

2020 pension scheme valuations: An action plan for trustees

May 2020



Governance

These can be tricky times to undertake and conclude a valuation – Covid-19 has, for many, resulted in higher, more volatile, deficits and, for others, also put a strain on the sponsor.



Covenant

These challenging times also need to be considered in the context of the Pensions Regulator's (TPR) consultation on the future of funding, and the Pension Schemes Bill 2020, which, combined could result in more prudent funding and investment strategies for many schemes in the future. TPR also issued its 2020 [Annual Funding Statement](#) (AFS) to support trustees with valuation - see our [News Alert](#).



Investment

Our action plan is intended to help trustees who are starting or in the early stages of a valuation work through the actions they need to consider in the key areas of governance, covenant, investment and funding. You may also find our Covid-19 [action plan](#) useful - it covers actions other than those directly related to the valuation.

In all decisions, as ever, it is important to be proportionate, keep long-term goals in mind and follow your processes - pension schemes by their nature are long-term; don't rush your decisions if you do not have to.



Funding

For further details of what the implications could be for your scheme, please contact the partner who usually advises you.

Governance

Area	Action
Valuation action plan	<ul style="list-style-type: none"> Work with advisers to get initial results available promptly to give time for negotiations over the results. The 2020 AFS does not give any easements on the normal 15-month deadline. Make timing realistic, consider when administrators can deliver data (without compromising business as usual service) and the sponsor can provide the information needed for the covenant assessment.
Trustee training	<ul style="list-style-type: none"> The pensions landscape has changed a lot in three years - training should include the implications of the Pension Schemes Bill, the TPR's consultation and the current Covid-19 environment.
Sponsor	<ul style="list-style-type: none"> Develop clear lines of communication with the sponsor. The most successful valuations are often those where the sponsor and trustees work collaboratively together to agree an outcome that best meets both their objectives.
Decisions	<ul style="list-style-type: none"> Set up a decision-making structure that works for you under current restrictions. This could include shorter but more frequent virtual meetings, use of subcommittees and webinar style training.
Conflicts	<ul style="list-style-type: none"> Consider whether the current circumstances give rise to any new conflicts (for example due to the workforce shrinking and trustees taking on different roles) and manage these appropriately.

Covenant

Area	Action
Independent advice	<ul style="list-style-type: none">• Decide if you need independent covenant advice, if not already doing so. The covenant assessment is key to make well informed decisions and often it is not straightforward, especially where the covenant is complex, deteriorating, stressed and / or deficits are relatively large.• Carefully document any decision not to obtain independent covenant advice and the outcome of your own review. TPR expects that trustees should only undertake their own assessment where they have sufficient expertise to do so and are free of undue conflicts of interest.
Timing of review	<ul style="list-style-type: none">• Decide when to undertake the covenant assessment. Many companies are firefighting due to Covid-19 and unlikely to be operating at “business as usual”. A review later in 2020 may be more appropriate when there may be more certainty regarding future prospects and affordability of deficit contributions.• Make sure you have a process to obtain regular updates of key information - the frequency and intensity of monitoring should be increased until covenant visibility and strength is restored.
Assessment	<ul style="list-style-type: none">• Determine the covenant assessment. This also includes determining your TPR category with its associated risks and expectations as set out in AFS2020.• Consider if it would be appropriate to model different scenarios of the covenant in the future, this could include Brexit impact as well as Covid-19’s short, medium and long-term impact.• Develop a suitable covenant monitoring framework and contingency plans to take action if the covenant deteriorates or to share suitably in future successes - for example contingent contributions linked to future profits, cashflows or dividends.
Covenant leakage	<ul style="list-style-type: none">• Make sure you understand the sponsor’s operations and how covenant leakage may occur, whether arising from dividends, inter-company loans, group trading arrangements, management fees, executive remuneration or other forms of value transfer.• Ensure when agreeing your recovery plan that the scheme is treated fairly compared with other stakeholders, checking against TPR’s expectations for this.• Seek suitable protections to compensate the scheme for the resultant deterioration in covenant in the event of existing or future covenant leakage (for example guarantees and/or contingent assets).

Investment

Area	Action
Strategy	<ul style="list-style-type: none">• Consider whether you are taking the necessary short-term actions in light of Covid-19. More detail is in our Covid-19 trustee action plan, including considering possible new opportunities.• Discuss and document how you plan to invest when the scheme reaches its long-term funding target, even in broad terms.• Debate the merits of different pathways to reach the long-term asset allocation eg steady de-risking vs a level risk profile, and the interaction with covenant strength.• Make sure the maturity of the scheme has been properly reflected in the investment strategy.
Risks	<ul style="list-style-type: none">• Consider the level of investment risk taken now and in the future and whether this is supported by the covenant. Agree on how best to test and evidence that risk is supported - for example by considering the Value-at-Risk in the investment strategy relative to relevant covenant metrics.• Determine what monitoring framework would best help you to assess changes in the covenant’s ability to support investment risk going forward.• Ensure an appropriate level of liability hedging and cashflow matching is in place (consider reviewing in light of significant Covid-19 related market moves).
Expected returns	<ul style="list-style-type: none">• Set your best estimate of long-term investment returns for individual asset classes and the overall strategy in light of current market conditions. Ensure this is robust to different scenarios for the economic recovery.• Make sure you know the balance between cash contributions and expected investment returns in achieving your long-term funding target.
Governance and flexibility	<ul style="list-style-type: none">• Make sure you have structures in place reduce risk swiftly if required (for example in the case of significant deterioration in sponsor covenant). TPR sets out its expectations for how schemes in a range of covenant situations should invest.

Funding

Area	Action
Initial results	<ul style="list-style-type: none"> Obtain initial results on your current Technical Provisions assumptions in line with usual timescales and then consider what changes might be appropriate as set out below.
Long-term Funding Target (“LTFT”)	<ul style="list-style-type: none"> Reassess the appropriateness of any agreed LTFT or consider whether one should be put in place. A key requirement of the new funding regime will be the requirement for schemes to have a LTFT to get to a low risk position by a future date depending on various factors including maturity and covenant visibility. It also requires consistent funding and investment strategies to support a journey plan to get to the LTFT. Our Chart your own course report contains further thoughts on setting a LTFT and journey plans.
Assumptions	<ul style="list-style-type: none"> As with any valuation, consider what assumptions might be appropriate to update in the light of changes since the last valuation. This includes: <ul style="list-style-type: none"> Covenant changes, noting that this may not be certain and may be subject to review as set out above. A deterioration in covenant would generally result in more prudent assumptions and therefore a higher deficit (or reduced surplus) and vice versa. Consistency with investment strategy with suitable adjustments for prudence, depending amongst other things on the covenant assessment and any LTFT. Mortality assumptions including to reflect the latest tables and scheme experience. It is too early to understand the impact of Covid-19. RPI Reform including the impact of the Government’s consultation - see our webinar for more details. Changes in member option terms including whether current terms need to be updated in the light of recent market movements and the treatment of transfer values. Allowance for GMP equalisation.
TPR consultation	<ul style="list-style-type: none"> Determine how your valuation stacks up against TPR’s likely Fast Track as set out in its consultation - our Fast Track Forecast can help here - and whether any assumptions should be changed in the light of this. Although it is a consultation rather than guidance, it is indicative of what TPR views as good practice and how TPR may assess your valuation. If you do not satisfy expected Fast Track, consider if you will be able to justify your position under the “Bespoke” route. Our April 2020 webinar gives an overview of what funding might look like in the future.
Recovery plan	<ul style="list-style-type: none"> Assess what modifications are needed to the current recovery plan to meet any deficit. Consider any plan in the context of sponsor affordability and getting a fair share compared to other stakeholders eg dividends. As mentioned above contingent solutions could be considered - for example contingent contributions if the sponsor performs better than expected, or contributions into escrow if financial conditions and thus funding levels improve faster than expected. Consider the appropriateness of allowing for changes in financial conditions after the valuation date and or member experience in setting the recovery plan. Assess any allowance for outperformance.
Other contributions	<ul style="list-style-type: none"> Consider what allowance should be made for expenses including the PPF levy (indeed TPR suggests this in its “Fast Track” solution in its funding consultation). Determine what an appropriate contribution towards any future service benefits should be - this could be more complicated if there are members who are furloughed.
Non-cash funding	<ul style="list-style-type: none"> Consider any alternative solutions proposed by the sponsor as part of the valuation agreement. Extraordinary times can call for innovative solutions and this could involve the use of Asset Backed Funding (ABF) structures, escrow, guarantees or other arrangements.
Scenario analysis	<ul style="list-style-type: none"> Look at various scenarios to understand the sensitivity of the valuation outcome to the assumptions. Such scenario modelling can be particularly valuable in uncertain times such as this, although uncertainty can be explored in different ways too and an integrated approach is key.
Integrated risk management	<ul style="list-style-type: none"> Work with your advisers to develop your IRM framework further to manage the risks you face on your future journey, and use this to aid decision-making for your valuation (and in future).
Buy-out	<ul style="list-style-type: none"> Make sure you understand your buy-out deficit, this may be lower than you think.

Want to find out more?

If you would like further information, please contact the partner who normally advises you.



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In this action plan we have split the various actions under the titles of covenant, investment and funding. In practice there is much crossover and an integrated approach to valuation discussions is key.

Access Chart your own course, helping trustees to navigate their pensions journey [here](#)

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