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Industry Update

2016 Actuarial Valuations – TPR's view

The Pensions Regulator (TPR) has issued the latest of its Annual Funding Statements for defined benefit schemes, covering 2016 actuarial valuations. TPR expects that most schemes will have larger deficits than at their previous valuations. It anticipates that for the majority of schemes the increase in deficit reduction contributions (DRCs) required from the employer may be affordable, but acknowledges that some schemes may be challenged.

Scheme Funding

TPR's 2016 Funding Statement is principally aimed at schemes with valuations with effective dates between 22 September 2015 and 21 September 2016. An accompanying analysis shows that TPR anticipates that for many schemes funding deficits will have increased compared to the previous triennial valuation, despite generally good investment returns. The cause is a significant increase in liability values, driven by the recent fall in bond yields, which form the basis of investment return assumptions. TPR's modelling suggests that, as a result, for a 2016 valuation a typical scheme may see an increase in its deficit (compared to the previous valuation) of 20-35%. If the existing recovery plan end date is maintained, then the median increase in required DRCs is 75% to 100%.

TPR's analysis indicates that the majority of sponsors have seen an increase in profits and balance sheets strengthen over the last three years. On that basis they suggest that the increase in required DRCs may be affordable for most sponsors. Where the increase in DRCs is more challenging, their modelling indicates that a 3 year extension in the recovery plan end date may be the solution in the majority of cases. TPR reaffirms that in such circumstances the trustees should seek to obtain additional security for the scheme.

Assumptions

Reflecting the fall in gilt yields, TPR expects that most schemes will adopt lower assumptions for future investment returns than at their last valuation. The minority of schemes who previously assumed that gilt yields would revert to a higher level and/or sooner than implied by the markets are advised to reconsider their approach.

Most schemes make an allowance for future improvements in life expectancy using the Continuous Mortality Investigation Model (CMI). This is updated annually, and the latest model (CMI_2015) actually produces life expectancies which are lower than the 2014 version, reflecting higher than expected mortality during 2015. TPR confirms that it would consider it reasonable for trustees to adopt CMI_2015 for their valuations, but cautions against also using the 2015 experience as a basis for reducing the assumption for the future long-term improvement rate. It considers that long-term assumptions should be left unchanged until it is clear that recent experience is a true indication of a longer term trend.

Similarly, TPR cautions against adjusting assumptions on the take-up of transfers out on account of the new 'pensions freedoms', as insufficient evidence is yet available to support such adjustments.

Other Issues

There is a reminder that trustees should now be adopting Integrated Risk Management (IRM) for scheme funding. Trustees should take a proportionate approach to understanding their scheme's exposure to risk across the three IRM constituents of employer covenant, investments and funding, and then put in place a funding and risk management strategy that is integrated across all of these areas.

As schemes mature they may need to sell assets to meet their cash flow demands. TPR's modelling indicates that, in volatile market conditions, having to sell assets at inopportune times can have a material impact on scheme funding and recovery plans. Such schemes are therefore encouraged to plan their cash flow requirements in advance.

There is a reminder that any schemes likely to miss the 15 month deadline for finalising their valuation should advise TPR in advance with the reasons for the delay and a clear timetable for completing the valuation.

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