

Briefing

# 2020 vision: funding in TPR's sights

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The Pensions Regulator (TPR) is set to issue a new code of practice on pension scheme funding in 2020. With new powers for a 'clearer, quicker, tougher' regulator on the cards and a subtle shift in TPR's approach to DB scheme funding – Tyron Potts looks ahead...

The Pensions Green Paper, published back in February 2017, heralded the start of something fairly new for defined benefit (DB) pension schemes. As well as exploring the possibility of DB scheme consolidation and easements for employers undergoing corporate restructurings, the Government asked some pertinent questions about the Scheme Funding regime and the wider role of TPR.

Fast-forward 13 months and the Department for Work and Pensions (DWP) published its White Paper on "Protecting defined benefit pension schemes", building on the themes in the earlier Green Paper. As a result, several pieces of legislation were drafted – some of which have been enacted, many requiring further Parliamentary debate.

This is where the main sticking point is – a well-documented impasse around Brexit has hamstrung Parliament and significantly reduced the prospect of seeing the promised changes anytime soon.

We don't yet know when the Queen will be opening parliament with her traditional speech, let alone when (or indeed whether) the 2019 Pensions Bill will make it in front of Parliament for debate. The smart money is on a Royal Assent being granted in mid-2020, in which case TPR's funding code of practice will either have to wait, or be written based around the narrower suite of powers currently available to TPR.

## THEME 1: LONG-TERM OBJECTIVES

### 2018 White Paper

In the white paper, the DWP proposed that TPR's code should set out how trustees and employers should set funding objectives in the context of long-term targets.

### Subsequent legislation / guidance

A Long-term objective (LTO) is a key theme of TPR's [2019 annual funding statement](#).

According to the statement, trustees must be 'prepared to evidence' that short-term strategies are aligned with their LTO.

### What next?

Trustees with valuations due or underway should engage with employers ahead of any legislative changes.

## THEME 2: DRCS vs DIVIDENDS

### 2018 White Paper

The Government wanted to 'reassure the public that companies are being run with proper regard for the interest of all parties rather than just shareholders' – and in the white paper they outlined some key steps already taken.

### Subsequent legislation / guidance

A very strong steer is given by TPR in its [annual funding statement](#) that, if dividends exceed DRCs, then trustees should seek a strong funding target and short recovery plan.

### What next?

TPR has already written to some schemes / employers where there may be an issue with regards to their dividend policy. TPR has acknowledged that the relative size of the scheme to the sponsor will nonetheless be a factor in their deliberations.

## THEME 3: RECOVERY PLANS

### 2018 White Paper

The Government proposed that TPR's new code of practice should set out how TPR will ensure recovery plans are linked to long-term funding objectives.

### Subsequent legislation / guidance

TPR's 2019 statement said that anything in excess of 'the average' Recovery Plan length is likely to be deemed 'too long', particularly for mature schemes with strong employers.

### What next?

TPR will be communicating directly with certain schemes it has identified later this year.

## THEME 4: TPR POWERS

### 2018 White Paper

The Government said it intended to legislate at the 'earliest opportunity' to require compliance with funding standards, and ensure TPR can enforce this requirement. New powers will include punitive fines to punish 'grossly reckless' behaviour, and a strengthened notifiable events framework.

### Subsequent legislation / guidance

In February 2019, the DWP [responded to a consultation](#) on improving TPR's powers so that it can be more proactive and become involved earlier where changes are made which impact pension schemes.

### What next?

We await draft regulations setting out these powers in detail.

## THEME 5: GMP EQUALISATION

### 2018 White Paper

The white paper said that further legislation will be prepared to help schemes tackling GMP equalisation.

### Subsequent legislation / guidance

The DWP subsequently published a [comprehensive guide](#) to equalising GMPs.

### What next?

The process is likely to take some time, but schemes should start the process of equalising GMPs now. We await confirmation from HMRC in particular regarding the tax implications of GMP-related uplifts.

Although things are moving slowly at Westminster, TPR is still actively engaging with the industry, giving guidance within its existing remit and steering trustees with 2019/20 Scheme funding valuation dates to consider specific actions.

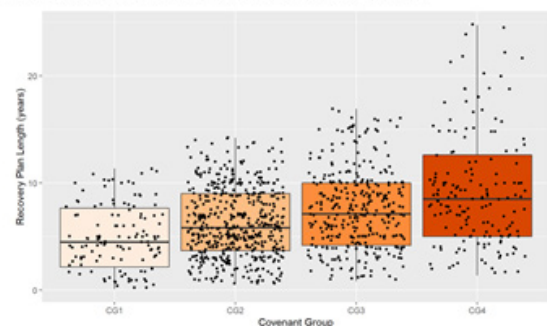
## Patterns emerging

Compared with their previous valuation, Tranche 12 Schemes (with funding valuation dates between September 2016 and September 2017) saw an 18% average increase in DRCs and a two-year extension to recovery plans. However, the variation is marked across different covenant groupings, particularly for weaker employers (Covenant Group 'CG4') where most recovery plan lengths fall in the range 2-25 years.

One quarter of schemes in CG4 have RP lengths above 13 years according to TPR's analysis.

Whilst this demonstrates schemes are using the flexibility in the current scheme funding regime, TPR is keen to get more of a grip and achieve greater consistency, whilst still protecting both member interests and the long-term viability of sponsors.

Figure 5: Distribution of recovery plan length by covenant (Tranche 12)



Distributions are trimmed at the 5th and 9th percentiles.

Source: TPR

## Guiding light

In contrast to the backward-looking Tranche 12 analysis, TPR's 2019 annual funding statement is more forward-looking – modelling the expected outcomes of funding valuations for Tranche 14 Schemes (valuation dates between September 2018 and September 2019).

TPR highlights good practice for trustees and employers, which is to agree a 'clear strategy' towards a 'long-term goal', recognising and balancing the risks associated with investment, funding and covenant (see also TPR's [Integrated Risk Management \(IRM\) guidance](#)).

However, TPR points out that they "do not assess the appropriateness of schemes' technical provisions or discount rates based on relationships to gilt yields or other indices". Instead, TPR guides expectations on a more granular level, looking at the interaction between employer strength and scheme profile, as well as noting the steps it expects trustees to take. TPR's focus will be on setting funding objectives according to employer covenant, starting from the basis that a stronger employer "should be required to fund deficits over a shorter period".

⋮ The average recovery plan is expected to be  
⋮ around 7 to 8 years.

TPR is quite clear that for stronger employers, anything in excess of this would be considered 'long'. However, this is not the only metric TPR looks at.

## Blog – back-door MFR?

Recently, TPR dispelled any remaining doubt that planned changes to the scheme funding regime would be relatively benign in a [blog written by David Fairs](#), Executive Director of Regulatory Policy, Analysis and Advice.

The blog confirms our previous understanding that there will be two consultations in the near future on scheme funding, the first on the broad "options for a clearer [funding] framework" in the summer, and a second on the content of a revised funding code of practice (due some time in 2020).

It is intended that this revised code will set out a 'fast-track route' that schemes may choose to follow - allowing them to demonstrate compliance with the regime without the need for TPR to more closely scrutinise assumptions or recovery plans.

TPR says that there is no plan for "MFR 2.0" – for example there will not be a specified basis for calculating schemes' funding liabilities and no hard-and-fast rules around bringing funding levels up to full coverage. Yet the fast-track approach could still be in danger of becoming the minimum standard, if not the default, for schemes who can't or won't engage in the holistic manner envisaged by TPR.

In the DWP's 'Tailored Review of TPR', the DWP itself said it should consider the benefits of extending TPR's powers to "enable them to make rules in specific circumstances". This presumably is intended to incorporate the independent setting of assumptions around this fast-track funding requirement.

We wonder therefore, whether this possible path-of-least-resistance, will indeed become a form of MFR by the back-door, despite assurances to the contrary.

## Action for schemes

Trustees of schemes with valuations coming up, or underway should discuss with advisors and sponsors:

- what their long-term objective (LTO) looks like
- how TPR's 2019 funding statement should be taken into account
- whether their approach to risk management is truly 'integrated'.

Otherwise, it's a case of watch this space. The next 12 months could get interesting for scheme funding, even if other events at Westminster continue to hog centre-stage.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch via the following:

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