A review of TPR’s 2017 Annual Statement and its implications

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ACA Meeting, London

29 June 2017

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Context

- TPR's approach this year driven by

  – Financial context (markets, increased deficits) ..... What do deficits look like? Why?
  – Business context (profitability, dividends, Brexit etc) ..... Are deficits manageable?
  – Political context (BHS, etc) .... setting expectations for the future

- Against background of wider DWP consultation and potential for some legislative change

- But T12 valuations will happen and be regulated under existing legislation.

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TPR's general message to trustees

On funding related matters

- We will continue to focus on trustees' quality of decision making and contingency planning within and IRM framework
- Emphasise that IRM is not a stand-alone compliance requirement. It is a way of thinking which is central to effective risk management.
- We are adopting a different style and tone
  - More directive messages, making our expectations clearer
  - Targeted at specific segments
  - In case management, less of 'hints and tips' and more of what we don't like and why

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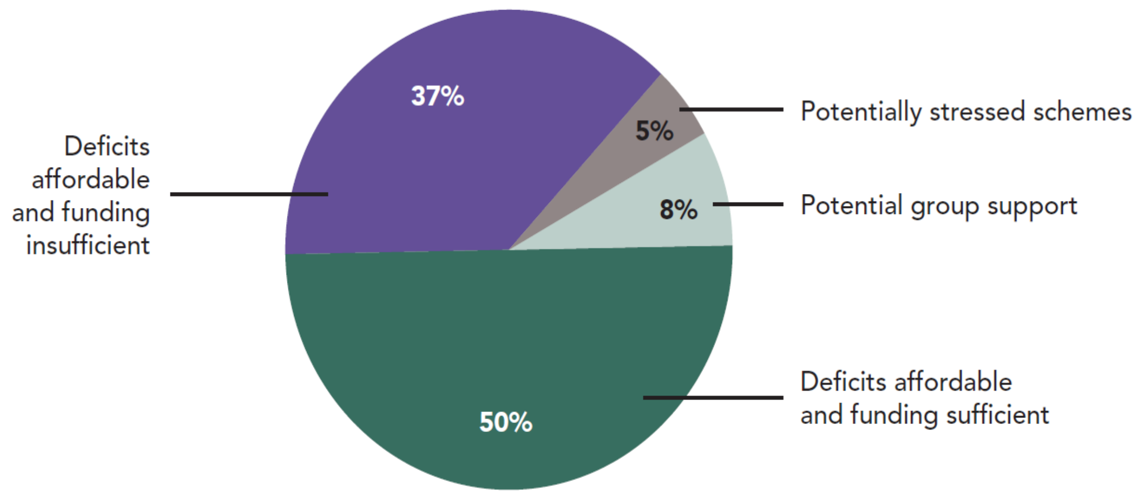
Our assessment - affordability and managing deficits

Figure 11: Segmentation of Tranche 12 schemes by affordability assessment



Majority of schemes undertaking 2017 valuations

- have employers with the ability to manage their deficits
- and currently have no long term sustainability issues
- But there is also a minority of schemes with potential affordability issues

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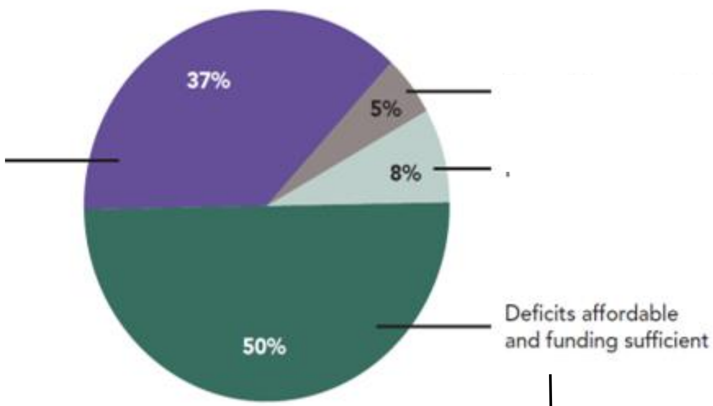
Managing deficits - what we expect (1)

Figure 11: Segmentation of Tranche 12 schemes by affordability assessment



- Strong covenant
- On track to meet long term funding objective
- TPs not weak and RPs not unduly long

- Continue current pace of funding
- Don't extend RP end dates unless without good reason.

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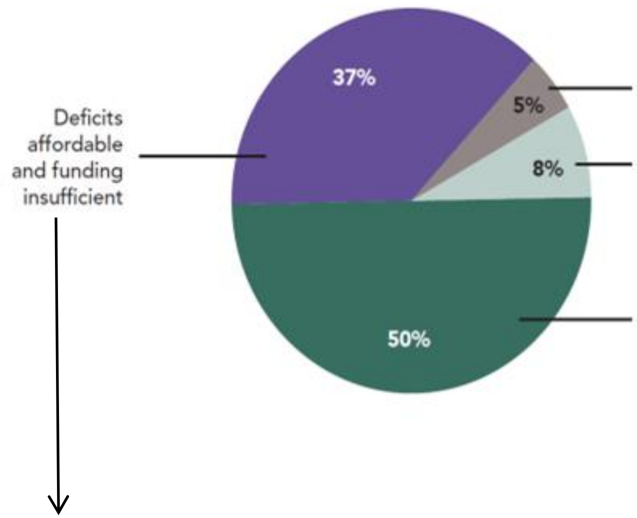
Managing deficits - what we expect (2)

Figure 11: Segmentation of Tranche 12 schemes by affordability assessment



- Strong covenant
- But weak TPs and long RPs

Risks

- employer covenant weakening and
- other scheme risks materializing

Seek higher contributions now.

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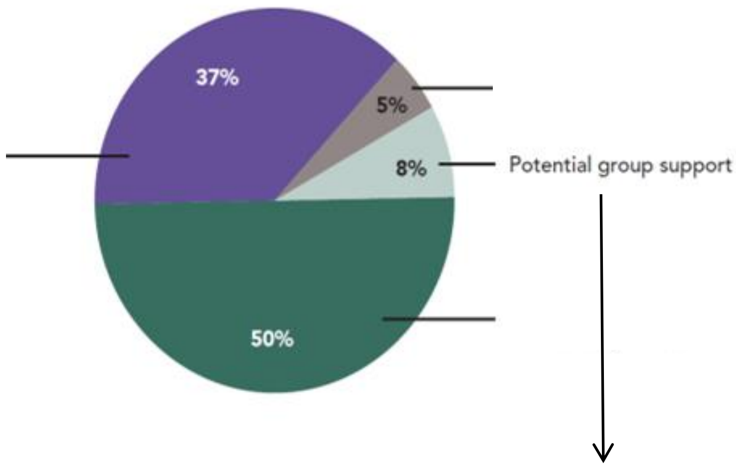
Managing deficits - what we expect (3)

Figure 11: Segmentation of Tranche 12 schemes by affordability assessment



- Weaker employers
- who assume that they have a strong covenant because they are part of a stronger and larger group of companies
- but have no formal support in place.

- Seek legally enforceable support or
- Secure additional funding or
- Reduce risk to an appropriate level

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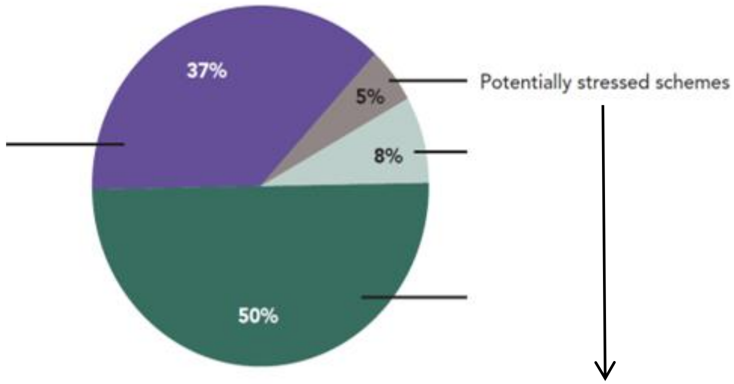
Managing deficits – what we expect (4)

Figure 11: Segmentation of Tranche 12 schemes by affordability assessment



- Employers at risk of becoming unable to adequately support the scheme
- Or, already there.

- Do your best with a focus on members' interest, while we work with DWP to explore options.
- But, trustees need to show evidence that they have taken appropriate measures to reduce and control risk.

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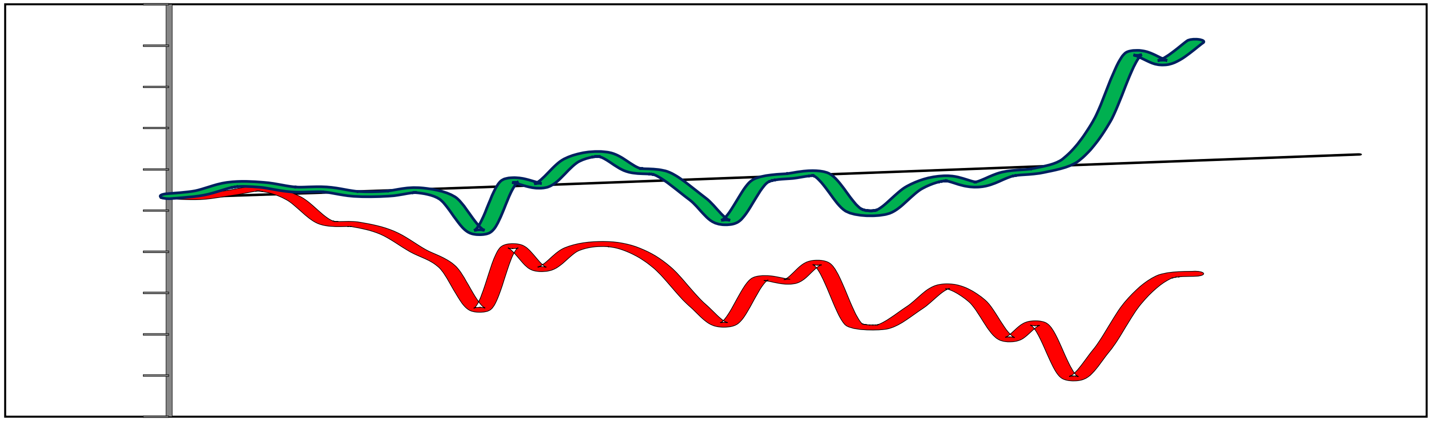
Risk management



Managed risk well and scheme now on target, or ahead.

- Keep it that way

Significant risk crystallised against scheme, leaving it below target

- implement the contingency plan!
- re-assess the scheme's risk strategy within IRM

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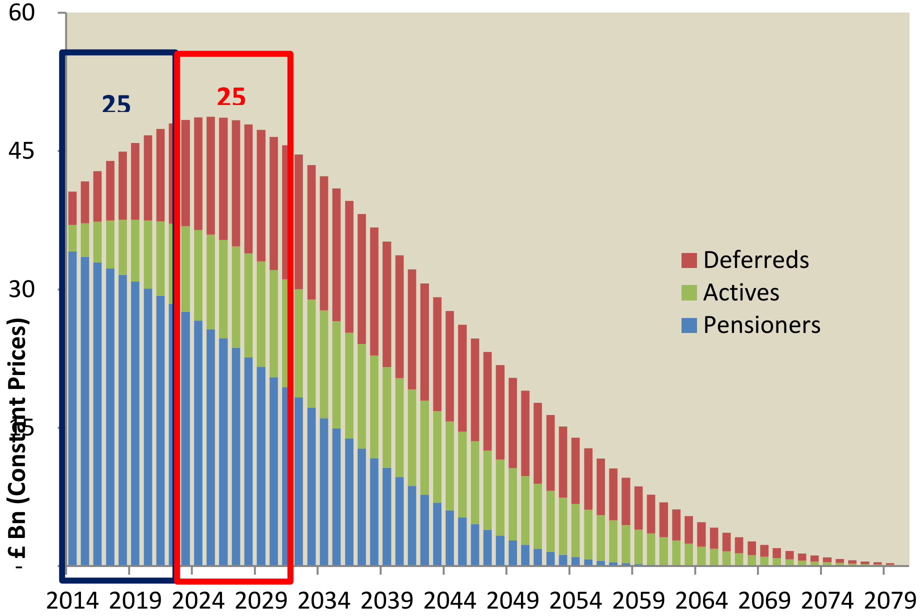
Scheme maturity



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TPR estimates for illustration only, based on data reported by UK pension schemes. Assumes all schemes closed to future accruals and all members commute 20% pension at retirement. Includes numerous other assumptions to unpack underlying

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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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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Others

Fair treatment

- Dividend payouts disproportionate to DRCs for many FTSE companies
- Where shareholder reward is relatively higher than DRCs, we expect short recovery plans underpinned by an investment strategy not relying excessively on investment outperformance

Covenant visibility

- Lack of visibility beyond the immediate short term often an excuse to ignore covenant in funding and risk management plans
- We expect trustees to consider the associated risks and focus on employer's ability to support these or contribute cash while there remains good visibility of covenant

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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What can you expect from us

Clearer, tougher, quicker

- Fair treatment between schemes and shareholders
- Late submissions
- RPNAs (recovery plans not agreed)
- More interventions more quickly in Db underfunding and avoidance
- More proactive cases

Any questions?

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