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Pensions

The Pensions Regulator's Annual Funding Statement 2017 – a robust approach to the supervision of scheme funding

Briefing

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Introduction

On *May 15, 2017*, the Pensions Regulator (TPR) published its latest annual funding statement, together with a summary, in which it outlines a more proactive approach to ensuring defined benefits (DB) scheme members receive their benefit entitlements. The statement is aimed primarily at DB schemes undertaking valuations with effective dates in the period September 22, 2016, to September 21, 2017, but it is relevant to all schemes providing DB benefits. The statement sets out TPR's expectations of trustees, drawing on its guidance and policy documents, and recommending actions for all DB schemes, but with a particular focus on "stressed schemes". TPR indicates a more prescriptive approach to the valuation process, emphasising the need for schemes to take appropriate advice and engage as soon as possible with TPR.

Bearing in mind the recent BHS saga, it is interesting to note that the statement specifically addresses the need to balance scheme and shareholders' needs, stating that TPR is likely to intervene where "we believe schemes are not being treated fairly". Given the criticism TPR received during the House of Commons committee proceedings on BHS, it appears that TPR will be looking much more closely at recovery plans and payments to shareholders in future.

New obligations for stressed schemes

Using the covenant grading system set out in its DB funding policy document, TPR's analysis shows that five per cent of schemes in the 2017 valuation cycle have an employer which is "tending to weak" or "weak". TPR views such employers as being at risk of either becoming unable, or already being unable, to adequately support the scheme. TPR recognises that "the least detrimental impact for members' benefits in these circumstances may be for the scheme to continue". However, it is aware that this may result in "PPF drift" that is, where a scheme's Pension Protection Fund (PPF) liabilities grow each year as more members reach normal retirement age. The parallel risk is that this increases ongoing funding costs for the scheme's employer.

TPR notes that many of these employers will not be "inevitably insolvent" within the next 12 months and so could not apply to TPR to sever the scheme from the employer using a regulated apportionment arrangement.

In future, TPR will require trustees of "stressed schemes" to show evidence they have taken appropriate measures, such as

- Closing the scheme to future accrual if this has not already been done.
- Checking the strength of the sponsoring employer.
- Considering whether any payments of dividends made or due to be made limit the ability of the employer to support the scheme and invest in sustainable growth.
- Identifying scheme risks and seeking to manage them.
- Where scheme rules allow, considering whether the scheme should be wound up.

Focus on scheme valuations

TPR confirms that it intends to take a tougher approach when schemes fail to submit their valuations on time (in 2016 approximately a tenth of DB schemes completed their scheme valuation later than the prescribed 15-month deadline). If schemes anticipate they cannot meet the deadline they should contact TPR, as it is more likely to take enforcement action in relation to a breach if delays could have been predicted, or where trustees do not engage with the process. TPR also calls on trustees to "seek and duly consider robust actuarial advice" from their scheme actuary on the valuation assumptions.

Balancing the scheme and the shareholders

TPR emphasises that it is likely to intervene in schemes where it considers that "schemes are not being treated fairly". For instance, it will look more closely where it suspects that recovery plan end dates are being extended unnecessarily or where dividend payments to shareholders are being prioritised and this restricts scheme contributions.

Scheme funding and deficit management

TPR's analysis shows 85-90 per cent of schemes carrying out a valuation in 2017 have employers who can manage the scheme deficit and have no long-term sustainability issues. TPR therefore accepts that up to 15 per cent of schemes (equating to approximately 1,000 in number) have sponsors who may not be able to afford their promised pension benefits. The funding statement sets out the actions TPR expects trustees to consider, depending on the scheme's type of employer and covenant grade.

For example, for "weaker employers" where there is no legally enforceable support (such as a guarantee), TPR's view is that trustees should not rely upon the covenant of the wider group to justify agreeing to higher levels of risk in their valuation. Instead they should pursue legally enforceable support, and "seek every opportunity to reduce risk to an appropriate level, or secure additional funding or legally enforceable support for the scheme". Where a scheme cannot rely upon the covenant of a wider group, TPR will not take account of that support in its risk assessment.

TPR warns schemes that it is "likely to intervene where … the employer covenant is constrained and total payments to shareholders (including dividends and share buy backs) are prioritised" thus restricting or reducing scheme contributions.

Comment

This statement represents TPR's clear indication that it intends to take focus on how risk, covenant and funding governance are being managed, and TPR highlights that schemes must take steps appropriate to their circumstances. TPR's view is that contingency planning is appropriate for all schemes, not just those at risk. In reaction to recent high profile corporate failures, TPR intends to intervene early where a scheme is not being treated "fairly". That said, the statement provides limited guidance for trustees of stressed schemes and it may be that TPR is awaiting the Government's response to the Green Paper to tackle the large number of employers who find funding their DB pension promises increasingly difficult.

However, with a hung Parliament being the outcome of the recent general election, it seems likely that key decisions on pensions will take a back seat while the wheels of Westminster turn slowly, and there are also calls for the Government to take a sensible approach to the regulation of DB pensions. While it is difficult to argue against the Green Paper's proposals to protect pensions from unscrupulous bosses, such reckless behaviour is rare.

In the post-election cabinet reshuffle, it has been confirmed that the new Work and Pensions Secretary is David Gauke, promoted from Chief Secretary to the Treasury. Mr Gauke spent five years at the Treasury during the coalition Government where he played a key role in developing the detail of the pension freedoms, as well as being a keen supporter of automatic enrolment, so he is seen as experienced and knowledgeable in pensions issues.

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