TPR publishes annual funding statement 2024

Alert | 25 April 2024

Introduction

TPR's latest annual funding statement was published on 24 April 2024. With the majority of schemes estimated to have improved funding positions, and in light of the Mansion House reforms announced in the year since the last statement, TPR encourages DB trustees and employers to use this "step change in position" as an opportunity "to reassess their long-term targets and consider run-on, consolidator or insurance options".

Key points

- Primarily aimed at schemes with valuation dates between 22 September 2023 and 21 September 2024 ("Tranche 19" or "T19"), the statement is also relevant to schemes which may have been impacted "over the last couple of years due to changes in market conditions".

- Most DB schemes have benefitted from "material improvements" in funding, with half of schemes expected to have "exceeded their estimated buy-out funding levels".

- Unsurprisingly, there is repeated emphasis on trustees considering transition options in light of their long-term funding targets ("LTFT"). However, against the backdrop of July 2023's Mansion House reforms and the subsequent Autumn Statement, TPR now specifically contemplates the possibility of schemes running on "to generate additional surplus to benefit members and employers".

- Notwithstanding the general improvements in funding, TPR emphasises that a "sizable minority of schemes are expected to still be in deficit on a technical provisions basis". As such, trustees of these schemes should continue to focus on achieving a recovery plan that is as short as reasonable, whilst factoring in employer affordability and covenant, given their higher reliance on them.

- Finally, with new legislation and a revised DB code on the horizon and expected to apply to valuations with effective dates from 22 September 2024 onwards, it "would be good practice for trustees to consider the steps they can take now to align (even if broadly) with the funding code when it is published", so as to avoid having to make significant changes at the next valuation.

General considerations for current valuations

DB schemes have seen significant changes over the last couple of years. TPR states that long-term objectives set in an era of low interest rates, and their associated funding and investment strategies, now need to be reviewed.

When considering requests from employers to reduce or suspend contributions, or requests from members for discretionary increases, trustees should look at the scheme's overall position, including the resilience of their investment strategy to future market movements, as well as the level of covenant support. Trustees should also bear in mind whether their scheme has a history of paying discretionary increases.

Open schemes

Open schemes may have seen a material reduction in estimated liabilities and, given their immaturity, many have seen larger movements in funding levels. TPR acknowledges that open DB scheme trustees are more likely to be focused on technical provisions ("TPs") than long-term targets. Therefore, they may be "maintaining greater covenant reliance for a longer period than their closed counterparts" and "may also be considering requests to use surplus to subsidise future accrual".

Economic uncertainty continues

While most trustees should be approaching T19 valuations from a "relatively healthy" funding position, they should still recognise the economic uncertainty that will continue to impact investments and employer covenant in different ways, including:

- **uncertainty over the "future path" of interest and inflation rates** – which could affect the scheme's assets and liabilities, as well as increasing borrowing costs for the employer

- **the high level of geopolitical instability** – which could impact supply and distribution chains for employers.

Employer covenant

The employer covenant remains an integral element to consider when assessing what level of investment risk-taking is appropriate. If a scheme is still materially reliant on covenant, trustees are reminded to keep in mind re-financing risks, covenant leakage and fair treatment.

Climate change

Climate change and wider sustainability issues are an area of increasing concern for trustees and companies, with the potential to impact investments, liabilities, resilience of funding strategies and the employer covenant. Trustees should allow for these potential impacts when considering their future scheme horizons, and their possible long-term covenant, investment and funding strategies.

Funding position

In last year's statement, TPR grouped schemes into three categories. TPR expects these groupings and the related expectations to remain relevant, noting that its guidance from previous years' statements continues to apply, including the accompanying tables in last year's statement.

Group I – funding level is at or above buy-out

According to TPR, trustees of schemes in this position have the main options of buying out (either outright or in stages) or running on. Given constraints in the insurance market, TPR recognises that trustees may adopt a strategy of running on “in the short to medium term” and then buying out “when specific targets are met”, eg when surplus, maturity, or asset size hit certain levels. Entering a DB consolidator could also be a possibility, subject to meeting gateway tests.

If considering run on, TPR emphasises the need for trustees to “ensure it is a better option for members, for example because it offers them, and the employer, potential to benefit from continued surplus generation”. It also highlights some of the risks involved in running on, such as investment, longevity, and the general expense “of a long run-off”, suggesting that trustees might be able to “mitigate some of this risk by creating a specific risk buffer using some of the surplus”. Larger schemes are regarded by TPR as having “greater economies of scale, better governance, and greater potential benefit to stakeholders from running on”.

For schemes considering an insurance solution, TPR encourages trustees to take sustainability into account during their due diligence and signposts the guidance on the Accounting for Sustainability website. The effect of buy-out on the possibility of future discretionary increases in payment is also flagged as a possible relevant consideration.

Whatever route schemes take, trustees should take advice about the risks and benefits and their relevant duties, and put in place suitable mitigation strategies. TPR also expects trustees “to document their strategy and explain why it is in the best interest of members”.

Group II – funding level is between TPs and buy-out

Trustees should review their long-term objective and the timescale for reaching it. If trustees haven’t agreed an LTFT yet, TPR reminds them to do so “as a priority”. Where funding levels have improved significantly, trustees should also “consider accelerating” the transition to align their investment strategy with their long-term objective.

In light of improved funding levels, trustees may consider other emerging options such as consolidators, capital-based journey plans and the recent consultation on the possibility of a public sector consolidator being run by the PPF, and whether these options “would be in members’ interests”. TPR acknowledges that a “wait and see” approach may be reasonable as these options are still developing.

Where full consolidation and insurance options are not yet affordable, it may be helpful to understand when they are likely to become so. In the meantime, trustees are encouraged to consider other approaches which might “improve governance and benefit from greater buying power”, and “not just accept the status quo”. Creating economies of scale may also allow for “greater value to be delivered to members” through increasing access to private market investments.

Finally, TPR intends to publish guidance on DB alternative consolidation arrangements later this year.

Group III – funding level is below TPs

If funding is below TPs level, unsurprisingly, trustees in this group should “focus on bridging this gap first”. They should also revisit the TPs to ensure they are aligned to the LTFT. Any risk-taking should be supported by the employer covenant and should reduce as the scheme becomes better funded or matures. Any deficit should be recovered “as soon as the employer can reasonably afford”.

Timetable for the new DB funding regime

In terms of the bigger picture, the pieces of the new funding and investment strategy regime are beginning to fall into place. Here's a quick of recap of where we are:

- the revised **funding and investment regulations** came into force on 6 April 2024
- the **revised DB funding code** was consulted on in December 2022 and the code is expected to be laid in the summer, to be in force in September 2024. It is designed to partner with the regulations, providing practical guidance on how trustees can comply with the requirements
- TPR's consultation on the statement of strategy that DB trustees will need to submit as part of planning and managing their scheme's funding closed just last week
- revised **covenant guidance** is expected in the summer
- TPR's **Bespoke and Fast Track** regulatory approach was consulted on in December 2022, and we are awaiting the final version
- the new funding and investment regime is expected to apply to scheme valuations with effective dates on and from **22 September 2024**.

Sacker & Partners LLP
20 Gresham Street
London EC2V 7JE
T +44 (0)20 7329 6699
E enquiries@sackers.com
www.sackers.com

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