TPR has posted guidance at the following link, which it will update as the situation develops. One of its pages contains guidance to trustees of DB schemes, whose sponsoring employers are in distress, including guidance about deferring deficit repair contributions.

https://www.thepensionsregulator.gov.uk/en/covid-19-an-update-for-trustees-employers-and-administrators

TPR suggests trustees ask their scheme's sponsoring employers

> "How have they considered how the impact of the virus and the measures to contain it may affect: …
>
> - cashflow - employers should be preparing 13 week cashflows where there is a significant impact on cashflow".

In this update I suggest also making 20-year cash flow forecasts of the scheme.

triennial actuarial valuations (TAV)

The statutory basis for valuing DB pension schemes is in part 3 of the Pensions Act 2004. If the present Pensions Bill is enacted, s221A(1) will require the trustees to determine (as surely is the trustees' duty regardless of any legislation) "a strategy for ensuring that pensions and other benefits under the scheme can be provided over the long term." Section 222 requires every scheme to "have sufficient and appropriate assets to cover its technical provisions", defines technical provisions as "the amount required, on an actuarial calculation, to make provision for the scheme's liabilities" and requires "assets to be valued in a prescribed manner".

The TAV compares with each other two amounts at the valuation date. One, the "amount required", is the total of the benefits to be paid to each member and each member's dependants discounted to their present values and the other is the value of the assets. If the amount required exceeds the value of the assets, the scheme is in deficit and, if the other way round, it is in surplus. The financial state of a pension scheme (consisting of two sets of cash flows, benefits paid, as outflows, and, as inflows, contributions received from the employer and active members, investment returns and the realisations of assets, both over a period of possibly seventy, eighty or more years) is thus reduced to one amount on one day; and the exercise is repeated after an interval of not more than three years.

The TAV also shows amount that would have been needed to secure benefits in full if the scheme had been wound up on the valuation date.

needed information

Shareholders and managers of employers, lenders and other people dealing with them and pension scheme members need the following information about the employer and its pension scheme:

1 whether the employer, as long as it continues in business, can afford to fund the scheme sufficiently to enable it to meet its liabilities as and when they become payable and to continue to do so for the whole, or at least the foreseeable, life of the scheme; and

2 whether, if a debt under s75 of the Pensions Act 1995, becomes payable (typically when the employer becomes insolvent and the pension scheme must be wound up) and members' benefits fully secured with an insurance company, the employer will have sufficient assets to discharge any deficit.

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The information needed for 2 above is provided by the TAV and is probably as good as good and useful as can be. The TAV does not however even attempt to provide the information required in 1 above. The nearest it come to doing so is to show whether the scheme, over its whole life, seemed to be sufficiently funded at the valuation date. The actuary's estimate of the contributions needed to fund the scheme might be as good as can be, but it is not as useful as it might be, because those who need to know cannot see how the contributions are related to the scheme's present and foreseeable needs. Discounted present values are tools to compare future cash flows with each other, but cannot be and do not serve as a reliable guide to the year to year running of a business or the scheme.

twenty (or so) cash flow projections

When employers and trustees need to decide what to do with pension schemes, they need not simply to satisfy the statutory obligation, which must still be done, but to have enough information to form a view of the feasibility of the employer supporting the scheme in the short (but not as short as TPR's 13 weeks) to medium term. The data and assumptions used by the actuary to produce the cash flows to prepare the TAV can be used on a spreadsheet to show, for each of the next, say, twenty years, the amounts reasonably expected to be paid in pensions, lump sums, transfers out and administration, and received in contributions and as investment returns: it is probably not prudent to assume disinvestment in a period materially less that the whole life of the scheme. Similar projections are needed for the employer's profits and cash flow.

If the scheme's outgoings and investment returns are treated in the spreadsheet as given, the employer's contributions can be treated as the variable. If nothing is inserted for them, the spreadsheet will show when the scheme will run out of money. Different amounts of contributions, perhaps different amounts at different times, will show what is expected to be needed to enable the scheme to continue to provide benefits during the twenty (or so) years.

The results of the exercise might show nothing unexpected, but its value is that they can show in the medium term whether:

(a) it cannot reasonably be expected that the employer can support the scheme without putting its commercial future in jeopardy, so, if the employer or its business is to survive, TPR's support is needed to enable the reconstruction of the employer or the scheme or both, probably involving the PPF, without triggering its moral hazard powers; or

(b) as in the example below, the scheme is viable, despite appearances as shown by the TAV, so there is no need for TPR to be too eager to be draconic in the exercise of its powers under s231 of the Pensions Act 2004.

an example

Before the Pension Act 2004 came into force, a small modest DB scheme had an MFR funding around 55% (on the face of it a "basket case"). The trustee's newly appointed treasurer, a very experienced banker, prepared a 5-year cash flow projection showing that the scheme would have net outgoings for 18 months and net inflows for each month of next three and a half years. The actuary checked and agreed the projection, which the treasurer then extended to 25 years, also agreed by the actuary, in which the net cash flows for each year remained positive. These projections gave the trustees confidence to persevere, despite the appearance, under the statutory valuation system, that the scheme was in a hopeless condition. The scheme remains open to new members as well as accrual.

END