Risk management, reduced recovery plans and mitigation—TPR's Annual Funding Statement 2022

Pensions analysis: The Pension Regulator (TPR) launched its Annual Funding Statement 2022 for trustees and sponsors of defined benefit (DB) pension schemes with valuation dates between 22 September 2021 and 21 September 2022, which sets out how to approach valuations in the current political-economic climate. TPR emphasises the importance of risk management across a DB pension scheme's assets, liabilities and employer covenant, encourages trustees to consider a long-term funding target, and highlights its reduced six-year recovery plan. Julia Ward, senior knowledge development lawyer at Stephenson Harwood LLP, examines the key themes in the funding statement and the actions trustees should be taking in response.

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What is the background to TPR's 2022 annual funding statement?

On 27 April 2022 TPR published its Annual Funding Statement 2022, particularly aimed at trustees and sponsors of DB pension schemes with valuation dates between 22 September 2021 and 21 September 2022.

The statement provides guidance to trustees and employers on how to approach their valuations against a backdrop of high inflation, rising interest rates, high energy prices and slower economic growth. There is also the evolving situation in Ukraine as well as longer term effects of coronavirus (COVID-19) and Brexit which TPR acknowledges may impact funding positions and employer covenant.

What are the key messages/themes in the statement?

It is unsurprising against this volatile backdrop that TPR emphasises the importance of robust risk management across a scheme's assets, liabilities and employer covenant. Trustees should be aware that the scheme's funding position and employer covenant could change quickly. A clear message in the statement is for employers and trustees to understand the impact of the political-economic environment on both the funding position of the scheme as well as the strength of the employer.

TPR is also keen to remind trustees to ensure that the pension scheme is being treated fairly compared to other stakeholders. This is especially the case given shareholder distributions are now increasing following a hiatus during the coronavirus pandemic. Trustees should also ensure that the scheme is properly protected in the event of any corporate activity.

Trustees are also encouraged to focus their minds on a long-term funding target. Once the relevant provisions of the Pension Schemes Act 2021 and new DB funding code are in force, trustees will be required to agree long-term funding and investment targets for schemes. TPR suggests that trustees should consider taking steps now and adopt a longer-term strategy. When setting this target, TPR notes trustees should consider the extent they are reliant on the employer covenant over time and engage with the employer to understand the risks to this covenant.

TPR has also highlighted that the length of recovery plans has reduced in recent years. TPR is therefore using a reduced length of a six-year recovery plan as a benchmark.

What actions should trustees be taking?

Trustees need to consider the impact of market conditions on the employer's business. This will directly impact the approach that should be taken when setting deficit repair contributions and recovery plan lengths. It is unsurprising in these uncertain times that a key message from TPR is for trustees to have in place and keep under review effective integrated risk management practices.

Trustees must also remain alive to wider sponsor activity ensuring that the pension scheme is treated fairly in comparison to any dividend distributions made by the sponsor group. Trustees also need to understand any corporate activity proposed and take a rigorous approach to assessing the impact of any proposals on the pension scheme. Trustees should be prepared to act quickly; seeking mitigation for any scheme detriment and ensure they keep detailed records in respect of deliberations in respect of the scheme. Once the new notifiable events framework comes into force, trustees should be involved in much corporate activity from the outset and scheme mitigation will be at the forefront of sponsor's minds.

Trustees may also want to start thinking about agreeing a long-term funding target with the employer now and setting their journey plan according to this. It is only a matter of time before this is a legal obligation in any event. It makes sense for trustees to focus their minds on this approach during the valuation process.

When approaching recovery plans, trustees should also bear in mind TPR's new benchmark of a reduced six-year length.

Interviewed by Banita Kalia

Julia Ward is a senior knowledge development lawyer for the pensions team at Stephenson Harwood LLP. Julia delivers legal training, drafts client briefings, and updates the team's precedent documents. Prior to this role, Julia practiced as a pensions associate and advised both trustees and sponsors on day to day advisory matters as well as providing pensions advice for complex and high value corporate transactions.