

The Annual Funding Statement 2022

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AFS 2022 – Key themes

- Economic and market uncertainty
- Better funding positions
- Managing risk through effective IRM

Covenant: Impact of economic uncertainty

- Trustees will be approaching T17 valuations during a time of economic volatility (high inflation, high energy / fuel costs, rising interests rates and low growth).
- Businesses will also be grappling with the uncertainty caused by recent market events:
 - The Russian and Ukrainian conflict
 - Covid-19
 - Brexit
- Market volatility makes scenario planning, contingency planning and monitoring even more important.

Covenant: Guidance for 3 groups

Trustees should consider the impact of these events on covenant in 3 broad categories:

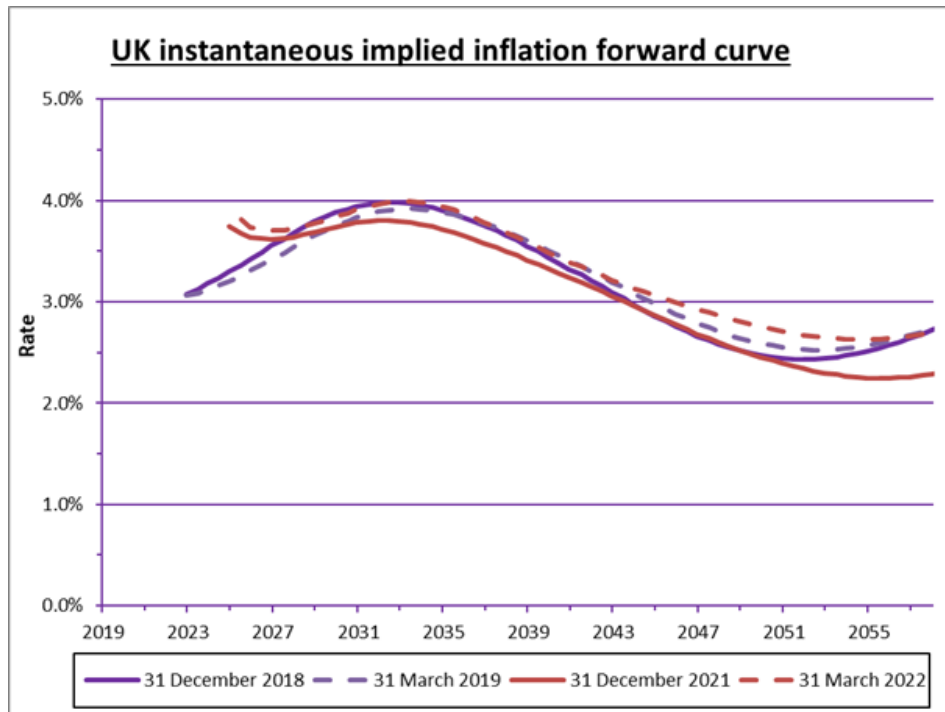
	Limited	Material but has/will recover strongly	Material with uncertain recovery
TPR expectations	• 'Business as Usual' • Don't expect DRC reductions /deferrals nor an extension of RPs • Shorter RP where possible	• May have short term constraints • Requests to reduce DRCs should be supported through higher DRCs later (to retain RP end date) • Restarting shareholder distributions not consistent with reducing DRCs	• Ongoing stress • If DRCs reduced, mitigations needed - i.e. - Cease dividends - Top-up DRCs (e.g. trading linked) - Fair treatment vs other creditors - Contingent assets
Contingent assets	Trustees should consider the impact of current market conditions on the value of the support		

Covenant: General messages

- Given the uptick in value 'leakage', we reiterate our fair treatment expectations (taken from AFS '19):
 - If distributions > DRCs - need strong funding targets and short RP (T14 – 5yr Av. RP length)
 - If weak employer and cannot support scheme, distributions should cease
- Valuations may be an opportunity to push for protections (e.g. dividend sharing; negative pledges)
- Corporate activity remains high – be alert and consider activity independently of concurrent valuations
- As schemes remain reliant on covenant up until they reach their LTFT (and beyond), it is important trustees understand the longer-term risks that could impact the employer

Inflation assumption – our expectations

- Modelling inflation in the short term?
- How does your inflation-hedging work in practice?
- Are assumptions consistent with inflation exposure?
- Do long-term interest rate and inflation changes affect your LTFT and end-game strategy?
- **Scheme specific**



Sources: BoE, Refinitiv
(financial markets data)

Your view on mortality

- Weighting for 2020 & 2021 experience in future improvements?
 - 0%
 - >0% up to 20%
 - >20% up to 50%
 - >50% up to 100%

Our view on mortality

- More evidence of a small adjustment for heavier mortality assumptions, but not conclusive.
- Why 2% on liability reduction?
 - Feedback from stakeholders
 - Insurance market
 - Prudent figure given true answers clearly not known yet

Table 6.9: Sensitivity to the 2020 and 2021 weight parameters, compared with the base case (males)

Age	25	35	45	55	65	75	85	95
$w_{2020}=w_{2021}=5\%$	-0.45%	-0.55%	-0.71%	-0.87%	-1.02%	-1.18%	-1.28%	-1.34%
$w_{2020}=w_{2021}=10\%$	-0.82%	-1.01%	-1.29%	-1.58%	-1.86%	-2.14%	-2.33%	-2.42%
$w_{2020}=w_{2021}=20\%$	-1.39%	-1.72%	-2.20%	-2.68%	-3.15%	-3.60%	-3.91%	-4.04%
$w_{2020}=w_{2021}=50\%$	-2.39%	-2.94%	-3.76%	-4.57%	-5.32%	-6.08%	-6.58%	-6.68%
$w_{2020}=w_{2021}=100\%$	-3.10%	-3.82%	-4.88%	-5.87%	-6.81%	-7.78%	-8.42%	-8.37%

Table 6.10: Sensitivity to the 2020 and 2021 weight parameters, compared with the base case (females)

Age	25	35	45	55	65	75	85	95
$w_{2020}=w_{2021}=5\%$	-0.27%	-0.34%	-0.43%	-0.52%	-0.65%	-0.78%	-0.92%	-0.99%
$w_{2020}=w_{2021}=10\%$	-0.50%	-0.62%	-0.78%	-0.96%	-1.18%	-1.42%	-1.67%	-1.78%
$w_{2020}=w_{2021}=20\%$	-0.85%	-1.05%	-1.33%	-1.63%	-2.01%	-2.41%	-2.82%	-2.99%
$w_{2020}=w_{2021}=50\%$	-1.47%	-1.82%	-2.29%	-2.79%	-3.42%	-4.11%	-4.80%	-4.98%
$w_{2020}=w_{2021}=100\%$	-1.90%	-2.36%	-2.97%	-3.61%	-4.42%	-5.31%	-6.22%	-6.27%

Source: CMI Working Paper 160: CMI Mortality Projections Model: CMI_2021 published March 2022

Managing Risks

- PSA 2021 requires schemes to have a (long-term) Funding & Investment Strategy. Trustees can take steps now to:
 - adopt a long-term funding target (LTFT)
 - set a journey plan (JP)
- For schemes in surplus vs TPs, trustees should:
 - focus on their LTFT
 - consider how their liquidity needs will change absent DRCs
- For all schemes:
 - Good IRM to identify and monitor key covenant, funding and investment risks against appropriate thresholds and set up suitable contingency plans.
 - Understanding the longer-term risks that could impact the employer.

Summary

- Covenant: impact of economic uncertainty, different actions across 3 broad groups, longer term covenant reliance is important
- Assumptions: consider inflation and mortality in current environment
- Managing risks: plan for longer term, particularly schemes in TP surplus, monitoring and contingency planning is good IRM

Covenant guidance changes

- PSA21 requires trustees to explain how they manage and support risk.
- Regulations will expand further on this.
- Covenant forms a key part of supportable risk - revised covenant guidance will expand on how to assess employer support and demonstrate risk is supported.
- There are no fundamental changes to how covenant is assessed.
- Covenant ratings will not be sufficient in isolation to demonstrate employer support.
- Clarity on expectations around the key elements of covenant: Cash, Contingent assets and Prospects (CCaP) – see next slide.

Timings

- Industry stakeholder discussions in Spring / Summer.
- Wider consultation at the same time as the DB code in late Summer / early Autumn.

Covenant guidance

Key objectives of the new guidance:

- reduce ambiguity around covenant support by use of general gradings
- assist trustees to express employer support in line with the 3 main elements of covenant – CCaP
- justify their conclusions about how much risk is supportable
- consolidate key regulatory covenant messages and guidance in one place

Main sections

- Cash support
- Contingent asset support
- Prospects including ESG
- Monitoring and taking action

Key changes

- Clear view on support provided by different guarantee structures
- Guidance structure will change
- More examples will be provided

Other guidance / key messages incorporated

- ABC guidance
- Distressed employer guidance
- Key principles from covid guidance
- Equitability & covenant leakage