February 2025

# XPS Express

Pensions news for employers

# Reshaping pension scheme investments: a strategic opportunity for employers

This edition of XPS Express is the **fifth in a series on setting long-term strategies -** read part **one, two, three** and **four.**

## At a glance

**The new pensions regulations require employers and trustees to agree a long-term funding and investment strategy.**

**This includes agreeing a notional long-term investment strategy, which is the first time employers have needed to agree any part of the investment strategy.**

**This offers an ideal opportunity for employers to redefine their schemes' investment strategy to ensure outcomes are aligned with corporate objectives.**

**Along with the long-term investment strategy, employers and trustees also need to agree the level of risk in their overall journey plan, which will itself influence the investment strategy over the journey.**

**The chosen strategy will directly impact the level and likelihood of future employer contributions, as well as how much surplus could potentially be generated, so it is important for employers to decide which strategy within the regulatory framework best suits their needs.**

## Journey to long-term strategy

It is key for employers to decide on the investment risk they are able to support along their scheme's journey plan.

For example, for an employer with a £250m scheme:

| | Strategy A | Strategy B |
|---|---|---|
| Expected return | Gilts + 2% | Gilts + 2.5% |
| 1-in-6 Value at Risk (downside scenario) | **£70m** | **£90m** |
| Maximum cash employer can afford over 6 years | **£85m** | **£85m** |
| Is risk supportable? | ✓ | ✗ |

## Key risks for employers

| Area | Key risks |
|---|---|
| Cash contributions | Signing up to a long-term strategy that leads to additional or new contributions |
| Investment returns | De-risking too early, limiting investment returns |
| Surplus generation | Missing out on growth and the opportunity to generate surplus |
| Business needs | Increased funding limiting the ability to meet other business needs |

## Actions employers should take

1. Review the current and long-term investment strategy for your scheme to understand how these fit within the new regulations.
2. Determine the level of investment risk the business is comfortable supporting now and as your scheme matures, including the downside risk you can fund.
3. Explore investment strategies that reflect the level of risk you can support and help meet your objectives.
4. Engage early and proactively with the trustees to ensure any decisions on the investment strategy are aligned with your corporate objectives.

# Strike the right balance between growth and cost

Schemes must aim to be de-risked to their long-term investment strategy by their long-term target date. There are different options to get there. How employers choose an appropriate journey to reach the long-term strategy will depend on the **maximum supportable risk and period of de-risking, with more flexibility for those with stronger covenant.**

For schemes that are in surplus, their surplus assets are not subject to the same requirements, which may offer further flexibility.

**Options for journey plan will involve a mix of:**

CURRENT POSITION → CONTRIBUTIONS | INVESTMENT RETURN | LENGTH OF JOURNEY PLAN → LONG-TERM STRATEGY: Regulations allow flexibility in asset allocation and risk

## Impact on cash contributions

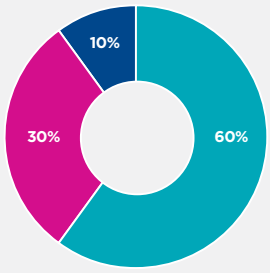
To ensure the level of cash contributions is appropriate, it is essential for employers to engage with trustees to agree a journey plan that uses the right mix of contributions, investment return and time, with covenant in mind.

This is demonstrated in the example below:

**Scheme size: £450m Funding level: 90%**

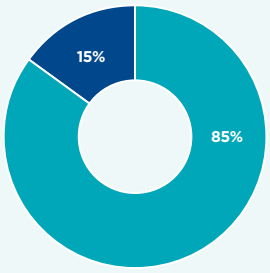
### Employer A

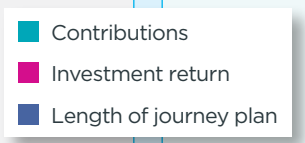
- **No employer input** and no review of current covenant support provided
- Trustees decide to target buyout and select low-risk long-term strategy with expected return of gilts + 0.7% p.a. using gilts/corporate bonds
- Scheme is mature so needs to be at long-term strategy within 5 years
- Trustees implement de-risking now to minimise investment risk
- De-risking results in **employer contributions of £6m p.a.** for the next 5 years




### Employer B

- **Employer proactively engaged** and was willing to provide a guarantee to strengthen covenant
- This allowed a higher risk long-term strategy to be supported under a run-on strategy with expected return of gilts + 1.5% p.a. using equities/credit
- Scheme is immature so some flexibility over when they reach long-term strategy
- Trustees decide to continue with investment strategy of gilts + 2.5% p.a. and de-risk later
- **No contributions required** from employer




**This highlights the importance of engaging with your trustees on the investment strategy to achieve the best outcomes.**

## Find out more

**For further information, please get in touch with Ieva Maseviciute, Charlotte Yuen or Dan Auton or speak to your usual XPS Group contact.**

**Ieva Maseviciute**
Consultant
e ieva.maseviciute@xpsgroup.com

**Charlotte Yuen**
Senior Consultant
e charlotte.yuen@xpsgroup.com

**Dan Auton**
Head of Corporate Solutions
e dan.auton@xpsgroup.com



© XPS Group 2025. XPS Pensions Consulting Limited, Registered No. 2459442. XPS Investment Limited, Registered No. 6242672. XPS Pensions Limited, Registered No. 3842603. XPS Administration Limited, Registered No. 9428346. XPS Pensions (RL) Limited, Registered No. 5817049. XPS Pensions (Trigon) Limited, Registered No. 12085392. Penfida Limited, Registered No. 8020393. All registered at: Phoenix House, 1 Station Hill, Reading, RG1 1NB.

XPS Investment Limited is authorised and regulated by the Financial Conduct Authority for investment and general insurance business (FCA Register No. 528774).

This communication is based on our understanding of the position as at the date shown. It should not be relied upon for detailed advice or taken as an authoritative statement of the law.