STEPHENSON HARWOOD

Pensions law team – March 2019

Dividends, recovery plans and long-term funding targets

The Pensions Regulator sets out new expectations and guidance in its annual funding statement 2019

Trustees and sponsors of defined benefit pension schemes should be aware of the annual funding statement issued by the Pensions Regulator in March 2019. Whilst this will be of immediate relevance to those with valuation dates between 22 September 2018 and 21 September 2019, all schemes should be aware of the Regulator's developing expectations.

Long-term funding targets

The Regulator expects **all schemes** to set a long-term funding target (**LTFT**) so that the scheme meets the objective of paying the benefits due. This target generally achieves funding at a level higher than where a scheme is fully funded on a technical provisions basis. The Regulator gives an example of such a target for a mature scheme - the scheme should have enough assets in order to reduce its dependence on the sponsor and allow it to be managed with a high degree of resilience to investment risk. Trustees need to be prepared to evidence that their short-term investment and funding strategies are aligned to allow the scheme to become fully funded up to the LTFT.

Sponsor dividend payments

The Regulator continues to highlight that dividend payments should not be excessive relative to deficit reduction contributions (**DRCs**). The Regulator makes clear that it will intervene with schemes whose valuations do not reflect an equitable position relative to other stakeholders, regardless of sponsor covenant. By way of example:

Sponsor/Scheme characteristics	Dividend payment permitted by the Regulator
Strong funding target and recovery plan relatively short	Dividend and other shareholder distributions that exceed DRCs may be permitted where there is a scheme with these characteristics. The Regulator will also consider the relative size of the sponsor and scheme deficit.
Sponsor "tending to weak" or "weak"	DRCs should be larger than shareholder distributions unless the funding target is strong and the recovery plan is short.
"Weak" sponsor unable to support the scheme	Payment of shareholder distributions should have ceased.

Recovery plans

The Regulator has found that the median recovery plan is **seven years**. Schemes with strong covenants are expected to have recovery plans that are "**significantly shorter**" than this.

The Regulator will be engaging with a number of schemes ahead of their 2019 valuations where it considers that the existing recovery plans are unacceptably long. In determining whether a recovery plan is an acceptable length, the Regulator will consider the maturity of the pension scheme and the covenant of the sponsor.

If a relatively mature scheme with a strong sponsor has a current recovery plan that is longer than the average length for the universe of schemes, this will be considered too long.

Balancing risks

The statement sets out ten categories of pension scheme based on sponsor covenant, investments, scheme funding and the maturity of the scheme. The Regulator highlights the risks that can present themselves in each situation and the actions it would expect sponsors and trustees to take as a result.

Late valuations

Whilst the Regulator does not want trustees to agree an inappropriate valuation just because the deadline for the valuation is imminent or has been missed, it does expect trustees to start the valuation process in good time. In addition, trustees must report any missed deadline to the Regulator in a timely manner and work with the sponsor to make every effort to agree the valuation and recovery plan as soon as possible. Where trustees have taken all reasonable steps to finalise their valuation, have acted responsibly and have genuine reasons as to why it has not been finalised, the Regulator has stated it may choose not to invoke a penalty for late submission.

Comment

The Regulator is keen to be "clearer in [its] expectations, quicker to respond and tougher where…need[ed]". Sponsors and trustees should be aware of increased scrutiny from the Regulator in the area of scheme funding and need to start considering an appropriate LTFT and ensuring that recovery plans are of an appropriate length. Sponsors should also consider the balance being struck between the pension scheme and stakeholders if they want to limit the risk of any intervention by the Regulator.

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