

DB code and strategy consultation

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ACA evening meeting
9 January 2014

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Agenda

- Purpose and structure of consultation
- How TPR will measure funding risk
- Linking reasonable affordability to the new objective
- Funding priorities by covenant grade
- Wider DB strategy
- Wrap up and seek feedback

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Key aims of the review of the code and strategy

- Reflect all our statutory objectives, including the proposed new objective;
- Promote balance within the funding context in the light of the needs of schemes and their employers;
- Reflect our ongoing experience of regulating schemes, understanding of risks and evolving best practice;
- Ensure it remains fit-for-purpose for challenges facing schemes over the coming years;
- Guide our interventions in the most efficient and appropriate manner;
- Be transparent about our actions and the reasons for them and so that the regulated community is clear about our expectations.

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Package for consultation

Statutory framework

The Pensions Regulator strategy and principles

Statutory framework
Organisational standards
Organisational priorities

Regulatory
approach

Corporate plan

Strategy

DB strategy

What we are setting out to achieve,
how we intend to do it

DB regulatory
strategy

Codes of practice

Set out practical guidelines on the
requirement of pension legislation

Code of practice
on scheme funding

Principles
for how
we
regulate
DB

New
Code for
scheme
funding

Policy

DB policy, statements and guidance*

What we will do/what schemes should do in a particular set of circumstances

DB
funding policy

Annual funding
statements

DB guidance
eg: Clearance, Identifying
your statutory employer,
Asset-backed contributions

Focus on
regulating
scheme
funding

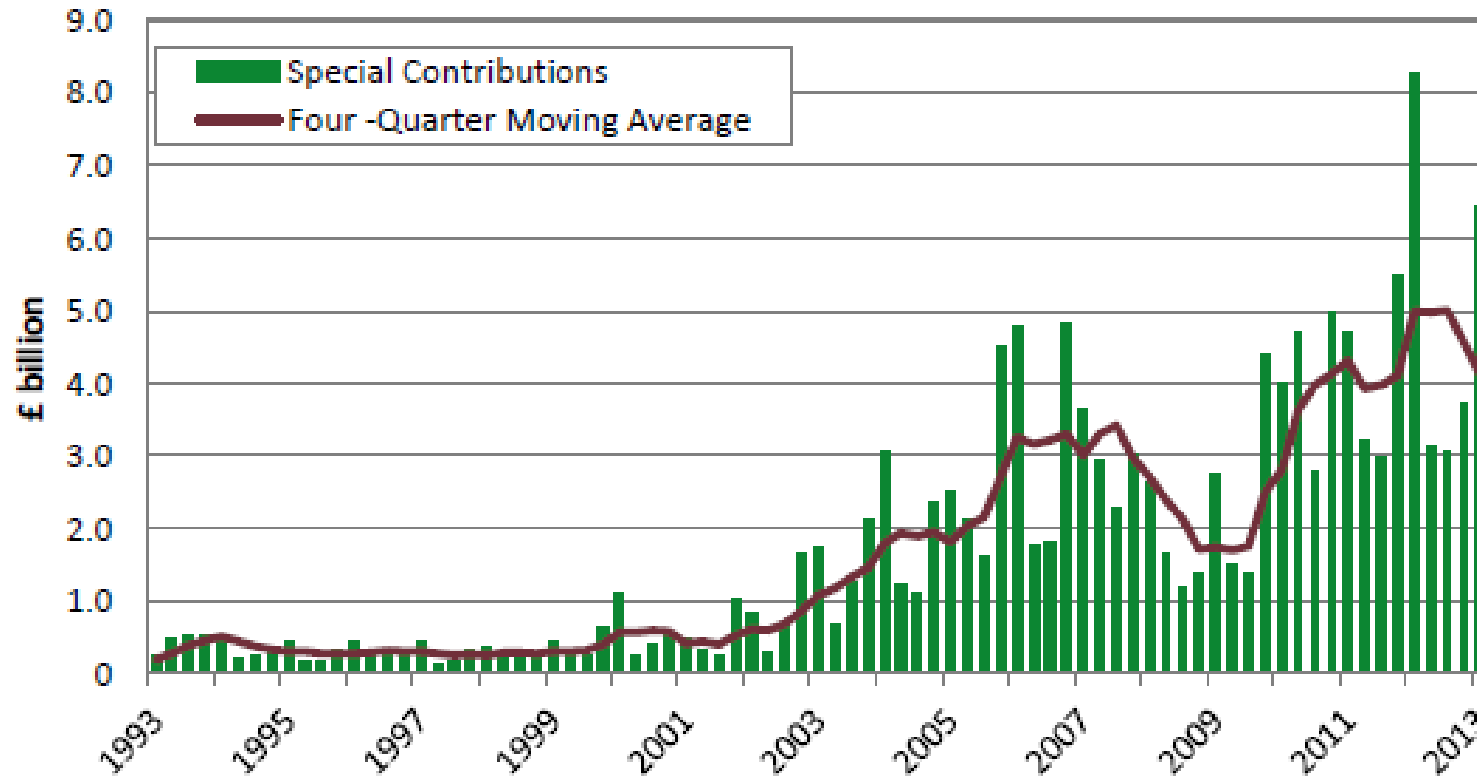


These documents are currently being consulted on



These documents taken together set out how we will regulate DB funding issues

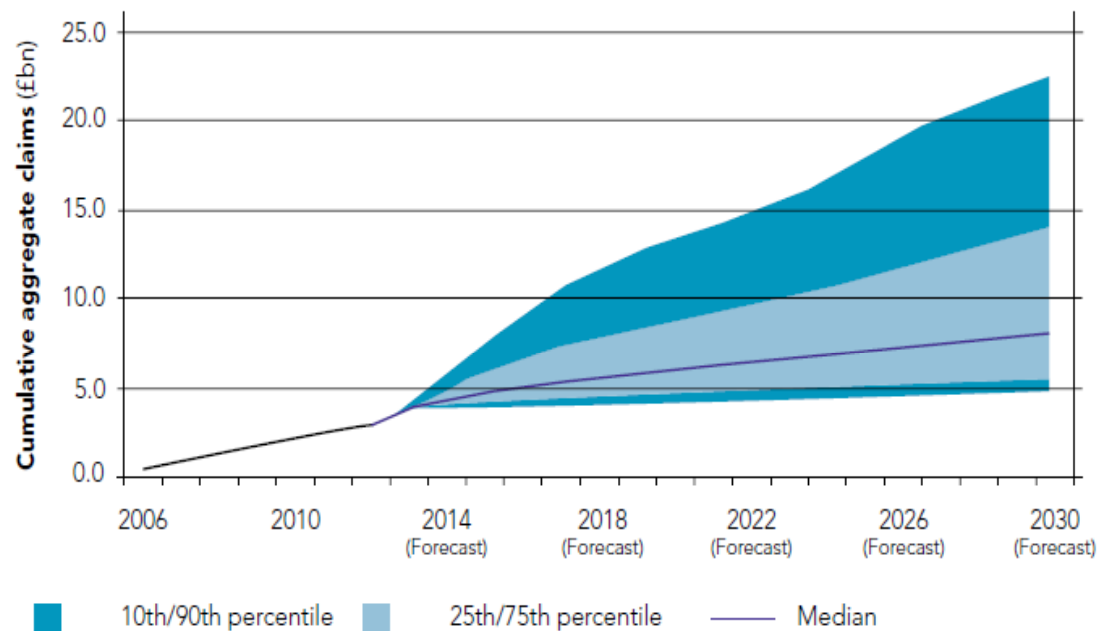
Trends in deficit contributions



Source: MQ5, 'Investment by Insurance Companies, Pension Funds and Trusts', ONS

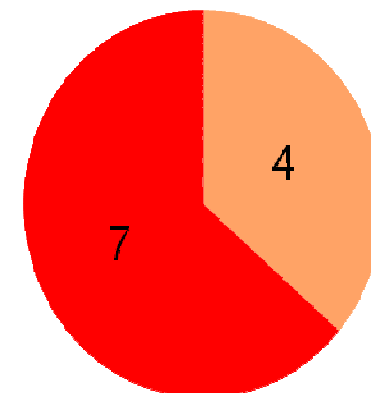
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Risk to members/PPF



Source: Pension Protection Fund data

DB benefit losses from employer default £bn 2005-13

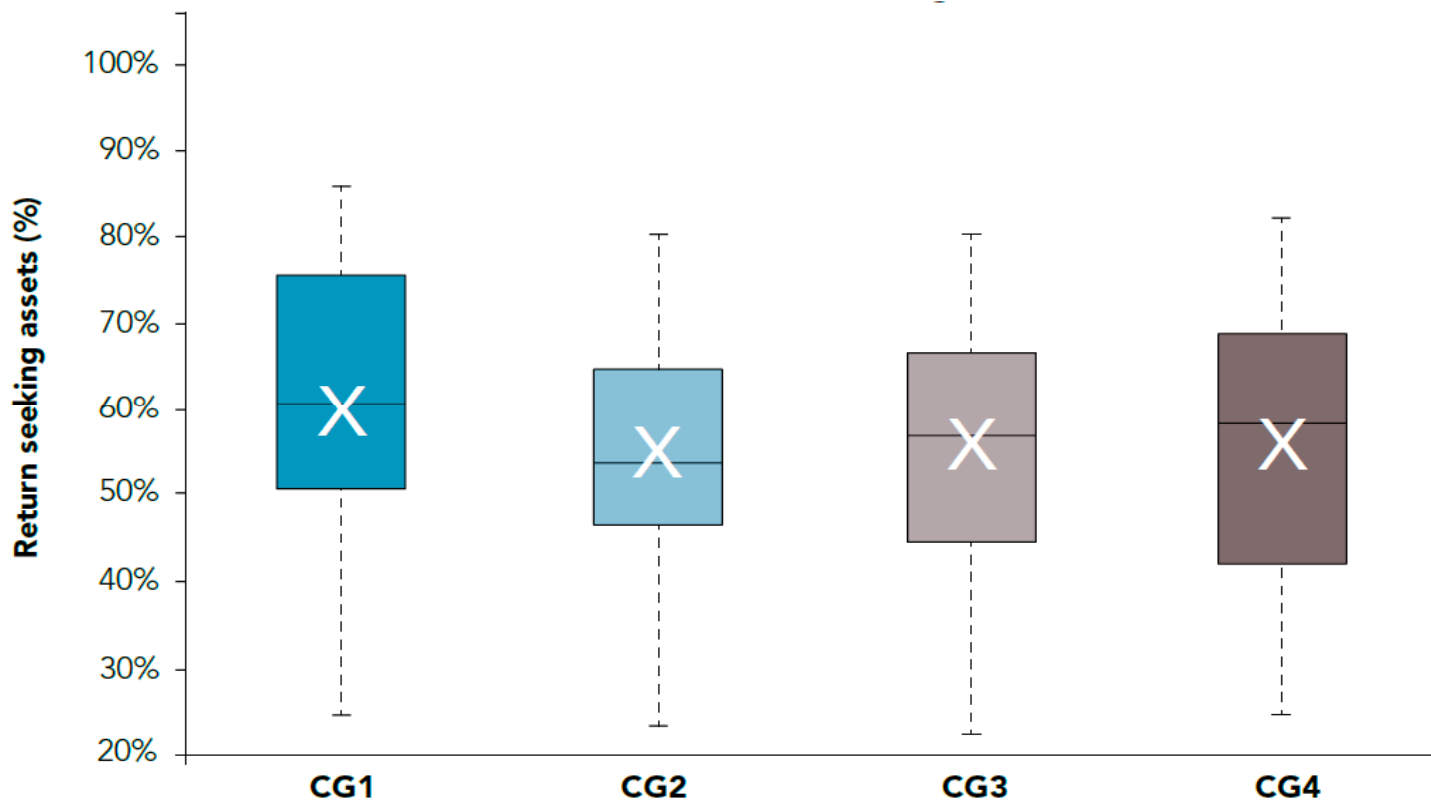


PPF compensated
Member losses

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Scheme risk

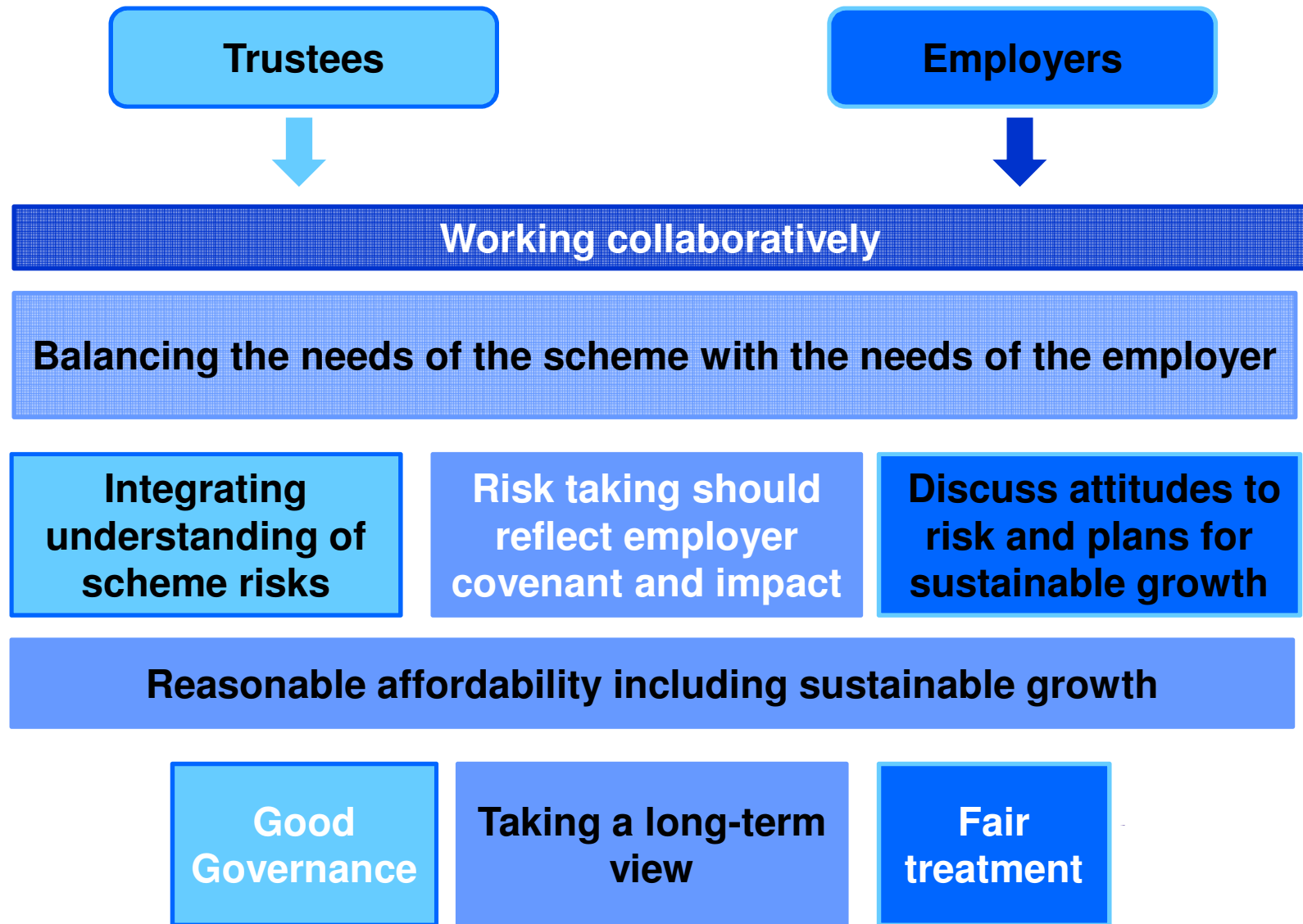
Chart 3.2 – Investment risk by covenant group



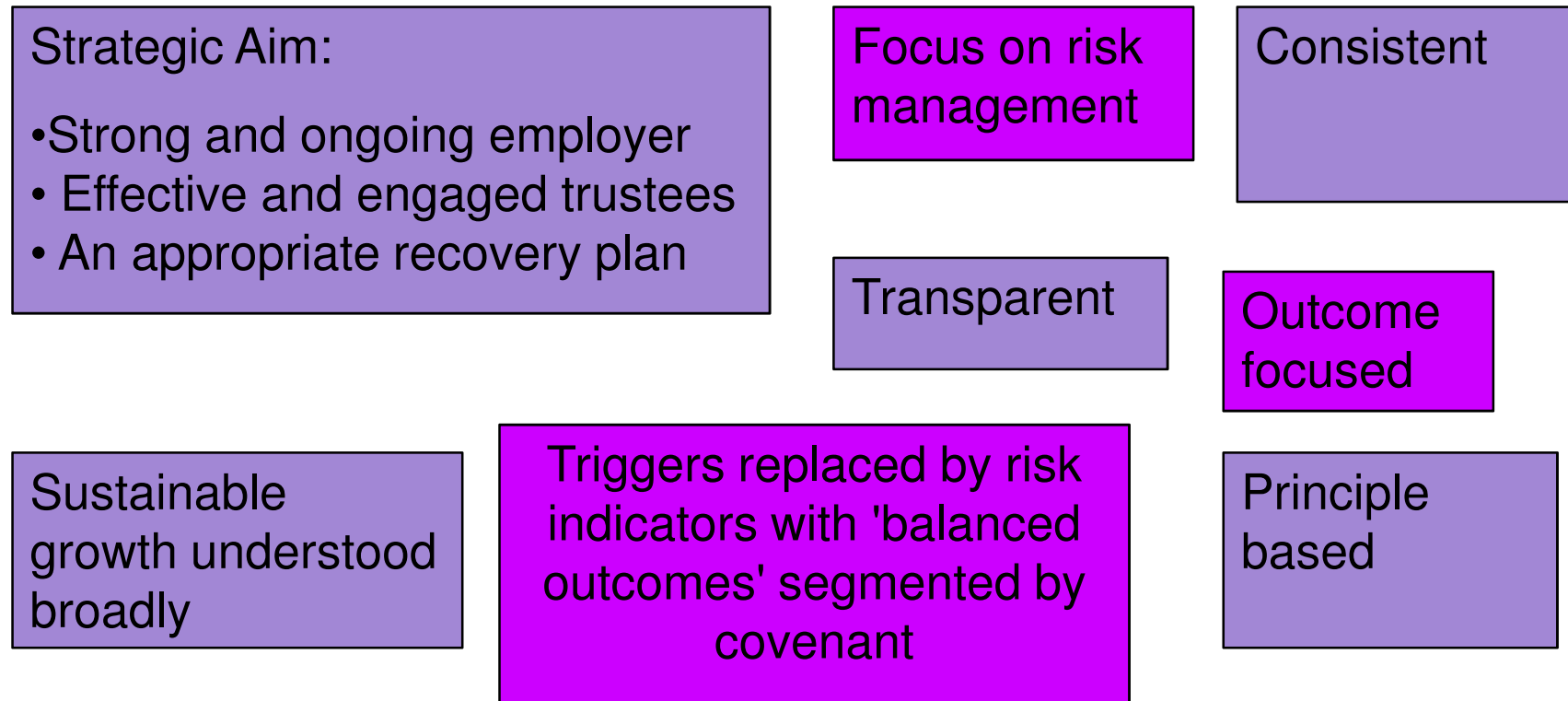
Source: The Pensions Regulator's data

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The new code – 9 principles



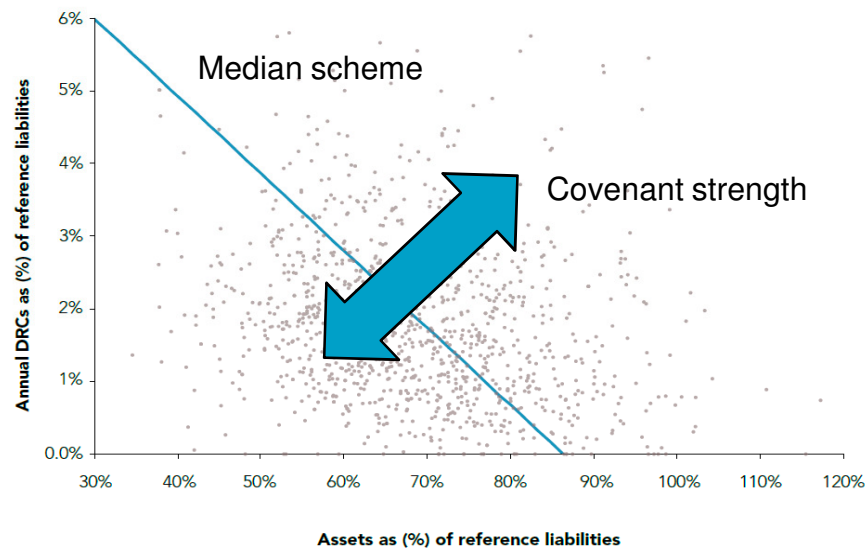
TPR's approach to regulating DB schemes



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TPR's tool for assessing risk

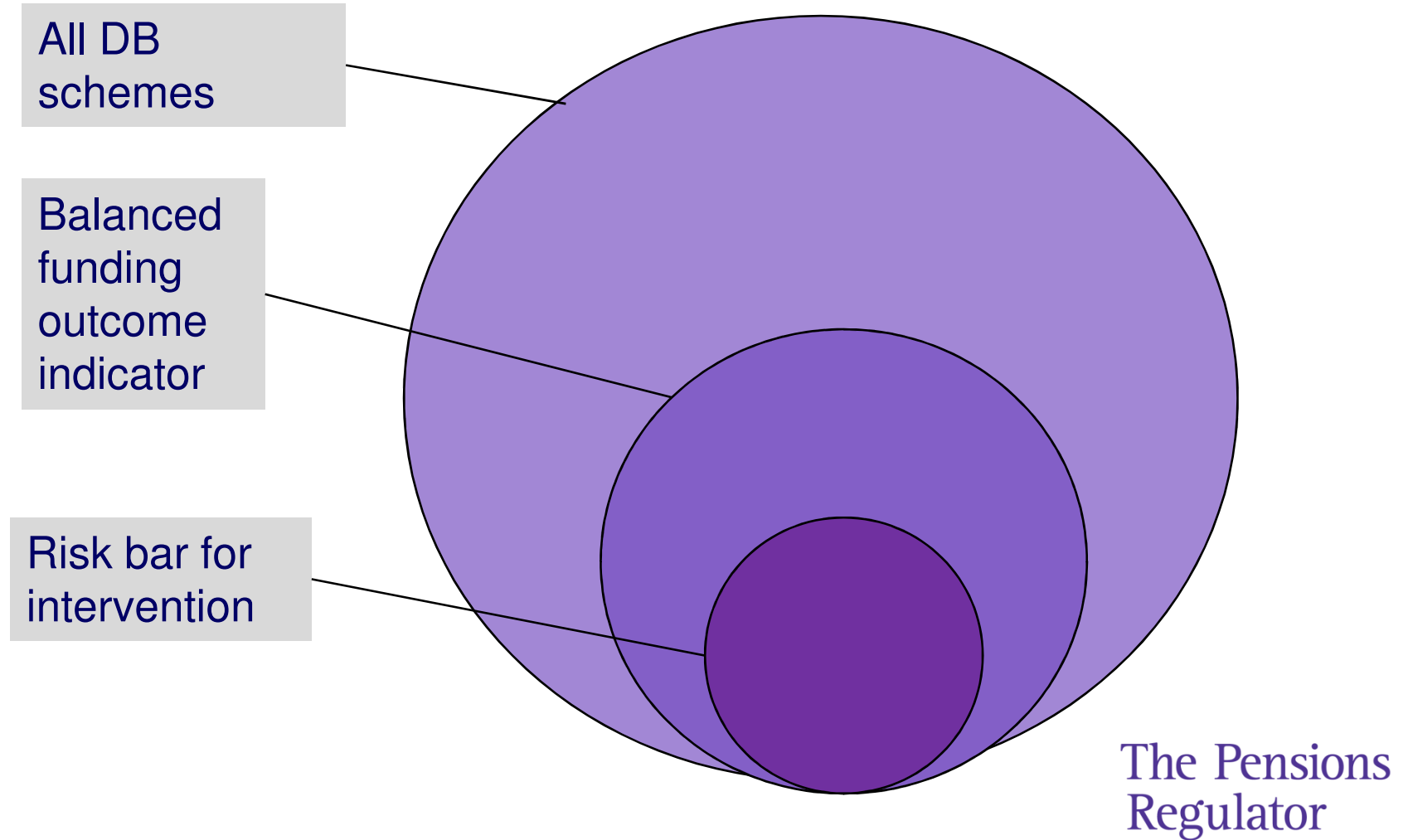
Balanced funding outcome indicator



- T8 universe estimates
- Reference liabilities based on gilts+50bps real discount rate

- Independent of SFO assumptions and investment strategy
- Adjusted for covenant – this is the key segment distinction
- Measures risk capacity not risk taking
- Indicators set annually
- Identifies where risk levels likely to be of concern
- Focused on DRC outcome not intermediate assumptions
- Does not take into account constraints on affordability
- Affordability can often justify below-BFO outcome

TPR's risk bars



The BFO is not the new MFR

MFR	BFO
Set schemes a minimum funding target	Risk assessment tool and gives TPR view of a balanced outcome
Hard and inflexible formula	Flexible application of principles in Funding Code for the correct balance between key risks.
One size for all schemes	Scheme specific
Single numerical answer	More than one acceptable outcome, driven by application of principles to scheme specific circumstances
No over-ride for scheme specific circumstances	Scheme specific context is main driver; TPR initial assessment simply puts us in the right ball-park for more detailed engagement based on trustees' frame of reference
Comply or else	Decide what is right for your circumstances and explain if needed
Inflexible during unusual and rapidly changing market conditions	Annual industry engagement on parameters
Costly professional calculations and certification (plus need for detailed rules)	TPR tool based on application of the same principles as trustees – no need for schemes to second-guess if they adopt right behaviours
Externally decided technical detail – investment strategy, funding assumptions and recovery period	Scheme specific technical detail, subject to proper application of principles in Funding Code

Evolution of covenant advice

- Understanding of covenant is key to integrated approach to risk management.
- Covenant advice enables the trustees to assess reasonable affordability and decide how much risk it may be appropriate to take.
- Focus on ability to afford resulting cash contribution requirements over the long term in planned and adverse scenarios
- Assuming covenant reliance retained, trustees should have realisable contingency plans in place identifying actions to be taken and when.
- It is important to remember that an agreement to discuss an issue further with the employer in given circumstances whilst potentially useful does not, of itself, constitute mitigation. It does not, alone, improve the position of the scheme.
- Focus on sustainability of the employer is key.

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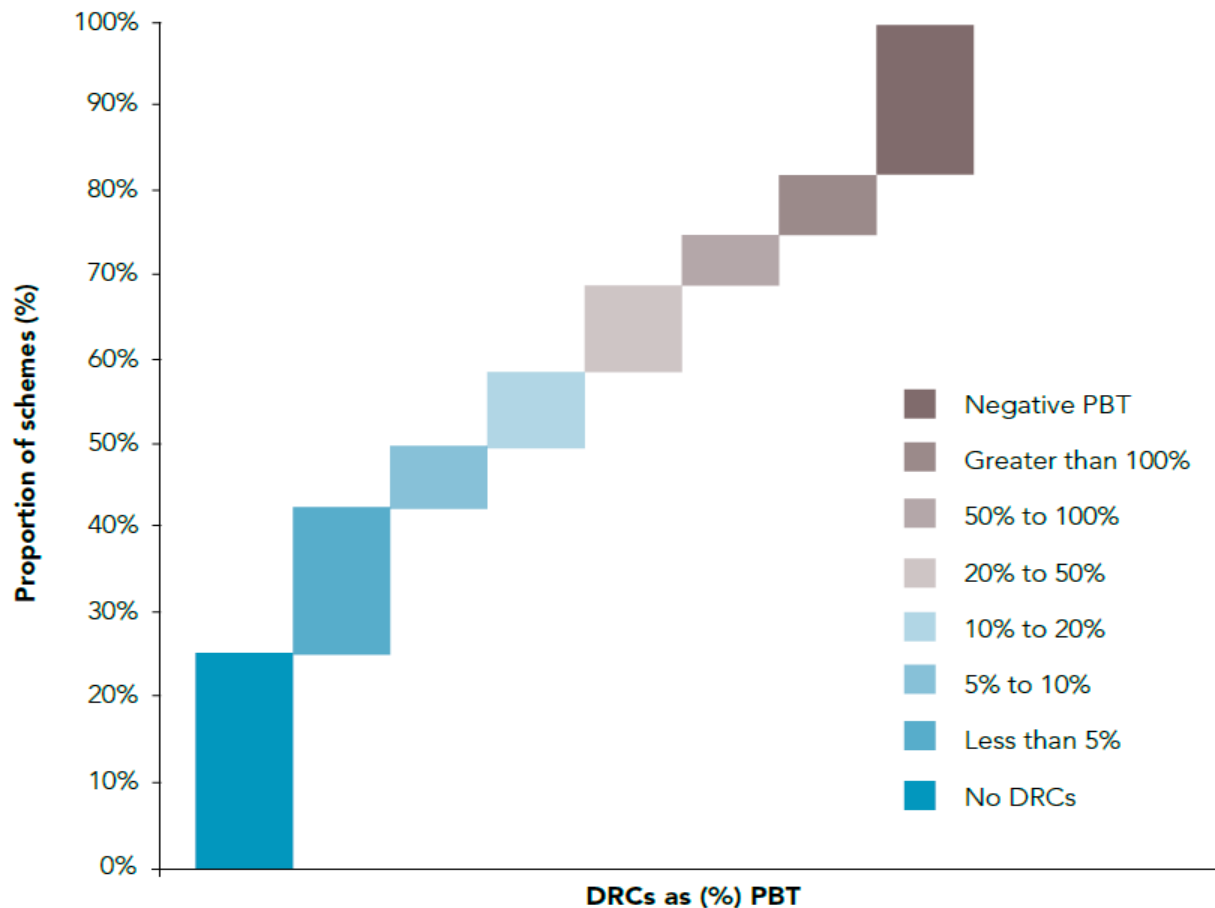
“A new objective as part of a balanced approach”

- Makes it explicit that we will: “***consider the impact on employers’ sustainable growth plans***” alongside members
- Investment in sustainable growth is key to the ability of the employer to support the scheme and we are encouraging trustees to take account of this in our funding Code
- Where an employer has insufficient cash generation and proposes to prioritise business investment against DRCs, trustees should:
 - Understand whether this is necessary and how this strengthens the covenant
 - Ensure shareholders share funding burden (e.g. by restricting dividends)
 - Share in any underspend against planned investment
 - Reflect anticipated growth from investment in future DRC schedule
 - Consider the effect on the scheme funding risks.
 - Seek security through other forms (e.g. contingent assets)
- The key (to sustainable growth) is to understand the context of an employer’s circumstances, including its investment aims and what will constitute success for its business.

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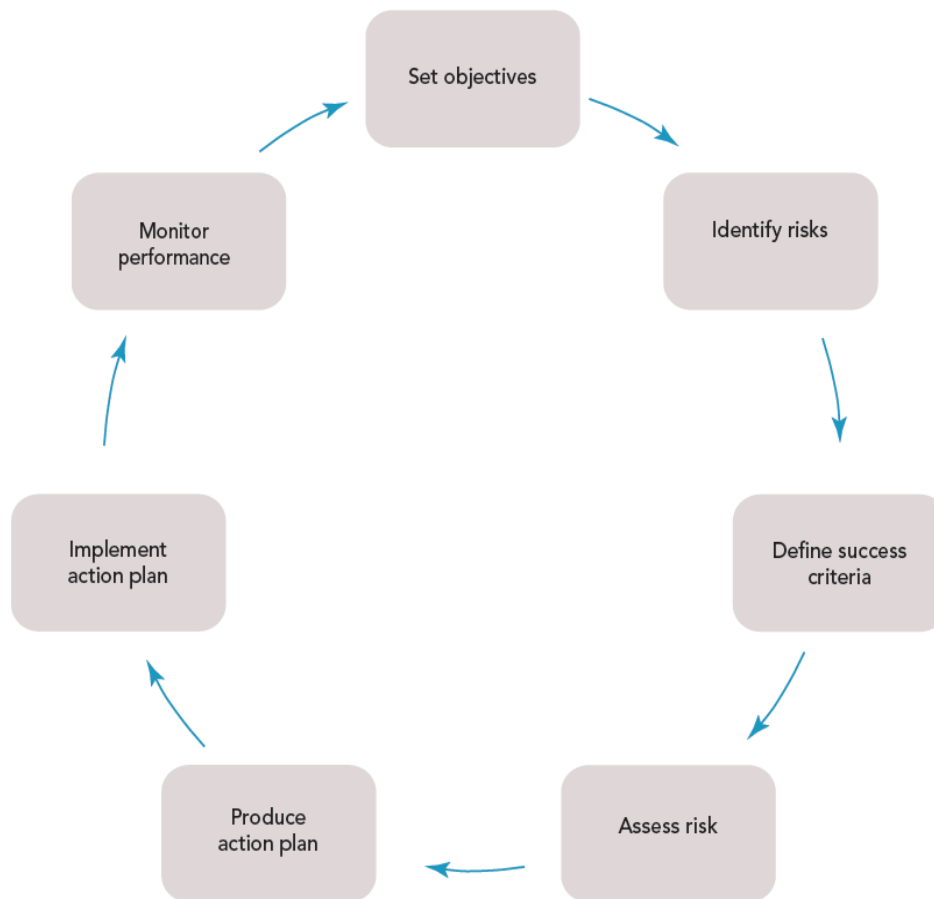
Linking reasonable affordability to sustainable growth

Chart 1.2 – Estimate of deficit recovery contributions (DRCs) as a percentage of employer's profit before tax (PBT)



Source: The Pensions Regulator and FAME

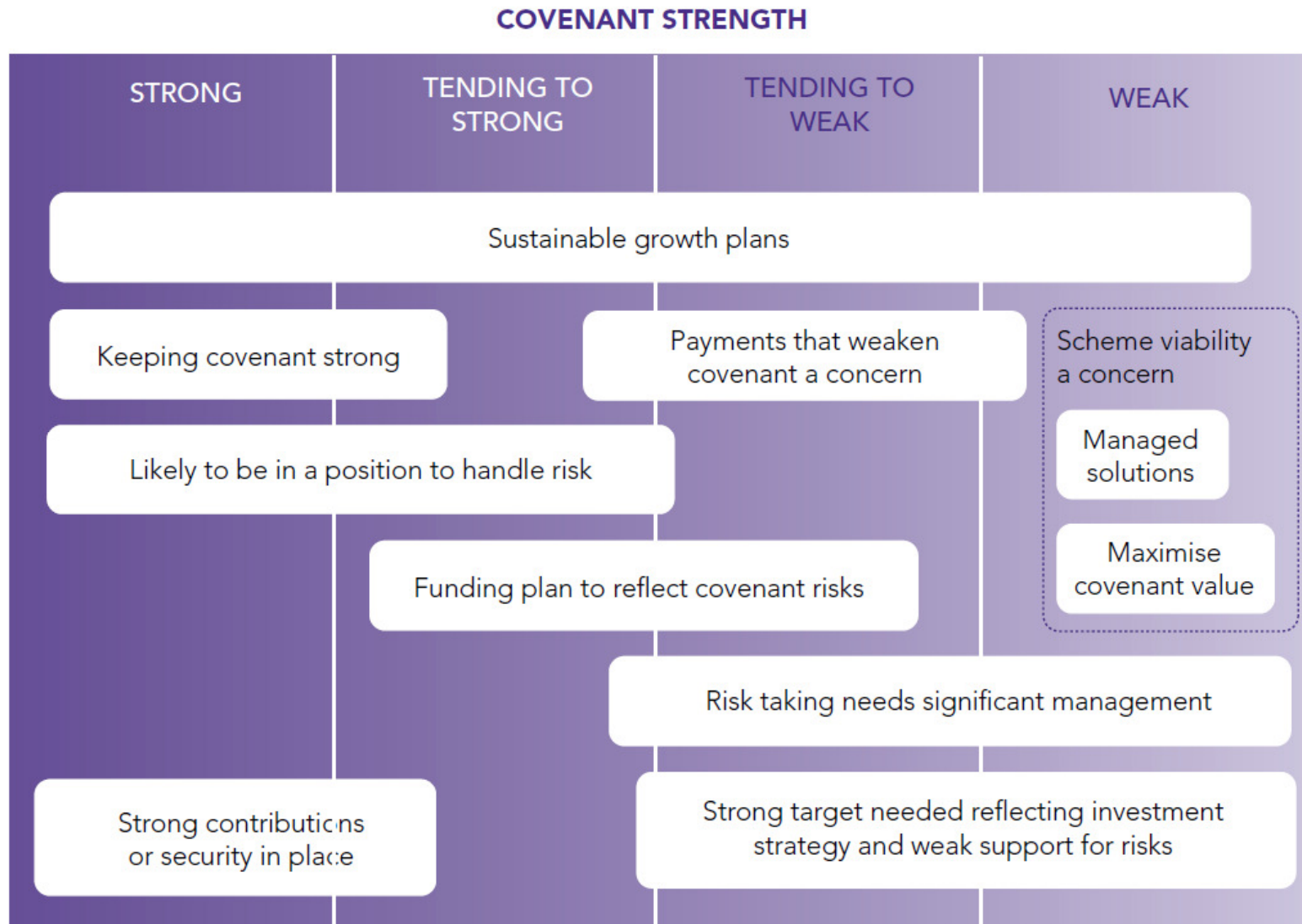
Integrated approach to managing risk



- Covenant funding and investment need to be considered together
- This is a mindset not a black box
- The environment is not constant so all the pieces need to be monitored and adjustments made as needed

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Funding policy segmentation – covenant grades



Approach is not just about funding

TPR's approach to regulating DB schemes

Strategic Aim:

- Strong and ongoing employer
- Effective and engaged trustees
- An appropriate recovery plan

Focus on risk management

Consistent

Transparent

Outcome focused

Sustainable growth understood broadly

Triggers replaced by risk indicators with 'balanced outcomes' segmented by covenant

Principle based

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Asset-backed funding

Principle based

- What impact will this have on member protection?
- “Unpack” ABC into contingent asset and income stream

Outcome focused

- How [much] will this increase member protection in the scenarios which matter?

Focus on risk management

- Complexity introduces unexpected risks
- Structure failure risk
- Governance problems

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Sum up

Our goals

- Reflect all TPR DB objectives, including the new one
- Balance needs of schemes and their employers
- Reflect TPR's ongoing experience, understanding of risks and evolving best practice
- Ensure Code remains fit-for-purpose for the coming years
- Guide TPR interventions in the most efficient and appropriate manner
- Be transparent about TPR actions and the reasons for them

Questions for you

- Will this achieve our goals?
- What would success look like?
- Major showstoppers?
- Refinement opportunities?
- Making this work for small schemes?
- Particular challenges for actuaries?

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