TPR 2017 Annual Funding Statement and implications

ACA Sessional Meeting

29 June 2017

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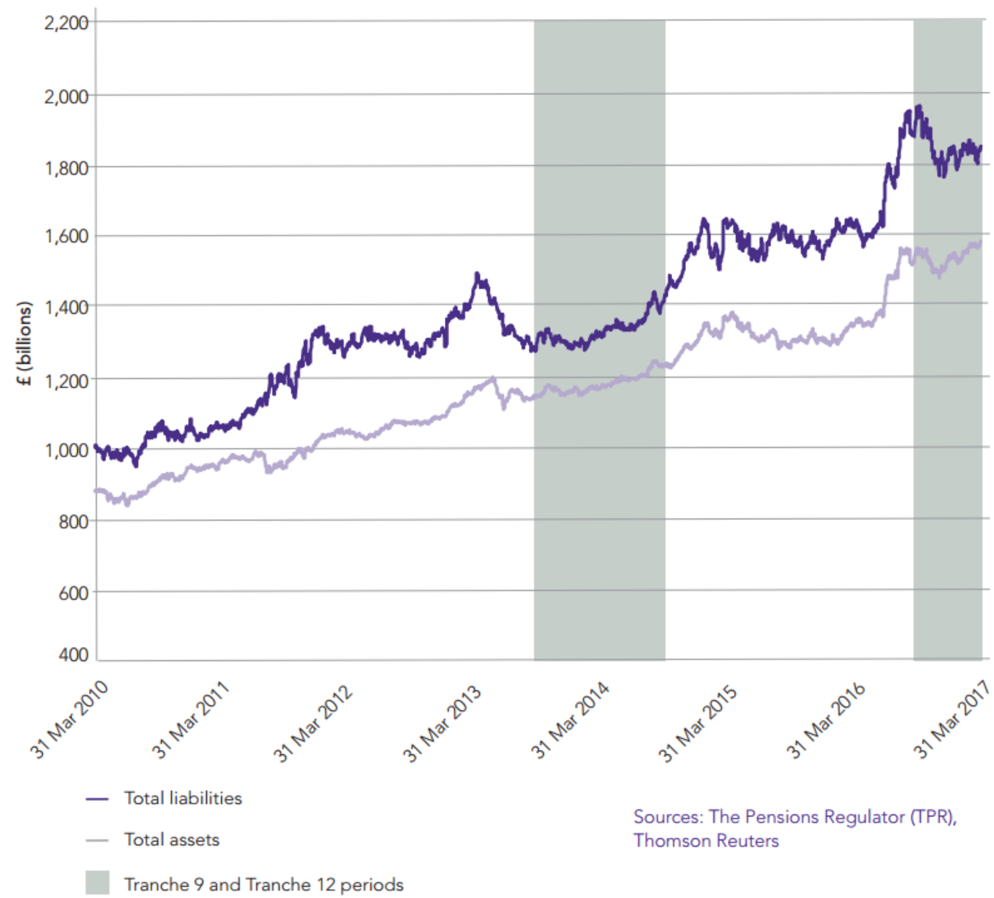
Clearer, tougher, quicker

- Affordable increased deficits
- IRM and contingency plans
- Discount rate methodologies
- Shareholder dividends
- Stressed schemes
- More tPR powers?

Tranche 12 – funding positions

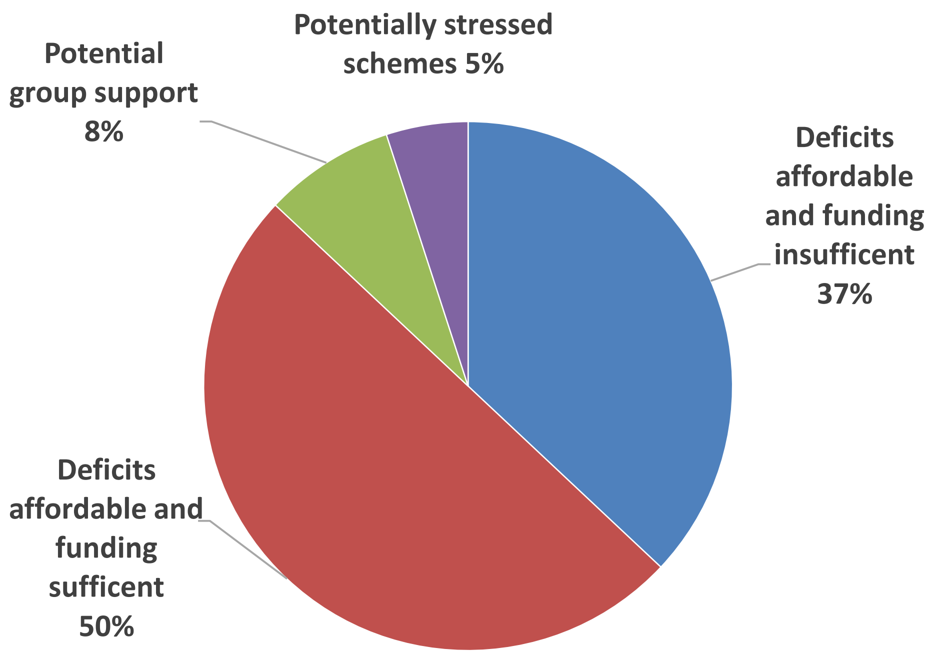
- Most Tranche 12 valuations likely to see increased deficits
- Aggregate deficit expected to be over 2x deficit three years ago
- Differences between those schemes that hedged and those that didn't



Source: Pensions Regulator – Tranche 12 analysis

Tranche 12 – affordability

- Affordability has improved for the majority of companies
- **37%** of Tranche 12 schemes deficits affordable and funding not sufficient



- How do you tell if part of the 37%?
- Asymmetry of outcomes
  - One way ratchet on funding
- Formalising group support
  - Comparison with banks / debt?
  - Brexit risks?
  - 8% taking too much investment risk
- Greater tPR intervention / proactivity

IRM and contingency plans

Increased focus on contingency planning with enforceable actions

Practical implications:

- How far do trustees go in scenario analysis – particularly for covenant risks?
- Constraints on sponsor, directors duties etc
  - Commercial need to maintain flexibility and balance with needs of other stakeholders
- Pushing for onerous contingent commitments can reduce *willingness* to fund earlier
- Can be resource and time intensive for questionable value

Discount rate methodologies

Legislation that:

"…the rates of interest used to discount future payments of benefits must be chosen prudently, taking into account either or both –

i. The yield on assets held by the scheme to fund future benefits and the anticipated future investment returns, and

ii. The market redemption yields on government or other high-quality bonds…"

Revisiting the options:

- Gilts Plus
- Inflation Plus
- Asset based
- Credit based

Combined with investment strategy review

Flatter risk profiles

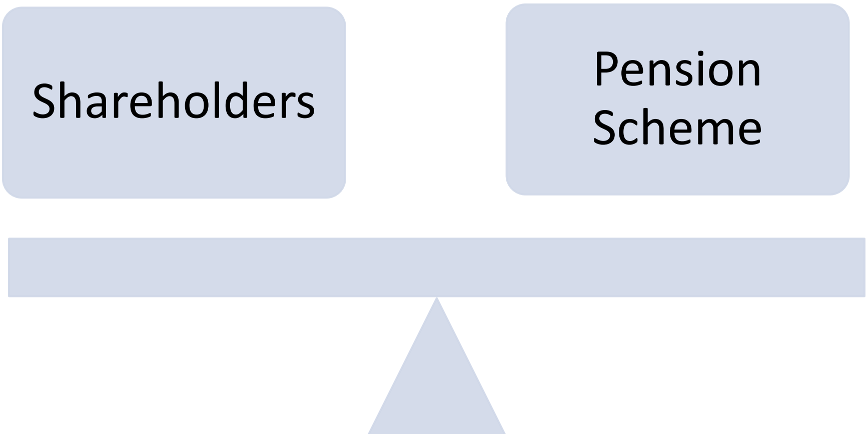
CDI as well as LDI

Journey planning

Balancing interests

DWP 2017 Green Paper: *“The UK DB funding regime is not designed to eliminate all risk to members’ benefits.*

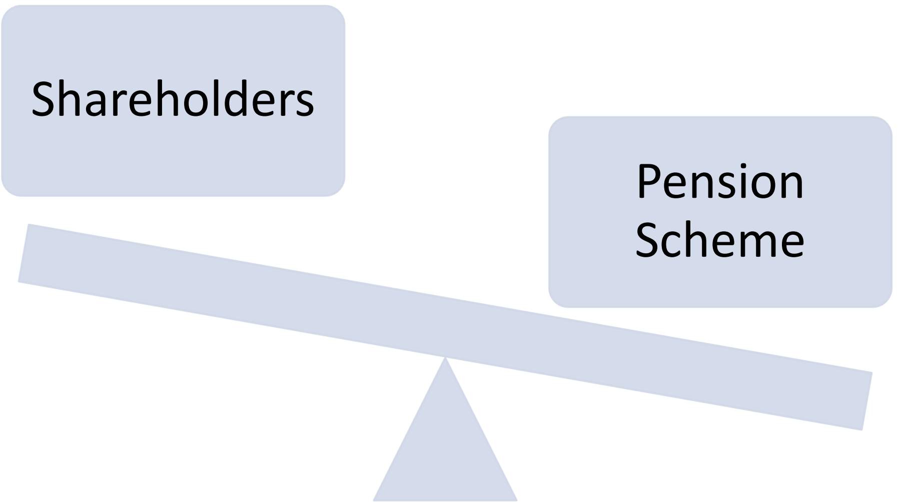
Rather it seeks to strike a reasonable balance between the demands on the employer and the security of member benefits, recognising that a strong, sustainable sponsoring employer is the best protection for a DB scheme.”



Balancing interests

tPR 2017 AFS: *“We expect where an employer’s total distribution to shareholders is higher than deficit reduction contributions being paid to the pension scheme to have a relatively short recovery plan and …*

…. is underpinned by an appropriate investment strategy that does not rely excessively on investment outperformance.”



Implications

- **What does “relatively short” mean?**

- **Move from “appropriate” recovery plans back to affordability driven?**

- **How does this work where:**
  - Wider support, contingent assets etc in place?
  - Large lump sum contributions previously paid?
  - Relatively high levels of TPs prudence?

Stressed schemes

- **Need to fully evidence taken appropriate measures (as far as possible)**
- **Provides a helpful list of considerations but not exhaustive**
- **Supporting DWP on Green Paper ….. watch this space!?!**

Implications:

- How do you know if you are in the 5% of 'stressed' schemes?
- Balance of interests re investment risk?
- How far do you go in considering extreme options?

Tougher tPR

And looking forward – tPR seeking greater powers.

Green Paper - two options

1. Either set out in legislation (but risk of MFR2)
2. Or tPR provides explicit standards with comply or explain regime (similar issues to 1. but more flex)

tPR prefers option 2!

Audience participation

Q: Do you think the Regulator should set explicit standards for funding with a comply or explain regime?

Questions