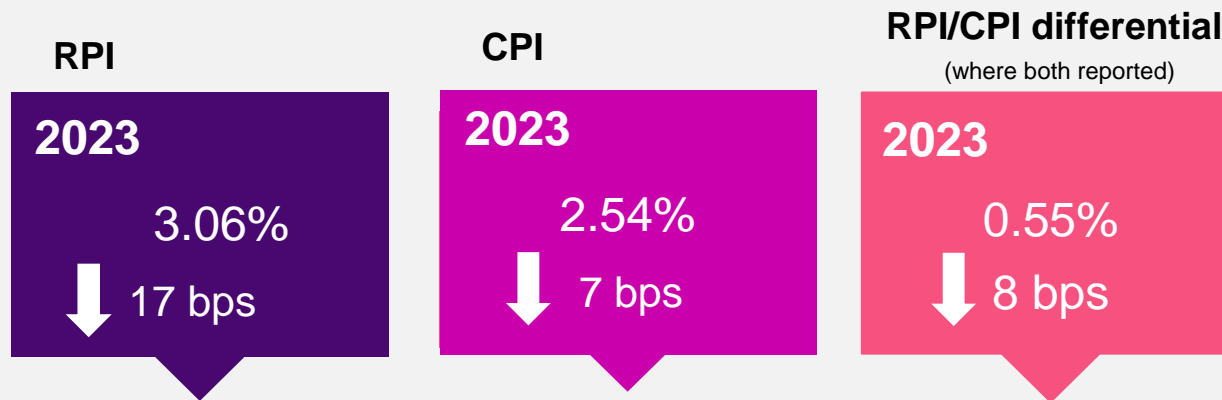
Then in 2022, there was a sudden end to the period of low rates and a return to figures last seen over a decade ago, with the average discount rate assumption more than doubling to 4.85%.

In 2023, discount rate assumptions fell back moderately to 4.57%, following a fall in long-term yields. This would typically increase pension liabilities by around 4% to 5%.

This reduction in discount rates was caused in part by a reduction in credit spreads, which have fallen to their lowest level since 2007.

Inflation assumptions ease

Average assumptions



Note: Data from December 2023 is compared to the data of December 2022.
The RPI/CPI differential is based only on the subset of companies who report both figures.

2021 and 2022 marked the return of high inflation in the UK. In December 2021, annual CPI inflation was recorded at 5.4%, the highest figure since early 1992. By October 2022 this had peaked at 11.1%, estimated by the ONS to be the highest since the early 1980s. The RPI stood even higher at 14.2%.

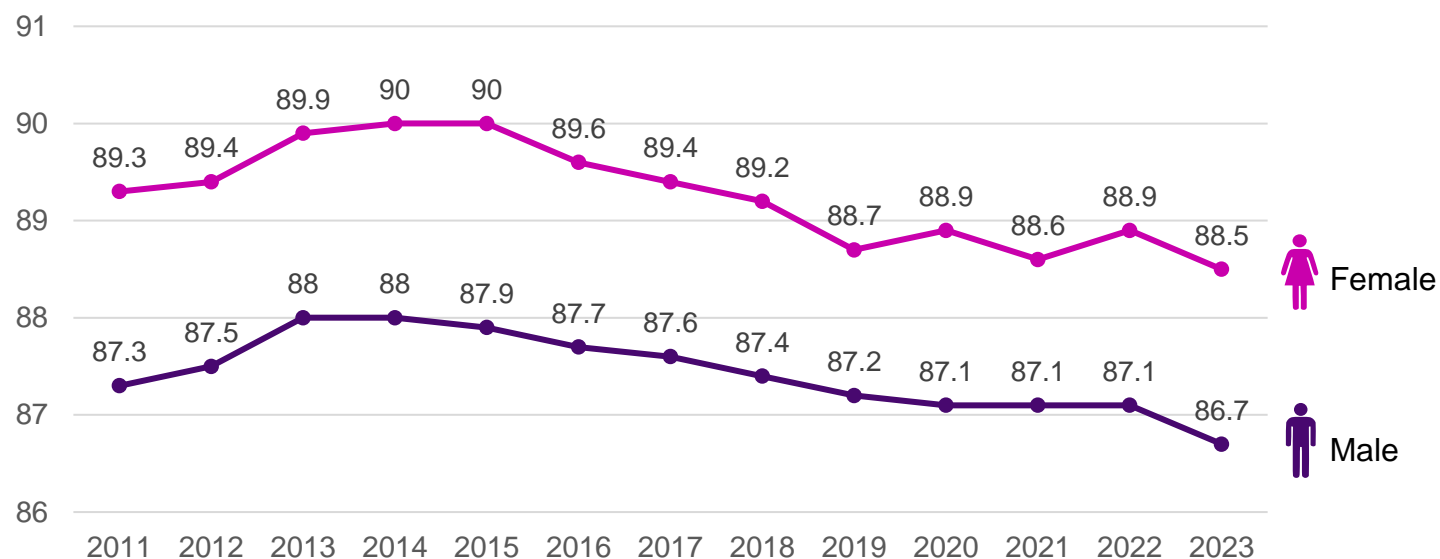
By December 2023, CPI had fallen to 4.0% and RPI to 5.2%, with many forecasters expecting CPI to fall to around 2% by the end of 2024, with RPI expected to be around 3%.

As inflationary expectations eased, pension scheme long-term inflation assumptions fell slightly, with the average RPI assumption 3.06% (compared to 3.23% in 2022), while CPI assumptions were 2.54% (compared to 2.61% in 2022).

The average differential between RPI and CPI assumptions also declined slightly, by 0.08% (based on companies reporting both figures). This decline in the wedge is expected, and will continue, as RPI aligns to CPI in 2030.

Assumed life expectancy falls to the lowest level for a decade

Average life expectancy for members aged 65 (years)



Life expectancies disclosed for scheme members peaked in 2014 (88 years for men aged 65, 90 for women aged 65) and since that time have largely trended steadily downwards.

2022 saw a pause in this trend. However, 2023 has now seen a further fall in life expectations by around 5 months to 86.7 years for males and 88.5 years for females. This reduces liabilities by around 1.5% to 2%.

Life expectancies are now at their lowest level for over a decade, but in 2014 were expected to continue to grow upwards. Indeed, expectations today are around 2 years lower than would have been anticipated in 2014. This worsening of longevity assumptions has reduced liabilities by around 7% over the last decade.

With the aggregate FTSE 350 funding level at 109%, falling assumptions of life expectancy make up the lion's share of this surplus.

What's behind the decline in 2023

In March 2023, the Continuous Mortality Investigation (CMI) confirmed how they intended to reflect mortality experience from recent years in their projections. These will be reflected by most employers when setting life expectancy assumptions in 2023 and 2024.

Whilst the peak pandemic years of 2020 and 2021 were previously ignored as being exceptional within the core version of the model, the key change was to recognise that the heavy population mortality (excess deaths) experienced in 2022 may be indicative "to some extent" (i.e. it may still reflect the aftermath of the COVID-19 pandemic, but also may reflect a true worsening of future life expectancy).

In 2023, mortality rates fell (longevity improved) relative to 2022, but they remained well above the pre-pandemic trend. The CMI felt that this data was also partially indicative of worsened future mortality. This may lead to further downward revisions to assumptions of life expectancy next year.

For 2024, the latest CMI tables suggest there may be a further reduction in life expectancies, but the pace is likely to slow down with perhaps a reduction of a couple of months relative to 2023.



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Disclosed liabilities would be around 7% higher if companies had used the same assumptions about mortality rates in 2023 and beyond that they were using in 2014 – before a ‘lost decade’ of mortality improvements. This would be enough to wipe out the lion’s share of the aggregate surplus in these companies’ accounts.

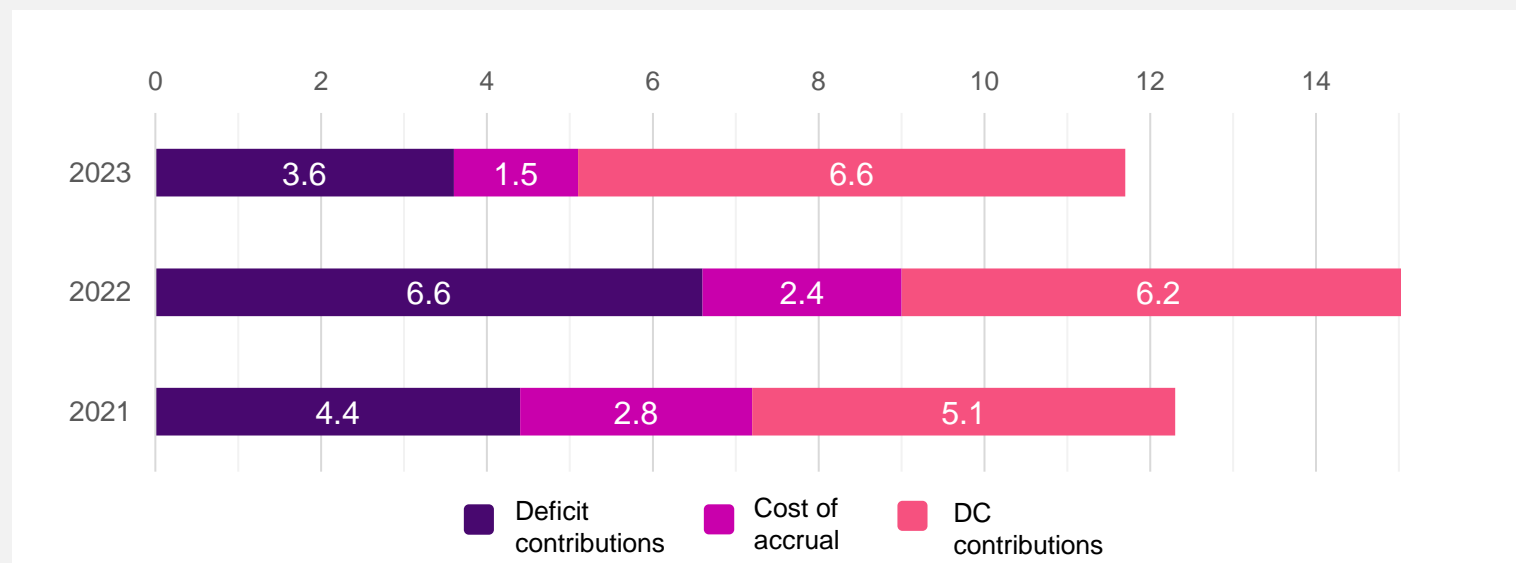
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Charles Rodgers, Head of UK Pension Accounting

DC contributions exceed DB contributions for the first time

Aggregate company contributions (£bn)

Data represents FTSE 350 companies with a 31 December year-end reporting in 2023



Change in 2023

- Median DB contributions fell by 21%
- Median DC contributions rose by 7%

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.

For much of the last decade, companies have sought to plug pension deficits by making considerable deficit reduction contributions (DRCs). In 2021 and 2022, with the start of improvements in funding, this behaviour started to reverse. Nonetheless, a small number of very large one-off contributions in 2022 (c£4 billion), actually pushed up payments to DB plans.

However, in 2023, companies now seem to be reaping the rewards of improvements: deficit payments declined

steeply (falling from a total of £6.6bn to £3.6bn) and the cost of accrual fell from £2.4bn to £1.5bn.

Over the last two years, DB accrual costs have nearly halved, and similar impacts will be seen in the cash contributions paid from funding valuations too (albeit perhaps delayed depending scheme's triennial valuation dates). With improved funding levels, we expect some companies may also be taking contribution holidays with accrual costs being paid from surpluses..

Contributions to defined contribution (DC) plans continued their long-term trend upwards, driven by growth in wages and membership, totalling £6.6bn in 2023. Over a two-year period, these contribution have grown by 30%.

For the first time total DC contributions exceed those paid into DB plans (where both are present). Given this, employers may now turn their focus to DC, considering retirement adequacy, choices and support.



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This is the first time that DC spend has exceeded DB spend amongst DB sponsors. As DC increasingly becomes ‘where the money goes’, we need to see more attention on how to deliver the best balance of risk and return, and how to support members who need to make a pot of ever-changing size last over a retirement of uncertain length.

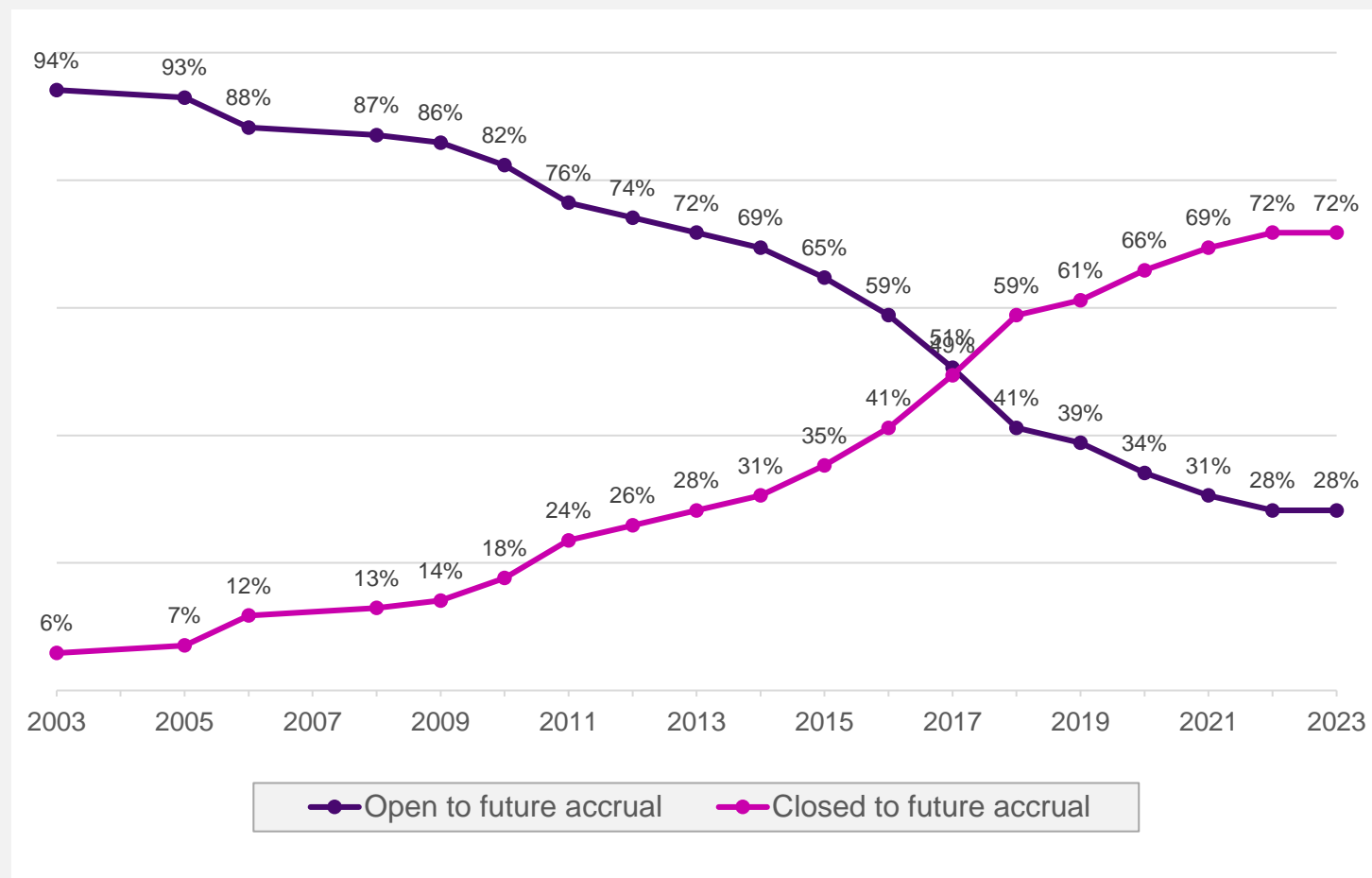
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Bina Mistry, Head of UK Corporate Pensions Consulting

Trend for DB closure stalls – for the first time in 20 years

DB plan closure

Data represents FTSE 350 companies with a 31 December year-end reporting in 2023.



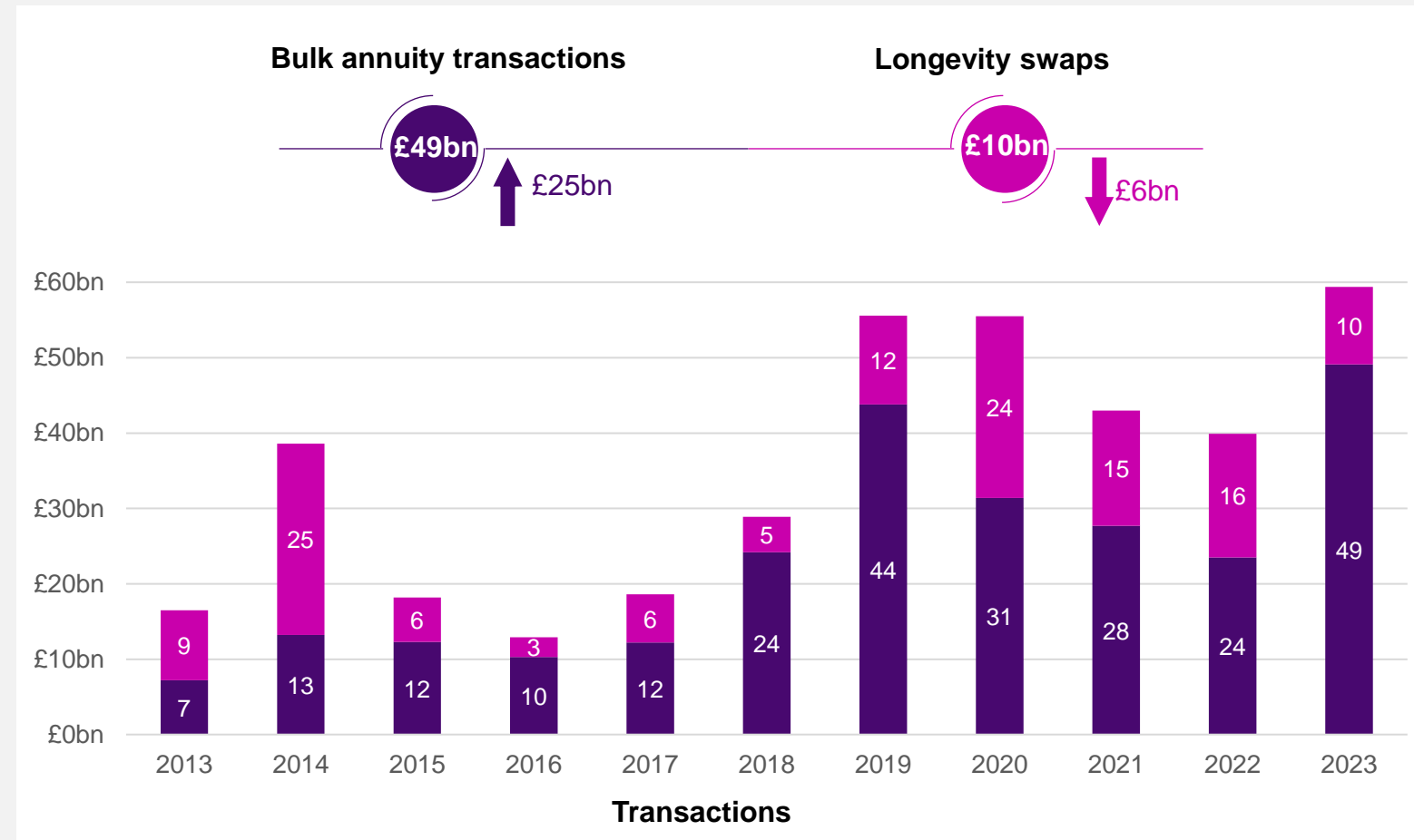
The proportion of employers with defined benefit plans still open to future accrual was unchanged in 2023, at 28%. This is the first year in 20 years where there have been no further closures. As recently as 2015, over two-thirds had (some) members still accruing DB pension benefits, today it stands at roughly three in ten.

For those companies with DB schemes that remain open to accrual, there are now conflicting pressures, that will impact future decisions on whether to keep schemes open:

- With DB accrual costs falling significantly and some schemes being in surplus (which could result in contribution holidays for DB accrual costs), the business case for change will have weakened significantly.
- In addition, with the Department for Work and Pensions (DWP) consultation on “Options for DB Schemes” potentially looking at permitting refunds of surplus on an ongoing basis, with lower funding thresholds, there may be greater incentives for schemes to run-on and hence avoid scheme closures.
- By contrast, many more schemes are now also fully funded, or close to, on a buyout basis. Sponsors looking to discharge their liabilities to insurers will need to proactively manage any ongoing active member accrual, which may therefore trigger further closures.

Pension risk transfer transactions hit a record high

2023 Volume of business (£bn)



With schemes finding themselves better funded thanks to increased gilt yields and attractive insurer pricing 2023 saw a significant jump and record year for pension risk transfer activity. Bulk annuity transactions doubled from c£24 bn in 2022 to £49bn in 2023. This surpasses the prior record (£44bn in 2019).

The picture is even more pronounced when you consider that gilt yields have been rising over the last couple of years, meaning that recent deal volumes would be significantly higher when converted to “old money”. Allowing for these changing market conditions, the total volume in 2023 would be double the previous 2019 record!

Within the growth seen in 2023, there was also a significant shift in the types of bulk annuity transactions, from partial buy-ins to full scheme buy-ins and buyouts.

2023 also saw two major milestones:

- The UK’s largest ever pension scheme buy-in took place in February 2023 (£6.5bn of RSA’s pension liabilities), reflecting the bulk annuity markets appetite for large transactions
- November 2023, saw the first superfund agreement completed with Clara-Pensions (“Clara”). With it an alternative route to de-risking (other than insured options) has now become a realistic possibility.

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

Questions for 2024 and beyond

Can companies get more value from their DB pension schemes?



- With many schemes in surplus there is a large and growing interest in using surplus on an ongoing basis.
- A DWP consultation proposes to make it easier to share surpluses with employers and members in DB schemes, provided sufficient safeguards are in place. Sponsors interested in these opportunities may want to proactively manage their investor messages and the P&L implications from these changes and start considering alternative performance metrics that are not skewed by such movements.
- Were this to happen, we could see a significant change in the landscape for DB pensions in the UK with more schemes looking to run-on to generate better economic outcomes for stakeholders

Focus turns to DC?



- While auto enrolment greatly expanded the scope of who saved, it did little to address the question of whether employees were contributing enough. Increasingly there is a recognition of the risk of inadequate retirement savings for many employees.
- The last decade has seen companies focus time and resources on addressing DB funding issues. With these seemingly in the rearview mirror, will greater attention turn to addressing DC provision?

Will more companies start to engage early with the market on strategic decisions?



- 2023 was a record-breaking year for de-risking transactions and this is expected to increase further in 2024.
- However, purchasing bulk annuities will lead to reduced balance sheet surpluses, with the effect recognised as settlement losses though P&Ls in some cases. Companies can start engaging with investors on the risk management benefits of such transactions and explaining the economic value of surpluses on balance sheets.
- Those likely to transact in a few years can also start planning for these impacts and consider using and quoting alternative metrics, that remove such distortions or exceptional items.

About the data

FTSE 350 DB Pension Scheme data

FTSE 350

155

Companies with
DB pension liabilities



DB liabilities

£502 billion

with December 31 2023
year ends

85

Companies with
DB pension liabilities



£359 billion

Further information

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

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This report is based on the published disclosures of 85 FTSE 350 companies with defined benefit pension liabilities reporting at 31 December 2023.

These companies comprise around 72% of all FTSE 350 DB pension obligations.

Disclaimer

This report has been prepared for general purposes only and does not purport to be and is not a substitute for specific professional advice. While the matters identified are believed to be generally correct, before any specific action is taken, specific advice on the circumstances in question should be obtained.

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