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Fully funded, not fully de-risked

Why strong funding levels may still leave DB schemes exposed

A discussion paper for Australian Defined Benefits (DB) trustees, sponsors and advisers

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Executive summary

Improved funding levels have transformed the landscape for DB pension schemes in Australia. Many schemes now find themselves in a position of relative strength, with funding levels approaching or exceeding full funding. This shift has created a meaningful opportunity to reassess long-term strategy and progress towards endgame solutions.

However, while funding positions have improved, underlying risks have not necessarily been reduced at the same pace. Many schemes continue to hold significant allocations to growth assets or maintain investment strategies that are not fully aligned with their liability profile. As a result, funding levels remain exposed to market volatility and may not accurately reflect the affordability of de-risking actions.

This dynamic creates a "funding paradox": schemes are closer to their endgame than ever before, yet may still be vulnerable to losing that position if conditions deteriorate or opportunities are missed. In this context, the key differentiator is no longer funding level alone, but the degree of preparedness to act when favourable conditions arise.

A structured glidepath to the endgame, encompassing investment strategy, governance, operational readiness and communication, is now critical. Schemes that successfully navigate this transition will not necessarily be those with the highest funding levels, but those with the clearest plan and the ability to execute it.

Defining "endgame"

In this paper, endgame refers to the strategic end-state for a defined benefit scheme – the point at which the scheme has fully discharged its obligations to members or transferred those obligations to another party. The principal endgame options available to Australian DB schemes are:

- **Run-on (or self-sufficiency):** The scheme continues to manage its assets and pay benefits until the last member liability is extinguished, typically backed by a low-risk, liability-matching investment strategy. This is usually more prevalent in schemes with lump sum liabilities as they are not exposed to ongoing mortality and longevity risk the same way as lifetime pensions.
- **Successor Fund Transfer (SFT):** DB pension members (and the associated liabilities and assets) are transferred to another superannuation fund operated by a life insurer, with members receiving equivalent rights and benefits in the new fund. Following the transfer, the original DB fund can typically be wound up, and the insurer assumes responsibility for ongoing administration, investment management and benefit payments. Considering tax and grandfathering arrangements, it remains one of the most common endgame paths in the Australian market.
- **Buy-in:** The scheme purchases an insurance policy that matches its liabilities but retains the legal obligation to pay benefits and the administration of the policies; the policy sits on the balance sheet as an asset.
- **Buy-out:** Liabilities are transferred to a life insurer in exchange for a premium; the scheme is wound up and members become policyholders of the insurer. In a traditional buy-out members' entitlements are replaced with individual insurance policies, which generally requires the consent of each affected member, a significant practical obstacle. Partly for this reason, and because of the potential for members to lose grandfathering treatment that applied within the superannuation environment buy-outs remain relatively uncommon in Australia; where a full transfer is pursued, it is often effected via a Successor Fund Transfer.
- **Hybrid approaches:** Combinations of the above, for example, a partial buy-in for the pensioner population, with run-on for active and lumpsum members.

While the Australian DB market is largely lump sum, and public sector funds dominate market scale, there still remains a c. $73bn[1] in total DB member benefits that include $14bn[2] in estimated pension liabilities this paper aims to address.

Throughout this paper, endgame planning refers to the preparatory work – investment, governance, operational, and stakeholder, required to execute any of these options when conditions are favourable.

[1] Figure is based on APRA Fund-level Superannuation Statistics report, excluding public sector funds
[2] Figure is based on Challenger internal estimate

1. A new DB reality: from funding maintenance to strategic optionality

The Australian defined benefit landscape has undergone a fundamental shift. While Australian DB schemes have not faced the chronic deficits that have characterised the UK and US markets, the sector has historically included meaningful variation across individual funds. ASIC's 2013 review of approximately 470 DB funds found 38% with a vested benefit index (VBI) below 100%, even after markets had recovered from the GFC.[3] While dispersion has narrowed since then, cross-sectional variation in funding levels remains a feature of the market.

Recent years have strengthened this picture materially. A combination of strong asset returns through 2021–2025, rising long-term yields, and the natural maturation of closed schemes has lifted funding levels across the market.

As at June 2025, the average APRA-regulated corporate/retail DB scheme reports a VBI of around 120%[4], with most plans comfortably in surplus. The sector overall is in its strongest aggregate position in over a decade.

This shift has important strategic implications. The focus for many schemes is moving away from funding maintenance and towards endgame planning. Trustees and sponsors are increasingly able to consider a broader range of strategic options, including insurance transaction pathways, long-term run-on strategies, or hybrid approaches that balance risk reduction with continued return generation. For the first time in decades, many DB schemes have genuine optionality.

However, improved funding levels do not, in isolation, reduce the underlying risks embedded within scheme portfolios. As schemes approach full funding, the consequences of adverse market movements become more pronounced – a surplus built over a decade can be materially eroded by a single sustained market drawdown. The challenge for trustees is therefore not simply to recognise improved funding, but to determine what that funding enables, and how best to protect it.

2. The funding paradox: fully funded, still exposed

2.1 Funding has improved markedly

The aggregate funding position of Australian defined benefit schemes has strengthened dramatically over recent years. Strong equity market returns through 2021–2025, the beneficial impact of rising yields on fixed income and hedging portfolios, and the natural run-off of liabilities as closed schemes pay benefits and membership matures have all contributed. The best-estimate discount rate used to calculate VBIs under APRA's SPS 160 framework has also risen modestly, further reducing the present value of liabilities[5].

To illustrate, consider a stylised A$500m[6] closed Australian corporate DB scheme with an average liability duration of approximately 9 years and a 60% growth 40% defensive allocation. Reflecting the experience of the average APRA-regulated corporate/retail DB fund (Figure 1), the scheme entered the past decade already comfortably in surplus, with a VBI of 112% in 2014. Funding remained broadly stable through the second half of the 2010s before the 2020 COVID drawdown and the 2022 market correction temporarily pulled the VBI down to around 109%, still in surplus, but a useful reminder of how quickly market shocks can compress the buffer. Since then, strong asset returns and the gradual run-off of liabilities have driven the VBI to 120% as at June 2025, an A$83 million surplus on A$417 million of liabilities. Unlike many UK and US corporate DB schemes, which spent much of the post-GFC era working through chronic deficits, the average Australian scheme has remained in surplus throughout, but the magnitude of that surplus, and what it now enables, is materially different.

[3] ASIC, "Defined Benefit Superannuation Fund Reporting," 2013. Cited in Milliman, "Meeting Australia's Defined Benefit Liabilities: It's not a crisis if you see it coming," May 2018.

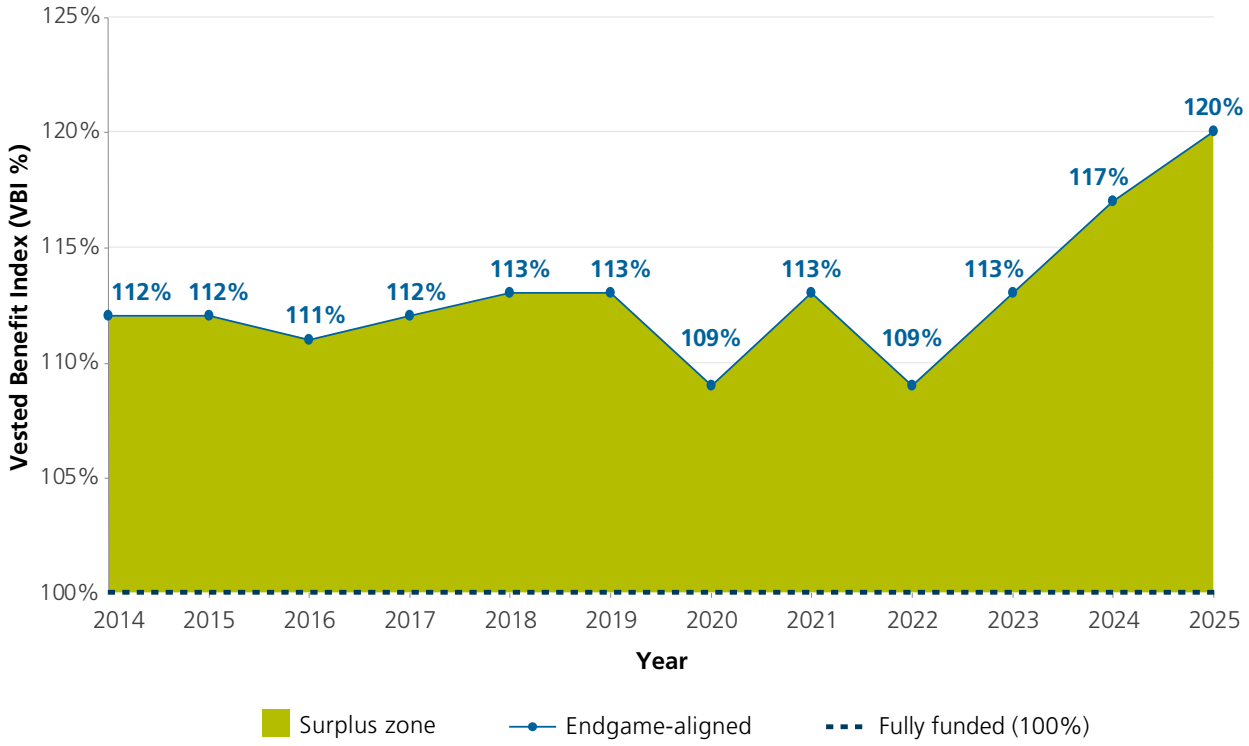
[4] VBI figures based on Challenger's internal analysis of Australian DB Scheme based using data for APRA regulated corporate/retail DB funds (excludes industry and public sector funds).

[5] The VBI is calculated under APRA SPS 160 using a best-estimate expected return on fund assets as the discount rate, distinct from the AASB 119 discount rate based on AA corporate bond yields.

[6] The illustrative size of a DB pension fund with A$500m in assets is based on the average figure of Australian DB schemes with at least A$25m in pension liabilities, excluding public sector funds. Source: Challenger analysis of APRA fund-level statistics and actuarial valuation reports.

The scale of this illustrative scheme is deliberate. Funding-level volatility of the kind explored in this paper is one of several triggers that bring endgame planning onto a trustee's agenda — and for well-funded schemes with material pensioner liabilities, it is often the most immediate. For others, the trigger may instead be operational: the sustainability of meeting each pension payment cycle, rising per-member administration costs, or maintaining continuity as membership declines. These considerations apply across the DB spectrum and frequently bring endgame decisions forward regardless of funding level. They are discussed further in Section 4.6. The analysis that follows examines the funding-volatility trigger in detail; it is one important lens on endgame readiness, not the only one.

Figure 1: Average Australian DB scheme – Vested Benefit Index (VBI) trend



Note: Historical VBI Trend based on Challenger's internal analysis of Australian DB Scheme based using data for APRA regulated corporate/retail DB funds (excludes industry and public sector funds) | Source: Challenger: APRA regulated corporate/retail DB funds | June 2026

2.2 Risk has not reduced in tandem

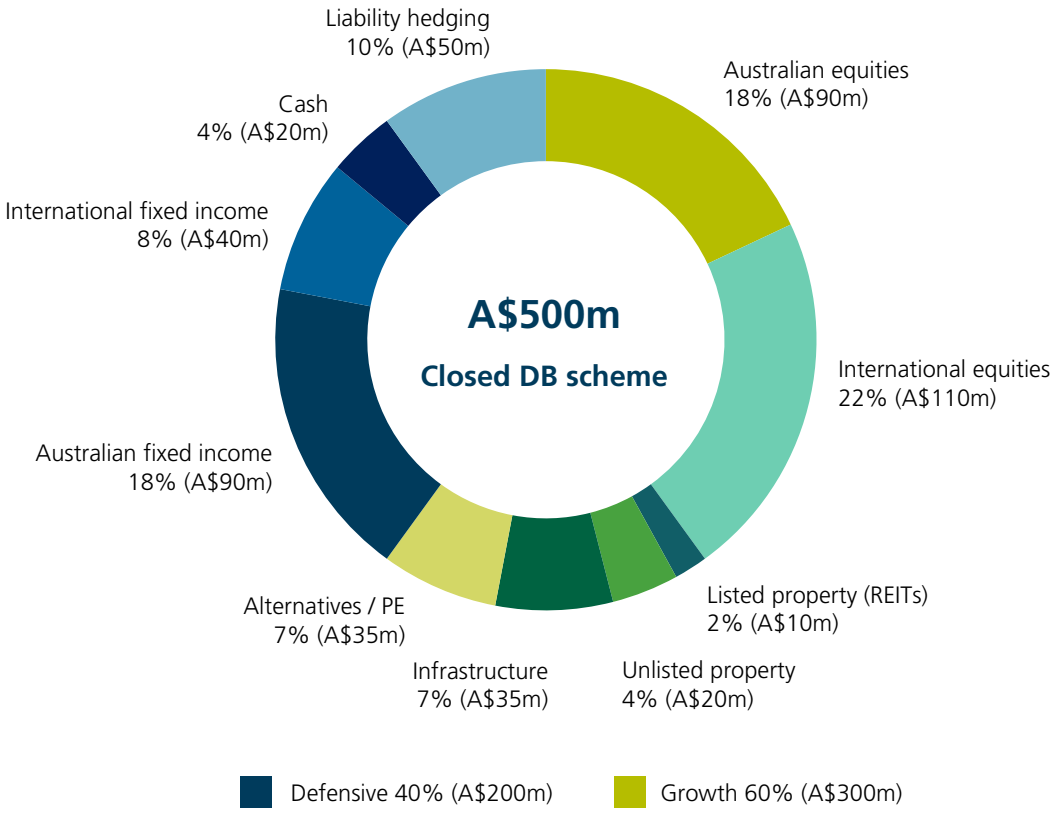
However, improved funding does not equate to improved risk positioning. Many schemes continue to hold substantial allocations to growth assets – equities, property, infrastructure, and alternatives – that were appropriate when funding levels were less secure. While these allocations contributed to the funding improvement, they embed a level of portfolio volatility that is increasingly misaligned with the scheme's strategic objectives.

Published asset allocations specifically for Australian DB sub-funds are not consistently disclosed. The CSC Default Fund (CSS/PSS) is publicly disclosed at approximately 75% growth assets, acknowledging that the government guarantees 100% of all CSC defined benefit pension payments regardless of the fund's status. Internal Challenger analysis of a broader set of approximately 40 APRA-regulated DB sub-funds[7] indicates a wide distribution of growth allocations – between below 40% to over 80%, with the overall average sitting around 60%.

A closed corporate DB scheme (typically smaller), with a mature membership and limited sponsor appetite for additional contributions, may hold a somewhat more conservative mix. For our stylised A$500m fund, we assume a 60/40 growth-to-defensive allocation, representing a scheme that has begun to moderate its risk positioning but has not yet undertaken material de-risking. Figure 2 illustrates this allocation.

[7] Source: Internal Challenger analysis of annual fund level superannuation reports and actuarial valuation reports; excludes non-public schemes

Figure 2: Stylised asset allocation – A$500m closed corporate DB scheme



Source: Illustrative, informed by APRA (March 2026), CSC and UniSuper published allocations | June 2026

This positioning creates a fundamental asymmetry. For a scheme approaching full funding, the upside of continued growth exposure is incremental – additional surplus beyond what is required to execute an endgame transaction adds diminishing strategic value. The downside, however, is severe: a meaningful drawdown could push the scheme back into deficit, delay endgame execution by years, and require additional sponsor contributions at a time when corporate appetite for DB risk is limited.

2.2 The paradox defined

This is the funding paradox: schemes are closer to their endgame than at any point in the past two decades, yet remain vulnerable to losing that position if market conditions shift unfavourably. Funding levels are inherently backward-looking, assets are measured at a point in time, and liabilities are calculated using assumptions (discount rate, expected returns, longevity) that are largely calibrated from historical experience. A reported VBI tells trustees where they are today on yesterday's assumptions, not how resilient that position is to a sudden change in market conditions.

The critical question for trustees is not "are we fully funded?" but rather "how resilient is our funding position, and how quickly could we act if conditions deteriorate?"

3. Understanding the real drivers of risk

3.1 Investment volatility and sequencing risk

The most immediate source of risk for a well-funded DB scheme is the volatility embedded in its asset mix. Growth assets, while historically rewarded over long time horizons, introduce sequencing risk that becomes increasingly consequential as a scheme matures and approaches its endgame. For a mature, closed scheme with net negative cashflows (benefit payments exceeding contributions), adverse returns in the near term cannot simply be "waited out". Each period of negative performance reduces the funding buffer available to support endgame objectives and may materially alter the range of strategic options available to trustees and sponsors.

To assess this vulnerability, we apply a severe but historically grounded market stress scenario. The analysis is not intended to represent an SPS 160 actuarial investigation, funding assessment or regulatory stress test. Rather, it is designed to illustrate how a major market dislocation could affect funding resilience, endgame timing and strategic optionality.

The scenario is broadly calibrated by reference to market conditions observed during periods of severe stress, including the Global Financial Crisis, when global equity markets experienced declines of approximately 40-50%, listed real estate securities suffered materially larger drawdowns, and government bond yields declined sharply. The objective is not to predict a specific outcome, but to test how a well-funded scheme might respond to a severe yet historically plausible market event.

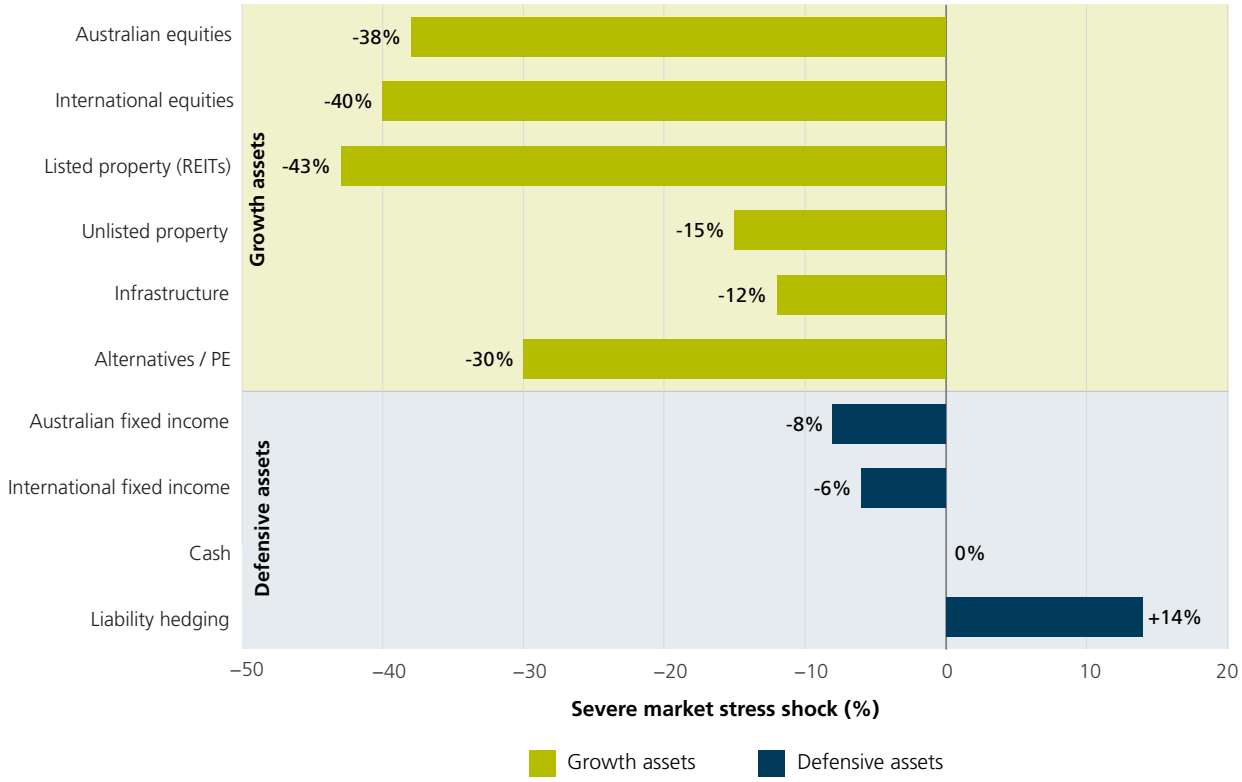
Importantly, the analysis should not be interpreted as suggesting trustees would be forced to transact or implement endgame solutions at the point of maximum stress. Under SPS 160, trustees are generally afforded time to respond to funding deterioration through monitoring, actuarial investigation and, where necessary, rectification planning. Funding levels may subsequently recover as markets normalise.

However, even temporary funding deterioration can have significant strategic consequences. A substantial drawdown may delay endgame execution by years, increase the affordability gap to buy-in or buy-out pricing, require renewed sponsor support, interrupt de-risking programs and reduce the range of feasible endgame options available to trustees.

The key risk is therefore not simply the decline in funding itself, but the potential loss of strategic flexibility at a time when schemes may otherwise have been in a position to act.

Figure 3 shows the shock magnitude applied to each asset class under this scenario.

Figure 3: Severe market stress scenario – shock magnitude by asset class

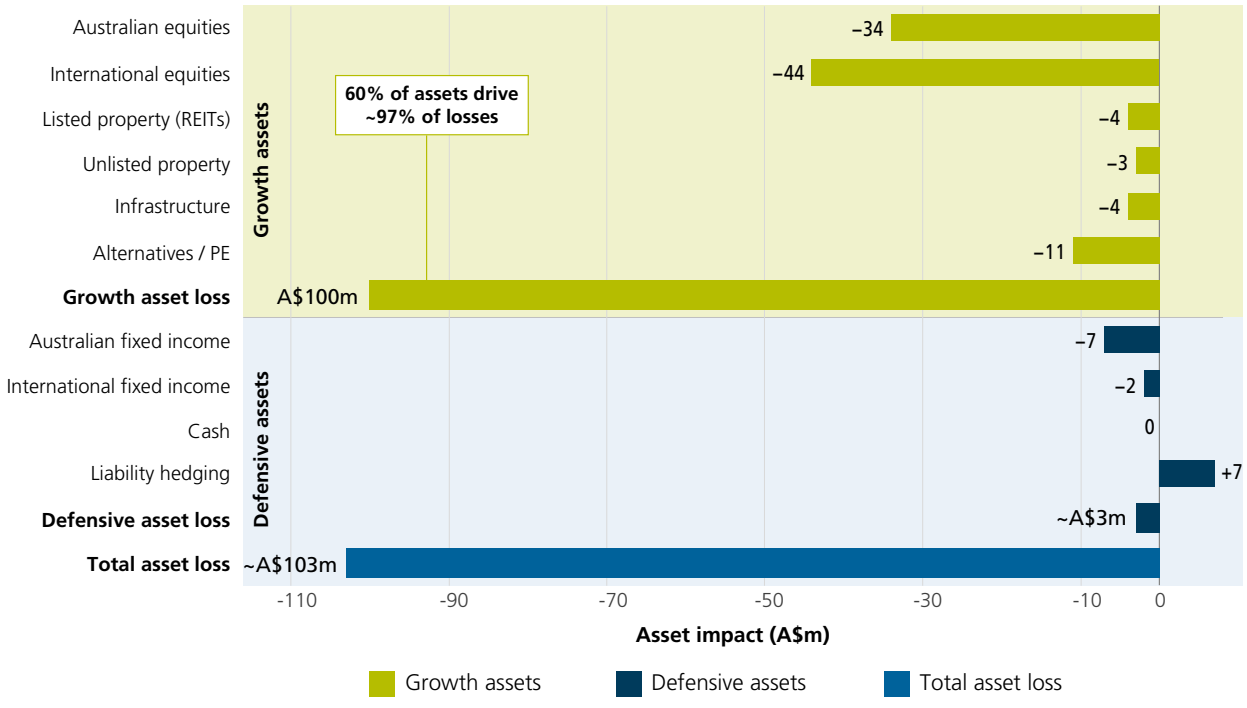


Source: Challenger illustrative analysis. Scenario is illustrative, historically grounded and not an SPS 160 regulatory stress test | June 2026

3.2 Where the losses actually fall

While the percentage shocks are informative, what matters to trustees is the dollar impact, and this is where the concentration risk in growth assets becomes starkly apparent. Figure 4 shows the loss contribution of each asset class in dollar terms (based on a simultaneous shock).

Figure 4: Severe market stress scenario – asset loss attribution (A$m)



Growth assets (60% of the portfolio) contribute approximately A$100m (~97%) of total losses; defensive assets approximately ~A$3m; total approximately ~A$103m | Source: Challenger illustrative analysis | June 2026

The total asset loss under the defined stress scenario is A$103 million. But critically, the losses are not evenly distributed. Growth assets representing 60% of the portfolio, account for 97% of total losses. International equities alone lose A$44 million, Australian equities A$34 million, and alternatives/PE A$11 million. Defensive assets contribute only A$3 million of net losses, partially offset by an A$7 million gain on the liability hedging overlay[8].

3.3 The double hit: assets fall, liabilities rise

The scenario is compounded by the behaviour of liabilities. In a severe market stress of this nature, central banks typically cut rates aggressively and risk-free yields decline. The scenario assumes a 150 basis point fall in ACGB yields, consistent with observed rate moves during the 2008 and 2020 crises. With an average liability duration of approximately 9 years, the present value of liabilities increases by roughly 13.5%, an additional A$56 million. The scheme is hit from both sides simultaneously.

Table 1 presents the full funding impact: assets, liabilities, VBI, and surplus, before and after the combined severe market stress scenario.

Table 1: Severe market stress scenario – full funding impact analysis

Asset class	Allocation (%)	Pre-stress (A$m)	Shock (%)	Pre-stress (A$m)	Loss/change (A$m)
Australian equities	18%	90	-38%	56	-34
International equities	22%	110	-40%	66	-44
Listed property (REITs)	2%	10	-43%	6	-4
Unlisted property	4%	20	-15%	17	-3
Infrastructure	7%	35	-12%	31	-4
Alternatives / PE	7%	35	-30%	25	-11
Australian fixed income	18%	90	-8%	83	-7
International fixed income	8%	40	-6%	38	-2
Cash	4%	20	+0%	20	+0
Liability hedging	10%	50	+14%	57	+7
Total assets	**100%**	**500**		**397**	**-103**
Liabilities		417	+14%	473	+56
VBI		120%		84%	-36%
Surplus / (deficit)		**83**		**-76**	**-159**

Source: Challenger illustrative analysis. Liability impact assumes 150bp yield decline, ~9yr duration | June 2026

An A$83 million surplus is transformed into an A$76 million deficit, a swing of A$159 million, under a single severe market stress event. This represents the funding position at the point of maximum stress rather than a permanent outcome; under SPS 160, trustees would typically have time to respond, and markets may partially recover. The significance lies not in the trough itself, but in the disruption a drawdown of this magnitude causes to endgame timing, affordability and optionality.

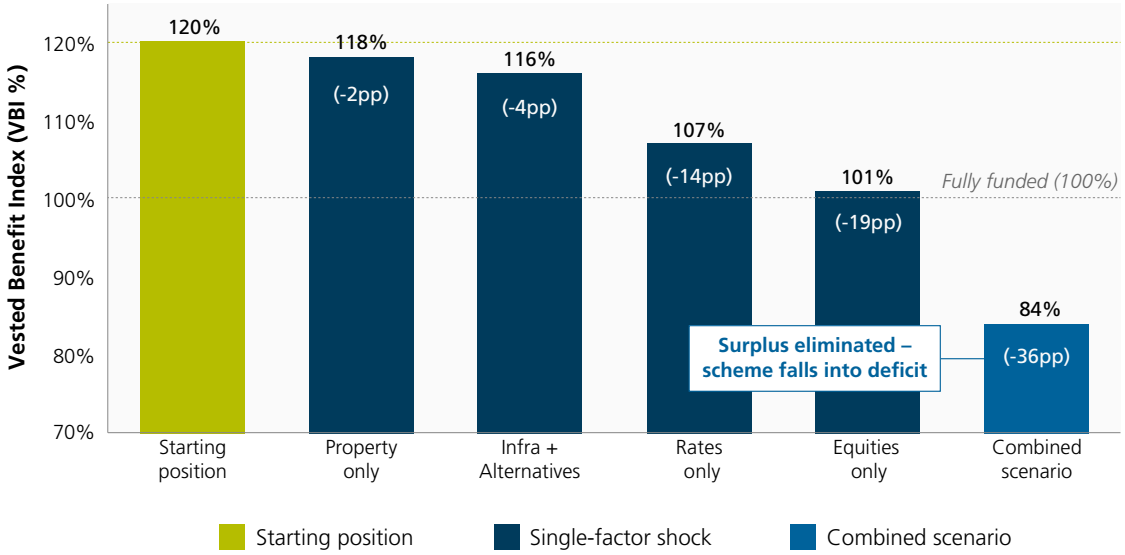
The scheme's VBI moves from a comfortable 120% to approximately 84%, falling 36 percentage points and from meaningful surplus to material deficit. This exposes a meaningful gap between regulatory compliance and risk resilience. APRA's prudential framework requires schemes to conduct stress testing under SPS 530 and SPS 220, and to monitor funding against the shortfall limit they set under SPS 160. However, the framework is principles-based: APRA does not prescribe a specific stress scenario, confidence level, or pass/fail threshold and each scheme defines its own shortfall limit (typically set below 100% VBI) at which a recovery plan is triggered. The depth and rigour of stress testing therefore varies materially across schemes. A scheme can comfortably satisfy every regulatory requirement today; having conducted "stress testing" that may not have contemplated a scenario of the severity analysed in this paper, and still be highly exposed to severe but plausible market events. Regulatory compliance is necessary, but not sufficient, for genuine funding resilience.

[8] Stated figures subject to rounding

3.4 Individual shocks can be just as damaging

It is tempting to dismiss the combined scenario as extreme. But it is worth noting that the individual component shocks, while presented separately below for illustrative purposes, are drawn from the same macro scenario, not from independent tail events. Even in isolation, single risk factors can impact funding levels severely. Figure 5 isolates each major risk driver and shows the resulting VBI.

Figure 5: VBI sensitivity to severe market stress components



Single-factor shocks are drawn from the same macro scenario, not independent tail events | Source: Challenger Illustrative analysis | June 2026

An equities-only drawdown (–38% to –40%) reduces VBI from 120% to approximately 101%, an A$78 million asset loss almost entirely eliminates the scheme's A$83 million surplus and leaves it barely above fully funded. A rates-only shock (–150bp yield decline) pushes VBI to approximately 107%, as liabilities swell by A$56 million with only modest offsetting gains from the hedging overlay. Even property and infrastructure/alternatives shocks in isolation (while less dramatic), push VBI to 118% and 116% respectively, eroding much of the surplus buffer. The combined scenario's effect is compounding, reflecting the reality that severe market dislocations rarely confine themselves to a single asset class. But the more important point for trustees is this: a scheme starting at 120% funded does not have a comfortable margin to absorb individual stresses, it has a working surplus that any one of several plausible risk factors can largely erode over a relatively short period. The optionality that surplus represents the ability to consider buy-in/out, SFT, run-on, or hybrid strategies on the scheme's own terms, is contingent on protecting it.

3.5 Funding vs endgame pricing

A further distinction worth understanding is that between actuarial funding and endgame pricing. A scheme's VBI reflects its financial position under best-estimate assumptions specific to its investment strategy and membership. Insurance pricing, by contrast, is anchored in market-observable rates, typically priced at an attractive margin over the swap curve, and reflects the pooling, capital efficiency, and longevity expertise of the insurer.

The relevance of insurance pricing depends on a scheme's liability profile and chosen endgame. In the Australian market, most schemes pursue a run-on or self-sufficiency strategy, or consolidate via Successor Fund Transfer; full buy-outs remain relatively uncommon, while buy-ins covering the pensioner population are a more accessible form of partial risk transfer. Where insurance solutions are feasible, the pricing dynamics are favourable: when market conditions are supportive, buy-in pricing can be at or close to the scheme's own funding basis, and in some cases more attractive than continuing to run the scheme, once the ongoing costs of investment management, actuarial oversight, governance, and residual risk are taken into account.

The key point for trustees and sponsors is that endgame pricing is not a static "premium" to be paid – it is a dynamic market outcome that reflects the same forces (yields, spreads, growth-asset volatility) that drive the scheme's own funding position.

A scheme that monitors both its VBI and its indicative insurance pricing on an ongoing basis will be well-positioned to identify, and act on, moments when the two align favourably.

3.6 Timing risk

Favourable market conditions do not persist indefinitely. The Australian experience of 2022–2025 (during which funding levels improved dramatically), was driven by a specific and somewhat unusual confluence of factors: aggressive monetary tightening, a global repricing of duration risk, and resilient corporate earnings. A reversion in any one of these factors could meaningfully alter the landscape. The UK's late-2022 gilt crisis demonstrated how rapidly funding positions can shift and how schemes that had pre-positioned for execution were able to transact at favourable levels, while those that had not were forced to reassess from a position of weakness.

Schemes that delay action in the hope of further improvement are implicitly taking a directional view on markets. For a scheme that is already at or near its endgame funding target, this is an asymmetric bet with limited upside and significant downside.

4. From funding to endgame: a structured glidepath

4.2 Endgame is a journey, not a transaction

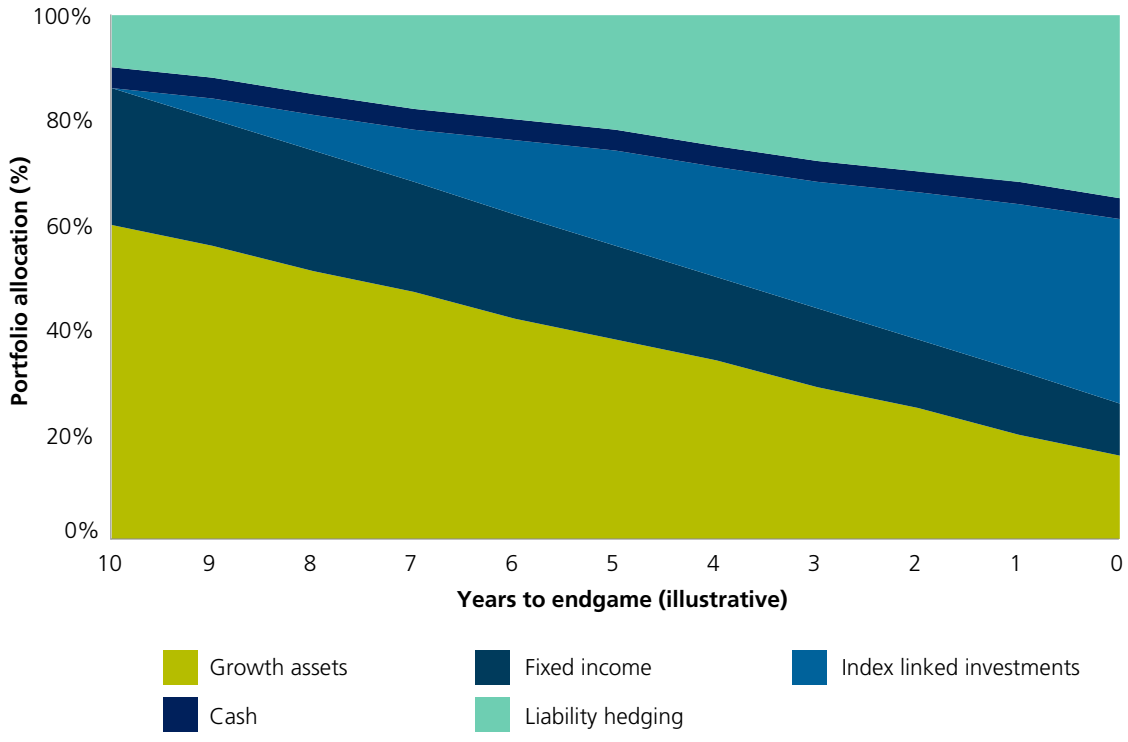
A common misconception is that endgame is a single event, and always an insurance transaction. In the Australian market, many schemes will pursue a run-on / self-sufficiency strategy, and Successor Fund Transfer; insurance solutions such as buy-ins (and, less commonly, full buy-outs) are one part of the toolkit rather than the default destination. What unites all of these paths is a common prerequisite: a resilient, liability-aware portfolio that protects the funding position until the chosen endgame can be executed.

Whichever path is chosen, endgame outcomes are determined well before the point of execution. The decisions made today around investment strategy, risk management, governance, and communication will shape the range of options available to trustees in three, five, or ten years' time. A structured glidepath — a phased, coordinated plan that progressively de-risks the scheme and builds execution readiness, provides a framework for decision-making that is responsive to market conditions but anchored to a clearly defined strategic objective.

4.2 Investment strategy: from growth to alignment

The investment strategy of a scheme approaching endgame should progressively reduce exposure to unrewarded or poorly compensated risks, while increasing alignment with the liability profile. Figure 6 illustrates how a portfolio might evolve over a 10-year glidepath.

Figure 6: Illustrative de-risking glidepath (10-year)



Source: Challenger illustrative analysis. Index Linked Investments represent index-plus investment strategies such as Challenger Index Plus, which deliver returns of a nominated benchmark (e.g. ACGB, AusBond Composite, inflation-linked bonds) plus an active return margin | June 2026

In practice, this means:

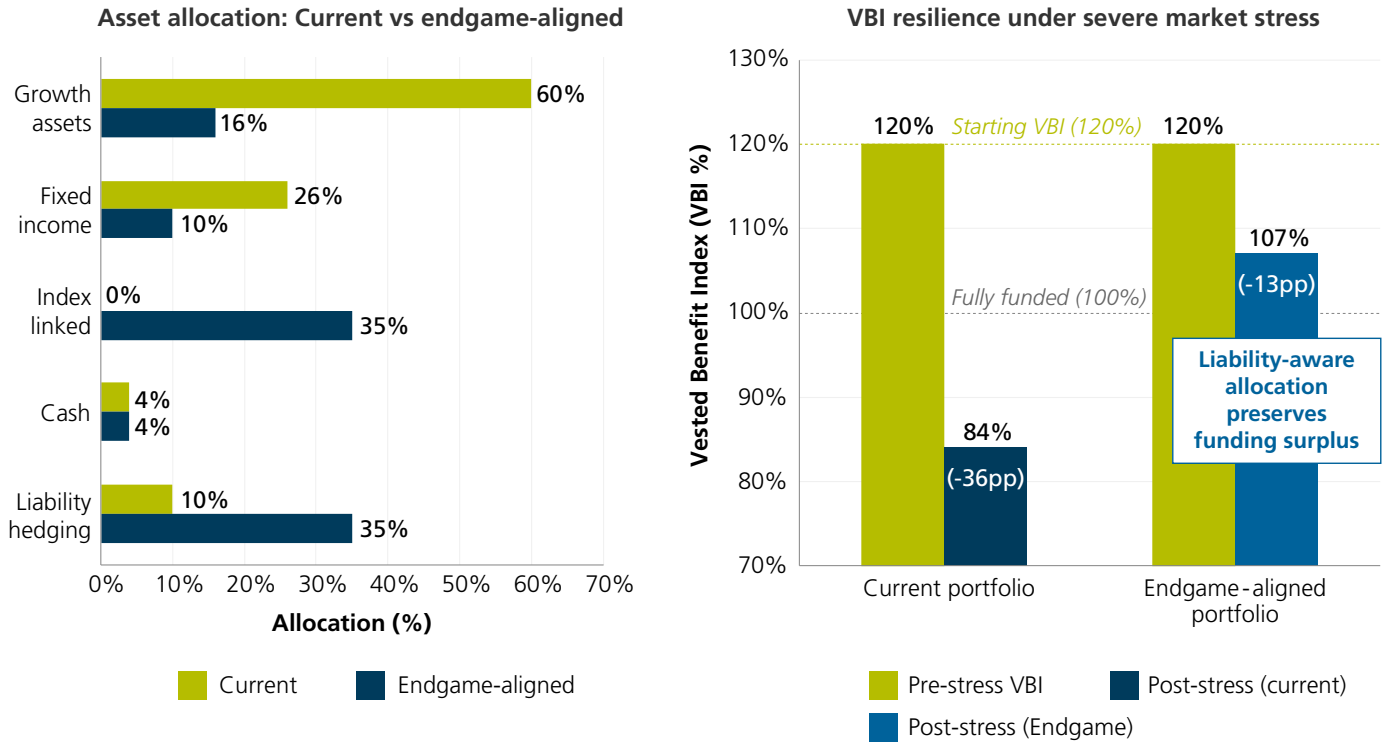
- Reducing growth asset exposure gradually, linked to funding triggers. For example, reducing growth allocation by 10 percentage points for every 5% improvement in VBI above a defined threshold.
- Building the defensive core through a combination of fixed income, index-linked strategies, liability hedging, and a modest liquidity reserve, providing capital preservation and progressively better liability matching.
- Increasing liability hedging toward 80–100% of interest rate and inflation sensitivity, typically via long-dated ACGBs, inflation-linked bonds, index-linked solutions or a tailored LDI overlay.

Beyond traditional passive fixed income, defensive allocations can be enhanced through index-linked strategies such as Challenger's Index Plus offering. These deliver the return of a nominated benchmark plus a contractual margin with zero fees, while preserving the interest rate, credit, and inflation exposures required for liability matching. Depending on the underlying benchmark, index-plus strategies can serve as fixed income core, real-return matching, or long-duration hedging.

This is particularly powerful in the middle stages of the glidepath, bridging passive fixed income and a full LDI mandate, delivering enhanced returns without compromising the matching characteristics of the underlying allocation.

Figure 7 compares the current (typical) allocation with an endgame-aligned portfolio (examples shows portfolio allocation with 10yrs to endgame).

Figure 7: Endgame alignment materially reduces funding volatility



Source: Challenger illustrative analysis. Severe market stress assumes Growth -35%, Fixed Income -7%, Index Linked +8%, Cash 0%, Liability Hedging +13.5%; liabilities +13.5%; Index Linked treated as liability-aware | June 2026

The benefit of this allocation shift becomes apparent when the same severe market stress scenario is applied to both portfolios. Under the endgame-aligned allocation, the VBI declines from 120% to approximately 107%, a fall of just 13 percentage points, compared to the 36 percentage point decline in the current portfolio (120% to 84%). The scheme remains close to fully funded even under severe market dislocation, retaining the optionality required to execute an endgame transaction without waiting for a recovery.

This is the practical manifestation of the funding paradox argument: it is not the funding level itself but the resilience of that funding level that determines whether a scheme can act decisively when the opportunity arises.

4.3 Governance, risk management, and operational readiness

Effective de-risking requires a governance framework that enables timely decision-making:

- **Defined risk appetite:** A clear articulation of how much funding volatility the scheme is willing to tolerate. For example, "the scheme targets a less than 5% probability of the VBI falling below 95% over a 12-month horizon."
- **Decision triggers:** Pre-agreed funding or market levels at which specific actions are taken, such as increasing hedge ratios, reducing growth exposure, or initiating an insurance quotation process.
- **Dual monitoring:** Tracking both the actuarial funding position and the estimated endgame affordability gap, whether that endgame is a buy-in, buy-out, self-sufficiency or run-on target — on a regular basis, ensuring trustees have visibility of both their current position and their proximity to endgame execution.

On the operational side, schemes should begin preparing well in advance of any anticipated transaction. This includes comprehensive data audits (ensuring member records meet insurer standards), benefit specification reviews (confirming all entitlements are clearly documented and legally robust), and trust deed and regulatory analysis (identifying any impediments to wind-up, transfer, or continuation).

4.4 A phased timeline

Table 2: Illustrative glidepath stages

Phase	Horizon	Key actions
Positioning	5–10 years	Define endgame objective; begin strategic allocation shift; establish governance framework
Transition	2–5 years	Increase liability hedging to 70–90%; implement formal glidepath with triggers; commence data and legal workstreams
Pre-execution	0–2 years	Achieve full portfolio alignment; complete data remediation; engage with insurers or finalise run-off plan
Execution window	Opportunistic	Active monitoring of funding and pricing; execute when triggers are met and operational readiness is confirmed

The pace of progression is driven by funding outcomes and market conditions, not calendar time alone.

4.5 Communication

Effective communication with members, sponsors, and other stakeholders, is a critical but often neglected pillar of endgame planning. DB members are typically older, often retired, and may be anxious about changes to the arrangement that provides their income in retirement. A well-designed communication strategy should provide clear, jargon-free information about the scheme's strategic direction, set realistic expectations about timelines and potential outcomes, and ensure members have access to appropriate support during any transition. For sponsors, regular and transparent updates on funding progress and endgame readiness help maintain alignment and support for the trustee's strategy.

4.6 Scaling the approach: considerations for smaller schemes

The glidepath framework described above applies across the addressable DB spectrum, but its emphasis shifts with scheme size. For larger schemes, the priority is a multi-year investment de-risking journey toward an insurance or run-on endgame. For smaller schemes, the more pressing considerations are often operational and cost-driven, and they frequently point toward acting sooner rather than later, regardless of funding level.

Three factors are particularly relevant for smaller schemes:

- **Per-member cost escalation.** As membership declines, the fixed costs of running a standalone plan — actuarial, audit, administration, trustee governance and compliance, are spread across fewer members, raising per-member costs over time. This dynamic can make consolidation or transfer economically compelling well before any funding-based trigger.
- **Cashflow and liquidity management.** Mature schemes paying out more than they receive must ensure sufficient liquidity to meet each benefit payment without becoming forced sellers of growth assets in stressed markets. For smaller schemes, maintaining a simple, liquid, liability-aware portfolio is often more important than pursuing sophisticated LDI structures.
- **A shorter, simpler glidepath.** Smaller schemes rarely need a full ten-year, multi-mandate de-risking program. The practical objective is more often to reach a resilient, transfer-ready position — a portfolio that a successor fund would readily accept, and a data and benefit-specification standard that supports a smooth SFT, rather than to build a bespoke LDI overlay.

For many smaller schemes, therefore, the endgame question is less "how do we de-risk over a decade?" and more "when and how do we transfer to a larger, better-resourced vehicle?" The preparation principles are the same: investment resilience, clean data, sound governance, clear communication, but the timeframe is often shorter and the destination more likely to be a Successor Fund Transfer than a standalone insurance transaction. The cost and cashflow pressures that build as a scheme matures mean that, for smaller schemes, the value of preparing early is often even greater than the funding analysis alone would suggest.

5. Conclusion: preparedness as the true differentiator

The Australian DB landscape is at an inflection point. Improved funding levels have created a window of strategic opportunity that may not remain open indefinitely. Schemes that recognise this moment for what it is, and take deliberate, structured steps to protect their position and build execution readiness, will be best placed to deliver strong outcomes for their members and sponsors.

The stress analysis presented in this paper underscores a sobering reality: a scheme at 120% funded with a 60/40 growth-to-defensive portfolio can see its funding fall to around 84% at the point of maximum stress in a single severe market dislocation — and while funding may subsequently recover, the disruption to endgame timing and optionality can persist far longer. Growth assets (60% of the portfolio), contribute 97% of total losses. The liability side compounds the damage: a 150 basis point decline in yields increases obligations by 13.5%, turning an A$83 million surplus into an A$76 million deficit, a swing of A$159 million. Even individual components of the stress scenario can eliminate a surplus entirely: an equities-only drawdown pushes VBI to 101%, while a rates-only shock drops it to 107%.

By contrast, the endgame-aligned portfolio considered in this paper remains approximately 107% funded under the same stress event, demonstrating the value of increasing exposure to liability-aware assets, particularly Index linked Investments and liability hedging strategies. The endgame portfolio sacrifices little in terms of expected return potential, but materially improves funding resilience.

The key insight is that funding level alone is not the differentiator. Two schemes with identical VBIs can have vastly different risk profiles, governance capabilities, and degrees of readiness. It is the scheme that has:

- **Aligned its investment strategy** with its liability profile
- **Pre-positioned its governance framework** for timely decision-making
- **Completed its operational preparation** (data, legal, benefit specification)
- **Engaged its stakeholders** transparently and proactively

These are the schemes that will be best positioned to execute their chosen endgame when opportunities arise.

The funding paradox, fully funded but still exposed, is not a failure. It is a recognition that the hard work of de-risking begins, not ends, with achieving full funding. The transition from funding maintenance to endgame execution requires a different mindset, a different set of tools, and a different standard of preparedness.

For trustees, sponsors, and their advisers, the question is no longer whether endgame planning is necessary. It is whether they are doing enough, quickly enough, to ensure they are ready when the opportunity presents itself.

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