



Pensions Newsletter No 7

tPR : REGULATING THE FUNDING OF DEFINED BENEFITS

The Pensions Regulator (tPR) published on Monday a consultation document giving more details of how it will regulate scheme specific funding. <http://www.tpr.gov.uk/schemeFunding/> As well as the principles underpinning tPR's regulatory approach, the paper defines the proposed triggers for regulatory intervention on:

- a. technical provision and funding objectives
- b. the recovery period for financing scheme deficits.

Principles

tPR defines its regulatory principles as:

protecting members – tPR will support trustees and employers working to protect the benefits that the employer promised to pay and that members are expecting.

scheme specific – it is not its role nor is it consistent with Government policy to set a funding standard, because each scheme needs to take account of its particular circumstances.

risk-based – regulatory intervention should be focused on the schemes that pose the greatest risk to their members or the PPF. While it is never possible to eliminate all risk, those in a position to do so should seek to mitigate pension risks wherever it is reasonable to do so.

proportionate – trustees are required to correct any shortfall as quickly as the employer can reasonably afford. tPR intend to discriminate between those schemes where rapid elimination of the shortfall would have a serious impact on the employer and those where employers could potentially afford to pay off the shortfall more quickly.

preventive – tPR need where possible to act before risks materialise.

practicable – tPR need an approach that can be operated within the constraints of the information and resources available to it.

referee not player – the responsibility for ensuring that schemes are fully funded rests with trustees, employers and their advisers – the regulator will not interfere with this responsibility where this is consistent with its own duties.

Regulatory action

The document discusses the considerations which have led to the formulation of the tPR's proposals, including the impact on sponsors and economic consequences..

tPR believes that sponsors now accept that unfunded pension liabilities are an obligation to be met. This has been helped along by both FRS17 and the June 2003 regulatory changes, which require solvent employers to fund a buy-out with an insurance company on scheme termination.



Trigger points

The tPR considers that typically a scheme's FRS17 valuation of liabilities will cover some 70-80% of the buy-out cost. As will the ratio of PPF liability to buy-out. It also estimates that for the majority of schemes the outstanding average working life of actives is less than 10 years. tPR therefore proposes:

Funding objectives which produce a ratio of FRS17 to buy-out or PPF to buy-out which falls below this 70-80% range will be considered for regulatory intervention. It will adapt these limits based on scheme characteristics eg maturity. It will be looking closely at schemes for which the ratio falls below 60%.

On recovery periods to rebuild deficits it will be looking to intervene:

1. If the recovery period is ten years or longer
2. If the recovery period is less than ten years but the employer is strong enough to pay off more quickly
3. The recovery plan weights payments towards the end of the period.

The first trigger derives from tPR's remit to protect the PPF. A scheme which has low cover for PPF liabilities is more likely to become a call on the PPF. The second corresponds to the tPR's wish that strong employers should pay down deficits as quickly as possible.

Contingent security

The tPR would like schemes and sponsors to be able to manage risk effectively and identify scope for using contingent assets, for example financial guarantees, but is obviously concerned about their reliability and value.

Comment

The scheme specific funding requirements are expected to take effect later this year for schemes having a valuation date after 21 September 2005. It may be three years before all schemes are brought within the new requirements. With funding levels generally low the proposals for recovery periods are going to be important. The typical spreading of deficit payments over 10 to 15 years will no longer be acceptable. This will usually increase short term contribution costs after the next valuation for sponsors who can afford to pay. A strong sponsor might see his additional contributions double - though payable for a much shorter period. Employers unable to pay can expect to have to work with their trustees and the regulator to devise a recovery plan.

Unfunded public service pension schemes are not directly affected.