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Legal

Key points from TPR's 2019 annual funding statement

March saw the publication of the Pension Regulator's (TPR's) Annual DB Funding Statement (the AFS), which set out its expectations of schemes carrying out valuations, and what schemes, in turn, could expect from TPR. Whilst the AFS does not have legal force, TPR is clearly setting out its stall, and schemes should make sure they have an eye to this update in their negotiations.

Long-term funding targets (LTFT)

Paying the promised benefits is of course the key objective for schemes. TPR now states that it expects all DB scheme trustees and employers to agree a clear strategy for achieving a long-term funding goal, which recognises how the balance between investment risk, contributions and covenant support may alter over time. Schemes should adopt 'journey plans' working towards meeting this new target, which should now look beyond being fully funded on a technical provisions basis.

Balancing risks

Consistent with existing guidance, TPR emphasises the need for an integrated risk management approach, with trustees evaluating covenant, investment risk and funding in the round. As in previous years, the AFS categorises schemes based on their risk profile. But this year a scheme's maturity is given as a significant factor. TPR explains that since most schemes are now closed to new members, scheme maturity issues should assume greater prominence when setting funding and investment strategies.

The statement contains a series of tables, setting out the key risks and actions which TPR believes trustees and employers should focus on, depending upon the category into which their scheme falls. It is essential that trustees and employers take advice to understand the specific implications for their scheme.

Investment strategy expectations

Also, for the first time, TPR spells out its investment strategy expectations in the tables, including:

- setting asset allocation consistent with LTFTs, and journey planning to get there
- quantifying the impact of adverse investment performance on funding, and
- testing and evidencing the ability of the covenant to support this without extending the recovery plan.

Dividends and deficits

TPR expects schemes to be treated 'equitably' with other stakeholders. The AFS states that it remains concerned about the disparity between dividend growth and stable deficit reduction contributions (DRCs), and makes clear that TPR expects:

- where dividends and other shareholder distributions exceed DRCs, that funding targets should be strong and recovery plans short
- if the employer covenant is tending towards weak or weak, that DRCs should be larger than distributions, unless the recovery plan is short and the funding target strong, and
- if the employer is weak, that shareholder distributions should have ceased.

Late valuations

TPR expects trustees to plan ahead so that their valuation process leaves sufficient time for advice, analysis and negotiation. A missed deadline should be reported 'in good time'. But, while parties should work to finalise an appropriate valuation and recovery plan as soon as possible, trustees should not agree merely because of time pressure, and should contact TPR if pushed to do so.

What now?

TPR confirms that it intends to review and update its DB funding code, consulting in summer 2019 'on various options for a revised funding framework', and 'shortly after' on the code itself. Until the updated code comes into force, trustees and employers should continue to refer to the current DB code and guidance.