

A reality check on DB pensions

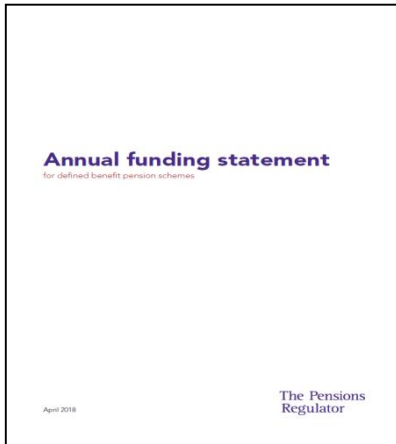
Update on topical issues
ACA Meeting, Glasgow
15 May 2018

Chinu Patel, Actuary
Helen Abbott, Business analyst



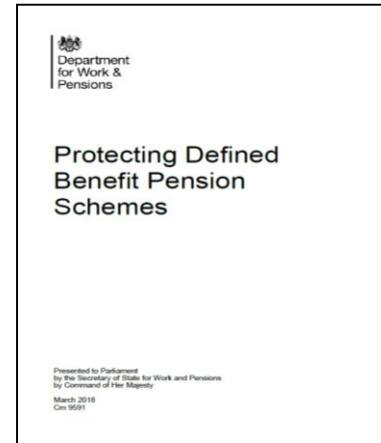
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Agenda



Sets out what TPR expects from trustees and employers, for valuations with effective dates between 22 September 2017 and 21 September 2018 (Tranche 13).

- Key messages



TPR is working closely with government to develop the proposals in the White paper, to ensure they are *proportionate*, *effective* and *work in practice*.

- Overview
- Closer look at funding

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TPR's 2018 Annual Funding Statement

- Three key messages:
 - Better risk management
 - Fair treatment for pension scheme
 - Clarity on managing deficits
- What you can expect from TPR

“... treasure trove of
gems but far from
unexpected”

Professional Pensions
5 April 2018



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Risk management



Risk management

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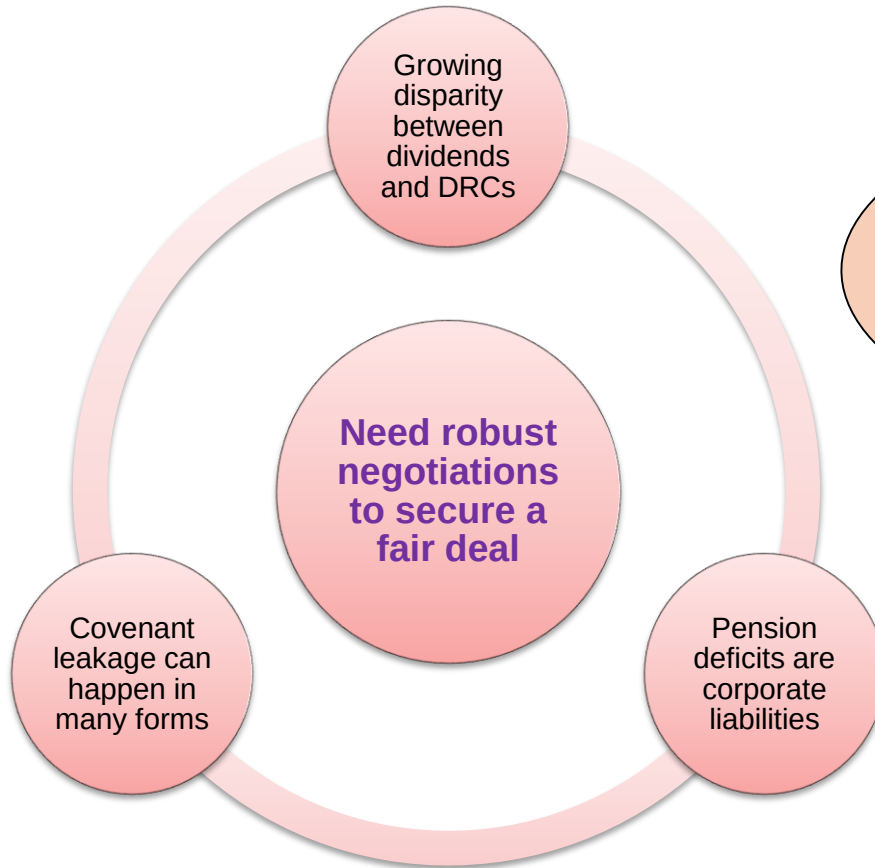
Contingency plans



Key test:
Tangible and practical

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Fair treatment

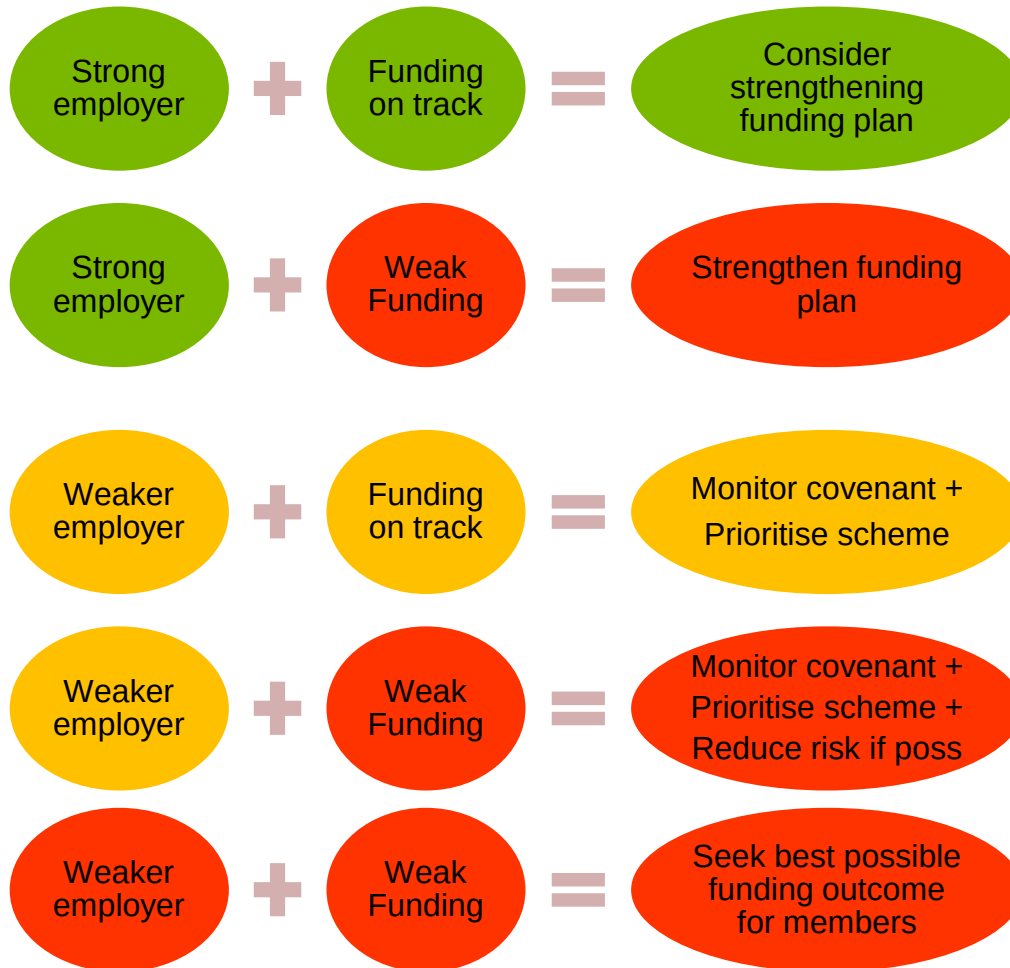


A strong covenant in itself is not a sufficient reason to accept a recovery plan with lower contributions than would otherwise be considered reasonable

Where dividends are disproportionate relative to DRCs, we would consider affordability not to be an issue

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Affordability and managing deficits



What you can expect from TPR

Clearer

- Clarity from case teams about their concerns
- Clarity on acceptable outcomes

Quicker

- Reactive cases: closure or formal investigation into powers within nine months of valuation submission (KPI)
- Earlier engagement on more proactive cases to continue
- Ongoing monitoring and engagement for certain schemes

Tougher

- Increased use of several powers (already happening - s231)
- Introduction of different interventions
- More intense engagement with smaller schemes

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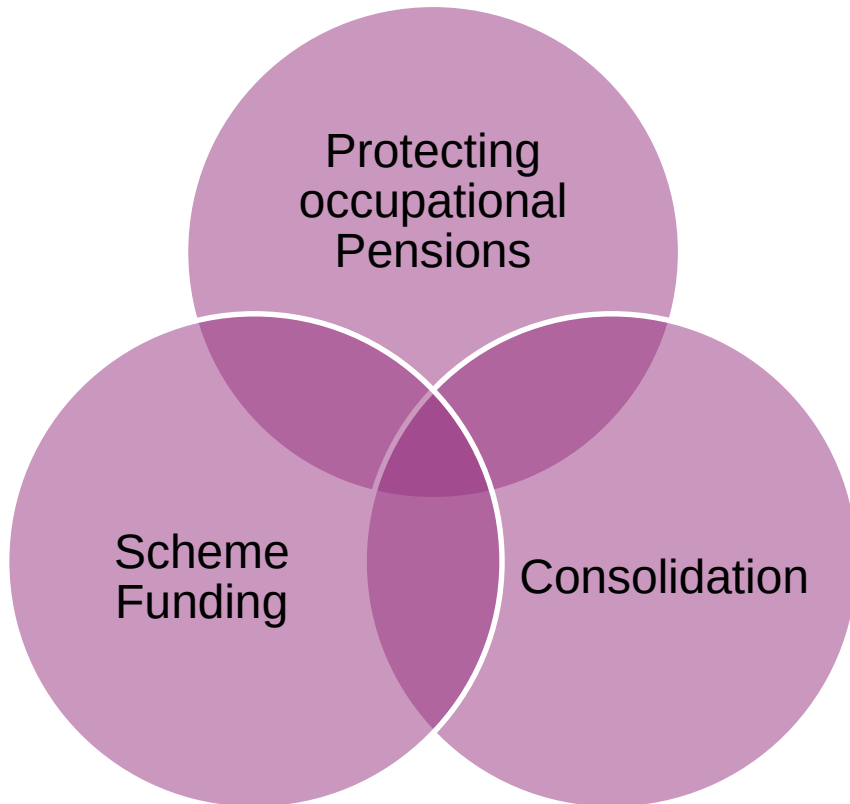
Any questions?

- Risk management
- Fair treatment
- Affordability and managing deficits
- Discount rates
- Transfer activity
- Scheme maturity
- Brexit uncertainty
- Knowledge and understanding
- Late valuations
- Proactive approach to scheme engagement to include smaller schemes
- Our risk assessment and case interventions



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DB White Paper on the sustainability of schemes



TPR to be provided with the
'right powers to do its job'

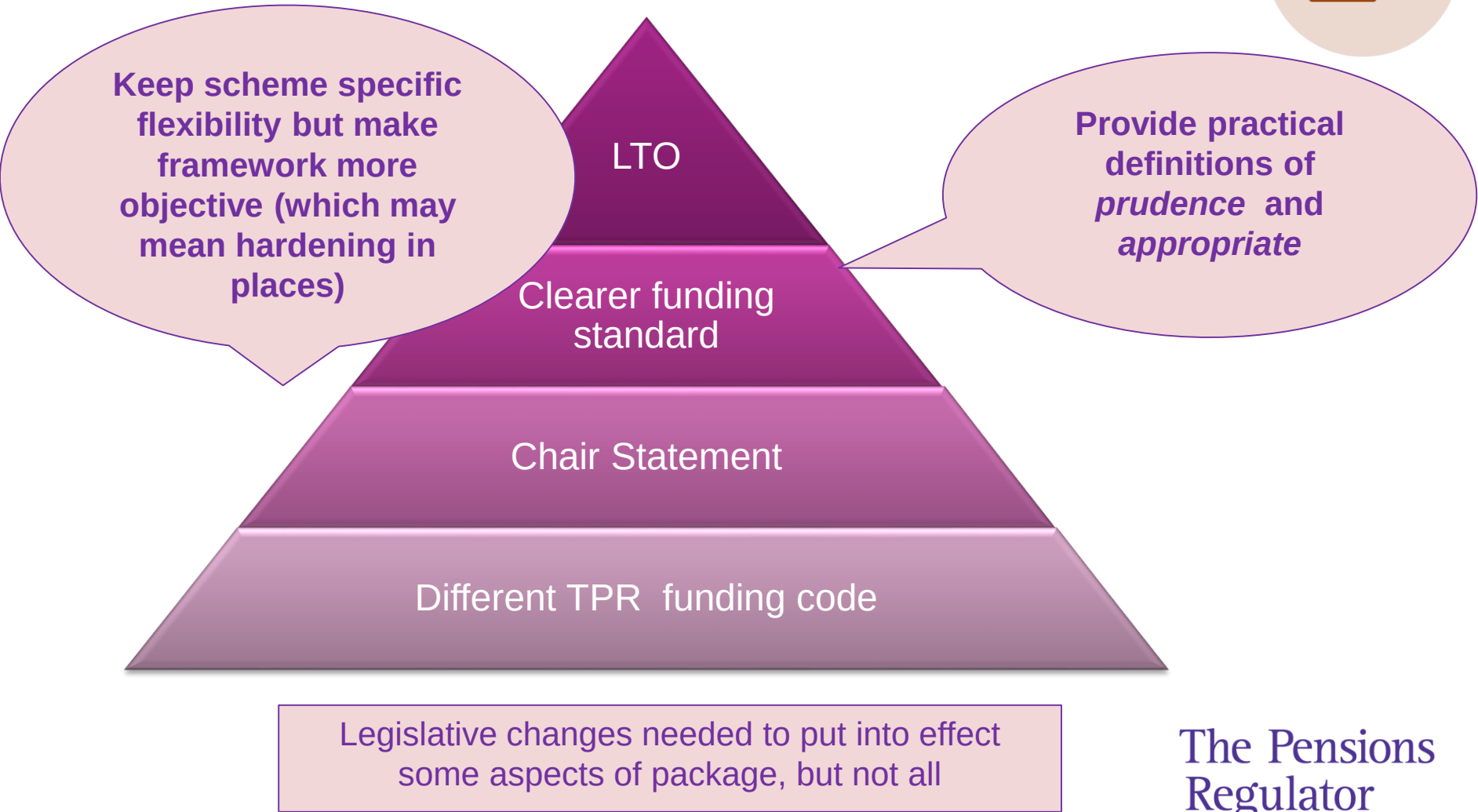
- New powers to gather information and punish wrong doing
- Revised funding code with new emphasis
- Authorisation and accreditation regimes for consolidation approaches

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Scheme funding: The key issues

- Trustee decision-making and risk management does not always reflect good practice and the principles set out in TPR's funding code
- Perception of short term focus instead of strategic thinking about long-term desired outcomes
- Concern about lack of accountability and transparency
- Lack of clear definition makes proving non-compliance and enforcement difficult, time consuming and costly

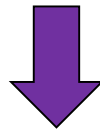
Scheme funding: Government's proposals



Intent of scheme funding proposals (1)

Trustees and sponsors to set their Statutory Funding Objective (SFO) in the context of and agreed long term objective (LTO)

- Current funding requirements (SFO, TPs, RPs) remain but will need to have the LTO embedded (TPR to give guidance in new Code).
 - Triennial valuations viewed as staging posts towards the LTO
 - LTO becomes a baseline against which scheme performance gets measured
- Therefore LTO needs to be specific, measurable and time-based.



- Formalisation of what many schemes already do?
- TPR looking to capture best practice.

Intent of scheme funding proposals (2)

Provide more clarity on DB funding standards to ensure better compliance and strengthen TPR's enforcement capability

- TPR's task is to work with industry and come up with practical definitions of:
 - what constitutes **prudent** TPs, and;
 - what makes an recovery plan **appropriate**

In context of a statutory funding objective which now captures the scheme's chosen LTO.



- How?
 - Some form of model driven probabilities?
 - A focus on acceptable outcomes linked to the LTO and things that can happen to de-rail them?
 - Something else? TPR looking for a range options and are open-minded.

Intent of scheme funding proposals (3)

DB Chair Statement, to be submitted with the scheme's triennial valuation.

- DWP has positioned it as a management tool first, for good reason:
 - Schemes may report to TPR every 3 years, but they are expected to be practising what they say they do all the time.
 - Telling TPR what they've done should follow as a by-product.
- We expect this to become a key component of 'do and show' by trustees. Key ingredients could be:
 - What's your chosen LTO and the rationale behind it?
 - What's your management plan for reaching it?
 - How robust is that plan?
 - How good are you at keeping to the plan?

Intent of scheme funding proposals (4)



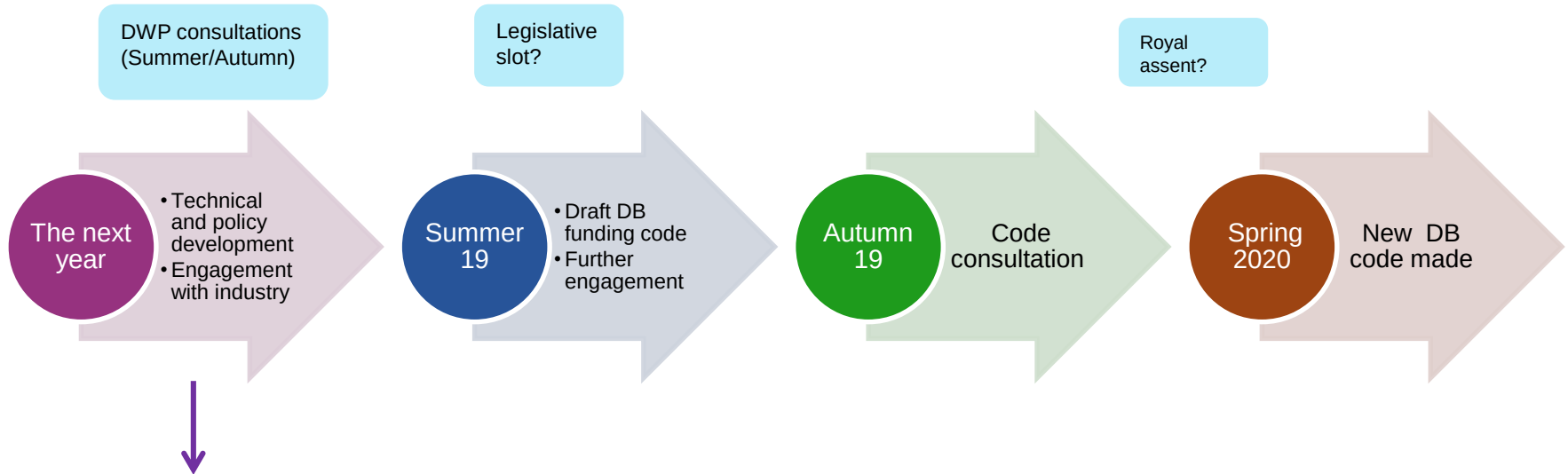
New funding Code with clearer funding standards and improved funding powers

New funding Code strengthened by legislation (at earliest opportunity) to **require** trustees and sponsors to comply with some or all of clearer funding standards.

S231 changed to ensure TPR can enforce non-compliance, including powers to make trustees and sponsors responsible for demonstrating compliance with funding standards or any statutory Code.

- Our expectation is to bring about some behavioural changes to improve and demonstrate quality of scheme management.
- Reporting requirements to be streamlined /amended for consistency with the new funding framework and powers.

Review of the DB funding framework



- Extensive engagement across industry
- Open policy making (DBchange@tpr.gov.uk)
- Keen to explore range of options
- Industry working group

Discussion

Keen to explore range of options

Your suggestions on how to make this package work?

You can send comments to

DBchange@tpr.gov.uk



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Appendix

More detailed supporting material on DB Annual Funding Statement

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Affordability and managing deficits



Trustees should take appropriate action depending upon the group they fall into as outlined in the table below.

Employer characteristics	Scheme characteristics	What we expect of trustees
Strong or tending to strong employers	• Scheme's funding position is on track to meet long term funding objective • Technical provisions are not weak • Recovery plans are not unduly long	• Consider strengthening technical provisions, increasing contributions or reducing recovery plan lengths • Where dividends/other forms of covenant leakage are disproportionate to DRCs, we expect a short recovery plan
Strong or tending to strong employers	• Combination of weak technical provisions and/or long recovery plans	• Strengthen technical provisions, increase DRCs and reduce recovery plan lengths • Consider strengthening short term security through other means such as contingent assets and guarantees
Weaker employer with limited affordability	• Scheme funding on track to meet long term target, technical provisions are not weak and contributions are reducing deficits at a slower but affordable pace	• Prioritise scheme liabilities over shareholder returns • Retain cash within the company to fund sustainable growth and address pensions deficit • Monitor sponsor covenant risk and limit member risk by securing proportionate reward for scheme from employer growth and/or maximising other forms of available support

Affordability and managing deficits continued



Trustees should take appropriate action depending upon the group they fall into as outlined in the table below.

Scheme employer type	Scheme characteristics	We expect trustees
Weaker employer with limited affordability	Combination of weak technical provisions and/or long recovery plans	- Prioritise scheme liabilities over shareholder returns - Maximise support for scheme by assessing (a) affordability and determining what cash, contingent assets and formal group support are available and (b) what plans and strategies put forward by the employer will sufficiently strengthen future covenant - Seek opportunities to reduce risk in order to protect employer and members
Weak employer, unable or unlikely to provide adequate support	Stressed schemes with limited or no ability to use flexibilities in the funding regime	- Seek best possible funding outcomes for members in the circumstances - Be prepared to show evidence of appropriate measures taken

Fair treatment



- We are concerned about the growing disparity between dividend growth and stable deficit reduction payments
- Recent corporate failures highlight the risk of long recovery plans while payments to shareholders are excessive relative to DRCs
- Pensions are deferred pay and pension deficits are corporate liabilities which need to be repaid
- We expect trustees to negotiate robustly with the employer to secure a fair deal for the pension scheme
- A strong covenant in itself is not a sufficient reason to accept a recovery plan with lower contributions than would otherwise be considered reasonable
- Where dividends are disproportionate relative to DRCs, we would consider affordability not to be an issue
- Trustees should be alert to other forms of covenant leakage when considering affordability and whether the scheme is being treated fairly

Risk management and contingency plans



- Trustees need to monitor risks and take action when required, irrespective of the scheme's funding position.
- Scheme size should not be a barrier to undertaking necessary work to understand the scale and nature of the risks.
- Trustees should prioritise risks and advisors have access to numerous tools to quantify this risk. Our quick guide to IRM is designed to help trustees with this.
- Effective risk management requires documented and workable contingency plans. Where possible, legally enforceable contingency plans represent the best protection for schemes.
- Where it is not possible, the trustees should at least agree the actions that would be taken if risks arose.
- If trustees are not satisfied that they could rely on a contingency plan which is not legally enforceable, they should consider a different overall strategy which leaves the scheme less exposed.

Discount rates

- Consider whether market conditions affect the longer term view of expected risk and returns, the choice of investment strategy and therefore the discount rates being used.
- Document the rationale for the chosen discount rate even if the method is not set to change.

Transfer activity

- Trustees considering whether to allow for transfer values in their valuation assumptions should consider their scheme's experience and likely future trends. If by making an allowance it reduces technical provisions, monitor experience and put contingency plan in place to make good any funding strains.
- Trustees should monitor transfer activity closely and take advice on liquidity management, consider the impact on investment strategy and suitability of their transfer value basis.
- Trustees should consider whether to reduce transfer values where there is underfunding. Smaller schemes should be alert to members with a large proportion of the liabilities where their transfer value can have a significant impact on funding.
- If trustees have concerns over the level of transfer value activity or the quality of the advice being given they should contact us or the FCA.

Scheme maturity

- We expect advisers to alert trustees to the risks to funding and investment from increasing scheme maturity.
- Trustees should understand the risks where a scheme is underfunded, volatility in the scheme assets and where the scheme is maturing rapidly. It is also worth understanding how an increase in transfer value activity can accelerate the scheme maturity.

Brexit uncertainty

- Whilst there remains uncertainty about how Brexit may affect schemes and sponsors, we expect open and collaborative discussions between trustees and sponsors to understand the potential impact for the scheme and the sponsor.
- Where it is considered reasonable for sponsors to hold back cash by extending recovery plans because of uncertainty due to Brexit, trustees should ensure that shareholders share the burden proportionately and trustees seek forms of other security.

Knowledge and understanding

- Where trustees perceive a lack of skills or conflicts, we expect them to seek appropriate advice.
- Trustees are entitled to expect their advisers to find proportionate and cost efficient ways of delivering advice and help.
- If advice is not clear, then trustees should challenge their advisers to deliver this in a way that allows trustees to understand the issues.

Late valuations

- We have discretion to impose a penalty where trustees fail to agree valuation within the applicable timescale.
- Trustees should take all reasonable steps to finalise the valuation.
- Where there is a genuine reason why the valuation cannot be finalised, we may choose not to impose a penalty.
- Trustees should not agree an inappropriate valuation merely because the deadline is imminent or has been missed.

Proactive approach for smaller schemes

- Extending our proactive approach to scheme engagement to include smaller schemes.
- We have approached a number of schemes and explained how we rate their covenant and set out the issues we want the trustees to address before their valuation is finalised.
- We have asked that when trustees submit their valuation they explain how they have addresses the issues we raised.

Our risk assessment and case interventions

- TPR is now clearer about what we expect, quicker to act and tougher on those who fail to act in the interests of members.
- We can intervene if a scheme is not being treated fairly using a selection of interventions from our regulatory toolkit, depending on the risk posed by the scheme.
- We judge the suitability of a scheme's technical provisions and recovery plan by quantifying the overall risks in the funding and investment strategies and the manner in which trustees are seeking to manage them.
- We can use our powers to direct how a scheme's technical provisions should be calculated and how (including over what period) its deficit should be funded (our powers under section 231 of the Pensions Act 2004).
- The approaches we use can vary from one-to-one supervision through to use of an improvement notice or a full anti-avoidance investigation.
- We have several investigations under way, all of which could lead to us exercising the power to help us achieve our objectives for a scheme.