

First Briefing, May 2022 Annual Funding Statement

The Pensions Regulator (TPR) has published its 2022 Annual Funding Statement. This will be of particular relevance to:

- schemes with valuation dates between 22 September 2021 and 21 September 2022 (known as Tranche 17 valuations), and
- schemes undergoing significant changes that require a review of their funding and risk strategies.

Key points

TPR highlights the uncertainties arising from the events in Ukraine and the lingering effects of the pandemic and Brexit.

Schemes will also be approaching valuations against an economic background of high inflation, high energy prices, rising interest rates and slower economic growth – all of which may impact scheme funding and employer covenant.

Favourable investment conditions over the last three years may mean that, for many (but not all) schemes, funding levels are ahead of plan.

Where schemes feel that changes to their mortality assumptions are appropriate due to Covid-19, TPR expects any reduction in liabilities to be no more than 2%, unless there is strong evidence supporting a larger reduction.

Schemes continue to be encouraged to adopt a long-term funding target (LTFT) and develop a journey plan to achieve that objective.

Once more, TPR provides a comprehensive set of tables outlining its expectations according to scheme characteristics. This year's tables are the same as last year's, but with references to the length of the recovery plan reduced from seven years to six years.

[Read the full Annual Funding Statement.](#)



Employer covenant considerations

TPR believes that employers are becoming more polarised in the way they have been able to react to significant market events. While some have thrived, others continue to be materially negatively impacted.

Trustees should consider obtaining specialist advice to help them understand and monitor their employer covenant, particularly where the covenant is complex, deteriorating, or has been materially, negatively impacted by recent market events.

Where market conditions have had limited impact on the employer's business, TPR expects a 'business as usual' approach to setting recovery plans. Where employers are experiencing short-term affordability constraints, trustees should carefully consider requests to accept a temporary reduction in contributions and seek mitigation.

Actuarial and investment considerations

Since the start of the year, long-term interest rates have increased and gilt yields have remained volatile. The impact on scheme funding will vary depending on scheme investment and funding strategies, and the level of hedging in place.

The impact of recent high inflation will be scheme-specific, and will depend on how scheme benefits and assets are linked to inflation.

Schemes should carefully consider their inflation assumptions pre- and post-2030 when RPI is currently planned to be aligned with CPI. Furthermore, any adjustment to market-implied inflation to allow for the presence of an inflation risk premium should be consistent with the scheme's exposure to inflation in the investment strategy.

TPR recognises there are differing views on the long-term impact of Covid-19 on mortality within schemes. Where schemes deem changes to mortality assumptions to be appropriate and justifiable, TPR expects any reduction to liabilities to be no more than 2%, unless there is strong evidence supporting a larger reduction.

Other considerations

Tranche 17 valuations will be regulated under the existing legislation and funding code.

TPR has reconfirmed that the second consultation on the new Defined Benefit (DB) funding code will be launched later in 2022, following consideration of the outcome of the Department for Work and Pensions' (DWP) consultation on the new draft funding and investment regulations.

The Pension Schemes Act 2021, once implemented, will make it a legal requirement for schemes to have a specific long-term strategy designed to deliver an agreed long-term objective. In the meantime, schemes continue to be encouraged to adopt a long-term funding target (LTFT) and develop a journey plan to achieve that objective.

As scheme funding positions and the employer covenant can change materially over a relatively short period of time, schemes continue to be encouraged to develop an integrated risk management (IRM) approach to funding, investment and covenant.

Key risks and TPR expectations

In recent years, TPR has set out its expectations in tables of the key risks that trustees and employers should focus on, and actions to take, according to scheme characteristics. There are five scheme types:

	Covenant	Funding
A	Strong or tending to strong	Funding position is considered to be strong, technical provisions are strong and recovery plan is less than six years
B	Strong or tending to strong	Technical provisions are weak, and/or recovery plans are longer than around six years
C	Weaker employer with limited affordability	Scheme funding on track to meet long-term funding target, technical provisions are strong and contributions are reducing deficits at a slower but affordable pace
D	Weaker employer with limited affordability	Technical provisions are weak and/or recovery plans are longer than around six years
E	Weak employer unable to provide support	Stressed scheme with limited or no ability to use flexibilities in the funding regime

Each table is then further subdivided according to whether the scheme is relatively immature or mature.

The tables this year are the same as those published last year, but with references to the length of the recovery plan reduced from seven years to six years, reflecting the reduction in average recovery plan lengths over recent years.

Trustees are asked to find the table closest to their situation and set about preparing their recovery plan to balance affordability with contributions linked to well-defined triggers, contingency plans and other protections for member security.

Further information

For further information, please contact your usual First Actuarial consultant.