CARTWRIGHT

TPR's 2019 Annual Funding Statement

The Pensions Regulator (TPR) has just issued the latest of its Annual Funding Statements (AFS) setting out its expectations for Trustees and Employers of Defined Benefit (DB) Schemes currently undertaking actuarial valuations.

Background

Following the Government's White Paper "Protecting Defined Benefit Pension Schemes" published in March 2018, TPR will shortly be revising and updating its DB funding code. Consultations on the new code will start later this year, and it is anticipated that the new code will be in force in Spring 2020. This year's AFS is therefore based on the existing code, but with some useful indications of TPR's current thinking on how the new code may operate.

Long-term funding target (LTFT)

The Government's White Paper set out its intention to introduce a requirement for schemes to have a specific long-term funding destination. TPR suggests that it would be good practice for the Trustees to prepare for this now by seeking to agree a long-term funding target (LTFT) with the scheme's Employer. Typically this LTFT would be higher than the current Technical Provisions (TP) funding basis, reflecting a low-risk funding approach with reduced reliance on the Employer covenant and a high degree of resilience to investment risks. The White Paper suggested that suitable LTFTs might be a fully funded "self-sufficiency" basis or even the ability to secure all benefits by a buyout with an insurer. Schemes should then establish a journey plan for moving beyond becoming fully funded on the TP basis towards being fully funded up to the LTFT, and reflect this in their investment and funding strategies.

Scheme maturity

TPR notes that the majority of schemes are now closed to new members, so that they will progressively become more mature as members retire. Mature schemes will be paying out significant amounts as benefit payments every year, and TPR stresses the need in such circumstances to consider carefully the ability to meet any funding shortfall through investment growth and/or Employer contributions in a reasonable timeframe. TPR's expectation is that the timeframe for achieving the LTFT should make allowance for future change in a scheme's maturity. The LTFT should be achieved when the scheme maturity is such that it would be appropriate to reduce a scheme's dependence on its Employer.

Guidance on TPR's expectations

The AFS sets out TPR's expectations on the key risks for Trustees and Employers to focus on, and actions to take, for schemes currently undertaking actuarial valuations. These are covered in 10 different scenarios which vary by Employer covenant, strength of funding basis and scheme maturity. Schemes should identify which scenario best reflects their own position and consider how their current approach meets with TPR's expectations. Some general themes are:

- Seeking to increase contributions and shorten recovery plans;
- Proportionate covenant monitoring;
- Recognising the shorter time horizon for more mature schemes in funding and investment strategies;
- Strengthening TPs where weak, and increasing short term security through contingent assets and guarantees.

Dividend payments

TPR continues to be concerned about the possible inequitable treatment of schemes relative to shareholders, with the disparity between dividend growth and stable deficit recovery contributions (DRCs). Recent corporate failures have highlighted the risk of long recovery plans while payments to shareholders are excessive relative to DRCs. TPR's stated approach is

- If dividends exceed DRCs, the funding target should be strong and the recovery plan relatively short (although this may vary if the deficit is small compared to the size of the Employer);
- For Employer covenants which are weak or tending to weak, DRCs should exceed dividend payments unless the recovery plan is short and the funding target is strong;
- There should be no dividend payments if the Employer is weak and unable to support the scheme.

Recovery plans

TPR will be contacting some schemes ahead of their 2019 valuations where they consider their existing recovery plans to be unacceptably long. Currently the average length of a recovery plan is 7 years. TPR expects schemes with strong covenants to have a significantly shorter recovery plan length, and it is clear that any scheme with a recovery plan longer than 7 years can expect to have greater scrutiny from TPR.

Evidencing the trustees' approach

There is greater emphasis than in previous AFS on the need for Trustees to document the reasons for their approach to funding. These include:

- Quantifying the impact on funding of potential adverse future investment performance;
- Testing and evidencing the ability of the Employer covenant to support DRCs without extending the length of the recovery plan;
- Evidencing how the TPs are consistent with the journey plan to reach the LTFT; and
- For weaker Employers, documented evidence of whether the Trustees consider independent covenant advice is necessary. If Trustees decide not to obtain such advice, they should be prepared to justify their approach.

This tallies with TPR's current thinking on its new DB funding code, which is that it should be on a "comply or explain" basis. It is intended that the new code will set out much more clearly and explicitly TPR's expectations on funding. Adherence with all aspects of the code will be deemed compliant with TPR's requirements. However, TPR accepts that it may be appropriate to adopt alternative approaches in particular circumstances, for example, where the Employer covenant is strong, or if the scheme is small relative to the size of the Employer. Such variations will be acceptable, provided that they are clearly evidenced and can be explained and justified if required.

If you would like to discuss this further, please get in touch with your usual contact at Cartwright.

March 2019

Mill Pool House
Mill Lane
Godalming
Surrey GU7 1EY

T: 01483 860201

E: enquiries@cartwright.co.uk

250 Fowler Avenue
Farnborough Business Park
Farnborough
Hampshire GU14 7JP

T: 01252 894883

E: enquiries@cartwright.co.uk

Marlborough House
Victoria Road South
Chelmsford
Essex CM1 1LN

T: 01245 293300

E: enquiries@cartwright.co.uk

The Mansley Business Centre
Timothys Bridge Road
Stratford Enterprise Park
Stratford-upon-Avon
CV37 9NQ

T: 01245 293300

E: enquiries@cartwright.co.uk