

The Pensions Regulator's Annual Funding Statement 2024



What you **need to know**

- The Pensions Regulator (TPR) published its Annual Funding Statement (AFS) on 24 April 2024. It is aimed at trustees and sponsors of occupational defined benefit pension schemes and is particularly relevant to schemes with valuations between 22 September 2023 and 21 September 2024. It is also relevant for schemes whose funding strategies and investment allocations have been significantly impacted by the changes in market conditions over recent years.
- TPR recognises that many schemes have seen material improvements to their funding levels. TPR says that trustees of these schemes should consider whether continuing with their existing strategy and level of risk is in the best financial interest of members. TPR continues that when reflecting on this, trustees should consider the range of options available, including running on to generate additional surplus to benefit members and employers, entering into a consolidator or insurance arrangement, and buyout.
- Trustees of schemes in deficit on a technical provisions basis are encouraged to agree a recovery plan that is as short as reasonable, taking employer affordability into account.
- TPR directs trustees to consider the steps they can take to broadly align with the new funding code when it is published (expected over the summer).



Actions you can take

- **Consider** whether your current strategy and level of risk is appropriate for your scheme. Your strategy should align with your long-term plan for the scheme which may have changed recently.
- **Outline** the steps your scheme would need to take to align with the funding code (when published). TPR notes that this would be good practice for trustees.
- **When facing calls** to reduce contributions or provide discretionary benefits, TPR recommends considering your scheme's funding position, investment resilience and strength of covenant support.

Key long-term options to consider

Item	Description
Buyout	Long considered the gold standard option when affordable, buyout results in a clean break for employers and reduced risks for members, and will remain an appropriate objective for many schemes. However, a changing pensions landscape with the Mansion House initiatives and the consultation on options for DB schemes means that trustees should objectively assess whether buyout remains the best path for their scheme.
Run-on	Continuing to run the scheme on and generate additional surplus could ultimately result in an uplift to member benefits. For example, members could be granted discretionary increases where benefits have received below inflation increases. However, the potential for additional benefits must be weighed up against the associated risks and operational costs of running a scheme on, with governance being a particular concern for smaller schemes. Run-on can also benefit the employer through surplus extraction and potentially boost the wider UK economy by productive asset investment.
Consolidation	Emerging options such as consolidation with a commercial consolidator or the recent consultation on a public consolidator managed by the Pension Protection Fund should be explored to ascertain if they would be in members' best interests. 'Gateway principles' or other eligibility criteria will need to be met under both models so this option will not be available to all schemes. TPR intends to publish guidance on DB alternative arrangements for consolidation later this year.

The finer detail: TPR's AFS 2024 – key items

Re-thinking strategy depending on current funding position

Funding at or above buyout: The main options are buying out with an insurer or running the scheme on. Trustees should be prepared to document and explain why their chosen option is in the best interest of members and have a clear understanding of the risks involved.

With a buyout strategy, trustees should consider scheme rules, take advice, consult the employer and consider whether an outright or staged buyout is the best approach. Trustees are encouraged to take climate change and wider sustainability issues into account as part of the due diligence procedure when considering an insurance solution.

With a run-on strategy, trustees should ensure it is the better option for members, for example because it offers them (and the employer) the potential to benefit from continued surplus generation.

Funding above technical provisions (and below buyout): Trustees should review their long-term objectives and where they remain appropriate, consider accelerating towards them if improvements in funding allow this. Schemes in this position are encouraged to consider all options including buyout, run-on and the emerging options of consolidation (including public sector consolidator via the PPF) and capital-backed journey plans.

While a 'wait and see' approach may be reasonable for some trustees due to the novelty of some of these options, trustees should timetable when it will be appropriate to consider them in future. Meanwhile, trustees may explore how they can improve governance and increase economies of scale to achieve more effective scheme management and ultimately deliver greater value to members.

Funding below technical provisions: For these schemes, bridging the funding gap will remain the key focus, recovering the deficit as soon as the employer can reasonably afford. Any risk-taking should be supported by the employer covenant and should reduce as funding improves and the scheme matures.

General considerations for current valuations

Long term objectives and funding and investment strategies previously set in an era of low interest rates now need to be reviewed. While many schemes will find themselves in relatively healthy funding positions going into this valuation cycle, economic uncertainty will continue to have an impact on investments and the employer covenant. Employer covenant must remain a key consideration when assessing the level of supportable risk that may be taken.

Open schemes may have experienced a reduction in the cost of future service accrual alongside a material movement in the funding position. Trustees must be mindful that their scheme may be reliant on the employer covenant for a relatively long period and understand the risks involved.

There is the potential for climate change and wider sustainability issues to impact investments, employer covenant and the resilience of funding strategies. Trustees should allow for this when considering their long-term investment and funding strategies and the employer covenant.

For further information, please get in touch with **Frasier Kings** or **Pauline McConville** or speak to your usual XPS Pensions contact.



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