PSIT Independent Trustees

Briefing note – May 2013

TPR's 2013 funding statement: a sea-change?

Overview

On 8 May 2013, the Pensions Regulator (tPR) published its second annual funding statement. It is aimed mainly at trustees and employers of schemes carrying out valuations with effective dates between 22 September 2012 and 21 September 2013.

The statement is noticeably softer in tone than previously, with some of last year's key messages on setting assumptions and agreeing recovery plans either significantly watered down or removed altogether. There is also an increased focus on encouraging trustees to take an integrated approach to managing risks.

Investment returns and setting discount rates

Trustees can use the flexibilities available in setting assumptions for both the technical provisions (liabilities) and recovery plans to 'adopt an approach that best suits the individual characteristics of their scheme and employer'. **The requirement that trustees should only accommodate strongly-held views on future market conditions in the recovery plan and not the technical provisions has been dropped.**

tPR notes that investment return assumptions may rise or fall from previous valuations, and reminds trustees to document their reasons for a change and consider any increase in risk it might bring. This is in contrast to last year's statement that any increase in the asset outperformance assumed in the discount rate would be viewed as an increased reliance on the employer's covenant.

The investment assumption used for the recovery plan will affect the level of contributions to be paid. It does not need to be the same as the discount rate for the technical provisions but tPR says 'it is important that it is consistent with the overall risk management of the scheme'.

Setting appropriate contributions and recovery plans

In line with last year's statement, when setting contribution levels trustees should take into account what the employer can reasonably afford. As a starting point, they should consider whether the current level of contributions can be maintained.

If there are 'significant affordability issues', lower contributions and, possibly, a longer recovery plan may be considered. Again, trustees should document the reasons for any change and consider the risks. This may be seen as a change of focus – tPR previously expected current contribution levels to be maintained in real terms unless there was a demonstrable change in the employer's ability to meet them.

Where there is a choice between paying contributions to the scheme or investing in the employer's business, it is important that the decision made 'neither damages the employer's covenant nor benefits other stakeholders at the expense of the scheme'. **If a decision to invest in the business is made, it is important that the employer's covenant is improved as a result.**

tPR suggests that the capacity of sponsors to meet planned contributions has increased, but that affordability is likely to vary across employers. However, it also expects deficits to have grown for most schemes with 2013 valuations.

Use of flexibilities and understanding of risk

Trustees should understand the risks their scheme has to deal with and ensure 'appropriate plans for mitigation are in place', taking advice where necessary. They are **encouraged to take an integrated approach to addressing risk management** (such as covenant, investment and funding risks). tPR intends to consult on integrated risk management later this year.

tPR's regulatory approach

Moving away from setting individual triggers for further investigation, such as the size of the technical provisions or the length of the recovery plan, **tPR is now continuing to evolve a suite of risk indicators**. It is also looking to focus attention on the schemes that it believes pose the greatest risks and where it might have the greatest impact.

tPR plans to consult in the autumn on revisions to its code of practice on scheme funding, as well as its regulatory approach to defined benefit schemes.

PSIT's opinion

It is hard to escape the feeling that tPR is trying to counter criticisms that its previous approach was inflexible and could possibly have hampered growth. These led to tPR being given a new objective in the Pensions Bill to have regard to sustainable growth for the sponsoring employer. The revised messages in this year's guidance may point the way to how tPR intends to regulate once the new objective has been introduced.

Employers with poorly funded defined benefit schemes are likely to welcome this more balanced stance. Trustees, on the other hand, are likely to have to give more attention to adopting an integrated approach to managing their risks.

Find out more

If you have any questions about tPR's funding statement or its implication for your next scheme valuation, please contact Mark Homer.

Mark Homer
Trustee services

- 020 3327 5370
- mark.homer@psitl.com