



PENSION JOURNEYS.

HAVE YOU SET THE RIGHT COURSE?

“Trustees and employers should be agreeing a clear strategy for achieving their long term goals, recognising how the balance between investment risk, contributions and covenant support may change over time, particularly as schemes become more mature and potentially better funded.”

The Pensions Regulator, announcing the 2019 Annual Funding Statement



PLAN THE JOURNEY

Schemes are often over-exposed to the fate of a handful of businesses in their covenant and the volatile returns of their investments. Getting to a place where less reliance is placed on these factors is crucial – this is a long journey for many schemes and requires careful planning.



STAY ON COURSE

Valuations are formal checkpoints along the journey to ensure risks remain balanced, but key variables need to be monitored continuously and contingency plans put in place, to prepare for expected events and withstand the unexpected.

**In the four roadmaps, we identify tools, resources, and ideas to help you successfully navigate through key phases of your scheme's journey.
Where is your scheme now?**

VALUATION

Reassessing how contributions and investment returns are balanced

Valuations are important pit-stops along your pension scheme's journey, giving you a chance to check you have enough gas left in your tank to easily reach your destination. For your pension scheme this means balancing the risk capacity and affordability of your sponsor with your scheme's investment strategy and funding needs — making sure your journey stays on track.

In keeping with current TPR guidance, here, we set out a risk-centric approach to a funding valuation – it's a natural evolution of the traditional funding-focused approach.

STAGE 1 DO YOU HAVE RESOURCES AND PLANS FOR THE VALUATION?

ENGAGE EARLY

Establish the regulatory backdrop for the valuation.

- Will The Pensions Regulator be involved in the valuation?
- Do you understand the criteria against which the scheme will be assessed?

PLAN YOUR VALUATION PROCESS

A valuation is a big project – make sure all the basics are covered.

- What are the timescales?
- Are there enough resources?
- Has the scheme engaged advisors with the right expertise?
- Do you feel confident and knowledgeable; are there training needs to address in the trustee board or sponsor?
- Are the required information sharing agreements (for example between the trustee and the sponsor) in place?

VALUATION DATE

STAGE 2 HOW TO BALANCE COVENANT, INVESTMENT AND DEMOGRAPHIC RISK

REVIEW YOUR INVESTMENT STRATEGY

With a firm understanding of your covenant, ask yourself whether your current investment strategy remains supported and appropriate.

- Are you aware of how your scheme's funding level will be affected in different economic scenarios?
- Is your scheme running the right amount of risk relative to your sponsor's ability to provide support in adverse conditions?
- Are the returns you need and expect realistic given where we are in the market cycle?

Your funding (or Technical Provisions) assumptions should then be set with your end-game target in mind, and only require slight rebalancing following the outcome of your covenant review and any subsequent changes to your investment strategy.

REVIEW COVENANT STRENGTH AND AFFORDABILITY

Covenant is one of the key drivers of your scheme's investment strategy, and affordability is often a key factor in funding negotiations – it is therefore a natural starting point for valuation discussions.

- Can your covenant support the current level of investment and demographic risk?
- Are there any scenarios where the scheme's investments and sponsor's covenant could deteriorate at the same time?
- What level of contribution is affordable, and how does this compare to The Pensions Regulator's views on equitable treatment of stakeholders?
- Are there options that could enhance the covenant?
- Have you considered the strength of your scheme's counterparties, including buy-in policies?

Updated funding
assumptions

Continued...

STAGE 3 TURN THEORY INTO PRACTICE

SET YOUR RECOVERY PLAN

Addressing your funding deficit in a manner that is both affordable to the sponsor and in line with your end-game target requires careful balancing of key factors such as:

- The credit risk of your sponsor, i.e. how reliable are future contributions?
- What level of contributions are affordable, ensuring equitable treatment of stakeholders and without unduly limiting your sponsors' sustainable growth?
- What level of investment return is realistic in the current environment?
- Where is your scheme on its journey to reach its end-game?
- How mature is your scheme?

CONSIDER ADDITIONAL TOOLS

Beyond the considerations outlined above, there are a wide variety of levers that can be pulled to develop a funding and security package acceptable to all parties.

- Consider asset-backed contributions for additional security.
- Contingent funding plans could provide protection in key downside scenarios.
- Consolidation or buy-ins may help to diversify your scheme's covenant exposure.

See 'Journey Planning' in this series.

15-MONTH
DEADLINE

What
next?

IDENTIFY NEGOTIATION STRATEGIES

Without a formally agreed journey plan, valuation discussions between trustees and the sponsor can sometimes be tricky, especially when it comes to the bottom line: cash contributions.

- Do the Parties understand its strengths and weaknesses?
- What resources are available to draw from?
- Seek expertise to ensure the best outcomes – reducing pensions risk is often a win-win strategy.
- Make sure to address behavioural biases – a mutual session of PensionSim can help to build empathy and break a negotiation stand still.

Visit pensionsim.com for more information.

UPDATE YOUR JOURNEY PLAN

Before closing the file on your valuation, you should revisit your journey plan.

- Does your journey plan remain appropriate given new information?
- What has changed and how might that impact key targets and assumptions?
- Have you been able to follow the valuation negotiation framework you had set out in your journey plan?