

United Kingdom

Key characteristics of the pension funds market



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1 Introduction

1.1 General

In the United Kingdom, there is one main type of occupational pension scheme falling under the scope of the IORP Directive (Directive 2008/41/EC). They offer defined benefit (DB), defined contributions (DC), and hybrid plans (HY). Members of the DB plan have no exposure to market risk. Members who have a DC plan, however, are fully exposed to market risk.¹

At the end of 2017 (2017 Q4), 37 990 occupational retirement schemes submitted their reporting package to the British National Supervisory Authority (NSA), the Pensions Regulator. Overall, these institutions accounted for about 90,2% of the occupational retirement schemes within the European Union (EU).

The United Kingdom occupational pension funds are largely focused on defined benefit and hybrid pension schemes, which account for 79,1%² of total pension fund assets, while the remainder focuses on defined contributions schemes. Table 1 reports the amount of assets in DB and hybrid pension funds by year end 2017.

Table 1 – Occupational pension funds by type

In Mio EUR	Amount	%
Defined Benefit schemes (DB)	1 757 902	100,00%
Defined Contributions schemes (DC)	0	0,00%
Hybrid schemes (HY)	0	0,00%
Total	1 757 902	100,00%
Total assets UK / Total assets EU %		47,60%
Ranking UK based on Total assets EU		1

Note (1) For the GB, the DB figure includes both DB and HY schemes as no breakdown between DB and HY is available.

Source: EIOPA EEA pension statistics and Deloitte-CEPS analysis

1.2 Balance sheet

As of end 2017 (2017 Q4), the British pension funds market ranked first in the EU in terms of assets, reporting a total of 1 757 billion EUR.

With regards to investments, the United Kingdom is ranked number 1 in absolute amount reaching 1 553 billion EUR. The reinsured technical provisions and other assets account for only a minor part of the assets by 0,7% and 10,9% respectively. However, it is worthwhile to note that the share of other assets is well above the EU average of 4,2%.

110,5% of liabilities are related to technical provision for pensions. As a result, British pension funds had a deficit of assets over liabilities equalling 184 billion EUR, corresponding to approximately 10,5% of the balance sheet total. Hence, in terms of ranking, United Kingdom is among the lowest ranked in excess assets over liabilities in the EU.

¹ Source: Deloitte-CEPS analysis of EIOPA's Database of pension plans & products in EEA

² This percentage is from 2016. The share of DB pension funds within the whole market is not available for 2017.

**Table 2 – Balance sheet and EU comparison of occupational pension funds**

in Mio EUR	UK			EU				
	Amount	Rank	%	%	Avg	Min	Max	StD
Total investments	1 553 985	1	88,40%	92,32%	89,43%	0,00%	100,00%	21,25%
Reinsured technical provisions	12 305	2	0,70%	1,60%	3,11%	0,00%	26,78%	7,68%
Other assets	191 611	1	10,90%	6,08%	4,21%	0,46%	18,90%	5,00%
Total assets	1 757 902	1	100,00%	100,00%	100,00%	100,00%	100,00%	0,00%
Technical provision for pensions	1 942 464	1	110,50%	99,26%	80,16%	0,42%	150,71%	38,15%
Other liabilities	-			0,66%	7,67%	0,34%	70,91%	18,13%
Total liabilities	1 942 464	1	110,50%	99,93%	67,74%	0,00%	151,82%	48,56%
Excess of assets over liabilities	-184 562	23	-10,50%	0,07%	32,26%	-51,82%	100,00%	48,56%
Total liabilities + Excess of assets over liabilities	1 757 902	1	100,00%	100,00%	100,00%	100,00%	100,00%	0,00%

Source: EIOPA EEA pension statistics and Deloitte-CEPS analysis

2 Investments

2.1 Asset exposure

From an asset exposure perspective, the pension funds market in the United Kingdom is mostly invested in bonds (debt and other fixed income securities account for 63,0% of total Investments), followed by equities and other variable-yield securities that also constitute a substantial part of the investments (32,8%).

Within the bond categories, the pension funds market is primarily exposed to sovereign securities (43,2%) with the remainder in financial debt (19,2%), both categories for which United Kingdom is ranked first in the EU.

Real estate investments form the remainder of the investment portfolio. The share of this investment category is relatively modest, corresponding to 4,2% of investments. Despite this, United Kingdom still ranks first in the EU in this category.

Table 3 – Total investments of occupational pension funds

in Mio EUR	UK			EU				
	Amount	Rank	%	%	Avg	Min	Max	StD
Debt and other fixed income securities	979 151	1	63,01%	53,75%	49,23%	12,51%	74,75%	17,30%
Sovereign	671 698	1	43,22%	34,52%	35,19%	4,38%	66,07%	18,72%
Financial	307 454	1	19,78%	10,37%	10,66%	1,45%	26,19%	7,89%
Other	n/a	n/a	n/a	8,86%	13,27%	0,11%	68,50%	15,52%
Equity and other variable-yield securities (excl, UCITS)	509 792	1	32,81%	31,75%	21,78%	0,40%	68,00%	18,34%
Equity - listed	456 263	1	29,36%	27,94%	18,43%	0,26%	47,44%	14,27%
Equity - other	53 528	2	3,44%	3,78%	8,42%	0,14%	68,00%	21,01%
UCITS	n/a	n/a	n/a	4,65%	30,43%	1,58%	77,59%	22,99%
Debt securities	n/a	n/a	n/a	1,88%	13,21%	0,43%	37,05%	12,36%
Equity securities	n/a	n/a	n/a	0,98%	15,63%	3,14%	33,48%	12,24%
Real estate	n/a	n/a	n/a	0,30%	2,16%	0,43%	3,92%	1,45%
Other	n/a	n/a	n/a	1,48%	13,33%	2,55%	40,07%	13,07%
Derivative instruments	n/a	n/a	n/a	0,00%	0,13%	-0,04%	0,64%	0,22%
Loans	n/a	n/a	n/a	1,21%	1,78%	0,00%	9,82%	3,16%
Real estate investments	65 042	2	4,19%	5,96%	3,81%	0,05%	11,37%	3,56%
Other investments	n/a	n/a	n/a	2,68%	9,23%	0,72%	23,20%	6,41%
Total investments	1 553 985	1	100,00%	100,00%	100,00%	100,00%	100,00%	0,00%

Source: EIOPA EEA pension statistics and Deloitte-CEPS analysis

2.2 Equity exposure

The equity exposures of pension funds can be calculated and presented in different ways. The list below includes the following equity exposure views:

- Equity exposure as the sum of direct investments in equity: listed and other equity (e.g. unlisted equity).

Table 4 – Equity exposures of pension funds

in Mio EUR	UK			EU				
	Amount	Rank	%	%	Avg	Min	Max	StD
Equity and other variable-yield securities (excl, UCITS)	509 792	1	32,81%	31,75%	21,78%	0,40%	68,00%	18,34%
Equity - listed	456 263	1	29,36%	28,60%	28,60%	28,60%	28,60%	28,60%
Equity - other	53 528	2	3,44%	3,60%	3,60%	3,60%	3,60%	3,60%
UCITS								
Equity securities	n/a	n/a	n/a	0,98%	15,63%	3,14%	33,48%	12,24%
Total equity exposure	509 792	1	32,81%	27,47%	1,80%	68,00%	16,17%	0,00%

Source: EIOPA EEA pension statistics and Deloitte-CEPS analysis

In United Kingdom, we note that about 32,8% of investments is in equity. The majority of these investments is in listed equity (29,4%). The unlisted equity only accounts for 3,4% of total investments. There is no information on the equity exposures coming from UCITS available for the UK.

3 Occupational pension schemes

3.1 Cash flow

For cash flows, British market is ranked first for total contributions, benefits payable, and transfer of pension rights. However, due to a substantially negative net cash flow, the GB ranks relatively low compared to other EU markets.

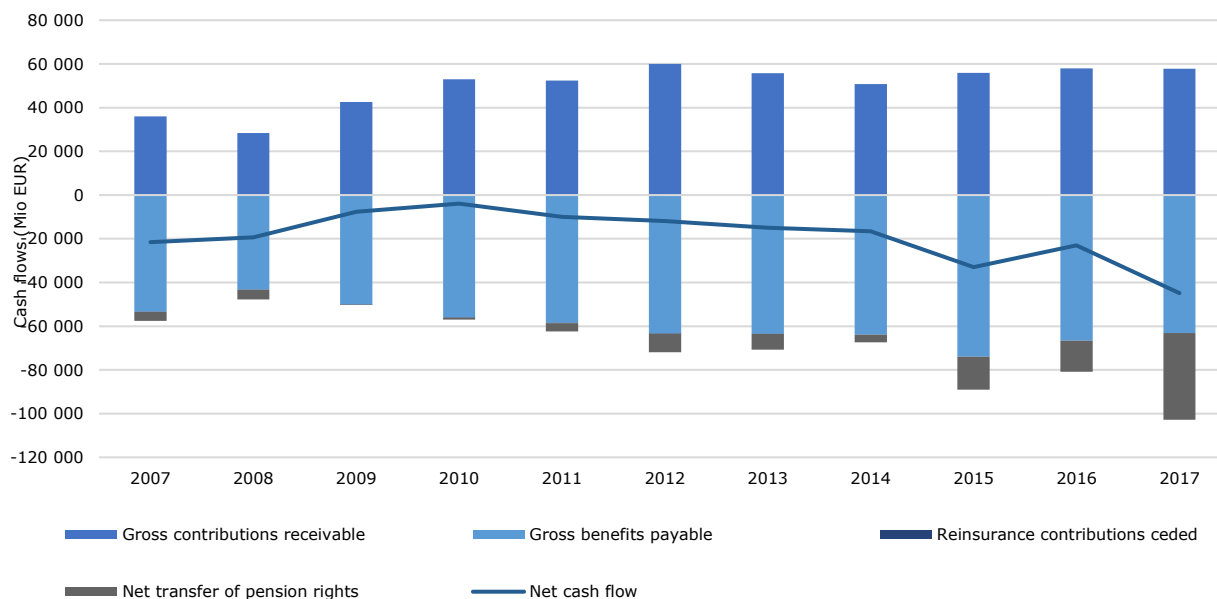
Table 5 – Cash flows of occupational pension funds

in Mio EUR / % of total investments	UK			EU				
	Amount	Rank	%	%	Avg	Min	Max	StD
Total gross contributions receivable	57 876	1	3,72%	8,01%	0,19%	17,86%	5,00%	0,00%
Reinsurance contributions ceded	n/a	n/a	n/a	0,88%	-0,01%	4,69%	1,52%	0,00%
Total net contributions receivable	57 876	1	3,72%	7,59%	0,19%	17,86%	5,03%	0,00%
Total gross benefits payable	63 125	1	4,06%	4,19%	-3,98%	10,99%	3,36%	0,00%
Reinsurance benefits received	n/a	n/a	n/a	0,63%	0,00%	3,02%	1,09%	0,00%
Total net benefits payable	63 125	1	4,06%	3,83%	-4,02%	10,99%	3,05%	0,00%
Transfer of pension rights (entrants)	2 497	4	0,16%	5,81%	0,00%	56,47%	15,00%	0,00%
Transfer of pension rights (leavers)	42 100	1	2,71%	1,37%	-0,09%	5,51%	1,70%	0,00%
Net cash flow	-44 853	22	-2,89%	6,34%	-6,20%	57,54%	12,69%	0,00%

Source: EIOPA EEA pension statistics and Deloitte-CEPS analysis

The chart below presents an overview of the evolution of cash flows for occupational pension funds in the GB.

Graph 1 – Evolution occupational pension funds cash flows



Source: EIOPA EEA pension statistics and Deloitte-CEPS analysis



4 Prudential regime, accounting & tax framework

4.1 Accounting framework

Typically, United Kingdom pension funds produce their financial accounts in accordance to the GB/IE GAAP. Yet, in accordance with the EU Accounting Regulation (Regulation 1606/2002/EC) all domestic publicly traded companies are required to produce their financial account following the IFRS standards. IFRS Standards are permitted for unlisted companies but their use is not mandatory. Hence, most British pension funds apply local GAAP in their financial reporting.³

4.2 Prudential Regime

In 2013, the legislation introduced a 100,0% limit on direct equity exposure. In addition, pension funds are subject to a 100,0% ceiling in equity investment from a single issuer and 5% limit in employer-related investment. Prior to 2013, no portfolio ceilings were applicable to British pension funds.

4.3 Tax framework

Pensions Funds in Great Britain are subject to a special tax regime: the so-called "Exempt-Exempt-Taxed" (EET) where beneficiary's contributions and funds' returns on the investments (including equity and dividends) are exempted, while withdrawals are subject to taxation (or partial exemption).⁴

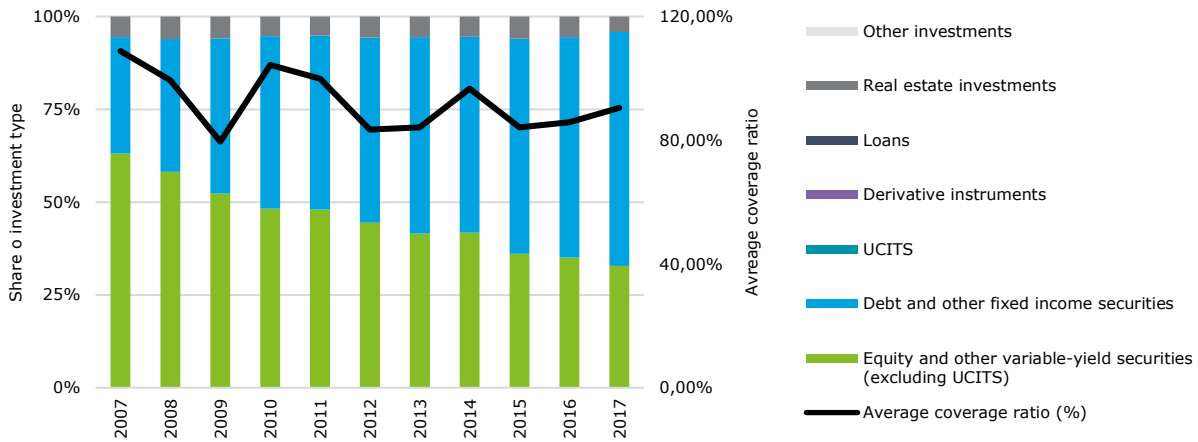
³ Source: Deloitte-CEPS analysis of annual reports of GB pension funds and IFRS country profiles.

⁴ Source: OECD (2015) Stocktaking of the tax treatment of funded private pension plans in OECD and EU countries

5 Historical data

The evolution of investment by British pension funds between 2007 and 2017 is displayed in Graph 2 broken down by type of investment. Furthermore, the graph illustrates the change in the average coverage ratio.

Graph 2 – Evolution investments and average coverage ratio (for comparison)

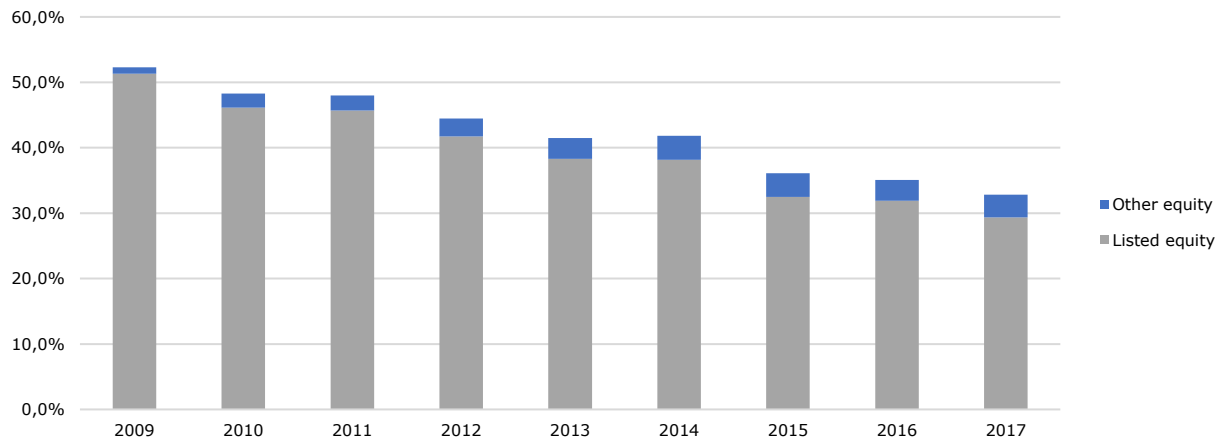


Source: EIOPA EEA pension statistics and Deloitte-CEPS analysis

The composition of British DB and hybrid pension funds' investment portfolios has remained relatively stable over time with a slight preference for debt and fixed income securities, as seen in the later years. A declining trend in investment in equity and other variable-yield securities (excluding UCITS) can be observed throughout the period.

The negative trend in equity investment for the United Kingdom is shown more explicitly in the graph below.

Graph 3 – Evolution of investments by equity type



Note (1) For the GB, data breaking down equity investment by type is not available prior to 2009.

Source: EIOPA EEA pension statistics and Deloitte-CEPS analysis