Update on topical issues

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The Pensions Regulator

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Agenda

1. AFS2017
2. Investment guidance
3. 21st Century Trustees
4. Questions and discussion

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T12 valuations

Current actuarial positions

- Expecting bigger deficits generally for T12
- But, as usual, lots of scheme specific variability depending on ....
- ..... and also on timing of valuation dates

Affordability

- Variable and scheme specific
- Historically this has been the ‘favoured’ cohort, have they got more in reserve?

Stakeholder views

- System not broken – trustees should not wait for any special bailouts
- Agreeing funding plans will be painful for some but manageable for most
- Stressed schemes – underlying problems might be different and not necessarily ‘actuarial’ or related to market volatility

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Current funding issues: Financial assumptions

- Outlook for future investment returns
  - Continuing uncertainty about future economic and financial conditions
  - Market expectations: interest rates to remain lower for longer, and to revert to lower long-term levels.
  - Responsible consultants encouraging more scenario planning which we support.
- Most funding strategies likely to be based on lower expected investment returns.
- But a scheme specific assessment and we expect this to happen within an IRM framework with more scenario planning and tangible plans to manage downside risk

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Current funding issues: Valuation methodology and discount rates

- Not our role to discourage innovation and new thinking, as long as approach is consistent with the legislative requirement.
- But interested in the rationale behind the approach used:
  - Documentation of rationale
  - Link with trustees long term objective, and plans for getting there
  - Consistency of proposed asset strategy with this and the sponsor’s risk appetite?
  - Longer term view of expected risk and returns
  - How is prudence determined
  - Treatment of the various risks along the way
  - Scenario planning and sensitivity analysis
- As users, we will take a particular interest in how you communicate to clients under TAS300.

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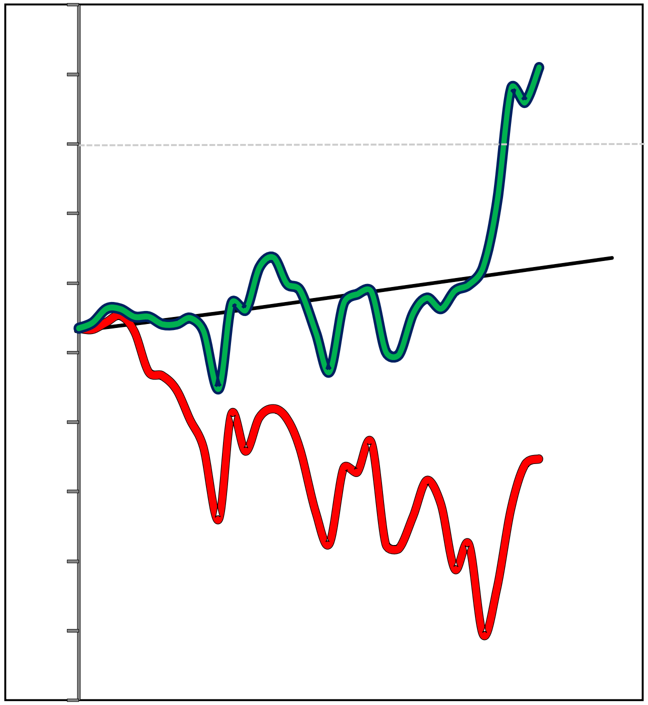
Current funding issues: Risk management



Inter-valuation funding progressions show a tale of two halves:

- Those who managed risks well – should be in a good position
- Those who took a strong view on interest rates not falling further – now in a much worse position.

Is this a fault of the markets or a reflection of good/bad risk management?

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Current funding issues: Scheme maturity

Cash flow management

- Have a sound policy to manage liquidity risks and monitor regularly

Funding

- Underfunded schemes should also consider impact on funding dynamics and additional strain on investment strategy
- A distant problem? Think again about benefits of advance planning to inform IRM (thresholds, tipping points etc)

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Current funding issues: Affordability and covenant visibility

Current affordability

- Variable, so scheme specific assessments

  .... underlying importance of covenant assessments
- Brexit boost for FTSE companies and foreign owned companies
- Dividend payouts disproportionate to DRCs for many FTSE companies
- Our internal analysis shows many who can pay more but choose not to do so

Covenant visibility

- Lack of visibility beyond the immediate short term often an excuse to ignore covenant in funding and risk management plans
- We encourage you to analyse the risks through scenario planning and consider mitigations.

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TPR guidance to trustees

- We will continue to focus on trustees' quality of decision making and contingency planning within and IRM framework
- Will emphasise that IRM is not a stand-alone compliance requirement. It is a way of thinking which is central to effective risk management.
- Expect a different style and tone
  - More directive messages, making our expectations clearer
  - Targeted at specific segments

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Key messages under consideration

- CG1/2 employers; on track to meet long term funding objective; TPs are not weak and RPs not long
  - *Don't extend RP end dates without good reason*
- CG1/2 employers; weak TPs and long RPs
  - *Seek higher contributions*
- Weak employers who think they are strong just because they are part of stronger and larger group of companies
  - *Seek legally enforceable covenant were you don't have it, otherwise don't rely on wider group*
- Weak and stressed schemes
  - *Do your best with a focus on member interests while we work with DWP to explore options in green paper*
- Managed risk well and are now on or ahead of target
  - *Keep it that way*
- Significant risk crystallised against you and are now below target
  - *Implement contingency plan and re-assess risk strategy within IRM*
- Lack of covenant visibility
  - *Consider the associated risks and focus on employer's ability to contribute cash while there remains good visibility of covenant*
- Fair treatment
  - *Where shareholder reward is relatively higher than DRCs, we expect short recovery plans underpinned by an investment strategy not relying excessively on investment outperformance*
- Small schemes
  - *Undertake sufficient analysis to understand risk exposure and take advantage of market innovations in risk management and investment for small schemes*

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Investment guidance

- Comprehensive guidance dealing with Investment governance, setting strategy, implementation and monitoring.
- Principles based, with many practical examples to assist trustees
- Setting investment strategy
  - Clear investment objectives consistent with long term evolution of scheme; method and time frame for achieving
  - Take appropriate risk to achieve objectives consistent with sponsor’s risk appetite
  - Have realistic contingency plans
  - Focus decision making through belief sets; critically evaluate advice and key underlying assumptions
  - Well chosen economic scenarios to help understand and mitigate risks
  - If don’t have the skills get them or simplify arrangements
  - Review and reconsider as circumstances change (and at each valuation)

21st Century Trustees

Key objective is to drive up standards of trusteeship and governance, through:

- Setting clarity: Tailored expectations for trustees and key players
- Taking action: Look more closely at trustees who consistently fail to meet our expectations around broader competence and governance standards.
- Encouraging consolidation (of schemes unwilling or unable to deliver good governance)

Professional trustees:

- Considering a partnership approach with industry to clarifying the higher standards for professional trustees
- Consulting on definition of professional trustee and fining framework

Effectiveness of chairs of trustees

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Any questions?

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