

SPENCE

Your Quarterly Pensions Update Quarter Two 2025



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Welcome to your Quarterly Pensions Update

The purpose of this report is to update sponsors and trustees with recent pensions industry changes in the quarter.

For your convenience, Spence has summarised the key developments and highlighted the necessary actions sponsors and trustees may need to take.

The report combines brief written comment with links to any further relevant information and any deadlines you should be aware of. We trust you will find the update useful and informative. If you require further information about how any of the topics covered might impact on your scheme specifically, please get in touch with alan_collins@spenceandpartners.co.uk or your usual Spence contact.



Investment update

The second quarter of 2025 was marked by significant volatility, primarily driven by US trade policy and conflict in the Middle East. Despite early market turmoil, most notably from Donald Trump's "Liberation Day" tariff announcement, markets recovered strongly as trade talks progressed throughout the quarter and economic data remained resilient.

Growth Assets

Global equities bounced back from a poor previous quarter, generating a strong return of 5.3%. Gains were seen across all regions with European equities leading the way at 6.5%, supported by the European Central Bank cutting rates. Emerging Market equities also performed well, returning 5.4%, with gains driven primarily by Taiwan as investor optimism around artificial intelligence increased. The strong gains were also due a weakening in the US dollar.

UK equities returned 4.1%, boosted by strength in large-cap Industrials, Real Estate and Utilities. US equities rose 4.9% as Technology and Communication sectors continued to deliver strong earnings and investor appetite for some of the "Magnificent 7" stocks reignited. Japanese equities gained 4.8%, helped by positive developments in US trade negotiations and ongoing corporate governance reforms.

UK Property performed well over the quarter, driven by resilient capital values and high income returns in commercial properties. In contrast, Infrastructure declined -0.7%, impacted by higher real yields and weaker performance in listed renewable energy firms.

Bonds

Global bond returns were relatively positive in Q2, supported by declining inflation and tightening credit spreads. UK Gilts returned 1.4%, while UK corporate bonds gained 1.9%, as resilient earnings and reduced fears of recession led to narrowing spreads. However, global high yield bonds saw a 0.9% decline, reflecting a lack of investor confidence in lower quality credit amid geopolitical tensions.

Real yields increased by 0.10% over the quarter. All else being equal, the move will have acted to decrease the value placed on inflation-sensitive pension scheme liabilities. Whilst nominal yields fluctuated quite a lot over the quarter, they finished broadly where they started at 31 March at 5.15%. All else being equal, the move will have not affected the value placed on pension schemes' liabilities. Credit spreads tightened 0.13% over the quarter.

Long-term inflation dropped 0.10% to 3.02% over the quarter.

All returns shown are shown in GBP terms unless stated otherwise, sourced: FTSE, Markit iBoxx, Morningstar Past performance is not a reliable indicator of current and future results. Data as of 30 June 2025.

Data Bottleneck: Capacity Challenges in DB Pension Risk Transfers

The defined benefit (DB) pension risk transfer market continues to experience sustained growth. Between 2022 and 2024, approximately 750 bulk annuity transactions were completed, covering around £125bn in liabilities. Most of these transactions were full scheme buy-ins, signalling a strong pipeline of schemes progressing toward wind-up and buyout.

However, the pace of completed wind-ups remains slow. Over the past five years, fewer than 100 private sector DB schemes per year (based on PPF Purple Book data) have fully wound up. While these figures include schemes that merged or entered the PPF, the overall message is clear: the number of schemes preparing for buyout far exceeds those completing the process, suggesting a growing backlog.

Current Capacity Constraints

- Successful bulk annuity transactions and subsequent wind-ups require significant administrative resource. This includes:
 - Data and benefit cleansing pre- and post-buy-in
 - GMP Equalisation implementation
 - Scheme wind-up preparation
 - Policyholder data validation for buyout
- Compliance with regulatory requirements such as the Pensions Dashboard is likely to still be required before wind-up will be completed

These activities go well beyond business-as-usual administration. The industry is facing mounting pressure on administrative resources, with both third-party administrators and insurers competing for a limited pool of experienced DB professionals.

Administrators and insurers are investing in technology, training, and systems. However, the lead time for these solutions to ease the resource burden is often too long to keep up with current demand.

Root Causes

The bottleneck is partly a result of historic underinvestment in DB pensions administration. Common issues include:

- Legacy systems that cannot support efficient data audits or benefit recalculations
- A focus on minimising cost rather than enhancing quality
- A tendency to lift-and-shift data between systems without resolving existing errors
- Hesitance to undertake cleansing projects due to perceived high costs

While some of these barriers are being addressed through modern platforms and automation, adoption is not yet widespread, and the demand for project work continues to outpace resource capacity.

Data Quality Risks

This underinvestment poses significant risks when inaccurate or incomplete data is used during a risk transfer process, such as:

- Pricing Uncertainty: Poor data quality leads to higher pricing margins from insurers to account for risk, potentially reducing value for the scheme.
- Limited Insurer Engagement: Schemes with poor data may receive fewer insurer quotes, reducing competitive tension and pricing leverage.
- True-Up Costs: After buy-in, final reconciliation of data and benefits may reveal material discrepancies, leading to unexpected “true-up” costs. These may require sponsor funding or erode surplus.

- Delays and Operational Cost Increases: Data rectification work can delay the wind-up timeline and increase ongoing administration costs.
- Missed Member Benefits: Errors in historic data can go unresolved for years, potentially disadvantaging members or resulting in complex late-stage rectification.

Outlook

With continued favourable market conditions and strong funding positions across many DB schemes, the demand for bulk annuity transactions is expected to remain high. However, without proactive investment in data quality and administration readiness, many schemes may face avoidable delays and costs during the risk transfer process.

Recommendations

1. Conduct Early Data Audits

Schemes considering buy-in should assess data quality now. Early identification of gaps allows time to correct issues before engaging insurers.

2. Prioritise GMP Equalisation

Complete GMP Equalisation projects as soon as possible, ideally before buy-in. Incomplete work may deter insurers or result in higher true-up costs.

3. Use Platform Transitions Strategically

If changing administration providers, treat the transition as an opportunity to cleanse and validate data rather than replicate legacy issues.

4. Plan for Capacity Constraints

Build realistic timelines that account for delays in administrative resourcing, particularly for specialist project work post-buy-in.

5. Leverage Technology

Use member self-service tools and automated data verification to reduce manual processing and increase efficiency.

6. Engage Early with Administrators

Discuss your scheme's data readiness and risk transfer plans with your current administrator to assess feasibility and lead times.

Pensions Bill review summary and roadmap timeline

5 June 2025 may go down as one of those seminal dates in the world of UK DB pensions, like the 17 May 1990 Barber window date and 'A day' on 6 April 2006. Why?

Pension Schemes Bill 2025 and the major changes for DB schemes

Firstly, the Pension Schemes Bill 2025 was released, introducing wide sweeping reforms across DC and DB pensions. From a DB perspective, it will permit surplus release from ongoing schemes and legislate for superfunds to encourage growth in that market. This should make a wider range of endgame options like run-on and superfunds genuinely viable for a broader range of DB schemes.

Secondly, on the same day the DWP confirmed that they will introduce legislation to allow retrospective actuarial confirmation that historic benefit changes met the "Reference Scheme Test," thereby removing a significant risk that could have led to additional liabilities for many pension schemes off the back of the 2023 Virgin Media Court case.

Whilst these are welcome developments, which over time will give much needed clarity to pension scheme trustees and sponsors and market participants, it will be some years before we get through the required secondary legislation and consultation processes for the developments to become effective.

What Trustees and Sponsors should do now

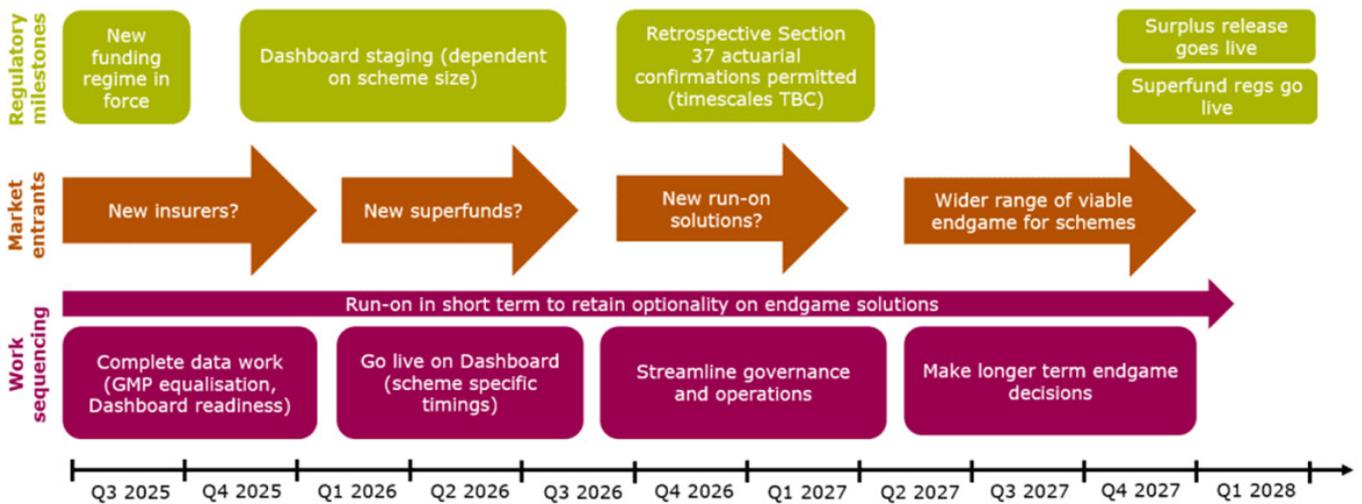
In the meantime, we have pressing data projects and deadlines that DB schemes need to meet. So how should DB trustees and employers navigate these developments, set their strategy and prioritise work and projects?

Strategies need to reflect the objectives, priorities and circumstances of individual trustee boards and sponsors, but below is a suggested approach for schemes operating under business-as-usual, rather than those facing a corporate transaction or other significant event:

1. Retain optionality on endgame solutions for now. These regulatory developments should lead to more participants in the insurer and superfund markets, and enable surplus release from ongoing schemes, meaning from 2028 onwards a full suite of viable, competitively priced endgame options should be available. For signing off a triennial valuation under the new funding regime, of course have a plan for reaching full funding on a low dependency basis (if you are not already there), but go no further than that for now.
2. Prioritise completion of required data projects in the short term. Many schemes still need to finish GMP equalisation, and most need to connect to the Pensions Dashboards over the next year. With some administrators facing resource constraints, this has to be the short term priority. It ensures you comply with impending deadlines, and helps give you clean, complete data that has benefits for all the endgame options.
3. Streamline the operations and governance of the scheme. Get the benefits fully coded and the calculations fully automated on the administration system, address retrospective actuarial confirmation of historic benefit changes if required, and consider leaner models like sole trustee and multi-trust solutions. This all reduces running costs, making run-on more viable and enabling quicker implementation of risk transfer end game solutions (either to insurers or superfunds).
4. Make endgame decisions in 2027/28 when we should have more competitive insurance and superfund markets, and clarity on how ongoing surplus release can operate.

Looking ahead: Timeline and key milestones

What are the timescales for these regulatory developments and sequencing of work? Well we're still waiting for details on some of this, although we know the government intends the surplus release and superfund regulations to go live in 2028, so working back from that, the plan looks like this:



Why 5 June 2025 marks a turning point

5 June 2025 could become a pivotal date in UK pensions history; the day superfunds and run-on became truly viable, and the headaches from the Virgin Media ruling disappeared!

While the recent reforms don't require immediate action, they do expand the range of viable strategic options for many DB schemes. Trustees and sponsors should now take the opportunity to revisit their long-term strategy and assess how these developments might benefit their specific circumstances.

TPR's Finalised Statement of Strategy: A New Era for DB Scheme Funding

On 28 May 2025, The Pensions Regulator (TPR) unveiled the finalised rules and digital tools governing the new Statement of Strategy for defined benefit (DB) pension schemes – marking a significant step in making DB funding more transparent, proportionate, and risk-aware, and meaning that scheme funding valuations with an effective date on or after 22 September 2024 can now be submitted.

At the heart of these changes is the new Statement of Strategy, a two-part document trustees must submit alongside their actuarial valuation. Part 1 focuses on the funding and investment strategy, typically requiring employer agreement; while Part 2 covers supplementary matters such as covenant assessment and risk planning, requiring employer consultation but not agreement.

Submit a Scheme Valuation: A Digital Shift

To ease the process, TPR launched the "Submit a Scheme Valuation" digital service. This user-tested tool guides trustees through a dynamic spreadsheet that adapts to scheme size and risk profile. It's designed to be intuitive, shareable, and easy to sign off once completed. Importantly, trustees must ensure the statement is signed by the Chair of Trustees before submission.

TPR also released detailed guidance to accompany the spreadsheet, emphasising a pragmatic approach. Trustees aren't expected to over-engineer their responses.

Who Submits What? – Tailored Requirements by Scheme Type

A standout feature of the final rules is the tailored approach to different scheme types:

- All schemes must submit a completed strategy spreadsheet, an actuarial valuation report, and dates confirming both the employer consultation and trustee sign-off.
- Schemes in deficit must additionally submit a recovery plan and schedule of contributions as part of the valuation.
- Fast Track schemes require actuarial confirmation that they meet specific Fast Track standards.
- Bespoke schemes (and some Fast Track schemes) must provide a summary of maximum affordable contributions.
- Most non-segregated, non-associated multi-employer schemes must include an assessment of the maximum supportable risk over the reliability period.

Support for Small and Low-Risk Schemes

TPR introduced a number of concessions to ease the regulatory burdens. For example, smaller schemes (typically those with 200 or fewer members, excluding certain categories like fully insured annuitants) will benefit from:

- Simplified actuarial and investment data requirements.
- Fewer covenant reporting obligations.
- A more streamlined valuation process, provided they meet Fast Track criteria.

Similarly, low-risk schemes, such as those in surplus after stress testing or with benefits fully secured with insurers, are exempt from submitting detailed covenant data.

Greater Flexibility and Transparency

Responding to industry feedback, TPR made a number of updates to the submission framework:

- Simplified templates: Reduced duplication, clearer language, and legal references moved to appendices.
- Flexible free-text boxes: Schemes can describe long-term objectives in their own words.
- Optional surplus reporting: Schemes without a clear investment strategy for surplus assets can skip this section.

The long-debated term “buy-out funding level” has also been replaced by “solvency basis” to improve clarity and reduce employer resistance.

Investment and Funding Journey Updates

TPR refined the structure for reporting on investment and funding plans:

- Long-term investment strategy: Trustees now categorise assets simply as “growth” or “matching”, with the ambiguous “hybrid” label removed.
- Funding journey plan: Simplified requirements and narrative flexibility allow for clearer, more tailored planning.
- Investment de-risking: Schemes now provide a high-level view of how assets will shift towards low dependency, with optional narrative for added context.

Crucially, schemes can use pragmatic approaches to estimate downside risks in another win for practicality.

Proportionate Covenant Reporting

Covenant reporting requirements have been scaled back – particularly for small and low-risk schemes. Figures are no longer expected to be exact, but presented as “at least” a certain level, allowing for a more reasonable assessment. Optional free-text boxes give trustees space to explain contextual nuances where needed.

However, Bespoke schemes still need to provide detailed data on maximum affordable contributions. This information is deemed essential for TPR to gauge the real-world financial support available from employers.

What Should Trustees Do Now?

- Review TPR’s final Statement of Strategy spreadsheet and related guidance.
- Consult with advisers to clarify scheme-specific requirements.
- Develop an action plan ahead of your next valuation submission.
- Ensure the Chair of Trustees signs the completed Statement of Strategy following appropriate employer consultation.
- Embrace the new structure not just as a compliance obligation, but as a tool to strengthen long-term scheme sustainability.

Mortality Update – latest mortality improvement model

Trustees and sponsors of defined benefit pension schemes will be well aware that the longer scheme members live, the more expensive the cost of providing benefits. Equally, the longer scheme members are expected to live can have a significant impact on the cost of funding their scheme in the shorter term. If trustees assume longer life expectancy in their funding valuation, benefits are expected to be paid for longer and therefore pension scheme liabilities (and any deficit reduction contributions) will be higher.

Therefore, mortality assumptions play an important role in actuarial valuations. Trustees and sponsors should carefully consider recent trends in life expectancy when setting these assumptions. As part of this, the latest update in this area is the recent release of the Continuous Mortality Investigation (“CMI”) 2024 mortality improvement model. It replaces the 2023 version of the model as the most up-to-date view of how quickly death rates are likely to fall in future.

As a reminder, base mortality tables, such as the Self-Administered Pension Schemes (“SAPS”) S4 Series, set out probabilities of death at each age. They are derived using past experience data and do not make any allowance for how mortality might change in the future. Therefore, when setting mortality assumptions, it is also necessary to make an assumption on any future improvement in mortality. This is where the CMI’s mortality improvement model comes into play.

What has changed in the 2024 version of the CMI model?

The CMI 2024 model is based on data for the population of England and Wales up to 31 December 2024, based on publications from the Office for National Statistics and CMI estimates. This version of the model incorporates a significant change to the approach taken to allowing for changes in mortality rates since the onset of the COVID-19 pandemic. In particular, the key changes to be aware of are:

- Full ‘weight’ given to data from all years since the pandemic: in all versions of the model since the pandemic, the core view was that only limited weight was given to mortality data during the pandemic years. This meant that pandemic era data had little to no bearing on the calculation of future improvements in mortality rates. In the 2024 version, the data from all years in the underlying dataset (1984-2024) are given equal importance, including pandemic era years.
- New ‘half-life’ lever: actuaries can toggle with a lever that controls how quickly an explicit pandemic adjustment factor fades. The core setting for this toggle is one year, meaning that the pandemic adjustment factor halves each year.

What difference does adopting CMI 2024 make?

For a typical pension scheme using all the core views in the respective models, moving from the 2023 to 2024 version of the model:

- Male life expectancy at age 65 increases by just over three months for males and around two weeks for females.
- A typical pension scheme might see a small, but not negligible, increase of up to 1% in its liability value.
- Life expectancy for pensioners increases while life expectancy for younger members is largely unchanged.
- The impact on life expectancies within your scheme, and hence the impact on liability values, will depend on the membership profile. Pension schemes with predominantly older memberships or with a high male population will notice the change most.

As ever, trustees and employers should continue to seek appropriate actuarial advice when setting these assumptions for valuation purposes.

GMP Equalisation: Understanding the Impact of the Lloyds Judgments on Historic Transfers

Background and Context

From 6 April 1978, individuals could build up an earnings-related state pension under the State Earnings Related Pension Scheme (SERPS). Employers were allowed to contract employees out of SERPS via workplace pension schemes, provided these schemes offered at least a Guaranteed Minimum Pension (GMP). GMP accrual was abolished from 6 April 1997, but for benefits earned before then, GMP remains a component of a member's overall pension.

The legislative formula for calculating GMPs can create gender-based inequalities, such as:

- Different retirement ages (65 for men, 60 for women)
- Faster accrual rates for women
- Different pre- and post-retirement increases in payment
- Different treatment of GMP vs non-GMP benefits, before and after retirement

Following the 1990 Barber judgment by the European Court of Justice, pension schemes were required to provide equal benefits for men and women. However, how this applied to GMPs remained unclear for decades. That changed with the Lloyds Banking Group Pensions Trustees Ltd v Lloyds Bank plc decisions, which set out the requirement to equalise GMPs and how this should be done.

Key Legal Developments

Lloyds 1 (October 2018):

Confirmed that trustees must equalise benefits for GMP differences between men and women and outlined permissible methods.

Lloyds 2 (December 2018):

Clarified the application of past service rights and implementation approaches.

Lloyds 3 (November 2020):

Focused on historic transfer values. The High Court ruled that trustees are legally required to revisit any transfers made since 17 May 1990 (the Barber date) to ensure the transfer reflected GMP equalisation.

KEY TAKEAWAYS FROM THE LLOYDS 3 JUDGEMENT:

There are a number of takeaways for Trustees that result from the Lloyds 3 judgement. The overriding message is that Trustees must review and, where reasonably and pragmatically possible, top up historic transfer payments if GMP equalisation was not reflected in the original calculation.

This obligation applies to both statutory and non-statutory transfers. There is no statutory time limit on claims, and responsibility lies solely with the transferring scheme, not the receiving one. Administrative complexity is significant, especially where there are a lack of records and/or tracing difficulties.

Challenges arising from the Lloyds 3 Judgement:

In many cases, records of past transfers are missing or incomplete. Former members who left long ago may be difficult or impossible to trace. The administrative burden of finding them and recalculating small top-ups may be disproportionate to the amounts involved.

There are also financial implications for both funding and accounting, particularly where large numbers of transfers are affected.

Our Recommendations:

To manage these challenges, trustees should follow a structured approach, beginning with identifying all transfers made since 17 May 1990 and establishing which former members had relevant service between that date and 5 April 1997. For those potentially affected:

1. Assess whether GMP equalisation was included in, or explicitly excluded from, the original transfer value.
2. Review the underlying data held on record for the members in scope. Where data gaps exist, take a pragmatic approach and make suitable approximations/assumptions.
3. Engage with the scheme actuary in relation to appropriate assumptions to make. Where historic transfer value bases are not held, ask the scheme actuary to derive a suitable proxy (or proxies).
4. Seek legal advice. Ask your legal adviser for comments on the methodology and the application of any de minimis or forfeiture rules.
5. Take a pragmatic approach when it comes to tracing historic members. For example, use a basic level trace for members with a top-up less than a set threshold (e.g. £250), and use a more extensive trace for members with higher value top-ups.
6. Ensure members records are updated accordingly to track the date and value of top-up payments made.

It is crucial that Trustees follow a structured and logical approach, keep clear documentation of the advice received and decisions made throughout the process. Provided such an approach is followed, Trustees should have no difficulty in successfully navigating the challenges of Lloyds

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