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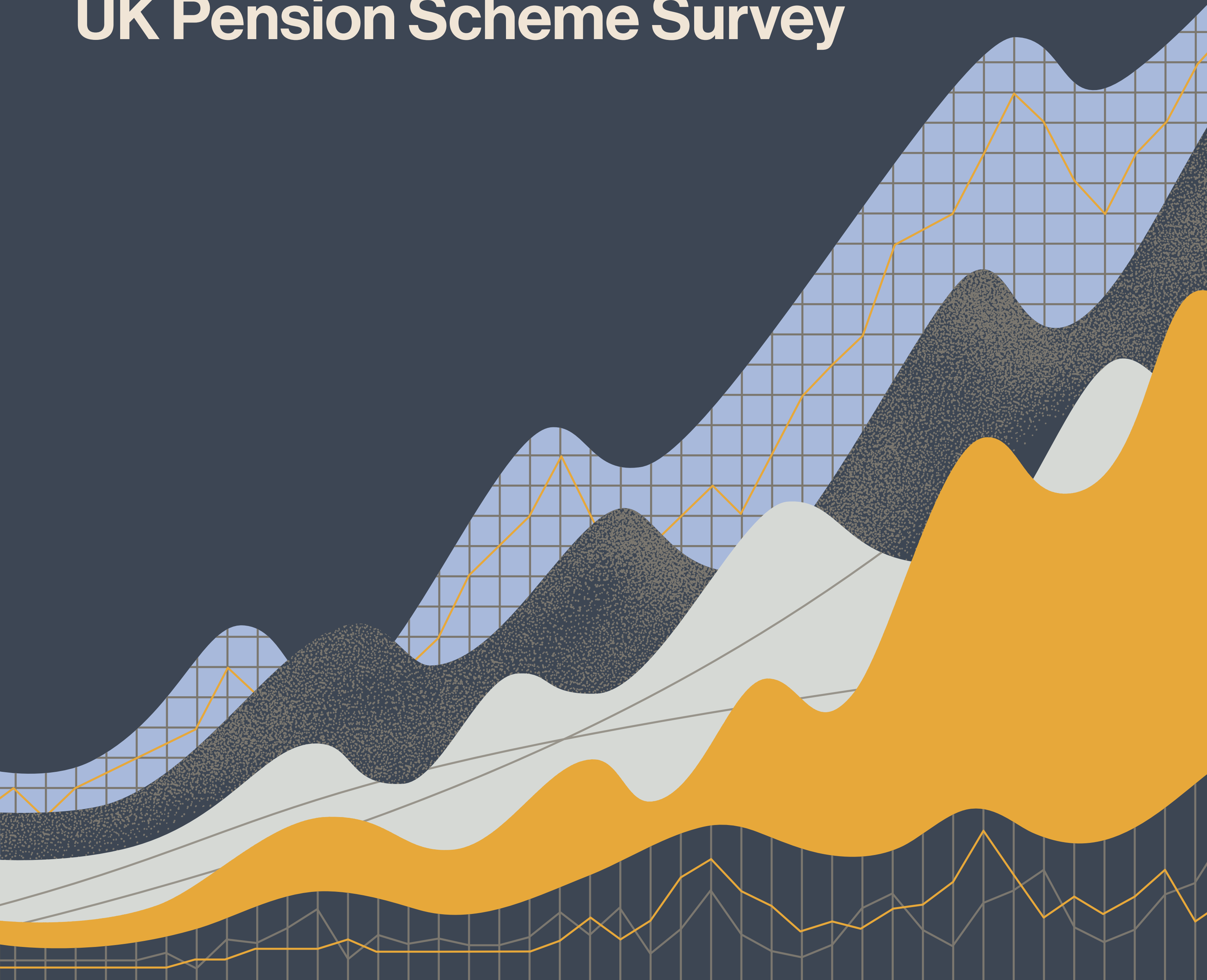
Navigating the Key Issues Facing Schemes in 2024:

Results from the Annual UK Pension Scheme Survey



Welcome to the fourth issue of the annual UK pension scheme survey from the Pensions Management Institute ("PMI") in conjunction with Schroders Solutions.

Introduction

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In the dynamic landscape of pension schemes, the fourth annual UK pension scheme survey, "Navigating the Key Issues Facing Schemes 2024," conducted by the Pensions Management Institute (PMI) in collaboration with Schroders Solutions, offers pivotal insights into the challenges and opportunities confronting trustees and advisors. This comprehensive analysis of the survey's findings and emerging themes aims to inform and guide trustees in their decision-making process in the year ahead.

The Fiduciary Management Strategic Forum was created in partnership with the PMI. This group represents many of the third-party evaluation firms involved in the Fiduciary Management market, along with senior independent trustees. The forum's mandate is to discuss the key areas affecting pension schemes across all governance models and sizes.

This survey analyses the perspectives of UK pension schemes with 102 respondents. The research was carried out via an online survey from 29 November 2023 to 16 January 2024.

We hope you enjoy reading the findings.

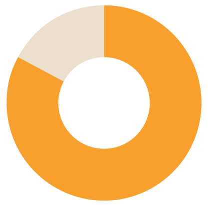
Key findings

The survey, drawing responses from a diverse range of pension schemes, paints a vivid picture of the UK pension industry's varied landscape. Several key themes surfaced, shaping narratives around the impact of a higher interest rate environment, the interplay between pensions and politics, sustainability, and other significant considerations.

Foreword

64%

of schemes have seen an increase in their funding level over the past year, with 35% seeing an increase of over 5%: This increase in funding levels suggests that many schemes are moving closer to their long-term funding targets.



83%

of schemes are defining an endgame strategy, with smaller schemes favouring buyout and larger schemes favouring low dependency: This highlights the impact of the higher interest rate environment on pension schemes' long-term strategies. It indicates a significant trend towards endgame planning in the pension scheme landscape and disparities between desired outcomes given scheme size.

> "Many trustee groups spent 2023 asking two key questions: Where are we after the LDI event and where do we / the sponsor want to get to? As the survey shows, these have generally been answered and the focus for 2024 will be: How do we get there and what form of asset management will we need to help us achieve this? I can see a lot of manager review, mandate change and implementation ahead."

Graham Jung, Professional Trustee, Pi Partnership

74%

of respondents are concerned about the impact of UK politics and policy on the long-term sustainability of pension scheme arrangements: This finding underscores the importance of political and policy considerations in the management of pension schemes. It also points to a need for trustees to stay informed about political developments and potential regulatory changes.

48%

of schemes indicate that liquidity needs have become a higher priority when making decisions: This shift in focus towards liquidity highlights the need for solutions and services that help schemes manage their liquidity needs more effectively.

Clear shift to fixed income solutions over the next 12 months: With 38% of respondents planning to increase corporate bond allocations and 29% of respondents signalling an intention to increase Liability-Driven Investment (LDI) allocations, there's a clear trend towards fixed income solutions. This shift in asset allocation preferences is indicative of broader de-risking among pension schemes.

38%

29%

> Over the next 12-18 months I expect there will be significant innovation with end game solutions and the size/type of scheme they are of benefit to. This coupled with increased optionality on how to use DB pension surplus will allow trustees/sponsors to reassess what the best long term funding target is for their scheme.
>
> André Kerr, Partner,
> XPS Group

Higher interest rates drive demand for fixed income endgame solutions

Over the past 12-18 months, central banks worldwide have hiked interest rates to curb inflation and stabilise economies recovering from the pandemic. This shift has far-reaching implications for pension schemes, affecting their funding levels and steering their strategic decisions.

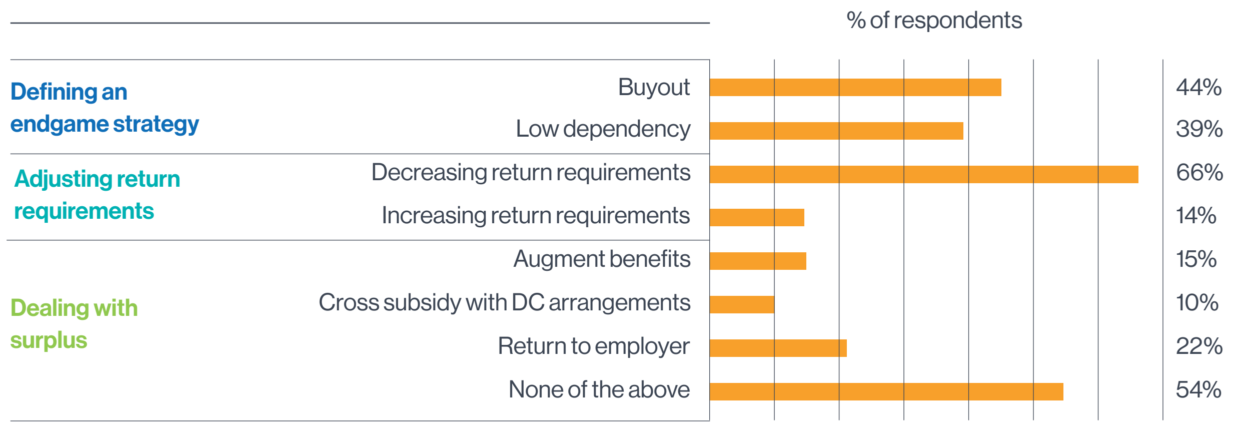
Funding Levels: 64% of schemes witnessed an increase in funding levels over the past year, with 35% experiencing a rise of over 5%. A noteworthy observation is that this surge could be against long-term funding targets, prompting trustees to evaluate their strategies.

Decision-Making: As a response to funding changes, 83% of schemes are defining an endgame strategy, with a 53/47 split between buyout and low dependency. The size of the scheme strongly influences this decision, larger schemes (over £500m) favoured low dependency whilst those under £500m favoured buyout. A noteworthy 78% of respondents are adjusting their return requirements, 83% of which are seeking to reduce their return requirements. The shift to a higher interest rate environment has created a surplus for some schemes, with 1 in 5 considering returning this to the employer.

How has the shift into a higher interest rate environment impacted your funding level over the last year?

9% Decreased by less than 5%
4% Decreased by more than 5%
24% No change
29% Increased by less than 5%
34% Increased by more than 5%

What decisions are you considering in response to changes in funding? (Select all that apply)



Asset Allocation: Respondents who foresee a shift in asset allocation over the next 12 months, favour increased allocations to corporate bonds and liability-driven investments (LDI), and reducing exposure to equities and illiquid assets. This trend is more pronounced among those targeting a buyout endgame. This is reflective of respondents' lower return requirements. As schemes reduce their return expectations, they are moving to assets with lower risk and return expectations.

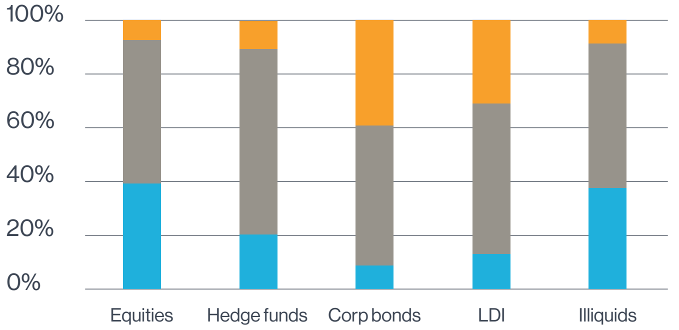
Fixed income and LDI solutions offer several benefits for schemes targeting low dependency and buyout. Fixed income investments, such as corporate bonds, can provide a predictable income stream and help to stabilise returns, making them a suitable choice for schemes with lower return requirements. They also offer lower volatility compared to equities, aligning with the risk profile of these schemes. Furthermore, they can be cost-effective and require less governance compared to other asset classes, which can be crucial for schemes looking to optimise their operations.

Moreover, fixed income investments can be structured to deliver regular cashflows, which can be aligned with a scheme's cashflow demands, further enhancing their suitability for these schemes.

LDI solutions, on the other hand, are designed to match the scheme's assets with its liabilities. This helps to reduce the risk of a funding shortfall and provides a clearer path to achieving the scheme's endgame. By adjusting their asset allocation in this way, schemes can better manage their risk and move closer to their long-term funding targets.

> While there is significant focus from schemes to target buy-in and ultimately buy-out, there are significant headwinds in terms of insurer capacity, administrator capacity and political/regulatory uncertainty. This may lead trustees to question, is buy-out the only route to securing member's benefits or are there other viable alternatives?
>
> Daniel Walsh, Client Director,
> Zedra Governance Limited

How do you see your choice of assets changing in the next 12 months?



Equity Allocations: 38% of respondents indicate a planned decrease in equity allocations over the next 12 months. This reflects a strategic shift as schemes seek to manage risk and reduce exposure to market volatility.

Corporate Bond Allocations: Conversely, 38% of respondents plan to increase corporate bond allocations over the next 12 months. This aligns with a broader de-risking strategy, emphasising stability and income generation.

LDI Allocations: 29% of respondents signal an intention to increase Liability-Driven Investment (LDI) allocations. This reflects a heightened awareness of managing liabilities effectively in the pursuit of a secure endgame.

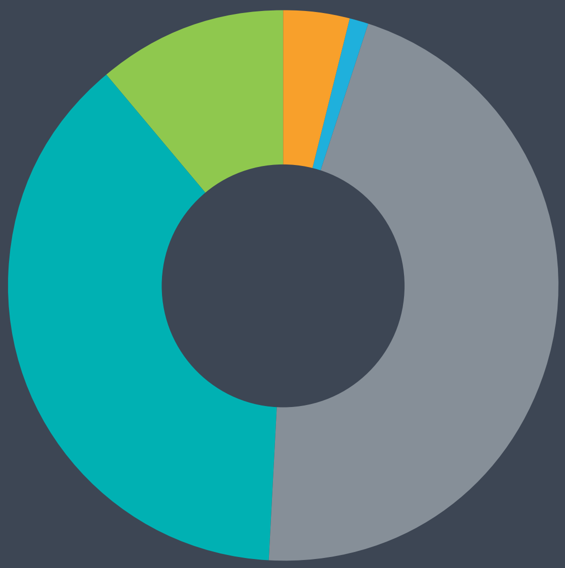
Illiquid Allocations: 40% of respondents plan to decrease illiquid allocations over the next 12 months. This adjustment could be a rebalance of portfolios post-gilts crisis or in preparation for a potential buyout transaction.

Liquidity Priorities: Indeed, for 49% of schemes, liquidity needs have become a higher priority in decision-making, potentially influenced by post-gilts crisis guidance from the Bank of England, CSFB, and CBI.

The shift towards LDI and emphasis on liquidity could also indicate a trend towards reducing leverage and increasing collateral coverage. This would improve schemes' liquidity and resilience to market shocks, a key lesson from the 2022 gilts crisis. This shift suggest schemes are either learning from past experiences or simply adhering to regulatory guidance.

In summary, we expect schemes to continue moving towards lower-risk, lower-return seeking portfolios. The focus is likely to be on fixed income portfolios that offer stability and income generation, with careful management of liquidity and liability risks.

How high a priority will liquidity needs be when decision-making in 2024?



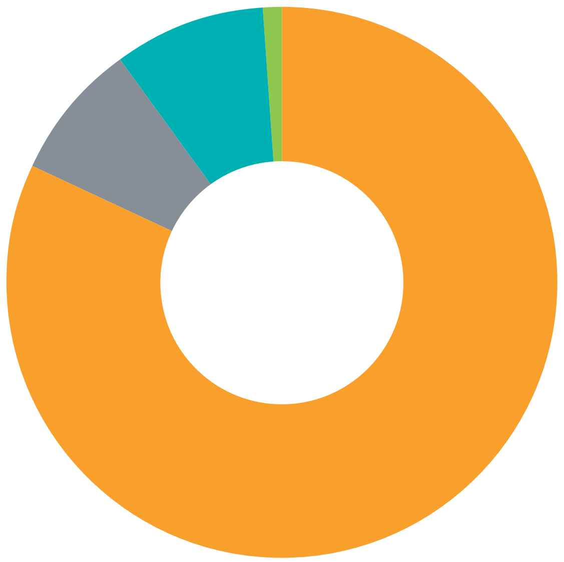
4%	Decreased moderately
1%	Decreased significantly
46%	No change
38%	Increased moderately
11%	Increased significantly

> "We are seeing the economics behind FM arrangements challenged for some providers. Falling AUM means less revenue for those managers who charge fees based on a percentage of assets. Now is a sensible time for trustees to consider the pricing of their FM services and how this should be structured to ensure this is both equitable and future-proofed against changing market dynamics."
>
> Peter Daniels, Head of Fiduciary Manager Evaluation, Barnett Waddingham LLP

Steady governance amid shifting costs

Current Governance Model: An overwhelming 83% of respondents expressed satisfaction with their current investment governance model. This reveals a robust foundation, but it is imperative to assess the adaptability of these models to changing economic and regulatory conditions.

Is your current investment governance arrangement under review as a direct result of the higher rate environment?



82% No, we are very happy with our current arrangements
8% None of the above
9% We are considering a change to our current arrangement
1% Yes, we would like to move to a tradional advisory from Fiduciary Management Outsourced CIO

Fiduciary Management and Advisor Fees: One in five schemes reported an increase in fiduciary management or advisor fees as a percentage of assets under management (AUM), highlighting the need for cost management as schemes shift towards de-risking. Interestingly, just over half of the respondents reported no change in their fees, while a quarter were unsure about the fees they were being charged, indicating a potential area for improvement in fee transparency and communication.

Have you seen an increase in Fiduciary Management or Advisor fees as a % of AuM?

54% No
25% Unsure
21% Yes

> “Asset management has been consolidating for a number of years now. One reason for this has been the rise of fiduciary management, where a provider bundles other services like advice alongside ‘running the money’. However, in the last two years, a big driver of further consolidation has been the de-risking and simplification of investment strategies. The trend of consolidation is not unique to the pensions industry. Our recent Global Asset & Wealth Management Survey highlighted that 73% of asset managers are considering a strategic consolidation with another asset manager in the coming months in order to gain access to new segments, build market share and mitigate risks.”
>
> Keira-Marie Ramnath,
> Head of Investments, PwC

Politics proves worrisome for pensions

The Mansion House speech, the Autumn Statement, and the upcoming general election could all herald significant policy changes affecting the pensions landscape.

Impact of UK Politics: An overwhelming 74% expressed concern about the impact of UK politics and policy on the long-term sustainability of pension scheme arrangements.

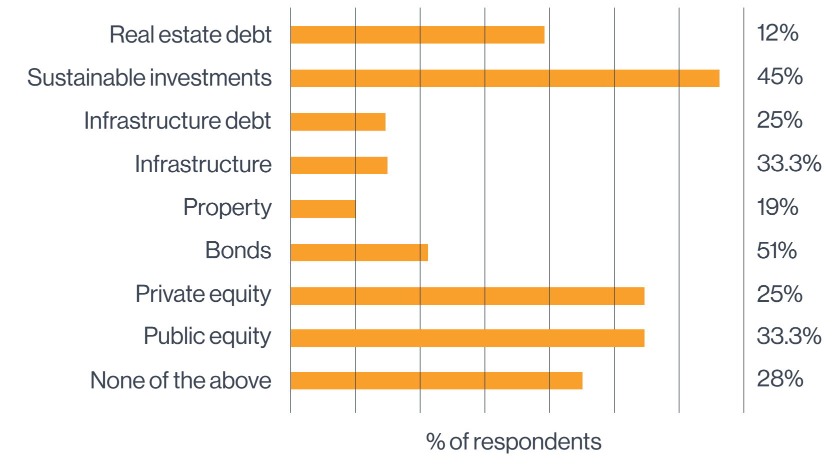
A looming political change within the next 12 months, coupled with new regulatory guidance and reporting requirements, adds to trustees' challenges. Despite the apparent will of the UK government, 86% believe it is not the role of DB schemes to finance the UK economy. This sentiment is expected to be influenced by potential regulatory changes, such as the Funding Code, to broader political developments such as the Mansion House speech and Autumn statement.

Are you concerned about the impact of UK politics and policy on the long-term sustainability of pension scheme arrangements?

Do you believe it is the role of the UK DB corporate pensions to assist in financing the UK economy?

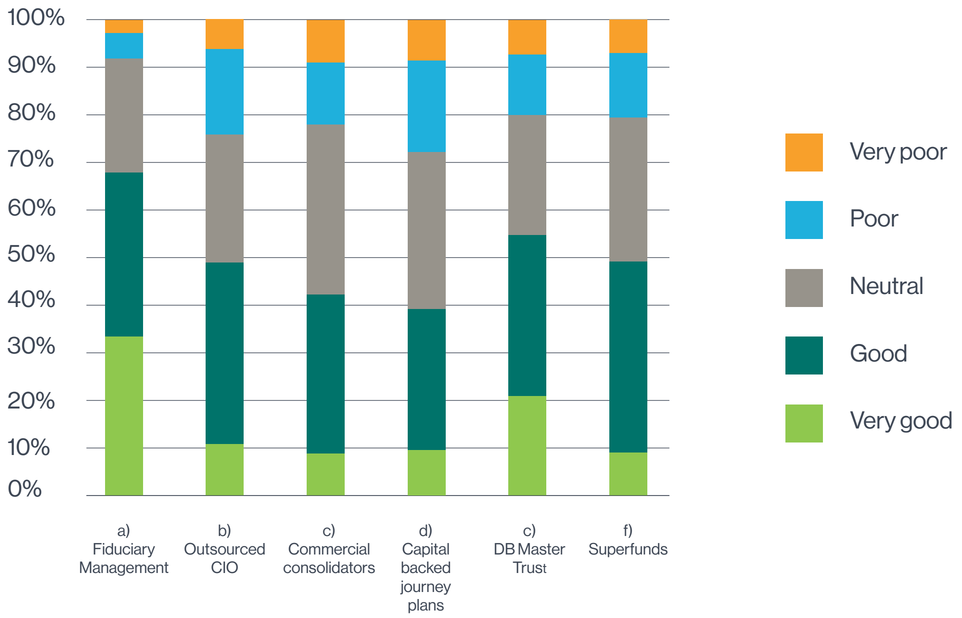
Investment Incentives: The survey explored whether trustees would invest in UK productive assets if incentivised. Bonds, sustainable investments, and public equity were the top preferences among respondents.

If you were incentivised via tax breaks or other mechanisms would you invest in any of the following UK productive assets? Select all that apply.



Consolidation Options: As we navigate the interplay between pensions and politics, one area of focus is the role of consolidation in the pensions landscape. Trustees rated their understanding of various consolidation options, with fiduciary management, DB master trusts, and superfunds topping the list. Notably, fiduciary management was by far the best understood consolidation option, with two-thirds of respondents stating their understanding was good or very good. However, for all other options, at least one in five respondents said their understanding was poor or very poor, with Outsourced CIO and Capital Backed Journey plans being the least well understood. This reflects the increasing importance of understanding consolidation strategies in the current landscape and indicates areas where further education may be beneficial.

How would you rate your understanding of the below consolidation options for pension schemes?

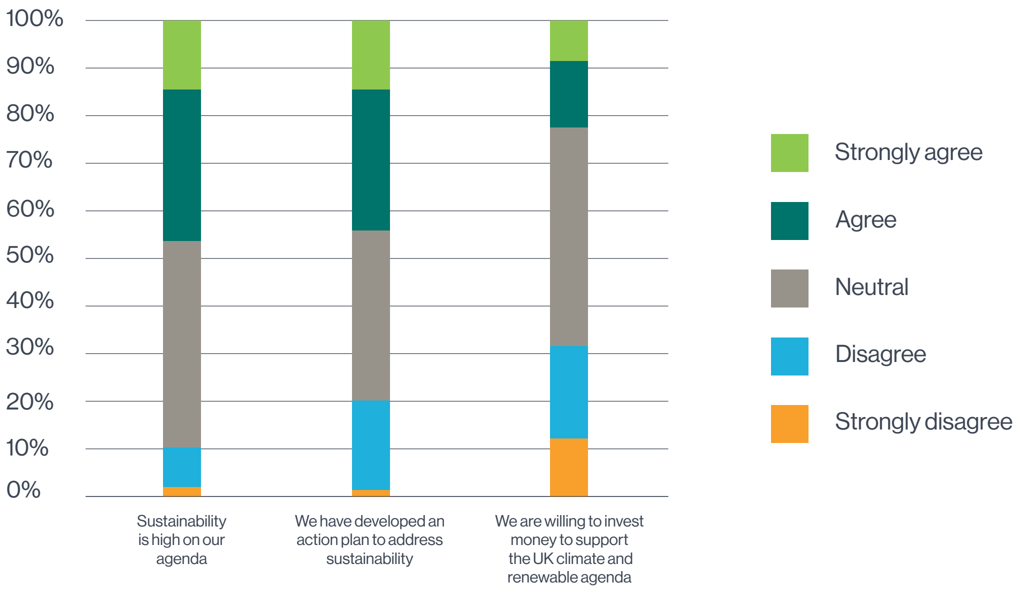


Pensions Management Institute
Navigating the key issues facing schemes in 2024

> "Sustainability took a back seat as Trustee Boards grappled with the pandemic and then the gilts crisis. Although 47% of Trustee Boards are willing, the focus on endgame planning could be another priority that gets in the way of meaningful and impactful progress."
>
> Melanie Cusack, Client Director
> Zedra Governance Limited

Sustainability back on the agenda

Sustainability, which took a backseat for many schemes in 2023 as they addressed the aftermath of the gilts crisis, is firmly back on the agenda for 2024. Responsible investment is important, but there are calls for a balanced focus on ESG. While 47% agreed that sustainability is high on their agenda and 44% have developed an action plan to address sustainability, only 23% expressed willingness to allocate capital to support the UK climate and renewable agenda. DB assets may not be the significant source of funding for the UK's energy transition that the government hopes for.



Other themes

Beyond the main themes, the survey uncovered additional crucial considerations for trustee boards in 2024:

- Administration and Data Management: Trustees are prioritising administration, data cleansing, and preparing for pensions dashboards while addressing cybersecurity and data protection concerns.
- Insurance and Buyouts: Issues related to buy-ins, buyouts, and self-sufficiency are top of mind, with capacity in the insurance market and the journey to buyout being key concerns.
- Governance and Regulation: Changes in governance, regulatory overload, and preparations for new funding regulations and the General Code are significant challenges.
- Member Communication and Involvement: Trustees are emphasising communication, member outcomes, and understanding, with some expressing a desire for member-nominated trustee board membership.
- Fraud and Cyber Risk: Trustees are vigilant about pension fraud and cyber threats, emphasising the security of IT systems.
- Other Themes: Public consolidation potential, desire for less regulatory interference, and the changing perception of Buy Out as the only "gold plated" option are additional considerations.

Recommended Actions for Trustees

Considering these findings, trustees are encouraged to consider the following actions:

1. Evaluate Endgame Strategies and adapt asset allocation: With a substantial proportion defining endgame strategies, carefully consider the implications of buyout versus low dependency, keeping in mind scheme size. Align asset allocation with your endgame target, emphasising corporate bonds and LDI, especially for schemes targeting a buyout endgame.

2. Manage costs and liquidity needs : Given the trend towards de-risking, closely monitor fiduciary management and advisor fees to ensure they align with the simplified solutions being pursued. Acknowledge the increased importance of liquidity in decision-making and incorporate it into investment strategies.

3. Stay Informed on Political Developments: Keep a keen eye on political developments and potential regulatory changes, especially those related to the Funding Code and Mansion House.

4. Understand Consolidation Options: Develop a deep understanding of consolidation options, including fiduciary management, DB master trusts, superfunds, commercial consolidators, and capital-backed journey plans.

In conclusion, the landscape for UK pension schemes is dynamic, and trustees must navigate through a myriad of challenges and opportunities. This research paper aims to empower trustees with insights and recommendations, helping them steer their schemes toward sustainable and successful outcomes in the face of an evolving environment.

About the study

This survey analyses the perspectives of UK pension schemes with 102 respondents. The research was carried out via an online survey from 29 November 2023 to 16 January 2024. Throughout the report, we complement our findings with commentary and insights from Schroders Solutions and industry experts.

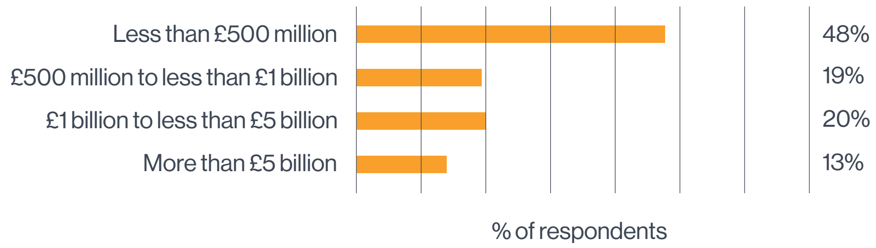
Breakdown by investment governance model

22% Full fiduciary management / Outsourced CIO

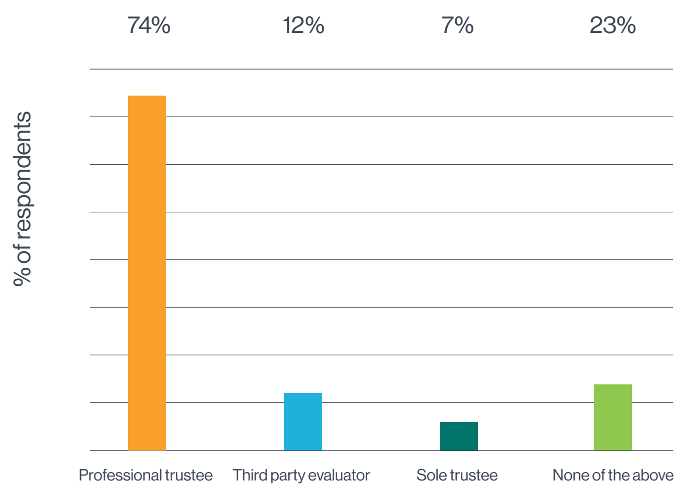
9% Partial fiduciary management / Outsourced CIO

69% Traditional advisory

Scheme assets under management



Do you use any of the following? Select all that apply.



Important Information

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