

THE CHANGING ECOSYSTEM OF DEFINED BENEFIT PENSIONS

VOLUME 5 – AUTUMN/WINTER 2024



russellinvestments.com/dbresearch

Foreword

In the latest volume of Defined Benefit Research, we share the changing attitudes of Defined Benefit (DB) pension schemes toward their end-game strategies. While the traditional path to buyout remains the default option, there is a subtle shift toward considering alternative approaches.

Respondents indicate a growing preference for retaining assets rather than automatically transitioning to buyouts, especially among larger schemes that are considering seeking to generate a surplus to improve member outcomes.

Size continues to be a critical factor, with schemes below the £200 million threshold more inclined to de-risk entirely due to the cost of maintaining assets on their balance sheets. Conversely, larger schemes are often more comfortable with extended time horizons and are cautious about selling illiquid assets prematurely, preferring to let these positions mature naturally.

Schemes are still largely allocated to bonds but are exploring alternative strategies where they could access higher-return assets, albeit with caution to avoid “re-risking”. Meanwhile, regulatory pressures and cases like Virgin Media’s liabilities have intensified, with schemes facing heightened challenges in assessing liabilities and seeking clearer government guidance on surplus use.

The report underscores a DB sector in a state of contemplation, balancing prudence with the need for long-term sustainability. We hope you find our research insightful and welcome discussion regarding our conclusions.



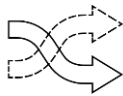
Simon Partridge

Head of UK Fiduciary Management

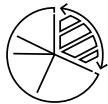
Contents

Key findings	4
Survey methodology	4
Focus group of 11 professional trustees	5
Endgame plans.....	7
Collateral management and quality managers in demand.....	8
Growing need for returns	9
Large and small schemes diverge.....	10
ESG focus persists	11
Preference for bonds and highly-rated credit	12
Growing dissatisfaction with performance	14
Regulation is main concern.....	15
Climate change and net zero disengagement	16
Summary	18

Key findings



Despite funding levels having improved significantly over the past couple of years, **nearly a third of schemes have not yet decided on their endgame target**. Buyout remains the preferred long-term objective but there has been a 33% increase in schemes looking to run on/off.



Risk management remains high on scheme agendas: focus on improving/maintaining funding levels (53% of schemes), managing market risk (44%) and derisking towards endgame (39%) are cited as the main priorities for respondents. Nearly a third of respondents also prioritise **cashflow generation** and **increasing returns**, representing a notable rise from prior surveys and reflecting greater interest in run on/off solutions.



Environmental, social, governance (ESG) is a focus but not a priority in the lead-up to endgame. While **better quality data on ESG** remains a change nearly a third of schemes want, less than half plan to focus on climate risk in the next 12 months, down from 58% in the last survey.



Over half the respondents employ a fiduciary manager or are planning to appoint one in the next 12 months. The reasons cited include notable increases in improving the **quality of manager selection** (48%, up from 36%), **leverage and collateral management** (38%, up from 14%), and **control of investment exposures** (35%, up from 17%).



Regulatory burdens, including Pensions Dashboard challenges as well as the ramifications of the Virgin Media case, continue to concern trustees.

Survey methodology

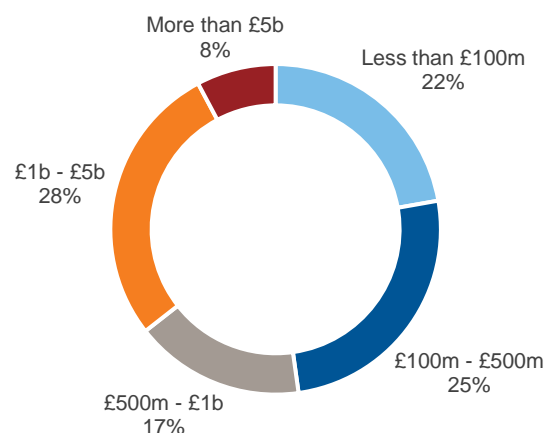
The Russell Investments UK Defined Benefit Market Insights survey is based on the responses from key stakeholders at 90 UK DB schemes in September and October 2024. The overlap of respondents from previous surveys is intentionally low to prevent repeated results.

Respondents include scheme CEOs, CIOs, professional, company- and member-nominated trustees, and pension managers. Responses were collected via an online survey conducted by SurveyMonkey.

To supplement our insights, detailed interviews with a focus group of 11 leading professional and independent trustees were undertaken to assess their views on a range of key topics. Comments from these respondents are included throughout this report.

We would like to thank those individuals interviewed for their time and insights.

Quotes reflect personal rather than firm's views.



Focus group of 11 professional trustees: Buyout still the default endgame, but doubt is growing

Conversations with 11 professional trustees convey a subtle shift in the attitudes shaping the UK DB pension market. While buyout remains the prevailing endgame objective, trustees are increasingly questioning whether it should be the default long-term target for their scheme(s).

Over half of the trustees shared positive reflections on their experiences over the past two years, with many accelerating buyout plans. However, a growing minority are exploring alternative strategies, including run-off. This divergence is particularly evident in responses regarding the likelihood of buyout: five trustees saw it as the default option, while four believed it to be less likely. Two others observed no material change in market dynamics.

The uncertainty surrounding endgame decisions is also reflected in conservative investment strategies. The trustees reported a strong inclination toward bond allocations, alongside infrastructure investments. Cashflow generation emerged as the most desired investment area for the next 12 months, closely followed by diversification and increased exposure to risk assets - aligning with schemes' need to balance return generation and stability.

Regulation continues to loom as the greatest challenge for this group of trustees. Conversely, ESG considerations appear to have diminished in importance, with seven of the 11 trustees indicating that it is less of a priority.

This nuanced picture reflects a changing landscape for UK DB pension schemes, where buyout remains a key focus but is no longer universally viewed as inevitable. As trustees engage with regulatory pressures and investment complexity, a greater openness to alternative strategies signals a future that is far from one-size-fits-all.



Focus group quotes

“For [one of my schemes], buyout is still the goal. We have had training and discussion on other options, but buyout is still where we expect to get to.”

Paul Watson, Capital Cranfield, Professional Trustee

“Some schemes and companies are now thinking that when you pay an insurance premium to take this [a pension scheme via buyout] off your hands, you’re paying a massive embedded profit to the insurer. Some are beginning to think that they may be able to do something better with that themselves.”

Mike Smaje, BESTrustees, Professional Trustee

“There are now more questions being raised. Firstly, about the strength of the insurer industry and its capabilities; and whether insurance provides good value for money, particularly in the short and medium term.”

Nicholas Chadha, Pan Trustees, Professional Trustee

“I still think there are slight concerns around capacity [of the buyout market]. Not in monetary terms, but rather the human capacity – administration, and a big focus on member experience post-buyout. As a trustee, we pass everything over to the insurer, but are we then comfortable that members are going to continue to have a positive experience?”

Dan Walsh, Zedra, Professional Trustee

Focus group observations:

Virgin Media impact

Several interviewees highlight concerns surrounding the impact of the Virgin Media legal case on the pensions market. Trustees are grappling with whether they should proactively identify potential additional liabilities - a challenge particularly pressing for schemes preparing to enter the insurance market, where clarity on such liabilities is required for buyout discussions.

Several interviewees express frustration over the lack of clear guidance, noting that this uncertainty risks trustees taking actions that may be difficult to reverse. There are warnings that the substantial costs the case is imposing on the pensions industry could divert resources that could otherwise be directed toward securing better outcomes for scheme members.

Industry consolidation

Feedback from the interviewees suggests that consolidation is not a major focus within the DB pensions market. Interviewees believe that smaller schemes, which stand to benefit the most from consolidation, are more likely to pursue the buyout route instead. There is a perception that consolidators are primarily targeting larger schemes (where the need for consolidation is less pressing) due to their greater financial appeal. Concerns were raised about the practicalities of consolidation, the need to simplify the pensions landscape, and ensuring that scheme members' needs are met during and after the consolidation process.

Appetite of insurers

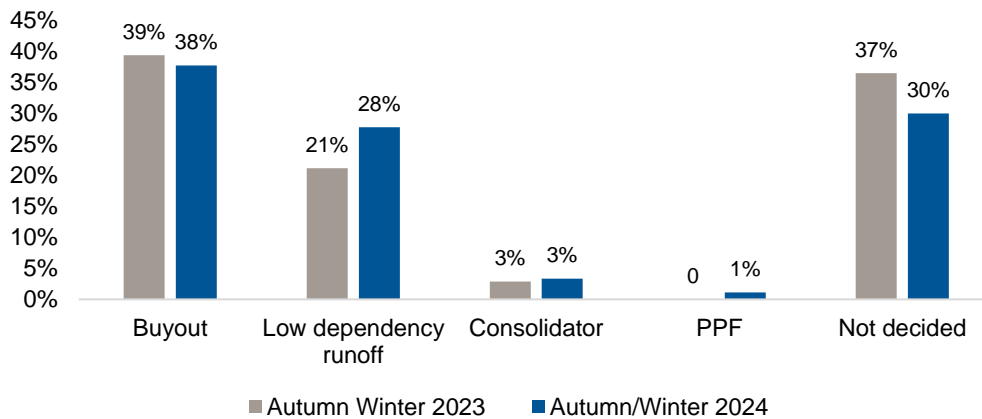
Interviewees suggest that while the insurance market's capacity constraints are clear, the entry of new players could ease some of these pressures in 2025. However, one interviewee noted that some insurers have requested to delay RFP responses until next year, which could limit opportunities for pension schemes looking to buy out at a time when valuations remain attractive.

Trustees also report that insurers continue to prioritise cash and bonds in pension scheme portfolios, with only a few willing to accept illiquid assets - an approach that will continue to drive schemes to derisk. Despite these constraints, one trustee highlighted that increased competition within the insurance market could potentially benefit pension schemes by influencing pricing and possibly encourage insurers to offer more flexible options, especially around illiquid assets.

Endgame plans

Results in our latest quantitative survey indicate that despite funding positions generally increasing over the past two years, nearly a third have not yet decided on their endgame target. Buyout remains the preferred long-term objective but there has been a 33% increase (+7 percentage points) in schemes looking to run on/off.

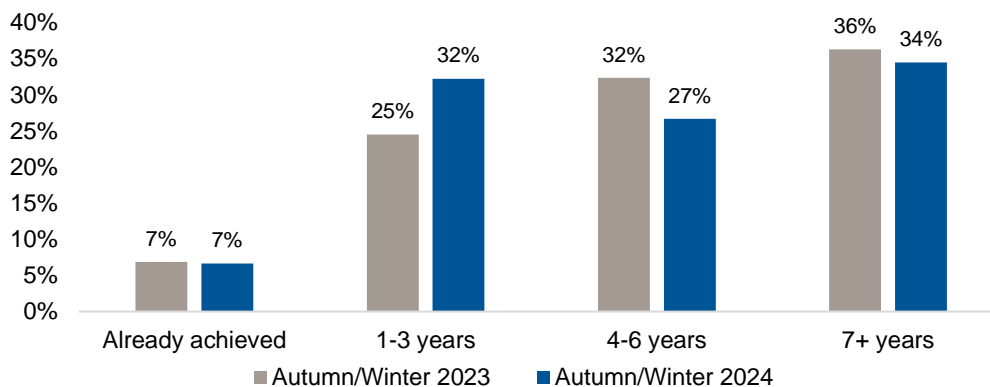
Exhibit 1: Current endgame target



Source: Russell Investments, October 2024.

Our results show that schemes are getting closer to their endgame goals. Nearly a third (32%) of respondents said they expect to achieve their endgame target within 1-3 years, an increase from 25% who said so last year. Conversely, the number of respondents saying they were expecting to achieve their endgame target in 4-6 years and 7+ years, saw a slight decline.

Exhibit 2: Expected timeframe for achieving endgame objective



Source: Russell Investments, October 2024.



Focus group quotes

“The LDI crisis has catapulted us forward a couple of years towards endgame. Generally, funding held up well during the LDI crisis. The buyout deficit is quite considerably less than it was. So, we’ve probably moved more to endgame planning.”

Paul Watson, Capital Cranfield, Professional Trustee

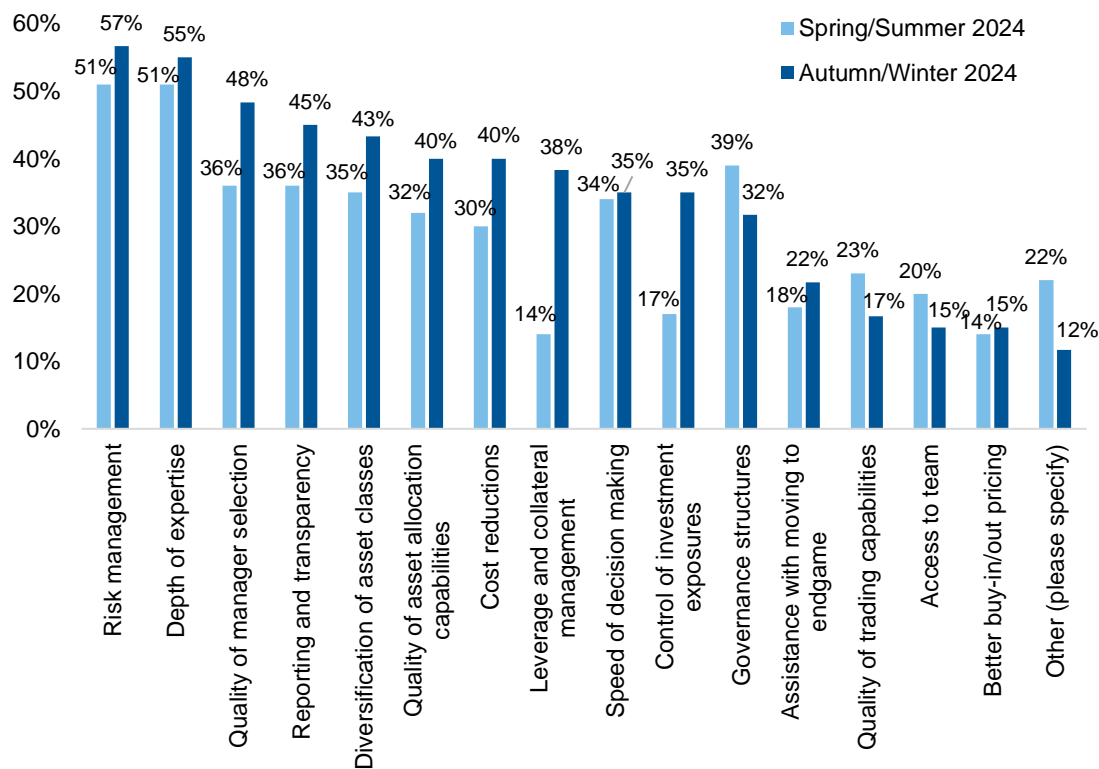
Collateral management and quality managers in demand

Over half the respondents employ a fiduciary manager or are planning to employ one in the next 12 months.

Reminiscent of our survey released in the spring/summer, ‘Risk Management’ (57%) and ‘Depth of expertise’ (55%) score highly as reasons for appointing a provider. However, one notable change has been in ‘Quality of manager selection’, which was chosen by 48% of respondents, up from 36% in our prior survey. This suggests that more trustees are seeking greater returns in their portfolios and recognise the importance of active management, particularly in turbulent markets, where the stock-picking expertise of high-quality managers can help protect on the downside as well as capturing upside.

‘Leverage and collateral management’ have also become important reasons for appointing an outsourced provider, rising from 14% in our previous survey to 38%. This reflects the growing complexity of managing DB pension schemes and the need for active oversight. Outsourced providers, such as fiduciary managers, deliver daily monitoring of the total portfolio, ensuring that exposures remain aligned with guidelines and providing trustees reassurance.

Exhibit 3: If you have appointed an outsourced provider or are considering doing to, what are you looking for the provider to improve (please select all that apply)?



Source: Russell Investments, October 2024.



Focus group quotes

“With the much smaller end [of the pensions market], a big issue is the cost and time of running these schemes.”

Miki Fairfax, BESTrustees, Professional Trustee

“I think there is discussion to be had around what is the optimal risk/return for portfolios that are not looking to transact in the next couple of years.”

Dan Walsh, BESTrustees, Professional Trustee

Growing need for returns

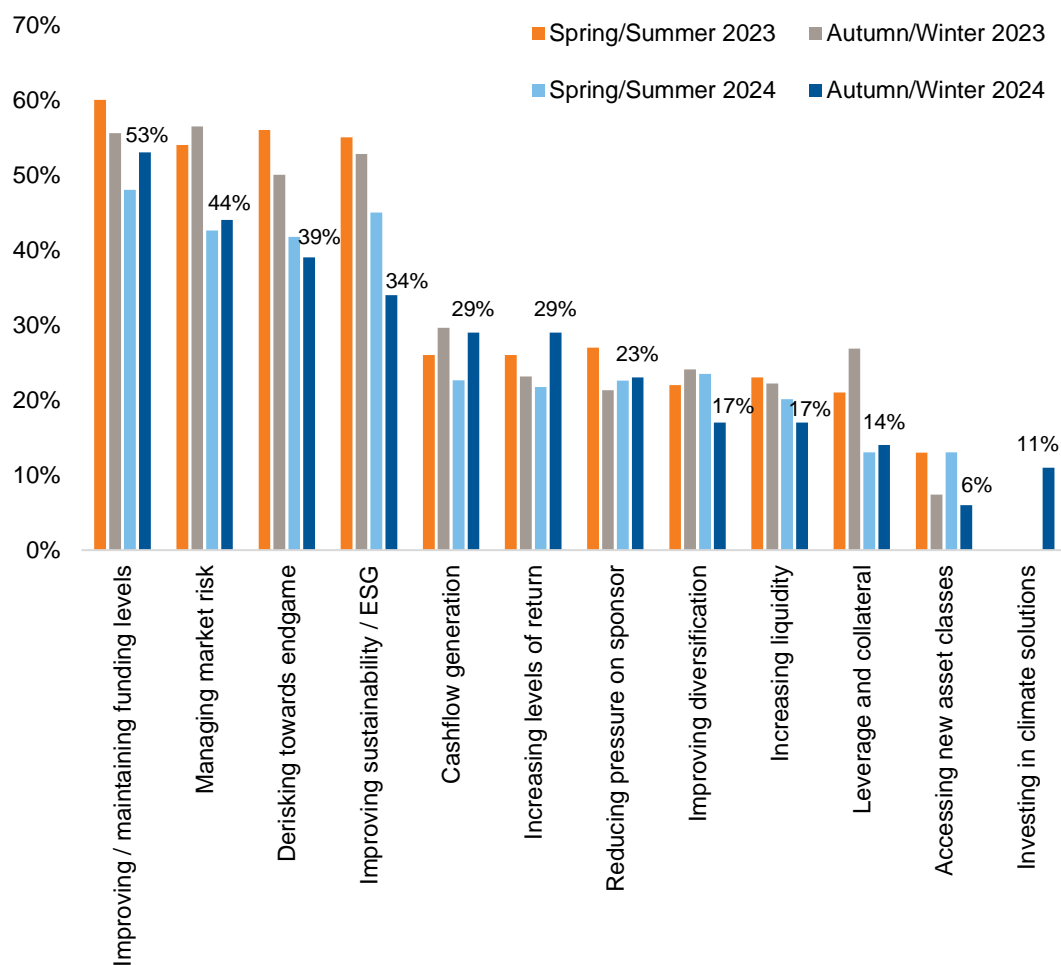
While 'Managing market risk' and 'Improving/maintaining funding levels' have remained of similar importance as in our prior survey, other priorities have dropped off to varying degrees.

Reflecting the improved and stable funding levels of pension schemes, 'Derisking towards endgame' has fallen to being selected as a priority by only 39% of respondents, down from a high of 56% in 2023.

'Improving sustainability/ESG' has also fallen off significantly to 34%, after registering 45% earlier this year. This might reflect the greater proportion of fixed income present in scheme portfolios as they continue to derisk. This is similarly illustrated by the low proportion of respondents who are looking to invest in climate solutions (11%).

As some priorities fall off, others have begun to emerge. In line with sentiment expressed among interviewed trustees, 'Increasing levels of return' (29%) and 'Cashflow generation' (29%) were both selected more than in prior surveys, signalling a growing desire to generate surplus returns. This trend is underscored by one interviewed trustee noting that some schemes are looking to enhance income generation from their portfolios, particularly in cases where deficit repair contributions from sponsoring employers are absent.

Exhibit 4: Current respondent investment priorities



Source: Russell Investments, October 2024. 'Investing in climate solutions' added for the first time in this survey.

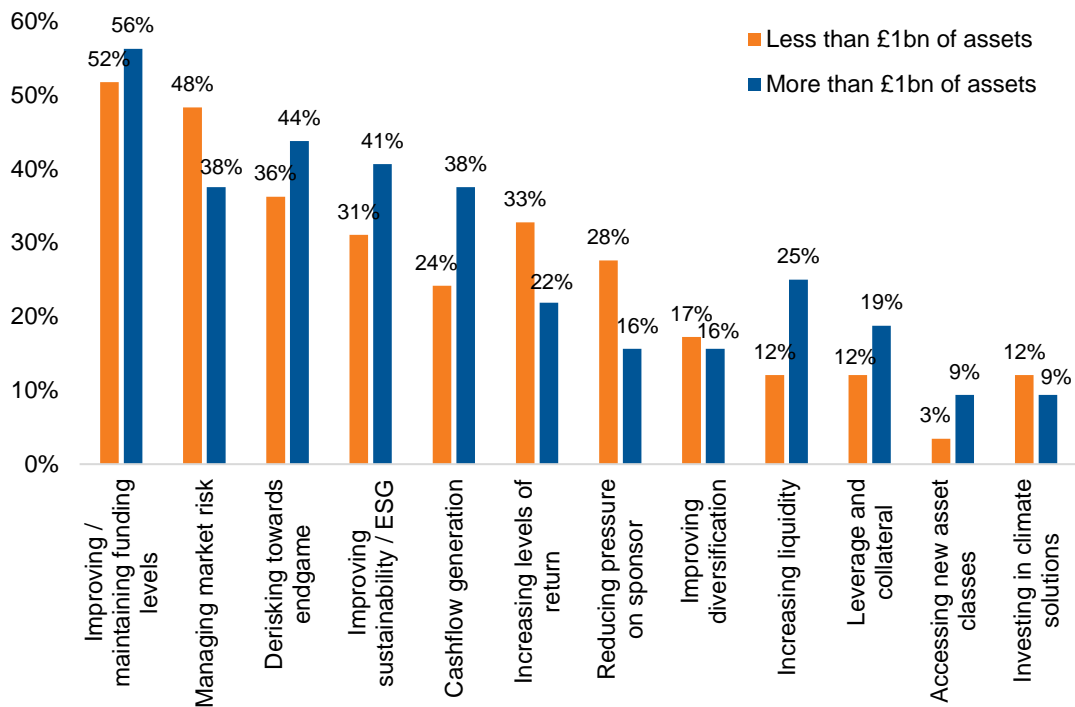
Large and small schemes diverge

Perhaps reflecting the perceived greater options available to larger pension schemes surrounding endgame, 44% of respondents with over £1 billion in assets say their priority is ‘Derisking for endgame’, down from 50% who said so in our earlier survey. Conversely, for schemes with less than £1 billion in assets, 36% said it was their priority, slightly up from 34% in our prior survey.

Smaller schemes also appear to be stepping up their priority to ‘Increase levels of return’ (33%) and ‘Reducing pressure on sponsor’ (28%), up from 23% and 18% in our prior survey.

Unsurprisingly, while there is appetite for increasing levels of return, there is little interest in illiquid assets. Only 3% of smaller schemes and 9% of larger schemes show an interest in ‘Accessing new asset classes’ while 12% of smaller schemes and 25% of larger schemes prioritise ‘Increasing liquidity’. This contributes to the idea that many schemes appear comfortable to run-on, primarily with the aim of reducing illiquid exposure in the meantime, with little appetite to take so-called “haircuts” on assets by rushing to sell them at a lower price via the secondary market.

Exhibit 5: Current respondent investment priorities by size of scheme



Source: Russell Investments, October 2024.



Focus group quotes

“We’re certainly seeing an acceleration [towards endgame]. Funding levels have gone up on average and there is a move towards buyout, particularly for smaller schemes. At the medium and larger end, there are various solutions being floated around. There seem to be a lot of them... but very little if anything seems to be transacting. This does raise a question over the quality of the solutions.”

David Fogarty, Dalriada, Professional Trustee

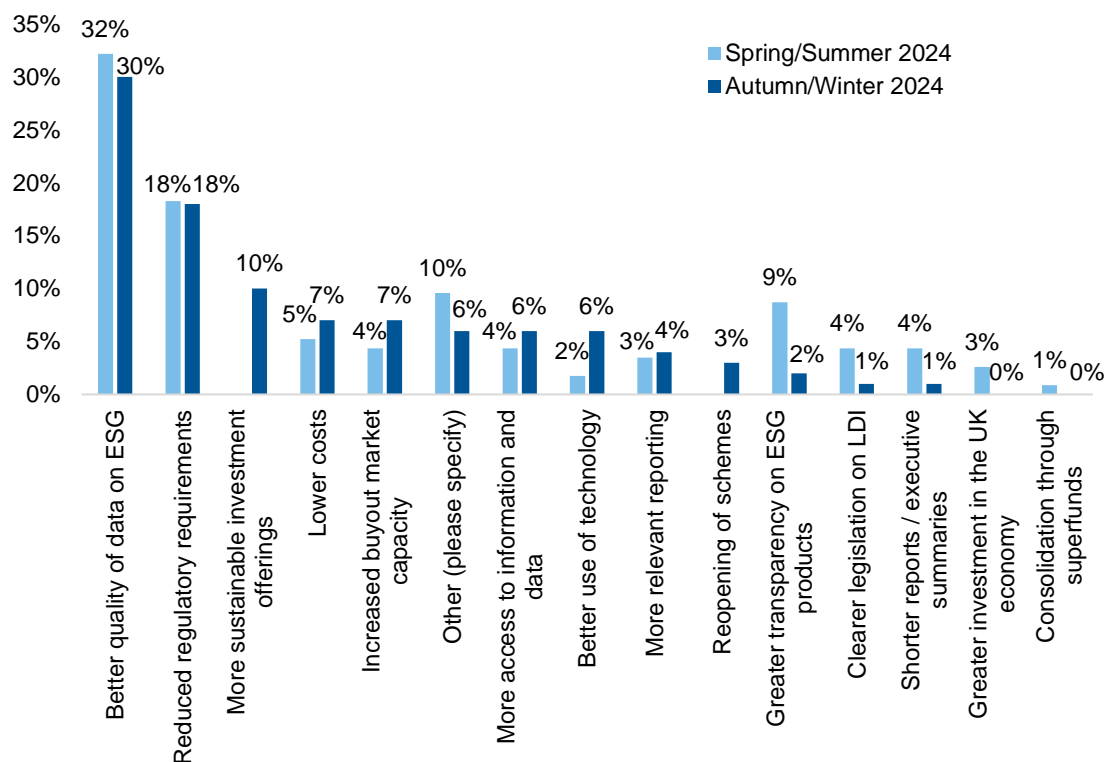
“Schemes are generally not re-risking. Equally, an emerging theme is about not derisking too much.”

Lok Ma, Law Debenture, Professional Trustee

ESG focus persists

When asked what change respondents would like to see in the UK market over the next 12 months, 'Better quality data on ESG' remained largely consistent with our results last year, being selected by 30% of respondents. The selection of the new option introduced in this year's survey 'More sustainable investment offerings', indicates that there is modest appetite to integrate sustainability into investment portfolios.

Exhibit 6: What is the one change that you would like to see in the UK DB market in the next twelve months?



Source: Russell Investments, October 2024. 'More sustainable investment offerings' is a new option added for this survey.



Focus group quotes

"Not many schemes have much equity left, but this doesn't stop you engaging on other assets: putting pressure on managers, thinking about specific companies within the portfolio that you are lending money to."

Alan Baker Law Debenture, Professional Trustee

Preference for bonds and infrastructure assets

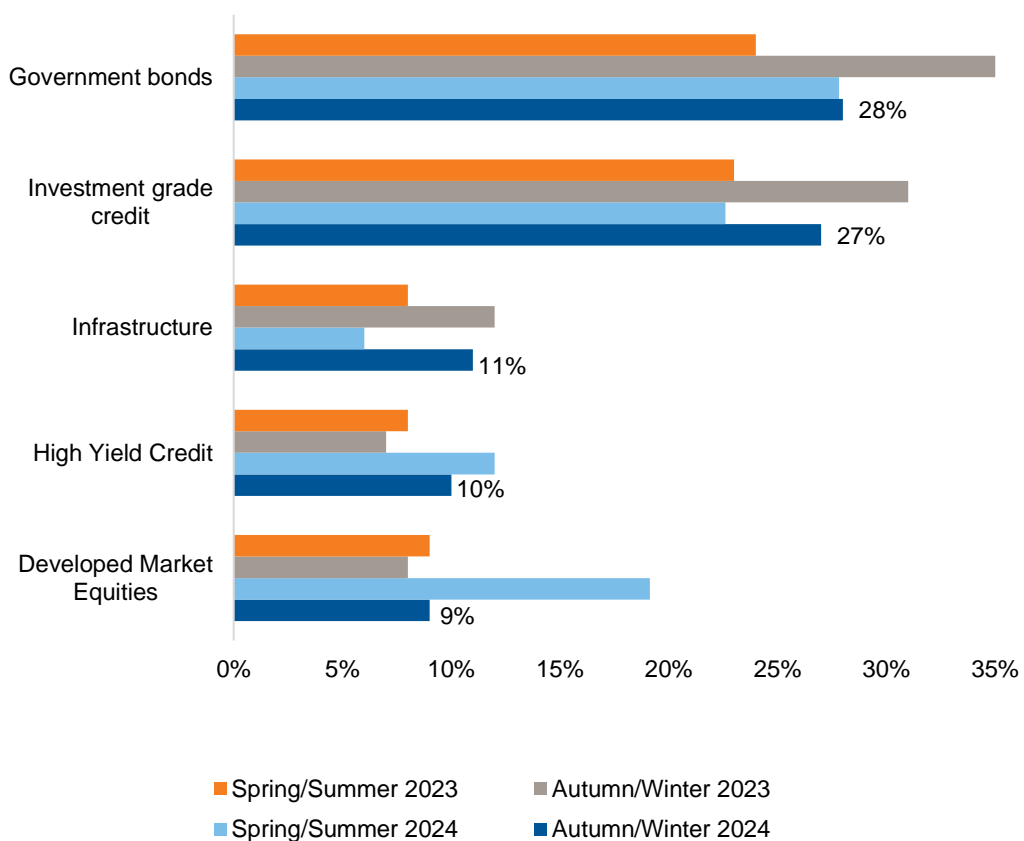
In the fourth volume of our DB research, released earlier this year, we highlighted growing respondent appetite for allocations to developed and emerging market equities. However, our latest findings suggest a notable reversal in this trend. Only 9% of respondents now expect to increase their allocations to Developed market equities, down from 19% in our previous survey. Similarly, just 7% express interest in allocating to Emerging market equities, compared to 15% previously.

Unsurprisingly, there remains a stronger preference for lower-risk asset classes. Government bonds (28%) and Investment-grade credit (27%) topped the list of preferred allocations as schemes continue to de-risk and seek cashflow generation. Infrastructure also saw a meaningful increase, selected by 11% of respondents, up from 6% in the prior survey. Many of these schemes may be investing in open and evergreen funds in this space which offer diversification and income benefits, but without the requirement to lock up assets for long periods.

Despite the broad decline in risk appetite, High yield credit has retained interest, with 10% of respondents expected to increase their allocations.

These findings illustrate a clear shift among schemes towards de-risking their portfolios, while retaining selective exposure to assets with potential for enhanced returns and cashflow generation.

Exhibit 7: Schemes expected to increase asset allocation exposures in the next six months

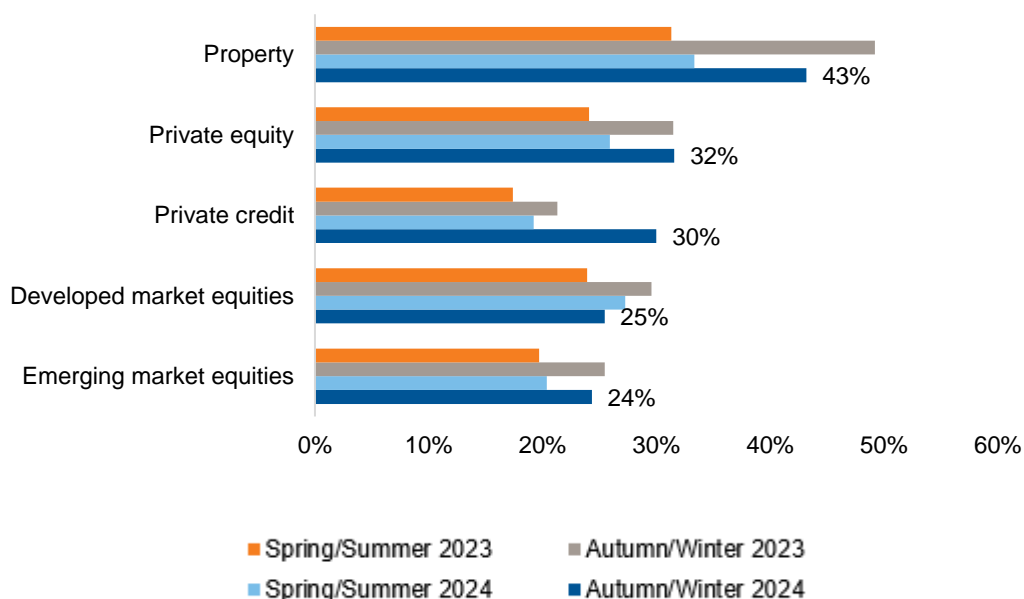


Source: Russell Investments, October 2024.

Given schemes' preference for lower-risk assets, it is unsurprising that many schemes expect to reduce allocations to Private equity (32% of schemes which currently hold this asset class) and Private credit (30%).

Similarly, as schemes continue to increase liquidity, property remains the main asset class to exit, with 43% of respondents whose schemes hold property expecting to decrease their allocation over the next six months.

Exhibit 8: Schemes expected to decrease asset allocation exposures in the next six months



Source: Russell Investments, October 2024.



Focus group quotes

“I’m not seeing many fire sales of illiquid assets on the secondary market. It is more likely for people to think ‘if it takes us a few more years [to run-off illiquid exposure], then we’ll do that’. Insurers are also increasingly willing to consider workarounds if illiquids are the main obstacle to a deal.”

Lok Ma, Law Debenture, Professional Trustee

“The challenge is trying to move to a credit focus and cashflow driven approach, but with credit spreads being where they are the issue is how to invest. We have been looking at areas of alternative credit as a vehicle to give credit exposure and still get reasonable returns.”

Alan Baker, Law Debenture, Professional Trustee

“I think people are questioning what derisking actually means in reality. There are a lot of questions over the corporate bond market and whether the risk on investment grade is properly priced in or is being distorted by high demand.”

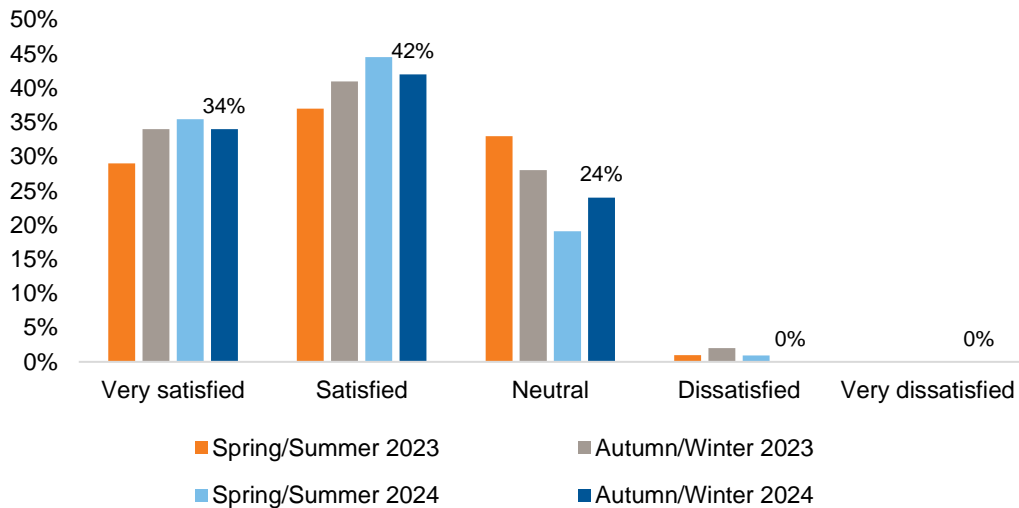
Nicholas Chadha, Pan Trustees, Professional Trustee

Rising demand for better performance

Liability Driven Investing (LDI) managers

Respondents generally remain satisfied with their LDI providers. Following the challenging period of the 2022 Gilt crisis, satisfaction levels have stabilised, reflecting increased confidence among trustees.

Exhibit 9: How satisfied are you with your LDI provider?

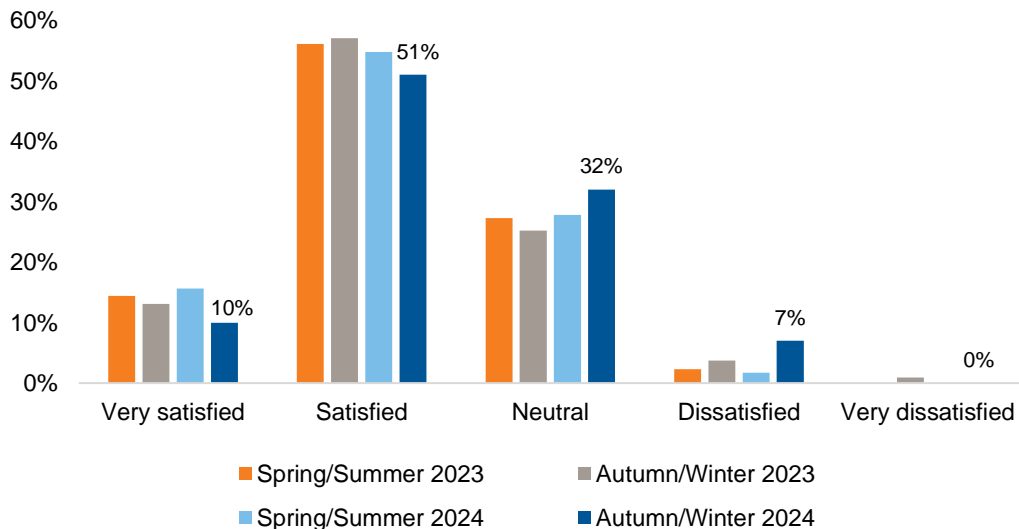


Source: Russell Investments, October 2024.

Growth asset managers

Respondents' attitude to their current growth asset investment performance is less rosy. Our survey showcases a general decline in the levels of satisfaction, with 'Neutral' rising to 32% and 'Dissatisfaction' rising to 7%. This is consistent with the broader feedback we have seen in this survey, which is that trustees are looking for additional performance in their portfolios.

Exhibit 10: How satisfied are you with your current growth asset investment performance?



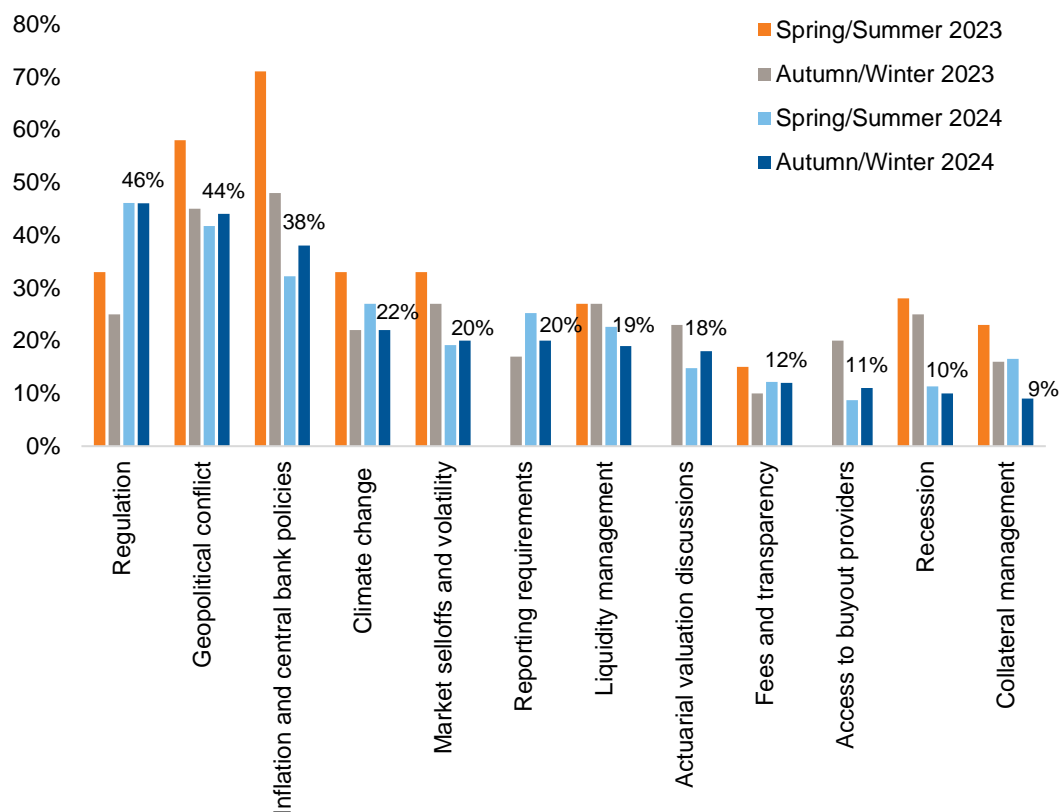
Source: Russell Investments, October 2024.

Regulation is main challenge

The concerns highlighted in our prior surveys remain largely unchanged; Regulation, 'Geopolitical conflict', 'Inflation and central bank policies' continue to dominate as the most significant challenges for the DB market. Fears around the impact of a Recession remain muted. Liquidity and collateral management continue to be seen as less of a challenge for schemes, most of whom will have now rebalanced their exposures following the 2022 Gilts Crisis. The lack of emerging macroeconomic and market concerns suggests a period of relative stability, with most challenges stemming from regulatory and administrative demands rather than market instability.

Feedback from the Focus Group interviews highlights that regulatory volumes remain a persistent burden, with Pensions Dashboards featuring as a particularly complex challenge. One interviewee emphasised the significant liability placed on trustees for these dashboards, despite trustees having limited direct control over their implementation. While DB-specific regulation is acknowledged as cumbersome, other interviewees noted that it is significantly less onerous than the regulatory demands faced by authorised defined contribution master trusts. As mentioned earlier in this survey, the regulatory implications for schemes surrounding the Virgin Media case have also been a pain point for trustees.

Exhibit 11: Key concerns for pension schemes in the next six months



Source: Russell Investments, October 2024.



Focus group quotes

“The single biggest issue facing the industry right now is the Virgin Media case. We have not heard from the Government or The Pensions Regulator on this. The Regulator has a responsibility to protect the PPF and the consequences of this case could result in significant PPF exposure and a massive hit to UK plc. Hopefully, tPR is lobbying the DWP and Government in the background in favour of the pragmatic solution the industry and UK requires.”

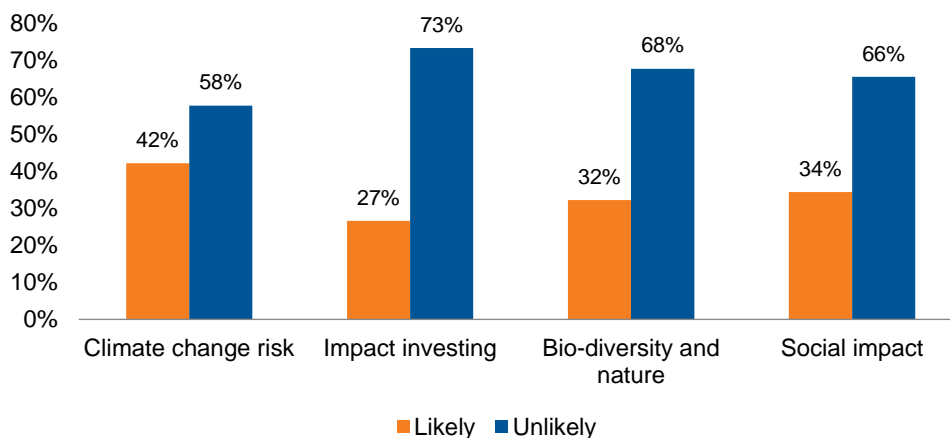
Nicholas Chadha, Pan Trustees, Professional Trustee

Climate change and net zero disengagement

Our research indicates that climate-related risks are not a primary focus for DB schemes over the next 12 months. Consistent with previous findings, areas such as 'Impact investing', 'Biodiversity', and 'Social impact' remain low priorities for respondents. More notably, the focus on 'Climate risk', which 58% of respondents in our prior survey expected to increase, has now dropped to 42% with the majority now unlikely to focus on this in the next year. This could reflect that many schemes have recently reviewed their investments through a climate risk lens and already made changes (or decided not to), or simply that there are other considerations which are higher up their list of priorities.

Clearly, while ESG considerations remain important, the structural constraints of derisked portfolios, often dominated by bonds, along with shorter timeframes for pension schemes, limit actionable steps on climate risk. Although the TCFD (Task Force on Climate-related Financial Disclosures) framework has successfully elevated awareness of climate issues, its administrative burden may discourage deeper integration.

Exhibit 12: How likely are you to increase your focus over the next twelve months to the following?



Source: Russell Investments, October 2024.



Focus group quotes

"My sense is that people are doing less [on ESG] than they would have anticipated doing three years ago. There are a few reasons for that. Certainly, the majority of people that are thinking to themselves that they will buyout in five years have kind of put it to one side. It's not really their focus, probably rightly so. They are more focused on liquidity."

David Fogarty, Dalriada, Professional Trustee

"ESG [is a focus] to an extent, but it is not a big driver. We know we have our fiduciary duties but in general we are derisking and have bond heavy portfolios. We are doing some work on ESG but I would not say it is a main priority at this stage."

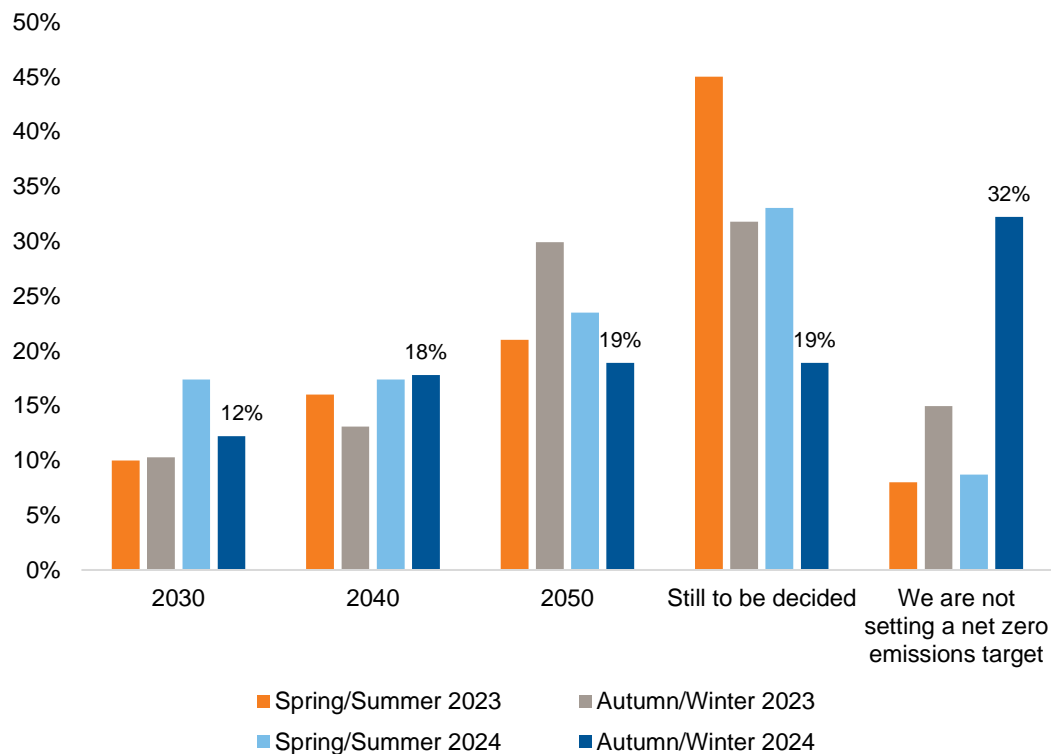
Paul Watson, Capital Cranfield, Professional Trustee

This survey also shows that some schemes have shifted from being undecided on their net zero plans, to deliberately not setting a target for their scheme. 32% said they do not plan to set a net zero emissions target, up from only 9% in our survey earlier this year.

This marks a tension trustees face between meeting fiduciary responsibilities and the feasibility of setting environmental goals, especially within portfolios that are heavily derisked or nearing buyout.

However, some interviewed trustees highlighted that member expectations around ESG, including net zero ambitions, are influencing conversations regarding the credentials of buyout providers. This suggests a growing need for awareness on how sustainability factors may intersect with member engagement and scheme legacy.

Exhibit 13: Pension scheme net zero targets



Source: Russell Investments, October 2024.



Focus group quotes

“If you are going to wrap up the scheme in the next few years, I would argue that the bigger ESG question is not how you invest your assets for that period, but which insurer you are going to hand the scheme over to, and how they are going to look after the assets and sustainability factors.”

Lok Ma, Law Debenture, Professional Trustee

Summary

The UK DB pensions market is experiencing a period of change and contemplation. While in the past uncertainty came from macroeconomic variables, today, uncertainty is more attached to cost, regulation, and shifting market dynamics.

Buyout remains the dominant endgame goal for many trustees, yet a growing number are questioning its viability and exploring alternative strategies, such as run-off. Investment priorities are subtly evolving too, with schemes increasingly focusing on cashflow generation and greater returns while derisking. Regulatory challenges, particularly those related to the Virgin Media case, Pensions Dashboards and various tPR Codes, remain significant concerns.

With schemes reflecting on the paths available to them, there is a demand for outsourced providers to help them on their journey to endgame. Whether it is a strong track record in risk management and investment expertise, generating surplus returns, improving governance structures, or alleviating administrative burdens, there is no one-size-fits-all approach for outsourced providers to support DB pension schemes.

FOR MORE INFORMATION

visit russellinvestments.com/ukdbresearch

IMPORTANT INFORMATION

For Professional Clients Only.

This material does not constitute an offer or invitation to anyone in any jurisdiction to invest in any Russell Investments Investment product or use any Russell Investments Investment services where such offer or invitation is not lawful, or in which the person making such offer or invitation is not qualified to do so, nor has it been prepared in connection with any such offer or invitation.

This is not a marketing document. Unless otherwise specified, Russell Investments is the source of all data. All information contained in this material is current at the time of issue and, to the best of our knowledge, accurate. Any opinion expressed is that of Russell Investments, is not a statement of fact, is subject to change and does not constitute investment advice.

Issued by Russell Investments Limited. Company No. 02086230. Registered in England and Wales with registered office at: Rex House, 10 Regent Street, London SW1Y 4PE. Telephone +44 (0)20 7024 6000. Authorised and regulated by the Financial Conduct Authority, 12 Endeavour Square, London, E20 1JN.

© 1995-2024 Russell Investments Group, LLC. All rights reserved.
