Pensions Regulator allows for COVID-19 impacts in its 2020 Annual Funding Statement

What you need to know

• The Pensions Regulator (TPR) has published its 2020 Annual Funding Statement, which is primarily aimed at schemes with triennial actuarial valuations between 22 September 2019 and 21 September 2020. It is also useful for schemes that are undergoing significant changes requiring a review of their funding and risk strategies.

• TPR highlights the need for trustees and employers to work together during the COVID-19 crisis to manage its immediate impact and also remain focussed on the long-term, as the best support for a scheme is a strong employer.

• The statement notes that schemes and their sponsors are all in different situations, and sets out a series of tables containing the key risks that trustees and employers should focus on and the actions that TPR expects as a result.

• For schemes nearing the end of their valuation process TPR does not expect assumptions to be changed but any recovery plan should take account of post-valuation experience, focussing on employer affordability.

• TPR suggests that deciding on assumptions for valuations with effective dates around March and April 2020 can be delayed until there is more visibility on investment returns, as well as the covenant and affordability of the employer.

• TPR recognises the challenges in setting long-term assumptions and steers trustees to carry out scenario analysis on possible outcomes for the economy.

• Trustees are encouraged to have a long-term target, setting technical provisions and managing investment risk consistent with it. Short-term decisions on funding in the current environment must be consistent with long-term objectives.

• Trustees are expected to monitor employer covenant more often, perhaps setting triggers.

• TPR has confirmed that the funding code and legislation currently in force apply to current valuations. While any new code is expected to apply from the end of 2021 at the earliest, some of the risk management principles in the consultation may be helpful to reviewing approaches.

Actions you can take

• Read TPR’s related guidance on COVID-19 alongside the Annual Funding Statement.

• Discuss openly with your employer the impact of COVID-19 on their business and monitor covenant regularly.

• Ensure your risk management procedure is being followed and updated and any contingencies are implemented where needed.

• If a valuation is due this year, consider how current valuations are finalised and if deferring assumption setting for new valuations is suitable for your scheme.

• Carry out scenario analysis to inform decision making on assumptions.

## The finer detail: Overview of the statement

### Background

In the current climate many trustees are being asked to review their funding plans, to potentially suspend contributions and to consider their investments. This statement gives guidance to these trustees as well as those currently undertaking their triennial valuations, taking account of the variety of challenges faced by schemes and employers.

### Valuations about to be signed off

Trustees signing off their valuation now do not have to change assumptions for their technical provisions but should consider post-valuation experience in recovery plans, focusing on the affordability of the employer.

### Changing the valuation date

Although this may be possible, TPR seem to be warning against doing so. It says trustees should carefully consider any decision to do this, take legal and actuarial advice beforehand and expect TPR to question their reasons.

### Delaying setting valuation assumptions

For March and April 2020 valuations, it may be difficult to form long-term views on investment returns, so TPR suggests that the agreement of assumptions can be deferred until more clarity emerges. TPR expects schemes to proceed with as much of the preliminary valuation work as possible. Scenario planning is encouraged to help understand the different ways the economy may recover and impact on funding.

### Recovery plans

Changes to the recovery plan must be made alongside an assessment of the employer’s covenant. A revised plan to recover the deficit should focus on affordability, whilst maintaining fair treatment of the scheme with other creditors and balancing sustainable growth of the employer.

### Long-term funding target (LTFT)

Schemes are encouraged to continue to aim to fund to their LTFT, although short-term adjustments may be needed. Those scheme without an LTFT are encouraged to set one, especially since it is the government’s intention to make this a legal requirement.

### Covenant monitoring

Trustees should consider obtaining a covenant assessment undertaken by an independent specialist, especially where the covenant is deteriorating. In these uncertain times covenant monitoring should be more frequent and ideally triggers should be set for a required action, for example paying a cash contribution.

### Fair treatment

Trustees should be aware of covenant leakage (e.g. payment of dividends) which affects the employer’s ability to support the scheme in the longer term, seeking suitable protection if necessary.

### Key risks by characteristics

Trustees are expected to focus on risks from investment, funding and covenant and the interaction between these. As schemes find themselves in very different circumstances, TPR sets out a table with ten categories to help match key risks to their particular situation.

### What next?

Trustees should ensure they have read the most up to date COVID-19 guidance on TPR’s website. Further guidance may be issued in the autumn, depending on how the economic situation evolves.

The new DB funding code is expected to apply from the end of 2021 at the earliest, but some of the risk management principles in the consultation may be helpful to reviewing approaches in the meantime.

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