BARNETT WADDINGHAM
beyond the expected

Briefing

Funding DB pension schemes in the charity sector

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Most defined benefit (DB) pension schemes are closed to new benefits, and are steadily maturing towards their 'endgame'. Alongside this, there have been high profile examples of employers failing, leaving behind underfunded pension schemes unable to pay the promised benefits.

Against this background, the Pensions Regulator (TPR) is consulting on a revised framework for their DB Funding Code. Following this initial consultation, the draft code is expected in late 2020 with the new code coming into force during 2021.

Pensions Regulator consultation – summary

The consultation is assessing:

- A clearer framework for what constitutes an appropriate funding plan, including what TPR sees as an appropriate 'long-term objective' (LTO).
- The concept of a 'Fast Track' route to demonstrating compliance, with scope for a more 'Bespoke' approach subject to greater regulatory scrutiny.
- Clearer guidelines on the effect of the financial strength of the sponsoring employer, and also on acceptable periods for any funding shortfall to be corrected.

Long-term objective

TPR has made it clear that pension schemes should have an LTO that targets full funding on a "low dependency" basis. This means having enough assets to pay the promised benefits without significant reliance on investment returns or on support from the sponsoring employer.

Pension schemes must assume that they will fund on this low dependency basis and reduce investment risk once they are significantly mature – i.e. when the liabilities relate to mostly pensioners. In the meantime, a reasonable level of investment risk can be allowed for.

For the Fast Track regime, TPR has indicated that the maximum assumed investment return under this low-dependency LTO will be between 0.25% pa and 0.50% pa above the rate of interest available on UK government bonds ('gilts'). Therefore, a pension scheme that has reached the LTO would only need a modest amount of risk, for example 10%-20% in equities, to achieve the required returns.

New funding regime – points to consider

The details are subject to consultation, and it will be a little while yet before the new regime is in force. However, the consultation will provide a clear steer as to TPR's direction, and may be supplemented by statements regarding expectations for schemes currently undertaking a funding review.

At the moment, the main question for trustees and sponsors is where they expect to sit relative to the Fast Track approach.

Broadly in line with the fast track requirements
Funding valuations are likely to be straightforward, although some minor tweaks may be needed.

Broadly in line with fast track, other than contributions to correct a shortfall being paid over a long period
Key consideration is what the employer can reasonably afford to pay. This can have some challenges for employers in the charity sector.

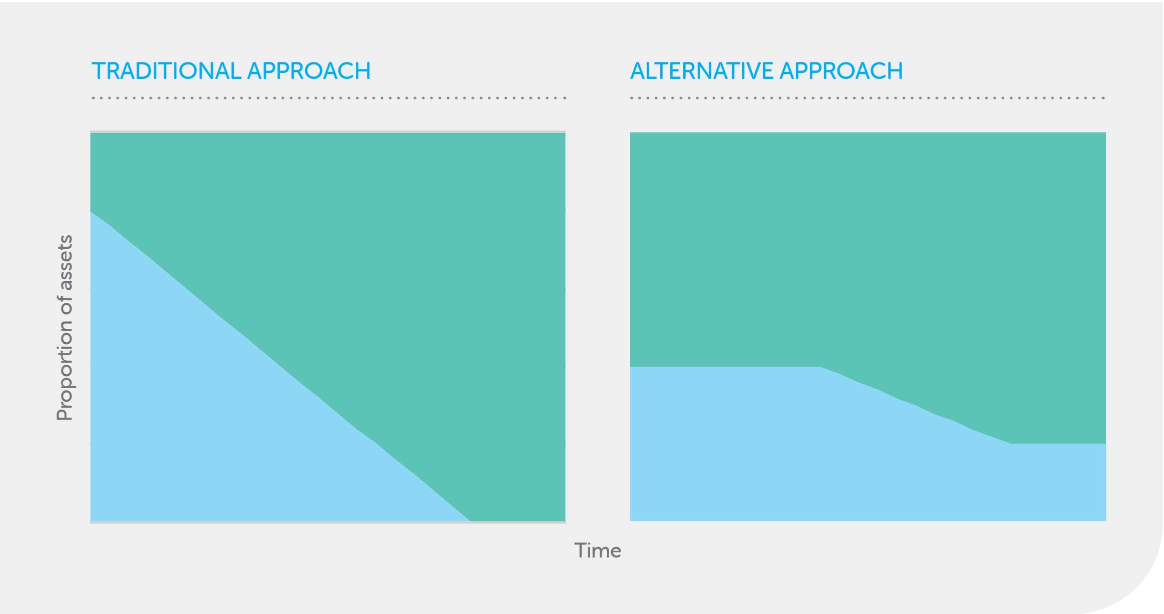
Not able to meet fast track approach
May be subject to greater scrutiny from TPR. Consider further analysis of risks and gather evidence to support funding plan.

Time to review objectives and strategy?

Reducing investment risk over time as members retire and become pensioners is a common strategy for UK pension schemes. However, these strategies are often imbalanced, with too much short-term risk leading to excessive funding volatility. A balanced approach would target a more even spread, albeit still with a modest level of long-term risk.

Many charities have long histories, and expect to be around for the long-term, but also have restrictions on the cash they can pay to their pension scheme in the short-term, particularly in light of the current Covid-19 pandemic.

If your long-term target is currently more cautious than the Fast Track LTO – for example, by assuming investment only in gilts – you should consider whether a more sustainable strategy would allow short-term risk and volatility to be reduced without increasing overall funding requirements.



If you want to check how your funding plan compares to the Fast Track regime, you can use our Fast Track Indicator tool, which is available on our website.

USE THE FAST TRACK TOOL

Barnett Waddingham recently hosted a roundtable in conjunction with Charity Times to discuss DB funding issues in the Charity Sector. A write-up of this roundtable is available in the digital Feb/March 2020 edition of Charity Times.

READ THE WRITE-UP

Barnett Waddingham is a leading provider of pensions consultancy services to the charity sector. If you wish to speak to somebody about your pension scheme, please contact Steve Hitchiner, Partner, via the following:

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