

# The Pensions Regulator – Analysis of Recovery Plans



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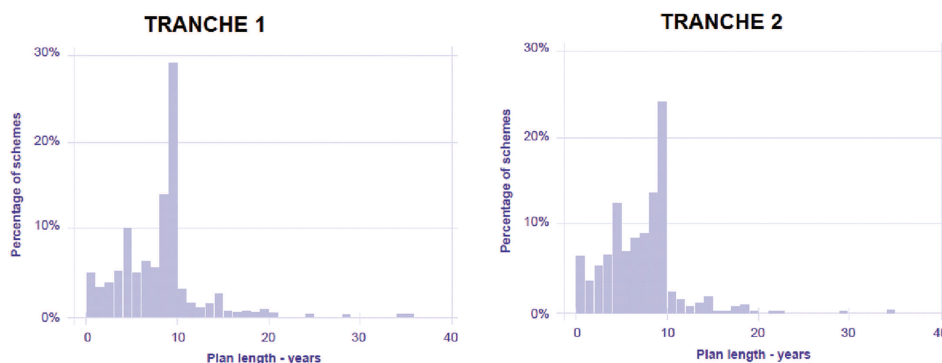
The Pensions Regulator has published its second analysis of pension schemes' Recovery Plans. The analysis compares changes between two tranches. The first covers 1,970 schemes with valuation dates up to September 2006 and the second 1,295 schemes with valuations between then and September 2007. It should be noted that the results of the analysis pre-date the recent financial turmoil.

The main findings are:

- The percentage of plans triggering (see shaded box overleaf) has fallen from 70% to 50%
- One in ten now trigger because the deficit period is too long. Previously this was one in five
- One third now trigger because the size of the technical provisions is considered too low. Previously this was around 50%
- Average technical provisions have increased from 72% to 75% of buyout liabilities
- Average technical provisions have increased from 107% to 119% of Section 179 (PPF) liabilities
- 42% of schemes have taken independent advice when assessing employer covenant

## Recovery Period

There remains a peak in the number of schemes eliminating deficits over exactly ten years, which suggests that some schemes are viewing ten years as a target. The weighted average deficit recovery period has however fallen from 9 years for Tranche 1 to 6 years for Tranche 2 schemes.



Source: The Pensions Regulator

## Discount Rates

The Regulator's analysis showed a wide range of discount rates (or investment return assumptions) has been adopted. Many schemes continue to use different discount rates before and after retirement, especially if they back these liabilities with different investment strategies. The average discount rates increased from Tranche 1 to Tranche 2 as follows:

	Tranche 1	Tranche 2
Pre-retirement average	6.13% pa	6.28% pa
Post-retirement average	4.63% pa	4.88% pa
Average where a single discount rate is used	5.02% pa	5.34% pa

Over the period gilt yields increased. The Regulator notes, however, that the discount rates relative to gilt yields generally became more cautious, from an average of 1% pa above gilt yields to 0.8% pa above gilt yields.



## Mortality Assumptions

In September 2008, the Regulator published guidance for trustees on setting mortality assumptions in scheme funding valuations. Plans for a fourth 'trigger' based on mortality assumptions were eventually dropped, but the Regulator states it is encouraged by the number of schemes who are adopting mortality improvement assumptions at least in line with its original proposals (ie 'Long Cohort' improvements subject to an overall minimum annual improvement). On average, schemes in the analysis expect current 65 year-old males to live for a further 21 years.

A large number of schemes have used scheme specific mortality adjustments on top of the standard tables and improvement rates. Only a few are basing their current mortality assumptions on the recently published analysis of Self Administered Pension Schemes (SAPS), though the proportion is expected to rise now that the SAPS ('S1') tables have been finalised.

## Regulator Involvement

Nearly all of the Recovery Plans that did trigger resulted in the Regulator 'signing-off' to say no further action would be taken. Only 0.5% of Recovery Plans received were escalated for more detailed investigation.

The Regulator repeats previous statements that it would rather see higher technical provisions and a long recovery period, than low technical provisions with a shorter recovery period. It expects schemes associated with weaker employers to have higher technical provisions.

The Regulator notes that it does not currently consider the accounting standard, FRS17, to be an adequately prudent measure of a scheme's funding position.

The Regulator notes that Recovery Plans must be determined by reasonable affordability, which implies easements where appropriate, and requesting enhanced payments if the employer can reasonably afford them.

## Action for Trustees

Scheme funding requires trustees to take their own specific circumstances into account and do what they consider is

correct and appropriate for their scheme and, we believe, not be directly influenced by the Regulator's triggers.

The reaction of the Regulator may, however, incur additional expense, time and effort should it decide to investigate further. Sometimes this can be avoided by presenting the results in a format that it finds acceptable. Whichever approach is adopted trustees need to:

- keep the employer's covenant under review
- continue to review the Recovery Plan once it is in place
- ensure that their technical provisions are, in their view, sufficiently prudent
- consider the Regulator's guidance on allowing for future mortality improvements
- be vigilant in the current economic climate (although be careful not to overreact)
- consider affordability in any agreements they reach

JANUARY 2009

*Please contact your consultant at Barnett Waddingham if you would like to discuss this subject in more detail.*

## Trigger Points

Since September 2005, a Recovery Plan is required for pension schemes where an actuarial valuation shows a deficit on the Scheme Funding basis. The Recovery Plan sets out how and when the scheme's sponsoring employer intends to make good the funding deficit, and must be submitted to the Pensions Regulator. The Regulator uses these Recovery Plans to help identify pension schemes for further investigation. The Regulator is particularly looking out for schemes where:

- the Recovery Plan covers a period longer than 10 years
- the Recovery Plan is "back-end loaded"
- the assumed rate of investment return is considered to be high
- the target funding position (ie "technical provisions") are low relative to accounting and PPF measures of the scheme's liabilities

The Regulator has said that these "triggers" should not be treated as targets.

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