08

Risk reduction

This chapter looks at the measures that schemes have taken to reduce their funding risk, which will also act to reduce the risk of schemes claiming on the PPF. These actions may also help schemes to reduce the amount of PPF levy they pay.

Summary

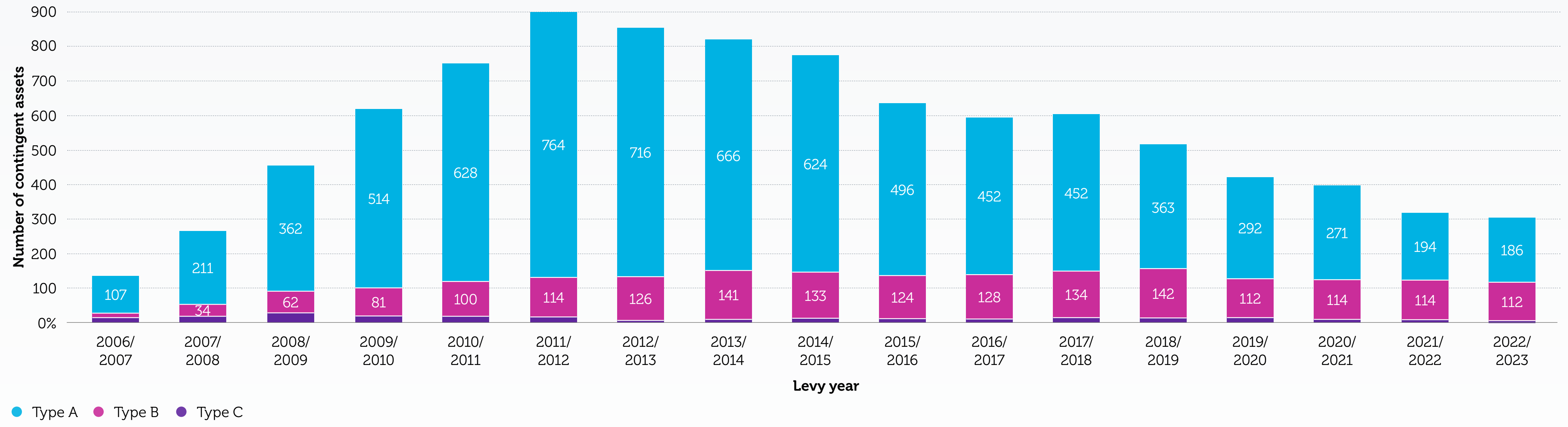
- This chapter contains information on the risk reduction measures DB schemes have put in place or undertaken, including contingent assets, longevity swaps, buy-ins and buy-outs. It also shows information on how recovery plan lengths and funding measures relative to DB schemes' Technical Provisions have changed over time.
- The total number of contingent assets submitted to the PPF for the 2022/23 levy year was 303 compared with 317 in 2021/22, continuing the downward trend.
- Based only on current recovery plans in place, total annual recovery plan payments are indicated to decrease by around 88 per cent over the next 10 years as schemes increasingly become fully funded on a Technical Provisions basis. The rate of decrease is planned to be similar between different scheme sizes and, in aggregate, annual recovery plan payments are set to fall from around £12.3 billion in 2022 to around £1.4 billion in 2032. Changes may be made to existing recovery plans and new recovery plans may be put in place in the future if experience is different from what is currently assumed by schemes.
- Analysis of TPR's latest Technical Provisions and recovery plan data shows that in Tranche 15[1], the average recovery plan length was 6.4 years, a year less than that of Tranche 12 (comparable given the three-year valuation cycle). The average funding ratio as measured by assets divided by Technical Provisions was 88.8 per cent in Tranche 15, which is the same as for Tranche 12.
- Technical Provisions as a percentage of s179 liabilities increased to 99.5 per cent from 96.9 per cent in Tranche 12. There was also a rise in Technical Provisions as a percentage of buy-out liabilities, from 68.8 per cent to 76.5 per cent.
- Total risk transfer business covering buy-outs, buy-ins and longevity swaps amounted to £351 billion between the end of 2007 and the second quarter of 2022. 36 per cent of these deals were longevity swaps.
- The total value of risk transfer deals was £43 billion in 2021, which was lower than £56 billion in 2020.

1 Tranche 15 covers schemes with valuation dates between 22 September 2019 and 21 September 2020.

Contingent assets

Figure 8.1 | Contingent assets by type

The number of recognised contingent assets has followed a general downward trend over the last 11 years and is at its lowest level since levy year 2007/08.



Source: PPF

Type A Contingent Assets are parent/group companies' guarantees to fund the scheme, up to a pre-arranged amount.

Type B Contingent Assets comprise security over holdings of cash, real estate and/or securities.

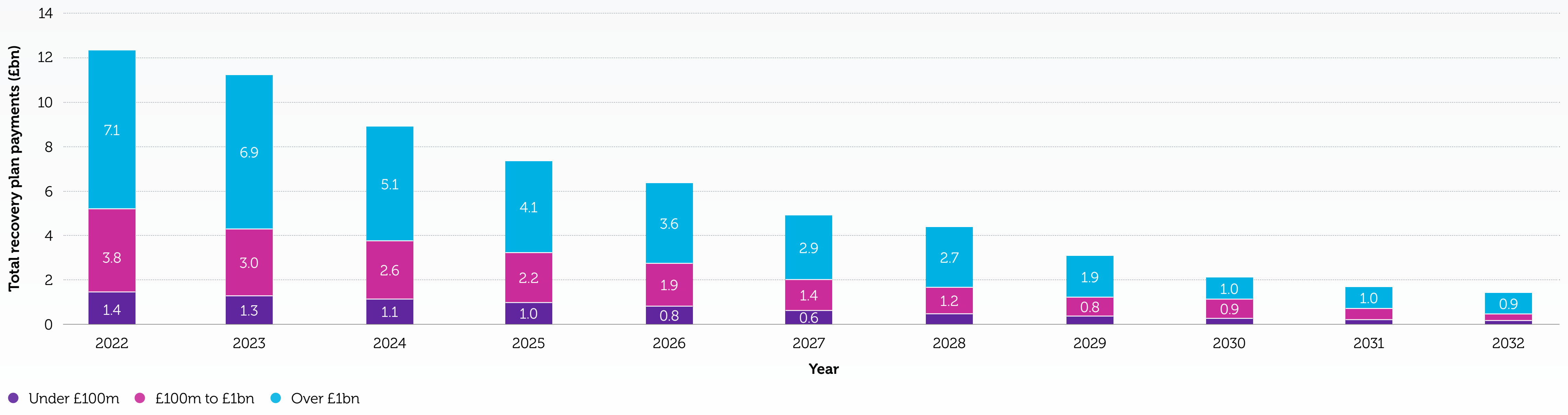
Type C Contingent Assets consist of letters of credit and bank guarantees.

Risk reduction continued

Recovery plan payments

Figure 8.2 | Planned recovery plan payments until 2032 by asset size

Total annual recovery plan payments are planned to reduce by around 88 per cent over the next 10 years, from around £12.3 billion in 2022 to around £1.4 billion in 2032.



Source: TPR

The scheme funding regime

Figure 8.3 | Technical Provisions and recovery plan lengths (unweighted averages)

In Tranche 15, the average recovery period was 6.4 years, a year shorter than Tranche 12 (comparable given the three-year valuation cycle).

Tranche	Year of valuation	Number of recovery plans	Average length of recovery plan (years)	Assets as a percentage of Technical Provisions	Technical Provisions as a percentage of s179 liabilities	Technical Provisions as a percentage of buy-out liabilities
3	2007–08	1,840	8.6	81.3%	110.7%	74.5%
6	2010–11	1,652	7.8	82.3%	109.7%	71.3%
9	2013–14	1,530	8.0	89.4%	102.5%	71.5%
12	2016–17	1,481	7.4	88.8%	96.9%	68.8%
13	2017–18	1,112	6.5	93.5%	100.0%	73.5%
14	2018–19	1,176	6.1	91.6%	102.9%	75.8%
15	2019–20	1,256	6.4	88.8%	99.5%	76.5%

Source: 'Scheme funding analysis 2022 Annex', TPR, July 2022

Notes:

(1) Valuation dates run from 22 September to 21 September.

(2) 75.9 per cent of schemes with Tranche 15 valuations reported valuations in respect of Tranches 12, 9, 6 and 3.

Risk reduction continued

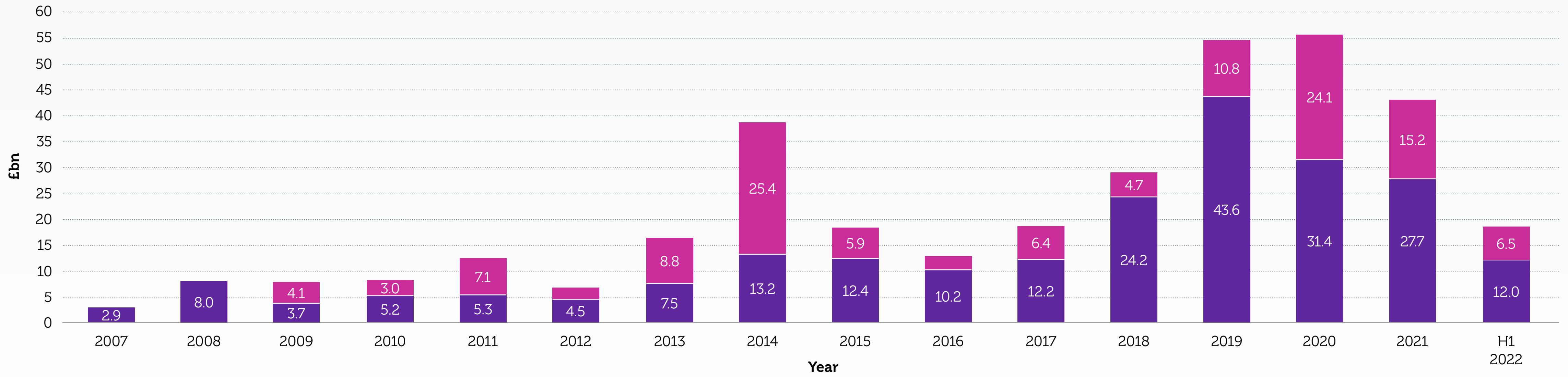
Buy-out, buy-in and longevity hedging

Buy-out and buy-in transactions provide schemes with the opportunity to remove risk relating to all or part of their liability. Under a buy-out deal, a scheme transfers its entire liability and scheme assets to an insurer in exchange for a premium. Insurers tend to require assets significantly in excess of Technical Provisions to compensate for the risk transferred. Buy-in deals result in an insurance policy as a scheme asset.

While both longevity swaps and buy-in/buy-out can mitigate the risk of greater than expected life expectancy, under the former there is no transfer of the underlying scheme assets to a counterparty. Longevity swaps entail the pension scheme exchanging fixed payments for cash flows that vary in accordance with the longevity experience of a reference population (either the named scheme members or a wider sample).

Figure 8.4 | Value of risk transfer deals since 2007

£42.9 billion of risk transfer deals were completed in 2021, which was £12.6 billion lower than in 2020.



Source: Hymans Robertson, 'Buy-outs, buy-ins and longevity hedging'

Risk reduction continued

Figure 8.5 | Number of risk transfer deals since 2010

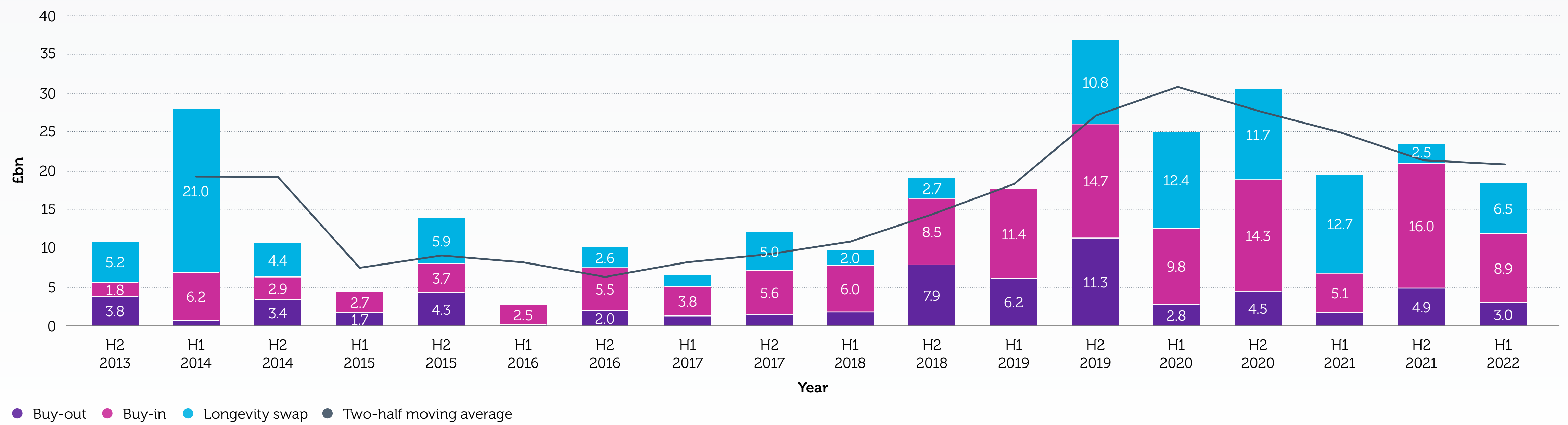
There were slightly more buy-ins and buy-outs in 2021 than in 2020. The number of longevity swaps remains low.

Year	Number of buy-ins/buy-outs	Number of longevity swaps
2010	174	2
2011	171	4
2012	167	2
2013	219	10
2014	177	5
2015	176	4
2016	104	5
2017	132	5
2018	171	4
2019	157	3
2020	141	8
2021	154	4
H1 2022	78	2

Source: Hymans Robertson, 'Buy-outs, buy-ins and longevity hedging'

Figure 8.6 | Value of risk transfer deals since H2 2013

The two-half moving average of risk transfer deals has fallen since H1 2020, although it has increased slightly over the last half year.



Source: Hymans Robertson, 'Buy-outs, buy-ins and longevity hedging'