Update on topical issues

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Agenda

1. AFS2017 – sharing work in progress and getting your views
2. Investment guidance
3. 21st Century Trustees
4. Questions and discussion

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T12 valuations: Headline expectations

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: Valuation methodology

- *Discount rates*
  - Is there a challenge to methodologies used by actuaries?
  - What are the alternatives?
- *Alternative valuation methods*
  - Cash flow projections rather than balance sheets?
  - What was the problem? Do they solve it?
- Not our role to discourage innovation and new thinking.
- But, as users, will take a particular interest in how you communicate to clients under TAS300. Working with JFaR and IFoA to reinforce this.

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Current funding issues: other measurement issues

- ***Mortality/longevity***
  - New CMI data and analysis
  - Is there sufficient evidence of a reduced long term trend?
  - We have not formed a view yet

- ***Pension freedoms***
  - Signs of greater take-up
  - Is there sufficient evidence to form an actuarial assumption?
  - We think not

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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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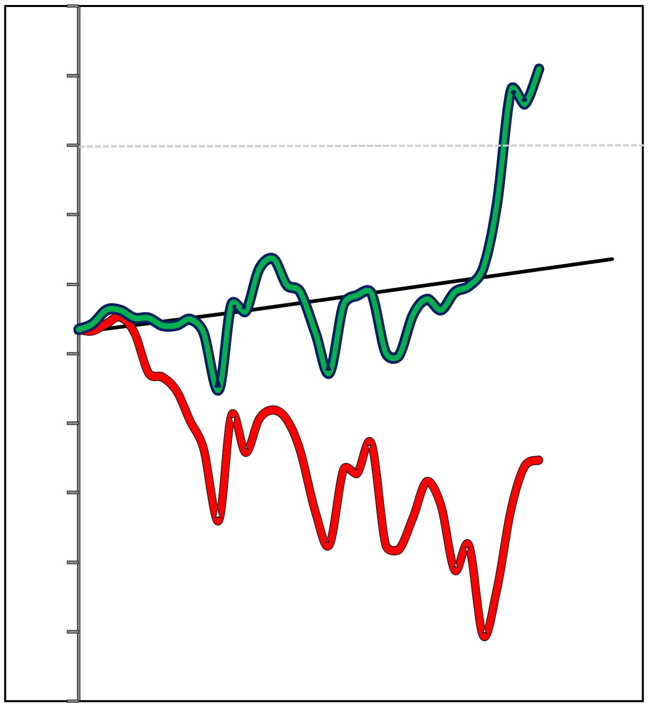
Current funding issues: Risk management



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: 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 address this through scenarios or in other innovative ways.

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TPR guidance to trustees

- Annual funding statement - still work in progress
- But 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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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)

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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: supporting debate, tackling orphans.

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

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Any questions?