08
Risk reduction

This chapter looks at measures that schemes have taken to reduce risk in their funding levels. This helps to reduce the risk of schemes claiming on the PPF, so taking such measures can help schemes to reduce the amount of PPF levy they pay.

Summary

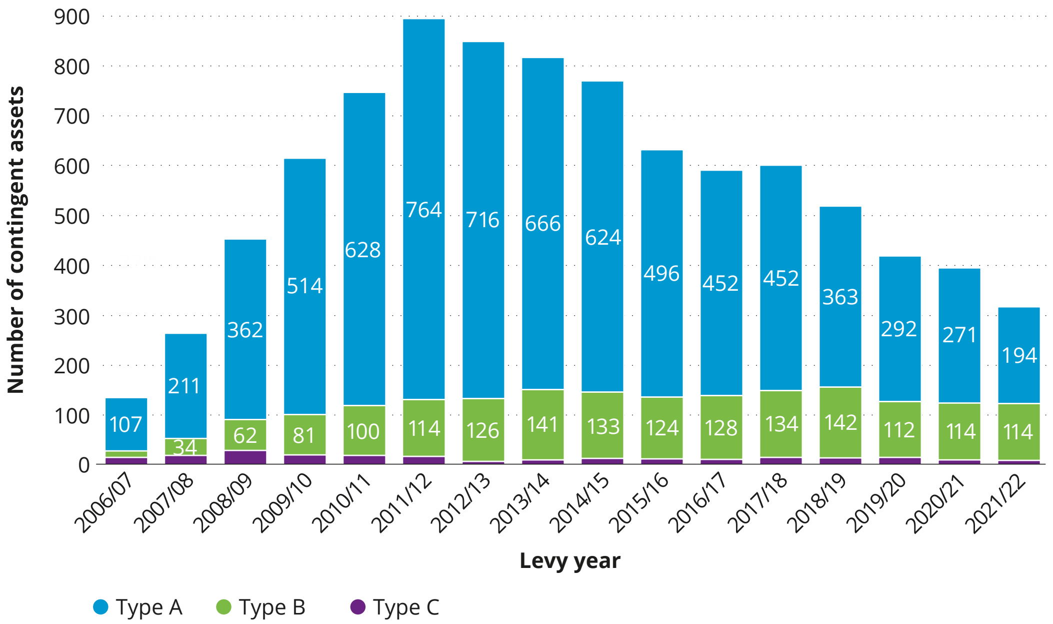
- This chapter contains information on the risk reduction measures DB schemes have put in place or undertaken, including contingent assets, longevity swaps, buy-ins and buy-outs. It also shows information on how recovery plan lengths and funding measures relative to DB schemes' Technical Provisions have changed over time.
- The total number of contingent assets submitted to the PPF for the 2021/22 levy year was 317, compared with 395 in 2020/21. This is almost entirely due to a reduction in the number of Type A Contingent Assets (employer parent or group guarantees).
- Based only on current recovery plans in place, total annual recovery plan payments are indicated to decrease by around 94 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 £12.2 billion in 2021 to around £0.8 billion in 2031. 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 has currently been assumed by schemes.
- Analysis of TPR's latest Technical Provisions and recovery plan data shows that in Tranche 14[9], the average recovery plan length was 5.9 years, over a year and a half less than that of Tranche 11 (comparable given the three-year valuation cycle). The average funding ratio as measured by assets divided by Technical Provisions was 91.4 per cent in Tranche 14, 4.4 percentage points higher than Tranche 11.
- Technical Provisions as a percentage of s179 liabilities increased to 103.0 per cent from 95.8 per cent in Tranche 11. There was also a rise in Technical Provisions as a percentage of buy-out liabilities, from 69.2 per cent to 75.7 per cent.
- Total risk transfer business covering buy-outs, buy-ins and longevity swaps amounted to £306 billion between the end of 2007 and the second quarter of 2021. 38 per cent of these deals were longevity swaps.
- The total value of risk transfer deals was £56 billion in 2020, which was slightly higher than £54 billion in 2019 and is the highest amount for a calendar year on record.

9 Tranche 14 covers schemes with valuation dates between 22 September 2018 and 21 September 2019.

Contingent assets

Figure 8.1 | Contingent assets by type

The number of recognised contingent assets is the lowest since levy year 2007/08.



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.

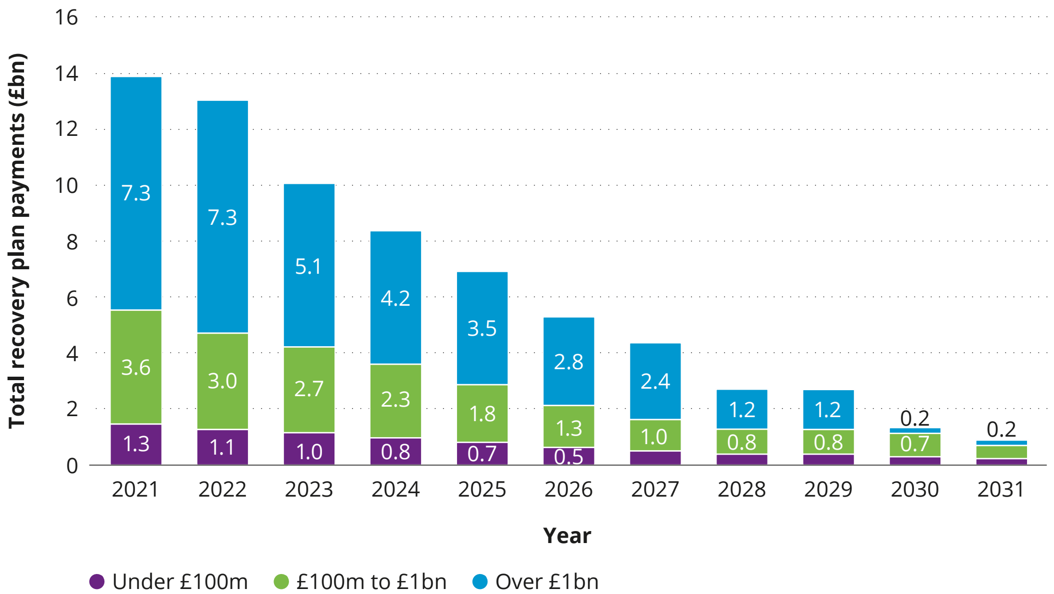
Type C Contingent Assets consist of letters of credit and bank guarantees.

Source: PPF

Recovery plan payments

Figure 8.2 | Planned recovery plan payments until 2031 by asset size

Total annual recovery plan payments are planned to reduce by around 94 per cent over the next 10 years, from around £12.2 billion in 2021 to around £0.8 billion in 2031.



Source: TPR

The scheme funding regime

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

In Tranche 14, the average recovery period was 5.9 years, over a year and a half shorter than Tranche 11 (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
2	2006/07	1,888	7.6	82.3%	113.5%	70.3%
5	2009/10	1,937	8.4	79.0%	112.3%	72.9%
8	2012/13	1,726	8.3	82.2%	98.6%	70.9%
11	2015/16	1,462	7.5	87.0%	95.8%	69.2%
12	2016/17	1,481	7.1	88.8%	96.9%	68.8%
13	2017/18	1,112	6.1	93.5%	100.0%	73.5%
14[10]	2018/19	1,144	5.9	91.4%	103.0%	75.7%

Notes:
(1) Valuation dates run from 22 September to 21 September.
(2) 74.8 per cent of schemes with Tranche 14 valuations reported valuations in respect of Tranches 11, 8, 5 and 2.

Source: 'Scheme funding analysis 2021 Annex', TPR, July 2021.

10 Tranche 14 covers schemes with valuation dates between 22 September 2018 and 21 September 2019.

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

£55.5 billion of risk transfer deals were completed in 2020, which was £1.1 billion higher than in 2019 and is the highest amount for a calendar year on record.

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

Figure 8.5 | Number of risk transfer deals since 2010

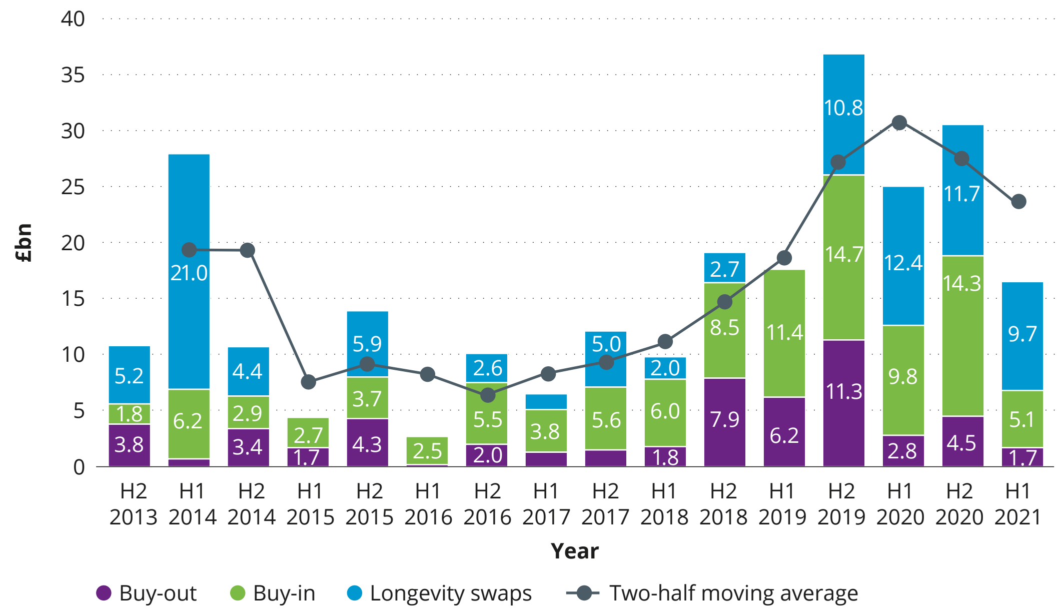
There were more longevity swaps in 2020 than in 2019. However, there were fewer buy-ins and buy-outs in 2020 than in 2019.

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
H1 2021	57	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 followed a general upward trend since H2 2016, although this has fallen over the last year.



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