

DB code and strategy 2014 annual funding statement

Andrew Dodd and Mouna Turnbull
Institute and Faculty of Actuaries Pensions
Conference
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Outline

- DB strategy documents
 - Key messages of the code and regulatory approach
 - Issues raised in consultation
 - What happens next?
- Annual funding statement 2014
 - Analysis of T9 valuations
 - Our key messages

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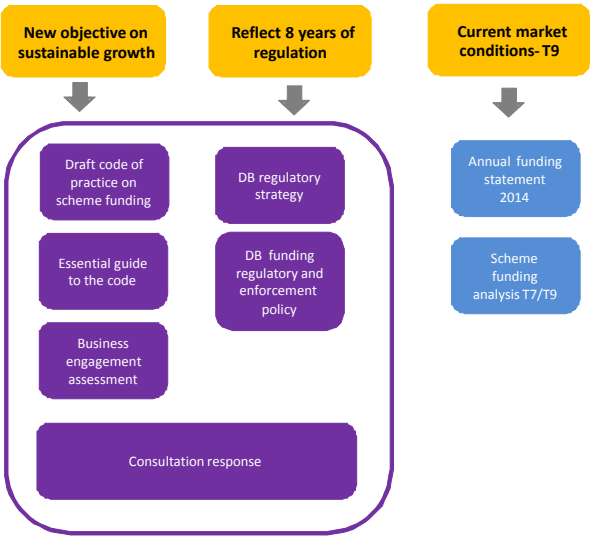
DB strategy

Mouna Turnbull
Policy Lead

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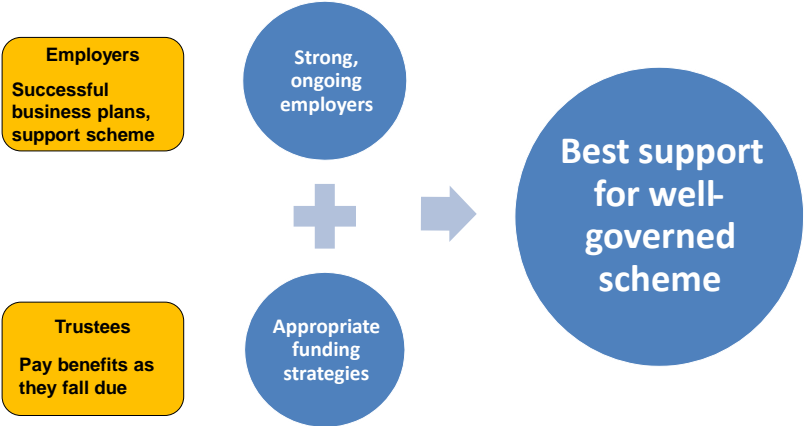
DB documents published on 10 June



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Approach to the funding code



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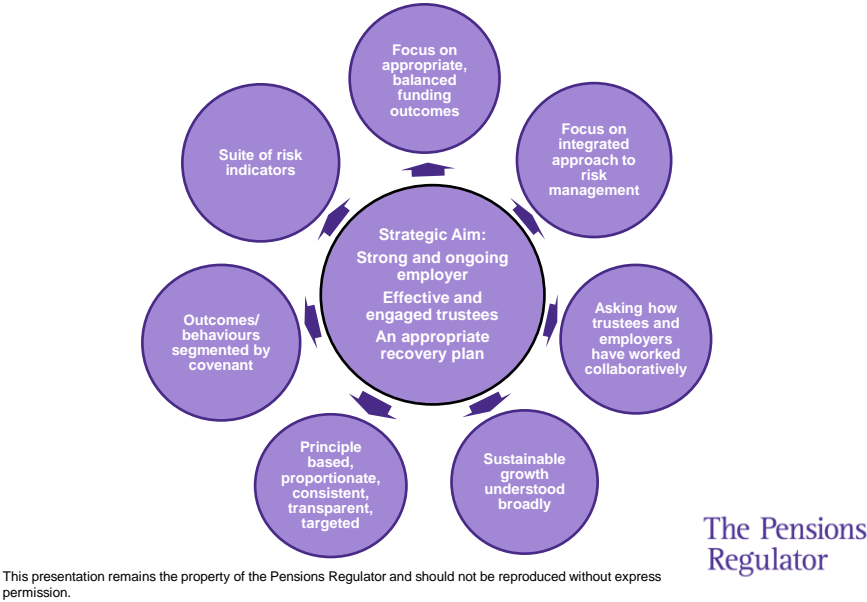
9 key funding principles



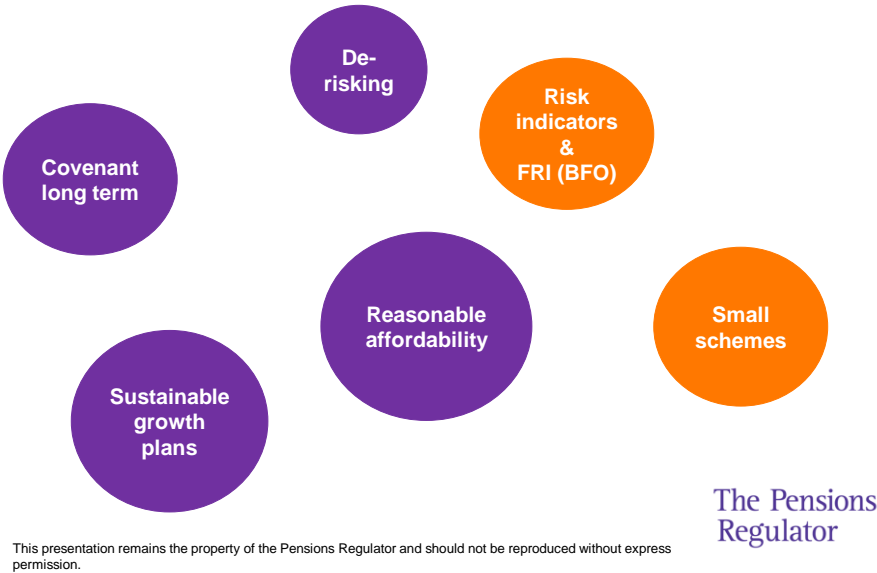
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The regulator’s approach to regulating DB schemes



Key issues raised in consultation



Transitional arrangements and next steps

- Transitional arrangements
 - Code expected to be made in Britain in July and in NI later on in the year.
 - Trustees and employers of all schemes should apply the code as far as is reasonable depending on where they are in the valuation cycle.
 - Be mindful of the key messages put out in the last few years.
 - We will take a pragmatic approach to looking at valuations.
- Next steps

Education

Evaluation

Implementation

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Annual funding statement 2014

Andrew Dodd

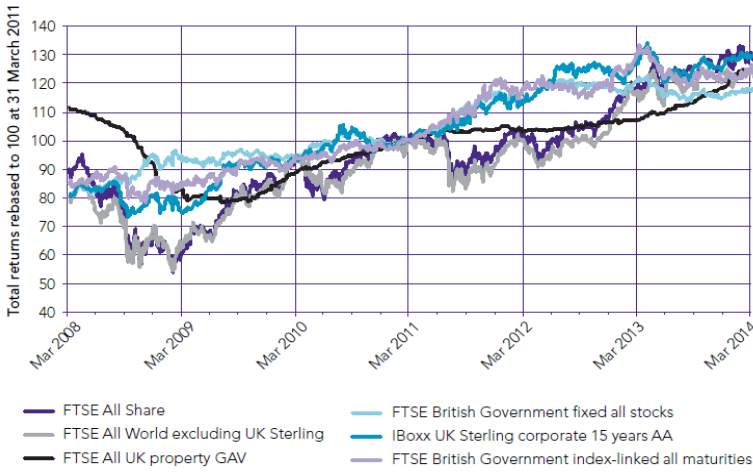
Actuary

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T9 valuations – market conditions

Figure 2: Asset returns

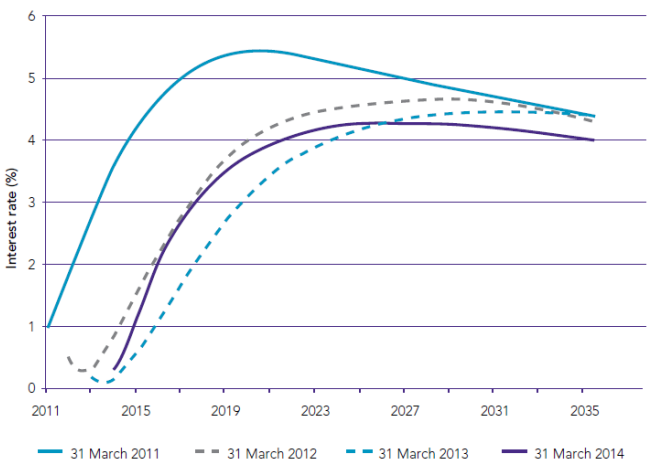


Source(s): The Pensions Regulator, Thomson Reuters, FTSE group, Markit iBoxx

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T9 valuations – market conditions

Figure 3: UK instantaneous nominal forward curve



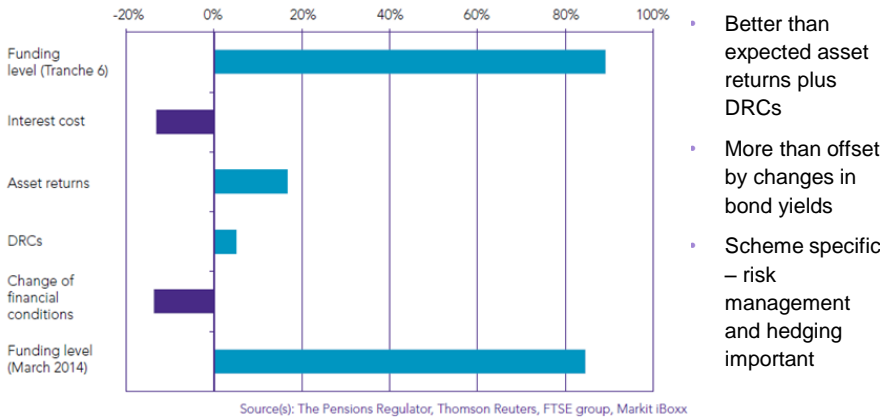
Source(s): Bank of England (BoE)

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T9 valuations – change in funding

Figure 8: Estimated impact of market conditions on Tranche 6 schemes

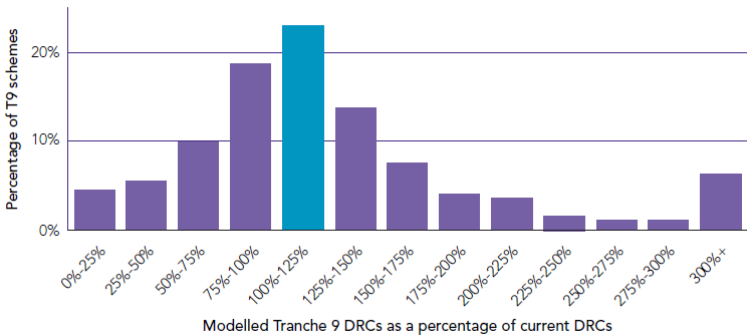


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T9 valuations – implications for DRCs

Figure 9: Proportion of current DRCs – based on additional three years to existing recovery plan end date and discount rate outperformance increased 0.25%



Our analysis highlights that most schemes with a 2014 valuation showing an increase in deficit should be able to manage the impact of this through an appropriate use of the flexibilities available.

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T9 valuations – affordability

Figure 5: PBT by covenant group (Tranche 9 only)



- PBT trend upwards since 2009/2010
- Wide variability in employer positions

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T9 valuations – potential outcomes

Table 2 – DRCs compared to sponsors’ PBT in Tranches 6 and 9

		Modelled Tranche 9 DRCs as a percentage of latest available PBT											
		0	0-10%	10-20%	20-30%	30-40%	40-50%	50-60%	60-70%	70-80%	80-90%	90-100%	100%+
Tranche 6 DRCs as a percentage of 2010 PBT	0	-	-	-	-	-	-	-	-	-	-	-	-
	0-10%	-	186	46	14	7	8	-	2	-	-	-	10
	10-20%	-	40	33	32	3	5	8	2	1	1	1	7
	20-30%	-	16	16	16	13	3	3	2	2	1	-	5
	30-40%	-	11	7	9	5	4	2	6	-	2	3	4
	40-50%	-	3	4	6	7	2	2	1	1	1	3	5
	50-60%	-	2	3	3	3	2	1	1	1	-	-	8
	60-70%	-	-	2	3	3	2	2	1	1	1	2	1
	70-80%	-	-	1	4	2	2	4	-	-	-	-	8
	80-90%	-	-	-	-	-	-	-	2	1	3	1	7
	90-100%	-	2	1	1	-	-	1	1	-	-	-	6
	100%+	-	5	8	6	3	9	4	2	6	6	1	62

40% of schemes modelled DRCs/PBT similar range to before

28% of schemes modelled DRCs/PBT have decreased

32% of schemes modelled DRCs/PBT have increased

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T9 key messages

- Potentially challenging valuations...
- ...but for most schemes manageable through appropriate use of flexibilities
- Working collaborative and transparently
- Proportionate integrated approach to risk management
- Assessing covenant is vital
- Planning for adverse outcomes

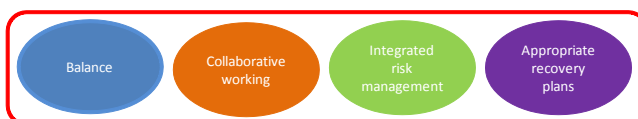
Finding the balance between the scheme's needs and the employer's is key

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Key takeaways

- New code and funding policy



Proportionate application

- Trustees should form their own views on covenant
- FRI is one of a suite of risk indicators
- The same standards apply to all schemes irrespective of size
- T9 valuations - challenging but manageable for most

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Questions?

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Annex – additional slides

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Responses to the consultation

- 85 respondents
- A wide spectrum of stakeholders
- Broadly supportive
- Many detailed comments

Organisation type	Number	%
Representative body	14	16
Professional Body	4	5
Advisory firm/consultant	32	38
Employer	15	18
Pension scheme	12	14
Pension scheme / Employer (joint)	1	1
Trustee	4	5
Regulator	1	1
Individuals	2	2
Total	85	

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Consultation key themes and our response – Code (1)

What people said	How we responded
Right balance between our objectives and broad interpretation is welcome but not using the exact wording may dilute policy intention.	Use the exact wording throughout while making it clear it is an objective for the regulator
Much support for focus on integrated risk management but too much emphasis on de-risking .	Stress benefits of upside risks more clearly. Trustees ought to 'manage', not 'mitigate' risks. No immediate repair of all risks which have crystallised.
Reasonable affordability means what employers can pay rather than should pay and very short recovery plans.	'As quickly' as reasonably affordable' does not mean very quickly. Emphasis changed to 'appropriate period'. Long recovery plans are not compatible with weak TPs.
Proportionality not followed through consistently.	Proportionality emphasised throughout and requirements reviewed e.g. covenant assessment. Considering further guidance.
Requirements on contingency planning inflexible and unrealistic.	Focus is on flexible response strategies and governance structures. Recognise there are different levels.

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Consultation key themes and our response – Code (2)

What people said	How we responded
'Long-term view' principle does not recognise practicalities of assessing covenant in long term .	Stress importance of looking at long-term scenarios. Limitations of covenant assessment does not mean covenant cannot be relied upon long term.
Approach to dividend payments is too stringent.	Recognise dividends are a normal business activity. Scrutiny should be proportionate.
Requirement for trustees to scrutinise employer's plans elevates pension scheme above other creditors .	Made clear it's not trustees' jobs to criticise employer's decisions. Scrutiny should be proportionate.
Code does not recognise particular circumstances of non-for-profit sector/NAMES schemes	Principles universally applicable. Recognise non-for-profit may have different considerations re. covenant assessment Considering further guidance. Recognise complexity of scheme design/employer relationships is consideration in proportionality assessment.
Code too long , lacks clarity.	Shorter by 20 pages. Essential guide for trustees.

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Consultation key themes and our response –
Regulatory approach

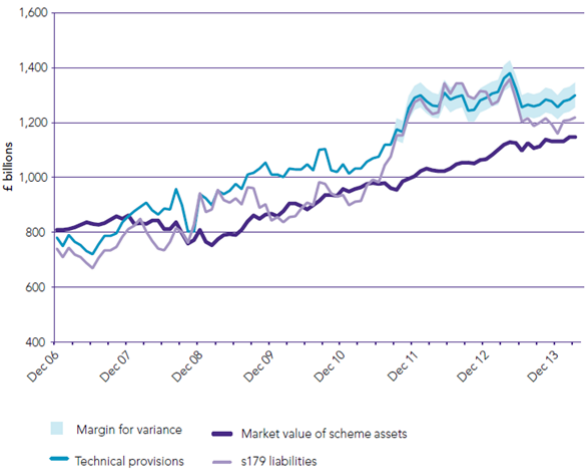
What people said	How we responded
Regulatory approach too rigid (e.g. approach to segmentation by covenant, use of BFO indicator) and may constrain use of flexibilities .	Our approach is flexible but made clear <ul style="list-style-type: none">• covenant segmentation is a tool to assess outcomes consistently but is for internal use• covenant is a continuum• BFO is one of many risk indicators – renamed FRI• we will look at employer's affordability
Welcome move away from old triggers but concern about rigidity and robustness of FRI and unintended consequences of publishing FRI	Considered risks and benefits carefully. Intend to undertake further work on risk assessment framework. Will not yet publish detail of our risk indicators.
Approach to risk-based prioritisation leads to insufficient regulatory scrutiny of small schemes .	As a risk-based regulator we believe our prioritisation approach is appropriate. Expect same standards from all schemes. Will continue to engage with small schemes

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T9 valuations – market conditions

Figure 4: Estimated assets and liability positions of DB pension schemes



Source(s): The Pension Protection Fund (PPF), The Pensions Regulator

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- Continuing low gilts yields and lower future expectations
- Higher assets value – driven by QE?
- Average funding position better than for T8 schemes...
- ... but worse than in T6.

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