The cost of prudence to UK plc

Robust protection or a missed opportunity?

LCP Accounting for Pensions

June 2023

Helping corporate sponsors

Welcome to LCP's annual Accounting for Pensions report analysing the 2022 disclosures of FTSE100 companies

This landmark report is LCP's 30th annual Accounting for Pensions report and the pensions landscape is unrecognisable today from the position when the first report was published in August 1994.

We arrive at the 30th edition having gone through a turbulent year like no other (again), with the aftermath of the Covid pandemic, the fallout from the LDI crisis, and sharp rises in gilt yields all having significant and long-lasting impacts on pension schemes.

Despite this, over the year we have seen reductions in risk and an increase in aggregate DB pensions surplus. Given the significant market changes, this could be seen as support and backing for years of de-risking. However, it could also be seen as a missed opportunity as schemes that retained risk have generally benefitted more with greatly improved funding positions.

DB pensions in the UK now stand at a crossroads – DB pensions could be consigned to the history books as the rapid increase in insurance de-risking takes hold, or potentially could be seen as an opportunity for growth and improved outcomes delivering enhanced value for all stakeholders and wider UK plc.

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Section 1:
Fallout from the LDI crisis

The fallout and consequences of the LDI crisis in September 2022 are still being reviewed and analysed, with various investigations setting out recommendations for widespread changes in market practice. Whilst we covered the immediate impact and response within LCP's Corporate Report last autumn, the implications could be felt by schemes and sponsors for years to come. There have been step-changes in expectations over what represents a reasonable level of risk for schemes to run (for example long-term changes in the expected level of leverage within liability hedging arrangements).

Whilst gilt yields were rising steadily over the first half of 2022, the large daily movements observed in late-September and into early October were unprecedented and led to rapidly increasing collateral calls for pension schemes invested in Liability Driven Investments (LDI). This caused unexpected liquidity difficulties for a number of investment managers and pension schemes, unintended reductions in pension scheme hedging levels for some schemes, forced sales of growth or other assets to provide additional collateral, and even cash injections from sponsors (possibly in the form of short-term loans).

Movement in 15 year UK gilt yield

Source: FTSE Actuaries UK 15 year gilt yield

Gilt yields increased four-fold over 2022 from c1% pa to c4% pa, and have risen further since.

In the short term, the focus was on ensuring that pension schemes' investments could withstand the market volatility and that they maintained sufficient liquidity to support their hedging levels and ongoing cashflow demands. Some schemes, which due to the specifics of their investment portfolio were not as impacted by the collateral squeeze, were even able to take advantage of short-lived improvements in insurer pricing.

Looking back, with the benefit of published data from company year-end accounts, we are able to start to analyse and quantify the impact of all this volatility.

Broadly, we see the financial impact on corporate balance sheets as a result of the following three things that happened (for some schemes):

1. **Balance sheet movements due to hedging levels on an accounting basis.**
2. **Forced selling of growth assets due to collateral calls resulting in missed investment returns.**
3. **Forced cuts in hedging levels quickly followed by large rises in liability values, resulting in relative losses.**

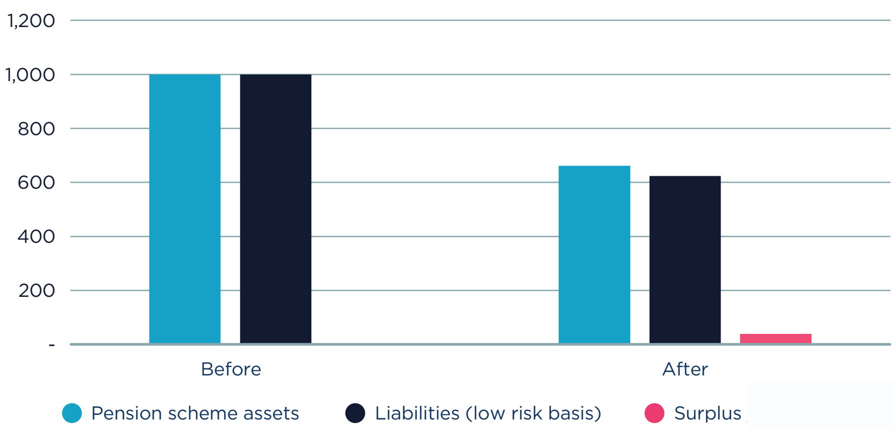
1. 'Over-hedging' on an accounting basis

Pension schemes use investments such as gilts, swaps and LDI to provide protection against worsening of the funding position due to liability values increasing following falls in gilt yields.

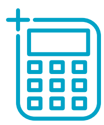
The level of protection varies by pension scheme. As funding positions have improved over recent years, the overall level of protection and hedging has generally increased. This has happened as trustees have sought to both lock in funding gains and to protect against future bad news, avoiding potential calls for additional deficit contributions. As a result, a majority now have a low-risk strategy with a high level of hedging set with reference to either the prudent triennial funding valuation basis (as this drives future cash deficit contributions) or a low-risk basis (as this potentially represents the longer-term objective for the scheme).

For example, consider a £1bn scheme which is fully funded and 90% hedged on a low-risk basis. For a 3% pa increase in gilt yields (broadly comparable to the increase in yields observed over 2022), the liabilities measured on a low-risk basis for this sample scheme fall by £380m. The hedging in place will cover 90% of this movement, meaning that the assets also fall in value – by 90% of the movement in liabilities (£340m). In aggregate, the funding position improves as a result of the change in market conditions by £40m – a 6% improvement in funding level. For schemes that are taking more risk and are hedged less, there will be larger gains.

Change in funding position for a sample scheme following a 3% pa rise in gilt yields



For schemes that are less than 100% hedged, the large rise in gilt yields will therefore have led to improvements in position on that measure. Over 2022, this has driven significant improvements in funding levels against insurer pricing and meant that many schemes hit full funding on an insurer basis ahead of schedule. As a result, combined with improvements in insurer pricing, we saw and continue to see record demand for insurer bulk annuity transactions. Recently, the Pensions Regulator's Annual Funding Statement, released in late April 2023, estimated that around a quarter of UK schemes are now fully funded on this measure.

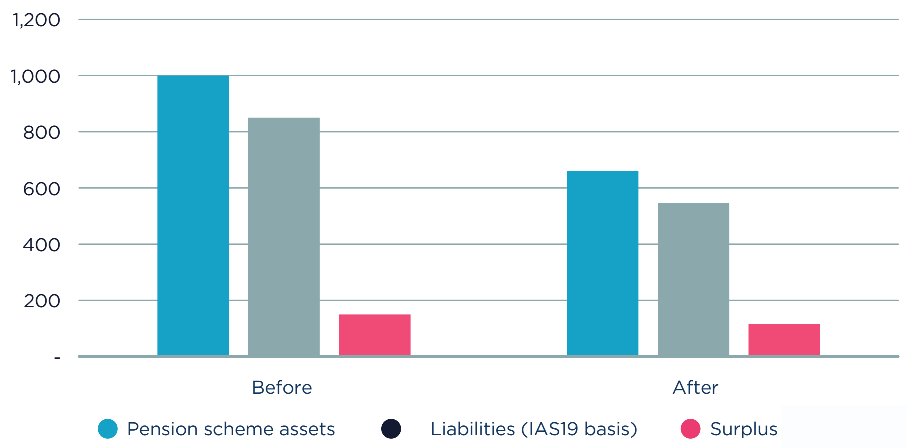


Large rises in gilt yields over 2022 have improved positions on funding and insurer bases.

Other than pension schemes sponsored by financial services companies (who have an increased interest in these matters due to risk capital rules based on IAS19), few pension schemes explicitly set their hedging levels with reference to the corporate accounting position and in a lot of cases this is not even considered as a factor when designing the preferred level of hedging and hedging reference basis. As IAS19 accounting liabilities are typically lower than liabilities measured on either a low-risk, funding or insurer basis, changes in market conditions can lead to unexpected results. This is because schemes that are close to 100% hedged on, say, a low-risk basis will be more than 100% hedged relative to the accounting liabilities. In that situation, a rise in bond yields will lead to a worsening position, as illustrated below.

Using the same example, the IAS19 liabilities for this scheme are £850m and the scheme has an IAS19 surplus of £150m before the change in market conditions. Following the increase in gilt yields, the assets fall by £340m (as before) but the IAS19 liabilities fall by only £270m. This lower impact reflects the smaller starting liabilities and how different liability measures respond to changes in market conditions. Overall, this represents a worsening of IAS19 balance sheet position of £70m.

Change in IAS19 position for a sample scheme following a 3% pa rise in gilt yields



As can be seen in the example, the differences in hedging on these two liability measures can lead to very different end results. Within the case study, there is a £40m improvement in position on a low-risk basis but a £70m loss on a corporate accounting basis - a £110m difference in outcomes.

Analysis of FTSE100 accounts has shown that the impact on individual schemes has varied, depending on the level of hedging and other factors. This impact on corporate balance sheets requires careful communication. Whilst the improvement on low-risk and insurer assumptions is a positive and has been well documented, the potential worsening of corporate balance sheets could be a surprise for shareholders and wider readers of accounts.

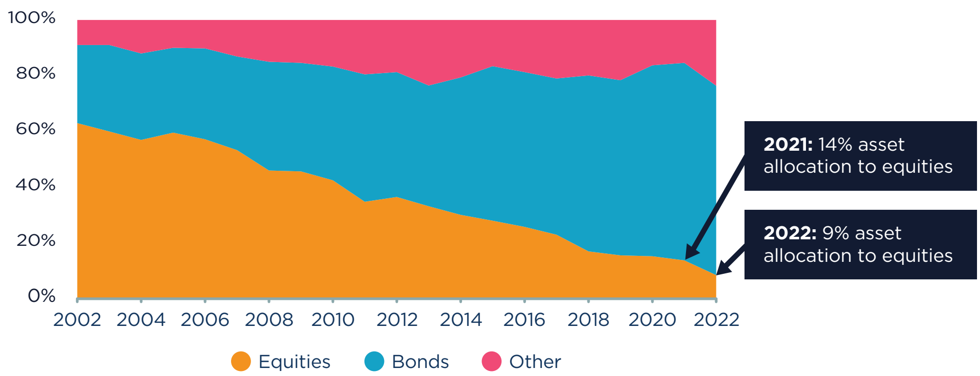
Material differences in impact of 2022 market condition changes due to varying hedging levels.

2. Missed investment returns due to collateral and liquidity actions

During the height of the LDI crisis, pension schemes were forced to make collateral calls at short notice and draw down on any available liquid assets to avoid hedging levels being cut. This often involved pension schemes divesting from assets such as corporate bonds and equities.

This trend is reflected in the disclosed accounts data from FTSE100 companies. The amount of FTSE100 pension assets invested in equities fell by £50bn during 2022. This corresponds to the proportion of scheme assets in equities dropping by a third over the year and being less than 10% of total DB pension assets for the first time.

Estimated overall asset allocation for UK pension schemes sponsored by FTSE100 companies



UK equity returns were broadly flat during 2022, but this was split as a loss of 9% over the first nine months before strong returns over the final quarter. There was a similar pattern for overseas equities with a 12% loss during the first six months, before positive returns in Q3 and Q4.

	UK equities	Overseas equities (unhedged)
Q1 2022	+0%	-3%
Q2 2022	-5%	-9%
Q3 2022	-4%	+2%
Q4 2022	+9%	+2%
Annual return	+0%	-8%

As gilt yields rose during 2022, equities and other liquid assets will have been sold as part of asset rebalancing and to provide collateral to LDI portfolios. Asset returns were volatile, and the timing of disinvestments could mean that pension schemes were locking in negative returns over the initial stages of 2022 and were then missing out on the strong positive equity returns at the end of the year and into early 2023.

Broadly, we estimate that the change in asset allocation may have hit FTSE100 corporate balance sheets and pensions funding positions by around £10bn.

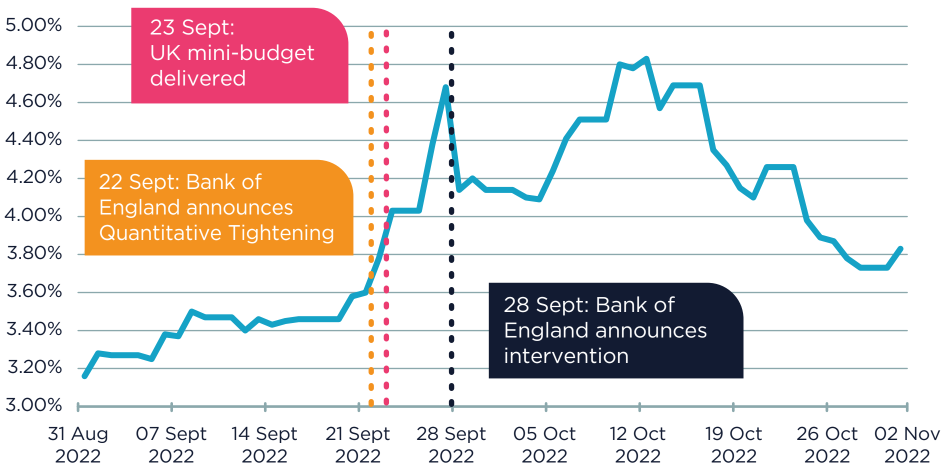
Changes in short-term asset allocation may have hit FTSE100 corporate balance sheets by around £10bn.

3. Forced cuts in hedging levels

Whilst planned reductions in hedging levels can form part of a pension scheme's overall strategy, unplanned or forced hedging cuts in volatile markets can cause material losses.

In the run-up to and in the immediate aftermath of the Bank of England announcement of Quantitative Tightening and the mini-Budget on 22 and 23 September 2022 respectively, gilt yields were rising sharply. As a result, LDI managers were issuing regular and often large collateral calls. This was in order to support schemes' desired levels of hedging and to avoid the risk of running out of assets should gilt yields continue to rise. When schemes could not meet these calls in time, the LDI managers could not maintain the level of hedging, reducing the protection to schemes.

Movement in UK 15 year gilt yield



Source: FTSE Actuaries UK 15 year gilt yield

This did not impact all schemes, and many schemes were able to retain their desired level of hedging throughout the crisis. However, for those schemes which had their hedging cut, the exact timing of when the hedging was cut and then perhaps reinstated would have materially impacted the scheme's finances as the daily moves in gilt yields were so large.

If hedging was cut when gilt yields were close to 5% pa, the subsequent fall in yields will have damaged funding levels on all measures.

The level of detail within published accounts on cuts to hedging levels is limited. Schemes that were most at risk of being impacted were those operating high leverage levels within their LDI portfolios and those with a large proportion of illiquid assets.

Whilst the impact from each of the three issues set out over the previous pages could potentially represent a significant loss to corporate balance sheets, it is necessary to provide some context.

Trustees and scheme sponsors typically set objectives and strategies with a view to limiting the need for future cash calls on the sponsor. Unless a pension scheme is fully insured, it isn't possible to manage both cash and IAS19 balance sheet risk at the same time as the funding measures are intrinsically different.

As a result, schemes that are not fully insured often target high hedging levels and adopt low-risk asset strategies to limit the impact of potential downside scenarios. Over the past year, whilst this approach could have impacted the IAS19 balance sheet position, schemes that have maintained this strategy have typically observed stable or improved funding levels on low-risk or insurer assumptions. This has meant no new cash contributions are due and the headline objective has been met.

What next?

Following an investigation, in February 2023 the House of Lords' Industry and Regulators Committee published their findings on LDI strategies used by DB pension funds and the financial turmoil following the September 2022 LDI crisis.

In summary, the Committee:

- Blamed market-based accounting standards (e.g. IAS19) for the rise of LDI and the lack of investment in wider growth assets.
- Called on government to review the underlying investment regulations to ensure they are appropriate in the way they permit pension schemes to borrow and leverage investments.
- Called for investment consultants to be more fully brought into the FCA regulatory perimeter.
- Called on regulators to focus more on systemic risk, including suggesting a new statutory objective for TPR in this area.

Was the Committee right to blame accounting standards?

Whilst accounting approaches largely initated a 'market-based view' of pension scheme liabilities, this has long since been overtaken by Scheme Funding Regulations as the key driver of trustee decisions to invest in LDI. These Regulations reflect the increasing focus on the security of DB pensions and have widely led to a short-term focus on bond-based valuations placed on scheme liabilities. Therefore, blaming 'accounting standards' seems to be only one part of the picture.

The Lords asked whether there is a different way to measure and report risk that can encourage a wider range of investments in pension schemes, long-term investment in UK plc and less herding into index-linked gilts. Interestingly, 'asset-led discounting' approaches, which can help achieve these goals and can also be helpful in reducing the over-hedge on a corporate accounting basis, are also promoted in the Regulator's new draft Code of Practice that was released for consultation in December.

On 24 April, The Pensions Regulator responded to the Lords and issued new guidance setting out further practical steps pension scheme trustees should take to manage risks when using LDI. It was released alongside FCA guidance to asset managers. The guidance asks trustees to think in terms of holding enough collateral to ensure the programmes can withstand large but plausible moves in the gilt markets.

In addition, there is emphasis in the guidance on trustees carrying out sufficient stress testing supported by their advisers and managers. Furthermore, trustees are encouraged to ensure they are receiving appropriate levels of reporting on key parameters like the distance to and likely size of future collateral calls.

The Government is due to consider the recommendations and respond in due course. It therefore remains to be seen what changes are enforced and how they will impact investment strategies and funding positions.

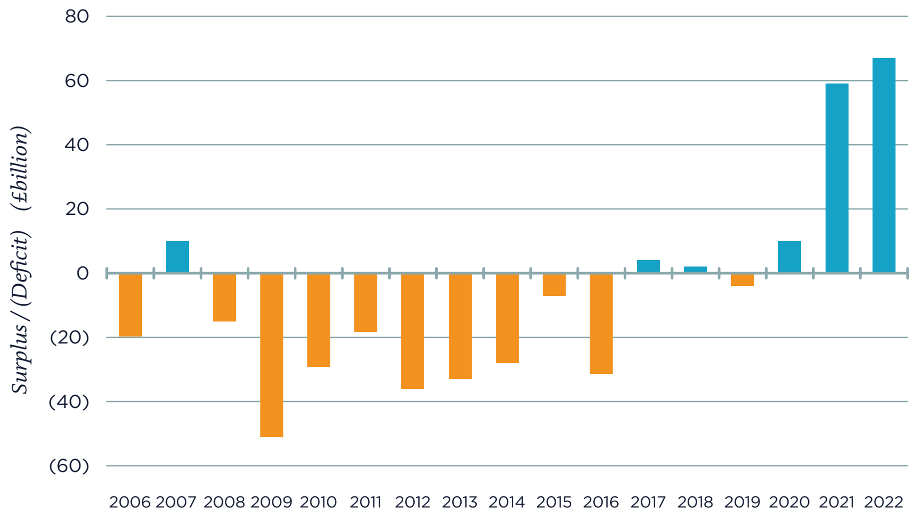
Changes to guidance on LDI reduce risk but place additional governance burdens on trustees

David Wrigley, Partner

Section 2:
The impact of pensions surplus

Even after allowance for the LDI impact on corporate balance sheets, the aggregate position for FTSE100 UK DB pension schemes improved over 2022. The surplus increased from £59bn at the beginning of 2022 to around £67bn at the year-end. Given the material fall in liabilities due to changes in market conditions (further detail in section 3), this translates to an improvement in funding level from around 110% to around 120%.

Estimated combined IAS19 position of FTSE100 companies at calendar year-ends



90% of FTSE100 companies disclosed a surplus in their UK pension scheme.

The improvement in aggregate funding position is also reflected in the individual FTSE100 accounts. Around 90% of FTSE100 companies with UK DB pension schemes disclosed a surplus in their 2022 accounts.

As surplus grows, the number of companies impacted by IFRIC14 accounting rules has also grown. 25 companies disclosed an adjustment to their balance sheet position to recognise that they do not have an unconditional right to the surplus and that they do not expect to derive full economic value from the accounting surplus. The number of companies impacted is up from 19 companies that disclosed impacts the previous year.

As the surplus grows, there is more focus on the likelihood and timing of stakeholders deriving value from the surplus.

Phil Cuddeford, Partner

Given the increasing number of companies in surplus and as the size of surplus that grows, companies should review their scheme's rules in detail to establish what might eventually happen to the surplus. We covered key considerations within LCP's Corporate Report with small changes in wording in the Rules impacting the options for the endgame and use of surplus. For example, rules over how the surplus could be used may be different between when the scheme is ongoing and when the scheme has commenced wind-up. Rules commonly set out the need for benefit augmentations or refunds to the employer, but this should be checked and where possible amended to ensure that the rules are consistent with the preferred endgame agreed jointly between the trustees and sponsor.

The default end destination for many pension schemes has historically been to "buy out as soon as we can without increasing contributions." However, over the past 12 months, changes in funding levels, high levels of inflation, market innovation, as well as some shift in sponsor mindset in the current climate, mean we are seeing more schemes explore and implement different options as they seek to enhance and share value amongst all stakeholders rather than simply pass the scheme to an insurer.

For schemes at or close to insurer funding levels, many are now deciding to run on beyond this level with a view to improving wider outcomes. Doing so clearly requires careful consideration of factors such as:

- The impact of maintaining the link between sponsor and scheme.
- Retaining control of the quality of member experience.
- The ongoing management and use of any emerging surplus (through possible discretionary increases, refunds to the employer, funding future accrual of DB or DC benefits, the payment of scheme expenses, or even improvements in DC contributions).
- In some cases the use of captive insurer solutions for the sponsor to participate in post transaction upside.

The past year has brought a sea change in long-term attitudes towards pensions. With improved funding positions and market innovation, pension schemes are no longer seen as a millstone weighing down corporate growth, but as an opportunity to improve outcomes and increase value for members, for scheme sponsors, and for wider stakeholders.

Jonathan Griffith, Partner and Head of Endgame Innovation

Defined benefit pension schemes have often had a significant and adverse impact on mergers and acquisitions. Relative to the size of the company, defined benefit schemes can represent material financial obligations and risks.

As a result:

- the **buyer** may decide not to pursue a particular target, or if they do, pension liabilities need to be factored into the purchase price. Additionally the buyer may decide to seek more certainty by negotiating an agreement with the pension scheme trustees that appropriately addresses pension obligations as part of the deal, in advance of a transaction. This can often require acquiring companies to provide increased funding and/or security packages to pension trustees, particularly in situations where additional debt is used to finance the deal; and
- the **seller** may wish to take steps to manage and/or potentially secure the pension liabilities with a third party before the transaction.

All parties are likely to be mindful of the UK Pensions Regulator, who has a remit to protect the position of pension schemes and strong powers to support them in this.

Given the recent improvement in funding levels, defined benefit pension schemes have become less of a financial burden with the result that they are not the deterrent to corporate activity they once were, although even with an apparently well-funded scheme risks remain and need to be carefully managed. The size of the surplus for some FTSE100 pension schemes is significant when compared to the company's market cap. For five FTSE100 companies, the surplus on a low-risk (ie very prudent) measure is now in excess of 10% of their market cap.

We are seeing buyers increasingly willing to acquire sponsors of UK defined benefit pension schemes, with a view to working with pension trustees to manage the journey to the scheme's 'end game' during their period of ownership. In many cases this has enabled trustee boards to improve the security of their members' benefits and reach their longer term goals sooner than anticipated.

Richard Pinder,
Partner and Head of M&A

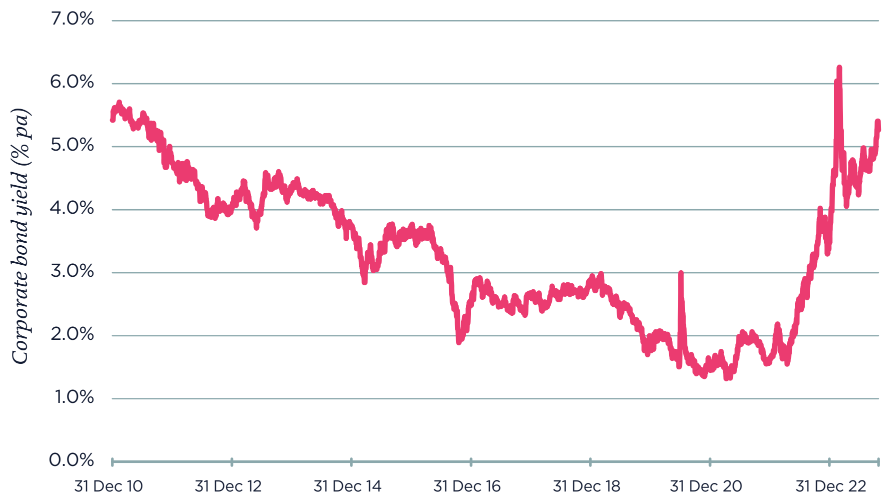
Section 3:
IAS19 assumption benchmarking

Discount rate

IAS19 discount rates are set with reference to high quality corporate bond yields. Over 2022, there was a sustained increase in these yields – rising from less than 2% pa at the start of the year to over 6% pa in the wake of September's LDI crisis, before falling to just under 5% pa at the calendar year-end. This was the highest year-end discount rate for over a decade. The increase in discount rate reduced IAS19 liabilities by around 40% - a material reduction in the size of the UK's pension schemes, broadly equivalent to a £200bn reduction in UK DB pension liabilities for the FTSE100.

£200bn fall in UK DB IAS19 pension liabilities due to increases in discount rates over 2022.

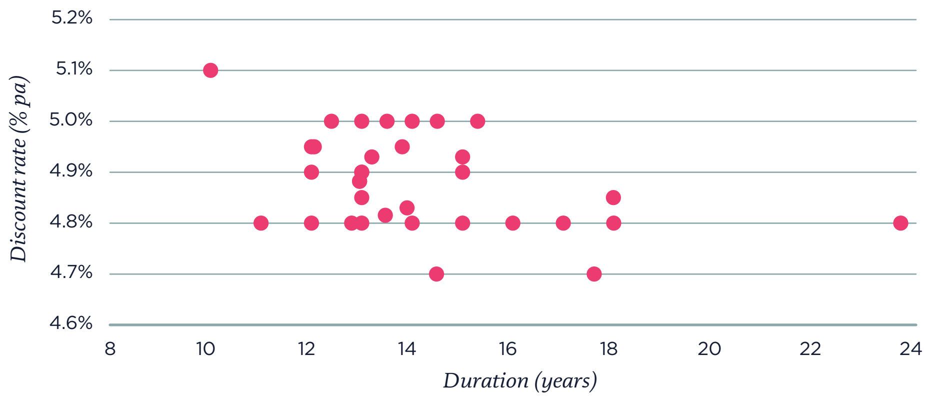
Movement in corporate bond yields since 31 December 2010



Source: iBoxx GBP AA Corporates 15+ yield

The chart below shows the disclosed IAS19 discount rates for FTSE100 companies reporting at 31 December 2022. The majority of companies reported in the range 4.8% pa to 5.0% pa (compared to 1.8% pa to 2.0% pa at 31 December 2021).

Disclosed UK IAS19 discount rates as at 31 December 2022



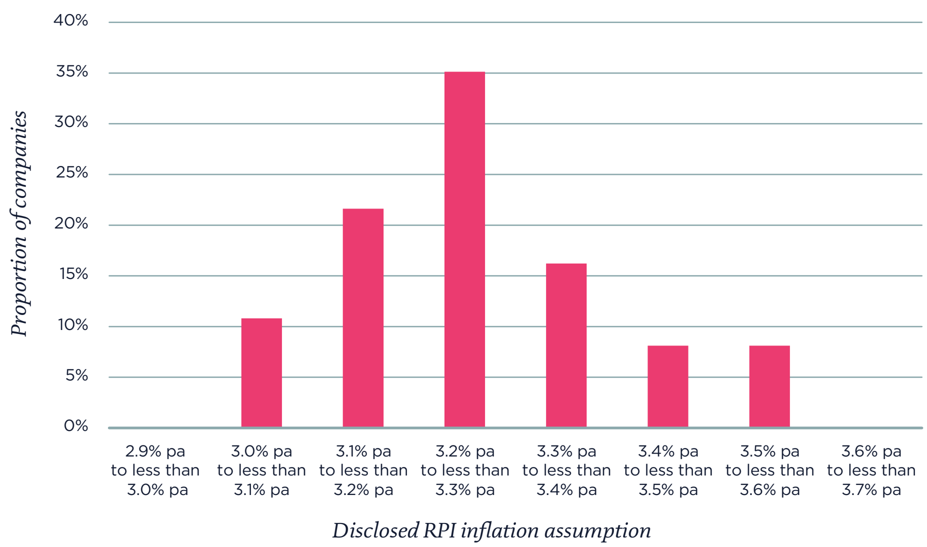
Despite the large increase in discount rates and changes in market conditions, the range of discount rates has remained stable. This could potentially be seen as surprising given the wide range of different data sets, models, and approaches used to set the discount rates, and could be seen as evidence of companies herding towards a single set of assumptions.

Inflation

Companies typically set their assumptions for future RPI inflation by comparing the market yields available on RPI-linked government bonds with fixed interest government bonds. The assumption is an average over the lifetime of the pension scheme, and the high levels of inflation expected in the short-term feed into this average.

The chart below shows disclosed RPI inflation assumptions for companies reporting at 31 December 2022. As for previous years, the average assumption decreases with increases in duration (as they are assumed to benefit more from expected lower levels of future inflation). The median assumption for the 2022 year-end is down 0.1% pa from 2021, leading to a small reduction in IAS19 pension liabilities. The majority of companies continue to use an inflation risk premium or 'IRP' of around 0.3% pa.

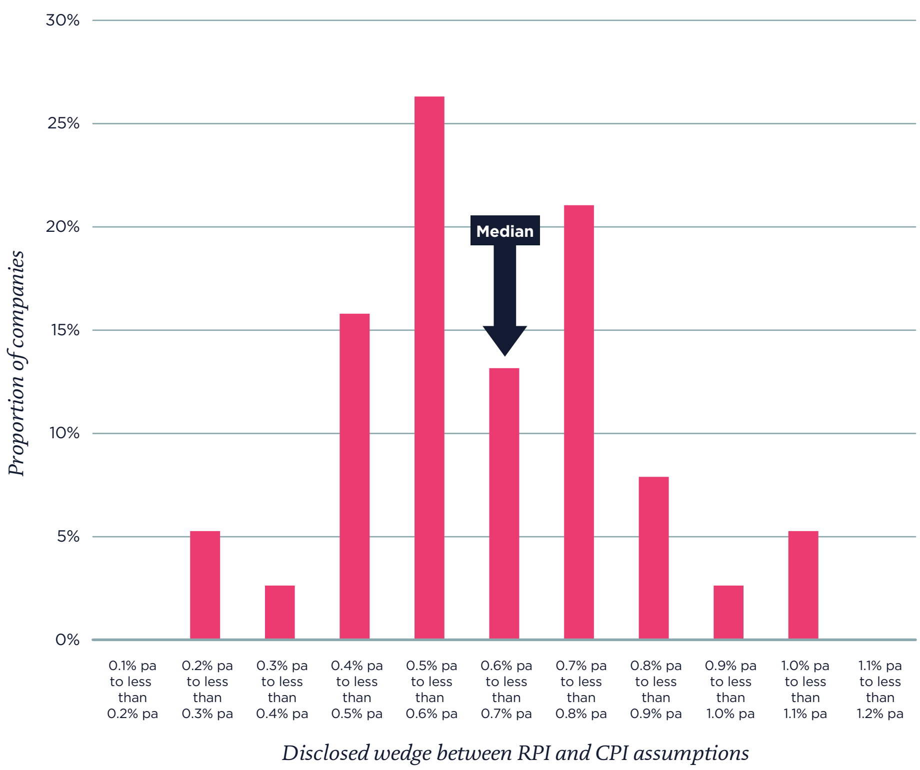
Disclosed UK RPI inflation assumption as at 31 December 2022



CPI inflation is then typically derived by taking a deduction from the RPI assumption to reflect structural differences between the two inflation measures – the so called 'RPI-CPI wedge'. As previously reported, in November 2020, the RPI inflation index is being reformed to bring it in line with the CPIH index (a variant of CPI) from 2030. Inflation measured by CPIH is consistently lower than that measured by RPI, and therefore these plans imply a significant step-change reduction in RPI inflation from 2030, and therefore also a significant reduction in the RPI-CPI wedge from 2030.

The impact of the planned change will vary significantly by scheme and the nature of the scheme's benefits. The chart below shows the wide range of RPI-CPI wedges for FTSE100 companies reporting in 2022. The median assumption of 0.6% pa and range of assumptions are both unchanged from last year.

Wedge between disclosed RPI and CPI inflation assumptions



Whilst the assumption represents the long-term average expectation for future levels of inflation, inflation over 2022 was high and resulted in increases in pensions granted to members that were above the long-term average level assumed at the start of the year. This is particularly true where schemes base their pension increases on reference months towards the end of the year (for example, the 12 month increase to September 2022 in RPI was 12.6% and in CPI was 10.1%). Collectively, higher than expected pension increases over 2022 may have caused an additional £10bn of liabilities for FTSE100 companies with December year-ends.

Higher than expected pension increases over 2022 may have increased liabilities by more than £10bn.

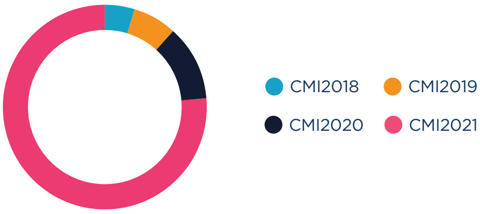
Helen Draper, Partner

Life expectancy

The assumptions connected to life expectancy and how it is projected to change in the future are the most challenging of the accounting assumptions to set objectively.

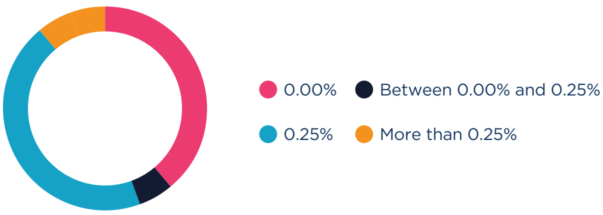
The level of detail disclosed varies significantly between companies – with some disclosing just life expectancies and others providing full detail of the many component parts of the mortality assumption. The charts below show the information reported in 2022 where information on the underlying component assumptions is provided. Where relevant, we have also provided commentary on how the position has changed since last year.

Projection tables disclosed by FTSE100 companies reporting in 2022 (42 companies)



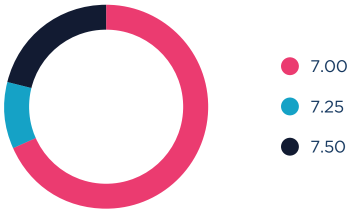
The projection tables estimate how life expectancies are expected to change in the future. New projection tables are released each year to include the latest available information. The latest such table is currently the CMI 2021 projections, which were released in March 2022 (the CMI 2022 projections are expected to be released in June 2023). Of the companies that disclose which projection data table they use, the majority continue to use the latest available table at the balance sheet date.

Initial adjustment parameter disclosed by FTSE100 companies reporting in 2022 (18 companies)



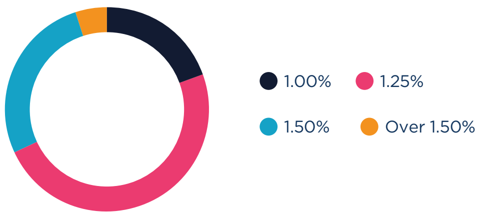
The Initial Adjustment Parameter (or A parameter) gives companies the flexibility to reflect different rates of improvement for their scheme relative to the general population of England & Wales to which the CMI model is calibrated. The appropriate size of this adjustment (if any) is subjective and the default 'core' approach is to make no adjustment. The position for 2022 relative to previous years is broadly unchanged, with companies typically making either no or a small adjustment.

Smoothing parameters disclosed by FTSE100 companies reporting in 2022 (19 companies)



The smoothing parameter reflects how much relevance is placed on the latest life expectancy data. A lower figure places more reliance on recent data, meaning that trends in life expectancy are recognised more quickly. The core parameter is 7, and a majority of companies adopt this.

Long term mortality improvement rates disclosed by FTSE100 companies reporting in 2022 (41 companies)



The long-term rate of improvement is a guess about the rate of life expectancy improvement in the very long term. Of the companies that disclose this, the median assumption is a long-term annual improvement rate of 1.25%. Whilst this median position has been established for a number of years, five companies reduced the assumed long-term rate for 2022 compared to 2021, whilst only one increased it.

Five companies reduced the assumed long-term rate for 2022 compared to 2021

The CMI 2021 projections contain parameters to determine how much weighting is placed on mortality data collected over 2020 and 2021 (the w2020 and w2021 parameters respectively). This data covered the main Covid outbreaks, and the default core approach is to place no weight on the data collated in either year (i.e. both parameters are set to zero).

Emerging market data, as well as analysis by LCP's Health Analytics team, suggests that there is likely to be an adverse long-term impact of the pandemic on life expectancy. 15 companies disclosed making some allowance within their 2022 accounts, compared to only five within 2021 accounts. Given the differences in the level of information disclosed, it is not clear whether this shift now represents a significant majority making an adjustment (for example by comparing to the number of companies also disclosing the A parameter) or whether it remains a minority (for example by comparing to the number of companies disclosing which projection table they used).

Three times the number of companies disclosed making an adjustment for the impact of Covid-19 in 2022 compared to 2021.

We are moving into a new era for longevity risk. Better understanding of exactly what is driving changes to mortality will be required over the next few years and more judgement will need to be applied as traditional models struggle to cope with post-pandemic experience. It is more important than ever to combine the views of actuaries and other experts to help sponsors and trustees set their mortality assumptions.

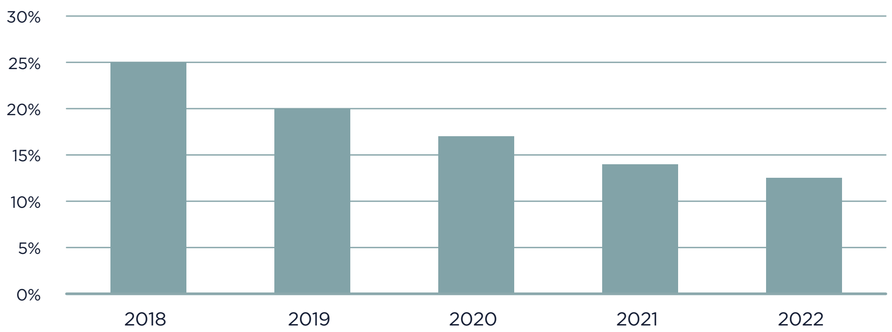
Stuart McDonald, Partner and Head of Longevity and Demographic Insights

Section 4:
Level of pension provision

Executive pensions

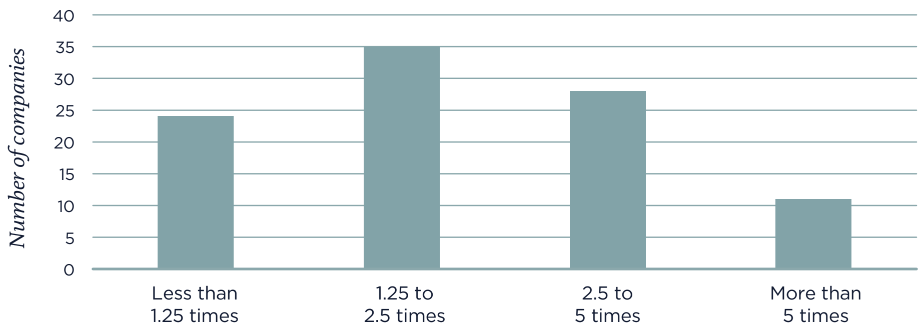
The Investment Association has been campaigning for companies to align pension contributions for executives with those available to the majority of the workforce. This has resulted in the average level of pension contributions (including cash in lieu of contributions) paid to a FTSE100 CEO halving since 2018.

Average pensions contribution to a FTSE100 CEO as a percentage of basic salary



The chart below shows how the rate paid to the CEO can be compared to the average rate paid to employees for each FTSE100 company. Around one in four FTSE100 CEOs are now receiving pension contributions in line with their employees.

Pension contribution rate for FTSE100 CEO relative to the average rate paid to employees



Whilst this suggests that three in four CEOs are receiving pension contributions well in excess of those paid to employees, this does not necessarily mean that they are in breach of Investment Association guidelines. Companies may offer higher levels of pension benefits to employees, but some employees may elect not to access these benefits.

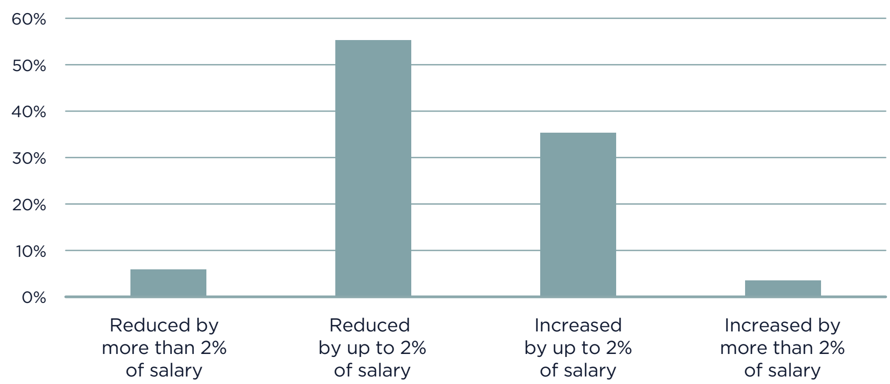
Employee pensions

Most ongoing accrual of pensions is currently through Defined Contribution or DC schemes. This typically involves offering a core base contribution from the company, plus additional matching contributions dependent on the level of employee contribution. To the extent that the employee decides not to pay more or reduces their contributions, then the company contribution would fall.

In light of the current cost of living crisis, our latest financial wellbeing report highlighted that many employees are cutting back across many areas with further spending reductions planned. Based on our survey information, around 12% of employees have already cut back on pension contributions to reduce the ongoing financial commitment – whilst increasing take home pay, this will potentially mean missing out on available matching company pension contributions.

Disclosed data within 2021 and 2022 accounts shows that the average pension cost has fallen and around 60% of companies have reported a drop in the average employee pension cost as a proportion of salary.

Change in company cost of employee pension provision



This fall is set against a backdrop whereby companies are typically improving their defined contribution pension offering which would, all else equal, expect to result in an increase in average pension spend. The chart is therefore a measure of how employees are managing their money and feeling the financial pinch and it will be interesting to see how the position evolves and how long it takes to recover.

Looking solely at disclosed DC pension contributions, we estimate that this fall has resulted in around £100m of lost pension contributions across FTSE100 companies alone.

Around £100m of missed pension contributions as cost of living bites.

We have seen levels of financial stress rising over the last few years resulting in many employees having to make tough decisions about their regular spending. 'Behind the scenes' spending such as choice of supermarket, mobile phone provider and regular subscriptions were the start, but now many employees are having to make more substantial choices with their spending which includes employee benefits, insurances, and pensions. There is a considerable role here for communication and education to ensure employees understand the consequences of their decisions and the resulting future financial impacts.

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At LCP, our experts help to power possibility by navigating you through complexity to make decisions that matter to your business and to our wider society. We are powered by our desire to solve important problems to create a brighter future. We have market leading capabilities across pensions and financial services, energy, health and analytics.

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