# Scheme funding analysis

A look forward to schemes with valuation dates between September 2013 and September 2014 (Tranche 9)

June 2014

The Pensions Regulator

# Introduction

The regulator aims to promote a good understanding of the defined benefit (DB) funding regime and to operate in an open and transparent manner.

In order to provide further context to our **2014 Annual funding statement**[1], we are publishing our analysis of the expected positions as at March 2014 of DB pension schemes with valuation dates between September 2013 and September 2014 (Tranche 9). This analysis highlights the estimated impact of the changes in market conditions since the date of these schemes' previous valuations.

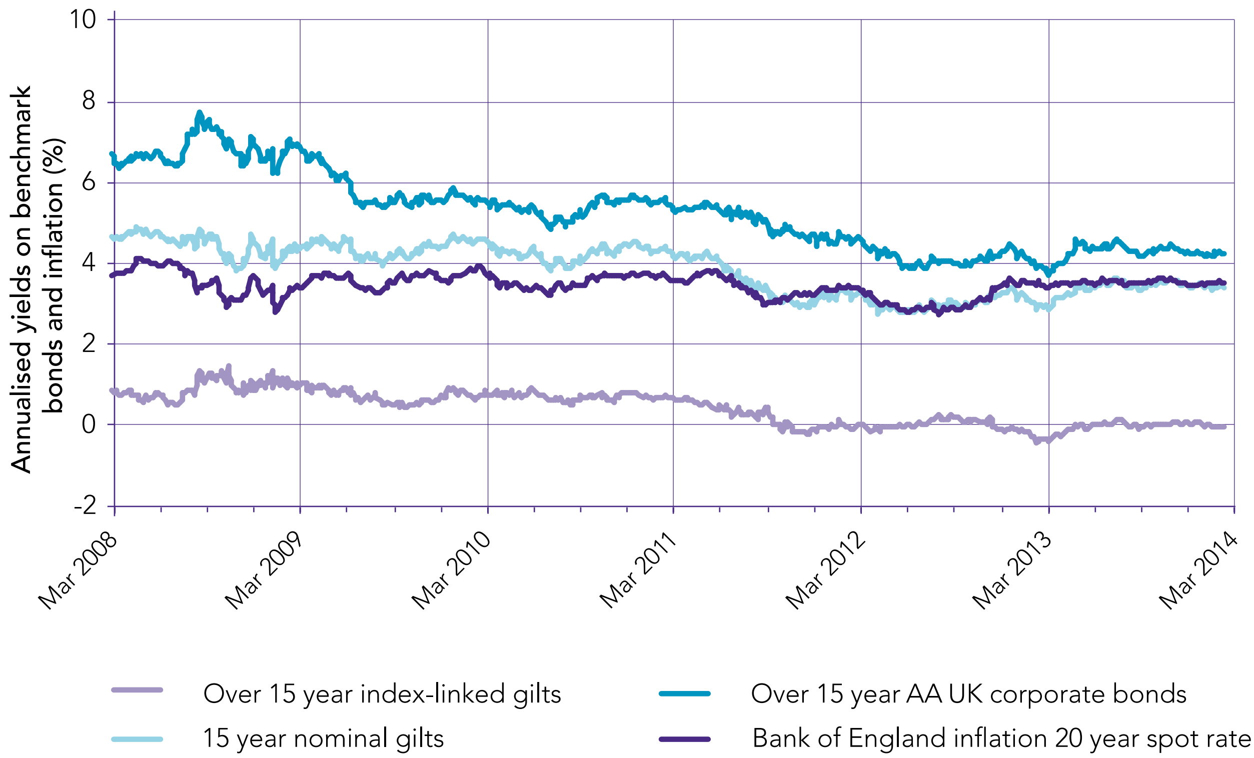
This analysis has been used to inform our approach and commentary on market conditions in our statement and our key messages to trustees and employers. However, our observations are of a generic nature having regard to market trends and their likely implications for scheme valuations. Individual schemes may, of course, have significantly different experiences.

1 www.tpr.gov.uk/funding2014

# Market indicators

Scheme funding is sensitive to the impact of the changes in market conditions on both the schemes' assets and the valuation of the schemes' liabilities. The changes in bond yields and the returns on various asset classes are key aspects to this.

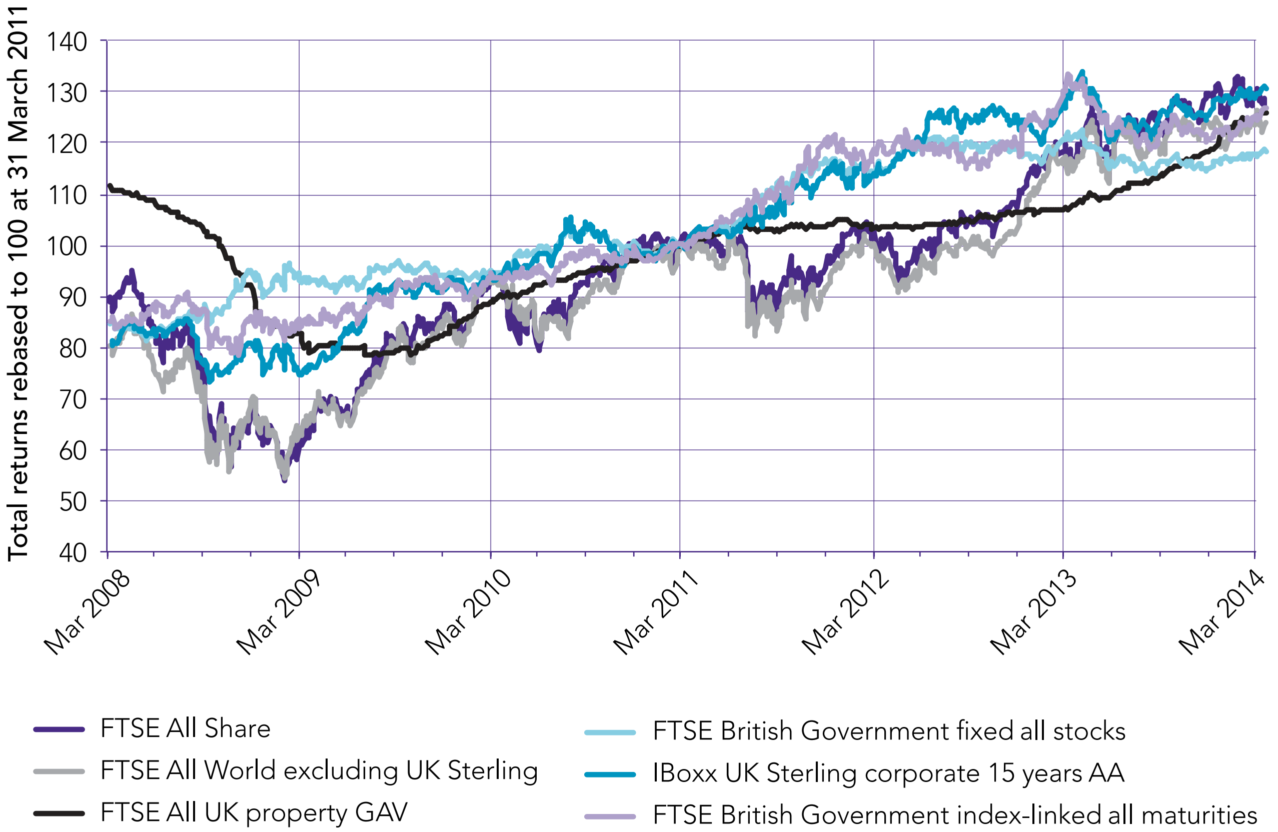
**Figure 1: Benchmark bond yields**




Source(s): The Pensions Regulator, Thomson Reuters, FTSE group, Markit iBoxx, Bank of England

Figure 1 shows the volatility and changing relationships between bond yields and break-even inflation over the last six years. These have, during the period shown, reduced.

**Figure 2: Asset returns**

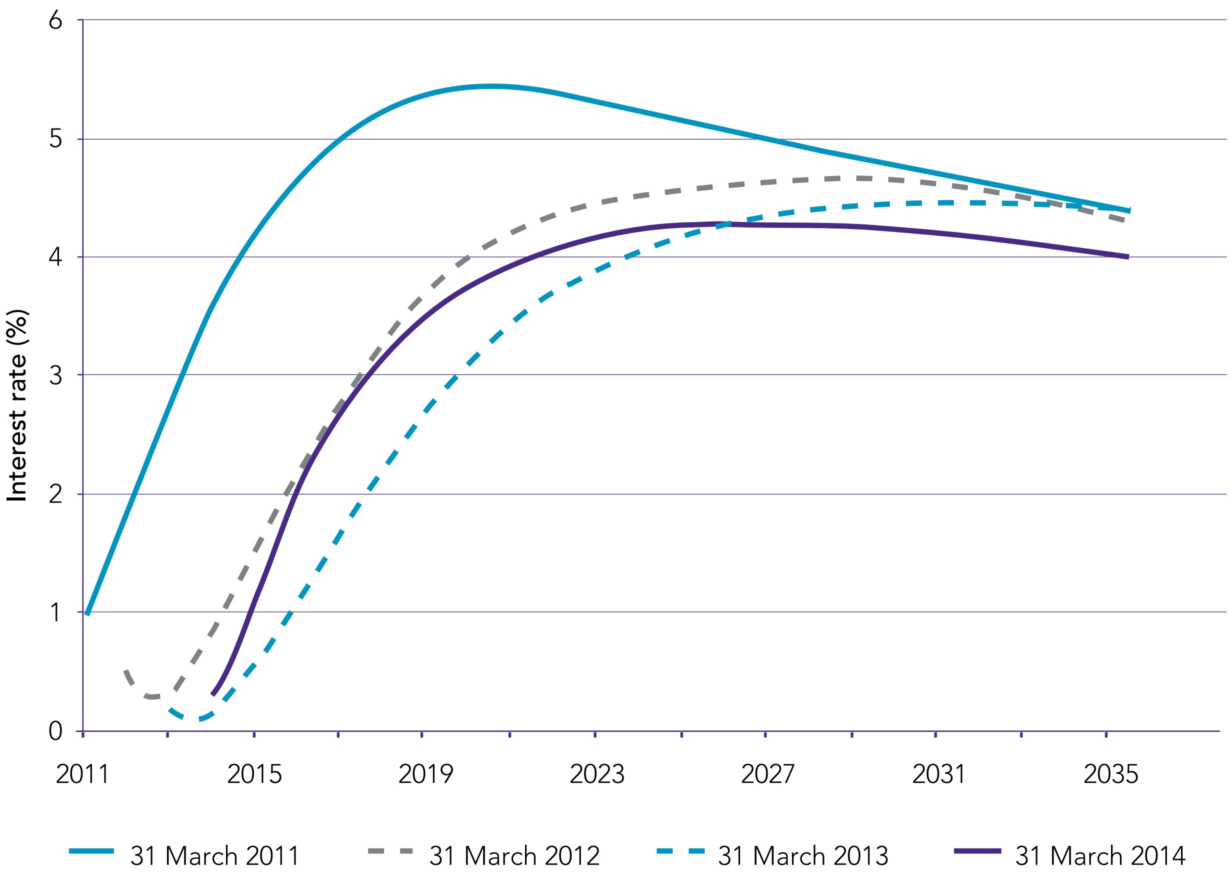



Source(s): The Pensions Regulator, Thomson Reuters, FTSE group, Markit iBoxx

Figure 2 shows total returns (increases in value with income reinvested) for a range of asset class indices since 2008. The returns have been rebased to 100 at 31 March 2011 (the central Tranche 6 valuation date), so that if equal amounts had been invested into each asset class index at that date, the chart shows the relative change from that point. These have, during the period shown, increased.

# Looking forward

**Figure 3: UK instantaneous nominal forward curve**




Source(s): Bank of England (BoE)

- Figure 3 shows the forward interest rates as estimated by the Bank of England as at March 2011, 2012 and  2013 and 2014.
- Compared to March 2011, the March 2014 implied forward interest rates are for future interest rates to be lower for longer and with lower yields in the long term
- Compared to 2012 and 2013, the implied forward interest rates are currently expected to increase more quickly in the short term but again with lower yields in the long term.

# Defined benefit (DB) schemes

**Figure 4: Estimated assets and liability positions of DB pension schemes**


Source(s): The Pension Protection Fund (PPF), The Pensions Regulator

Figure 4 shows estimates of assets, s179 liabilities and technical provisions derived from the movement in the PPF 7800 index for all schemes in the 7800 index. This is aggregate analysis based on highly summarised data. It may not be representative of individual schemes whose results will depend on many scheme-specific factors.

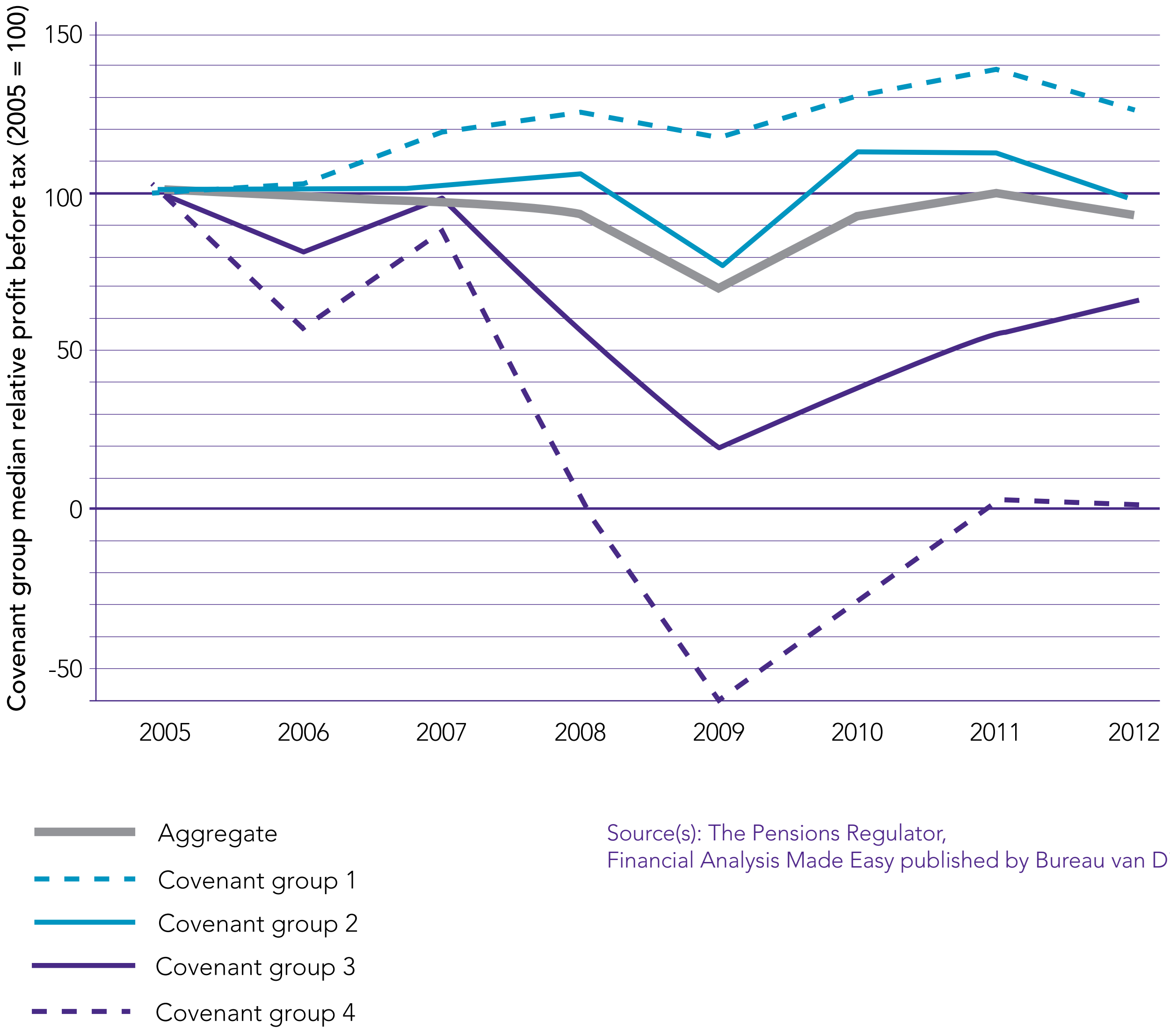
It shows an illustrative range for technical provisions, since the actual position for individual schemes will be dependent on market conditions and how schemes measure their technical provisions to reflect their scheme-specific circumstances.

The changes in market conditions since their last valuation mean that deficits on a technical provisions basis are expected to have increased for many schemes in Tranche 9, although schemes with risk management strategies, such as hedging, may have fared better.

# Sponsor trends

## Trends in profit before tax (PBT)

**Figure 5: PBT by covenant group (Tranche 9 only)**




Source(s): The Pensions Regulator,
Financial Analysis Made Easy published by Bureau van Dijk

The lines shown in Figure 5 represent the median of all schemes in each respective category. Therefore 50% of the schemes are above and 50% below this line in each respective category.

In practice, there is a wide distribution of schemes either side of the median and therefore these charts are fit for showing broad, central trends rather than drawing specific conclusions for individual sponsors.

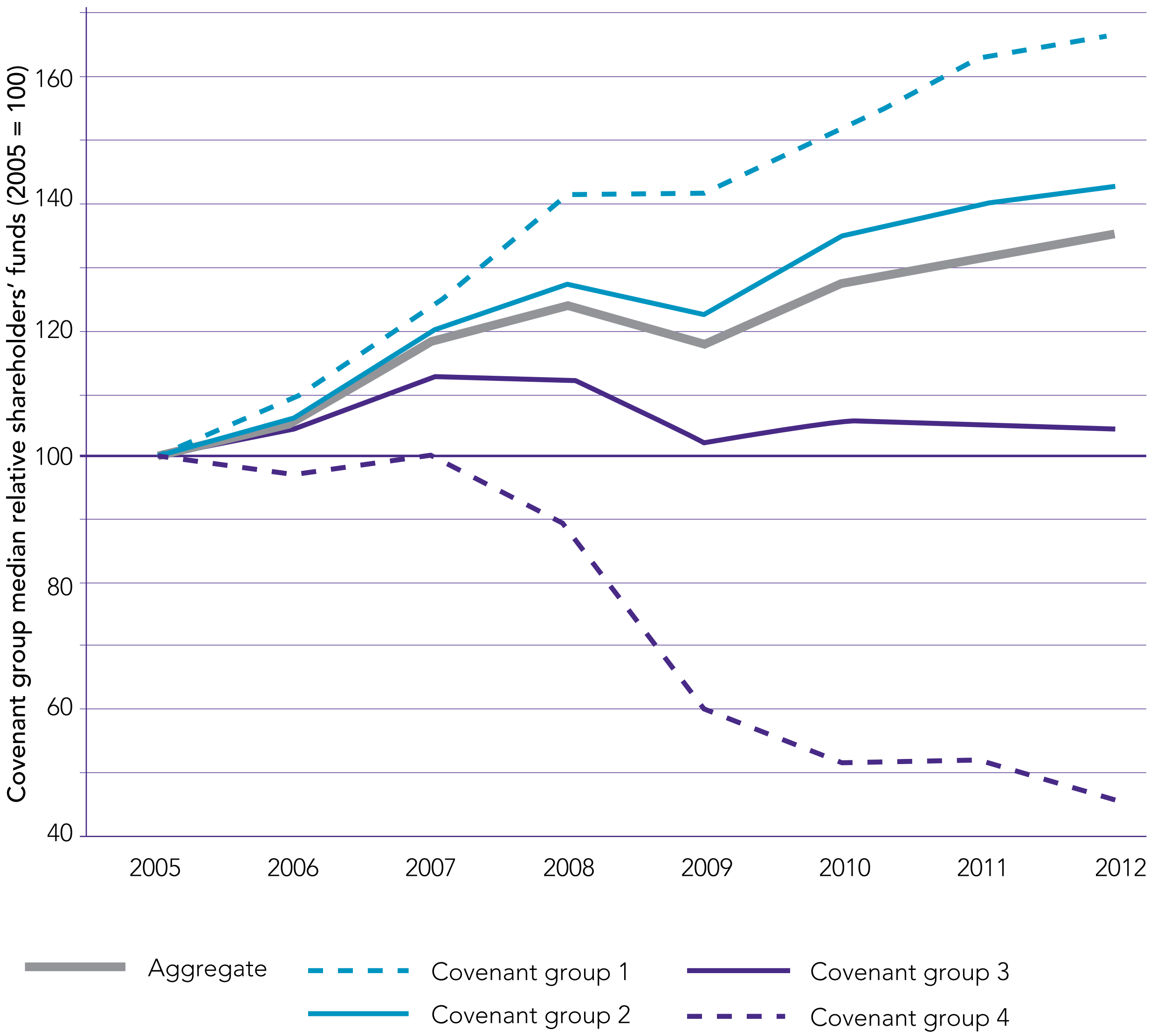
- For each recovery plan we receive, we carry out an in-house initial assessment of the scheme covenant grade (CG) ranking from strong (CG1) to weak (CG4). This assessment is used for the purpose of segmenting the DB funding universe, prioritising our resources and targeting our policies
- Figure 5 shows the median trends in PBT for sponsors of schemes with a Tranche 9 valuation date, split by the most recently assessed covenant grade. The chart has been rebased to 2005 to show the median trend from that date
- For schemes with strong sponsors (CG1) the median suggests that for the majority, PBT has increased since 2005, with the median above the 2008 level
- The median suggests that over 50% of schemes with tending to strong sponsors (CG2) saw their PBT drop below its 2005 levels in around 2008 and 2009 but that the median position had broadly recovered to 2005 levels by 2012
- The median suggests that the majority of schemes with tending to weak (CG3) and weak (CG4) sponsors have seen a more pronounced drop in PBT since 2005 with a low in 2009. Median PBT has recovered somewhat since then but remains significantly below 2005 levels, especially for a majority of CG4 sponsors.

## Additional notes

- PBT is calculated net of pension financing items on an accounting basis. This has not been accounted for in this analysis
- Due to differences in the way financial statements are collated and reported, certain types of employer (eg banks/financial services) have been excluded from this analysis
- Due to insufficient PBT data certain schemes have been excluded from this analysis. This is most prevalent in the smaller scheme population representing a limited proportion of total liabilities
- Where PBT in respect of a particular scheme is missing or negative in 2005 year end accounts, the 2006 or 2007 year end accounts value may have been substituted as the base which may distort the distribution slightly in these early years
- On average, 63% of all schemes anticipated to be conducting a valuation in Tranche 9 are included in each yearly distribution from which the median(s) are derived.

# Trends in shareholders' funds

**Figure 6: Shareholders' funds by covenant group (Tranche 9 only)**




Source(s): The Pensions Regulator, FAME published by Bureau van Dijk

The lines shown on this chart represent the median of all schemes in each respective category. Therefore 50% of the schemes are above and 50% below this line in each respective category.

In practice, there is a wide distribution of schemes either side of the median and therefore these charts are fit for showing broad, central trends rather than drawing specific conclusions for individual sponsors.

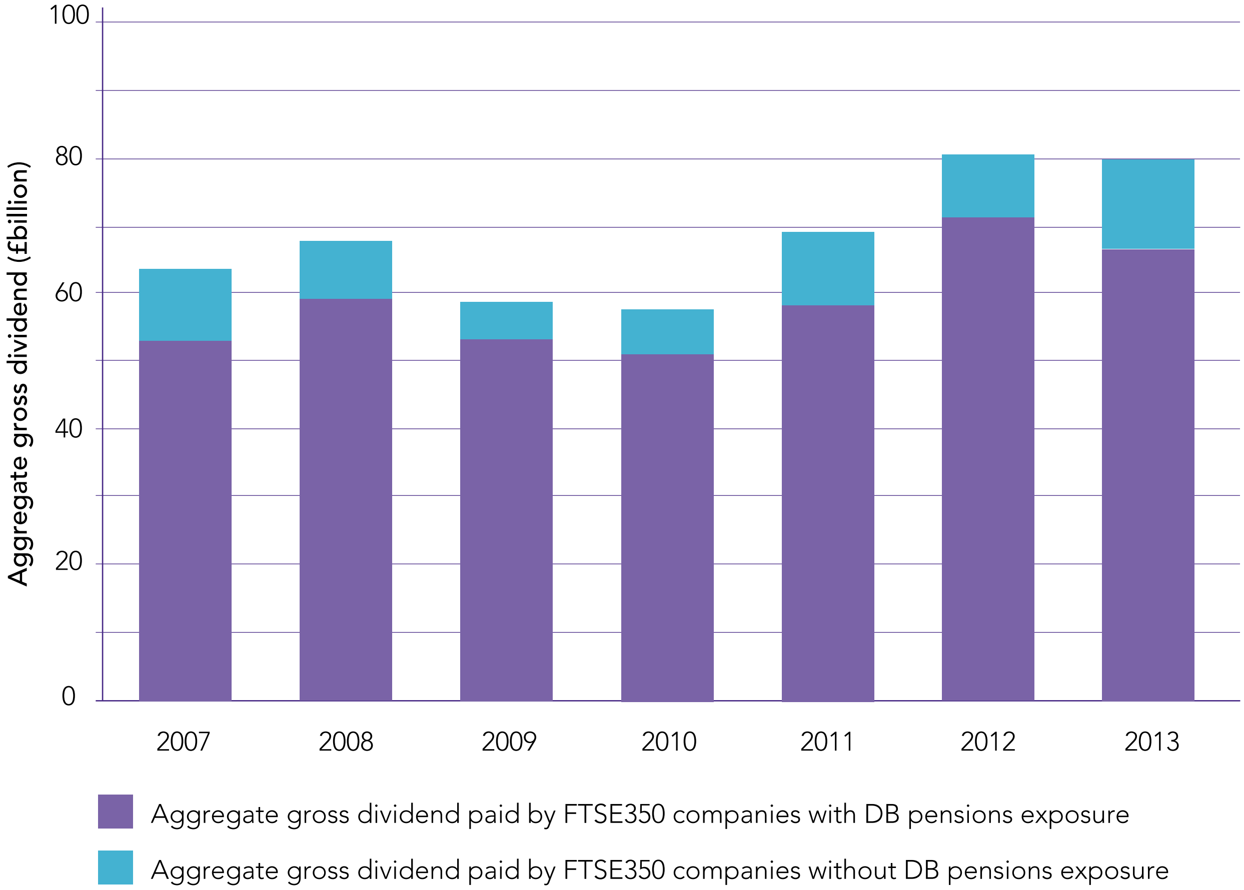
- Figure 6 shows the median trends in shareholders' funds for sponsors of schemes with a Tranche 9 valuation date split by the most recently assessed covenant grade. The chart has been rebased to 2005 to show the median trend from that date
- For schemes with strong (CG1) and tending to strong (CG2) sponsors the median suggests that for a large majority, shareholders' funds have increased significantly since 2005 to around 170% and 140% of their 2005 levels, respectively
- The median suggests that 50% of schemes with tending to weak sponsors (CG3) have reported shareholders' funds being at least at 2005 levels. At least 50% of schemes with weak sponsors (CG4) have reported shareholders' funds dropping to approximately half of their 2005 levels.

## Additional notes

- Shareholders' funds are calculated net of scheme surplus/deficits on an accounting basis. This has not been accounted for in this analysis
- Due to insufficient shareholders' funds data, certain schemes have been excluded from this analysis. This is most prevalent in the smaller scheme population representing a limited proportion of total liabilities
- Where shareholders' funds in respect of a particular scheme are missing or negative in 2005 year end accounts, the 2006 or 2007 year end accounts value may have been substituted as the base which may distort the distribution slightly in these early years
- On average, 69% of all schemes anticipated to be conducting a valuation in Tranche 9 are included in each yearly distribution from which the median(s) are derived.

# Gross dividends paid by FTSE 350 companies

**Figure 7: Dividend trends**




Source(s): The Pensions Regulator, Capita Registrars and FAME published by Bureau van Dijk

- Figure 7 shows the trends in gross dividends for the FTSE 350 from 2007 to 2013 split by those employers who sponsor DB schemes (estimated to be 208 as at 1 April 2014) and those that do not
- It shows that the FTSE 350 aggregate dividends dropped in 2009 and 2010 but have returned to peak levels in 2012 and 2013 and amounted to a headline of £79.8bn for 2013. Capita Registrars' current forecast for 2014 is for aggregate headline dividends to reach £99.4bn[2]
- However there was a reduction in dividends amongst the 208 FTSE 350 companies with UK DB pensions exposure in 2013 of about 6.8% compared to 2012. This compares to an reduction in earnings before interest, taxes, depreciation and amortisation (EBITDA) across all FTSE 350 companies of about 6.7% for that year[3].

2
Capita UK Dividend Monitor, issue 19 April 2014

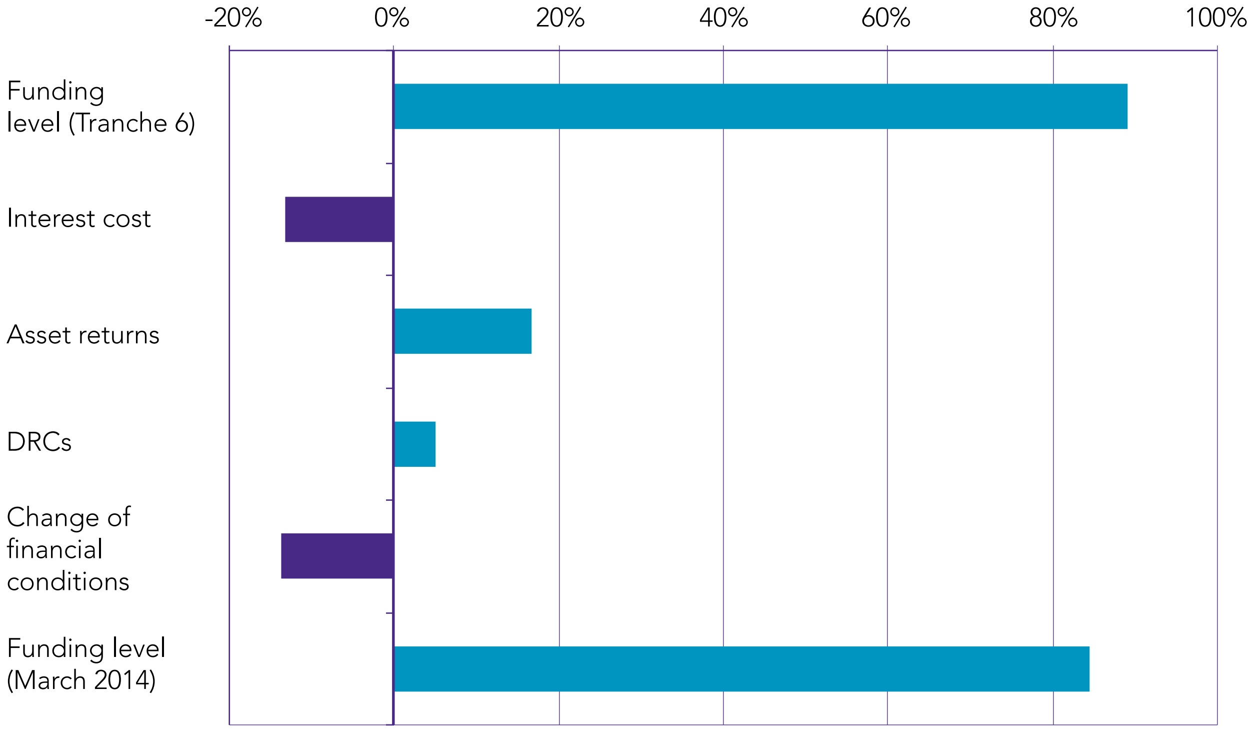
3
Hymans Robertson, FTSE350 Pensions Analysis October 2013

## Additional notes

- The analysis includes 208 companies in the FTSE 350 (estimated as at 31 March 2014) that support – through direct participation or ownership of participating employers – UK defined benefit pension schemes
- Ownership is defined as where a FTSE 350 company is the Domestic Ultimate Owner (DUO) of a directly participating employer, where the minimum percentage that must characterise the path from a subject company up to its DUO is 50.01%. In some cases the regulator does not have sufficient data to identify the DUO of a subject company (employer)
- Dividends shown are total dividends paid in each respective year, including any special dividends, and are a 'gross' amount ie they include a notional 10% tax credit treated as a deemed payment of tax to HMRC which is only used when calculating a shareholder's personal tax liability.

# Implications for scheme funding

**Figure 8: Estimated impact of market conditions on Tranche 6 schemes**



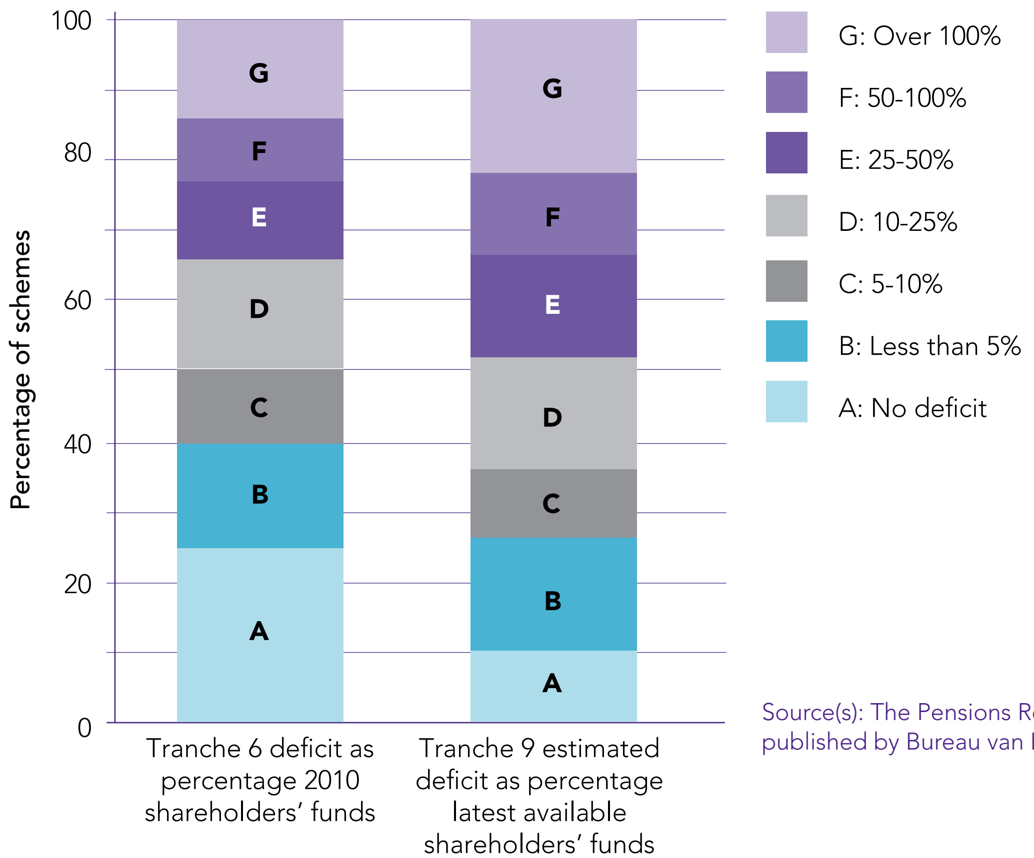

Source(s): The Pensions Regulator, Thomson Reuters, FTSE group, Markit iBoxx

- Figure 8 shows the estimated change in funding level for the aggregate of all schemes that carried out valuations in Tranche 6 (those schemes who are anticipated to submit a valuation in Tranche 9), over the period from each scheme's valuation date to 31 March 2014
- Schemes were on average around 88% funded on a technical provision basis at their Tranche 6 valuations. The asset returns achieved over the period have been significant and have outpaced the interest cost on the schemes' liabilities. Together with the DRCs paid over the period, scheme deficits in aggregate on a technical provisions basis would have materially improved
- However, the changes in market conditions over the period, specifically the fall in bond yields, have meant that schemes are likely to be slightly worse funded in Tranche 9 than three years ago, if calculated using the same discount rate relative to gilts.

## Additional notes

- We have assumed the same spread of discount rates relative to gilts used in the calculation of technical provisions as the previous valuation. This is shown for illustrative purposes only
- In practice schemes may choose to adjust their discount rates to reflect their views of changes in the market conditions, changes in their investment strategy and/or other changes in circumstances, in line with their risk management approach.

**Figure 9: Scheme deficits as a proportion of shareholder funds**




Source(s): The Pensions Regulator, FAME published by Bureau van Dijk

The significance of schemes and their deficits to their employers varies. For some schemes, their deficits are easily manageable in the context of the strength of the employer; however, for others, the level of employer support needed and the extent to which it is available can be a material consideration for both the scheme and the employer.

In Figure 9:

- the bar on the left shows the deficit on a technical provisions basis as a proportion of the sponsor's shareholders' funds relevant at their Tranche 6 valuation date
- the bar on the right shows the estimated deficit as at March 2014 on a technical provisions basis as a proportion of the sponsor's shareholders' funds using the most recently available data.

For example, the left hand bar above shows that deficits at Tranche 6 were less than 10% of shareholders' funds for around 50% of schemes in this analysis. However, in Tranche 9 it is estimated that this figure is reduced to around 35% of schemes.

This analysis suggests that for many schemes the ratio of a scheme's deficit relative to the sponsor's shareholders' funds is likely to have increased over the last three years.

## Additional notes

Shareholders' funds are calculated net of scheme surplus/deficits on an accounting basis. This has not been accounted for in this analysis and would serve to reduce the ratio of deficits to shareholders' funds for some schemes.

Approximately 9% of schemes anticipated to be conducting a valuation in Tranche 9 have sponsors who reported negative (2010 and/or latest available) shareholders' funds. These have been excluded from the analysis but many of these schemes and employers may face significant challenges to the extent that shareholders' funds adequately reflect business value.

Approximately 12% of schemes anticipated to be conducting a valuation in Tranche 9 have been excluded due to insufficient (2010 and/or latest available) shareholders' funds data. Insufficient shareholders' funds data is most prevalent in the smaller scheme population representing a limited proportion of total liabilities.

The latest available shareholders' funds data is drawn from accounts with 2013 year ends for approximately 30% of employers and 2012 year ends for the remaining 70%, owing to Companies House filing requirements.

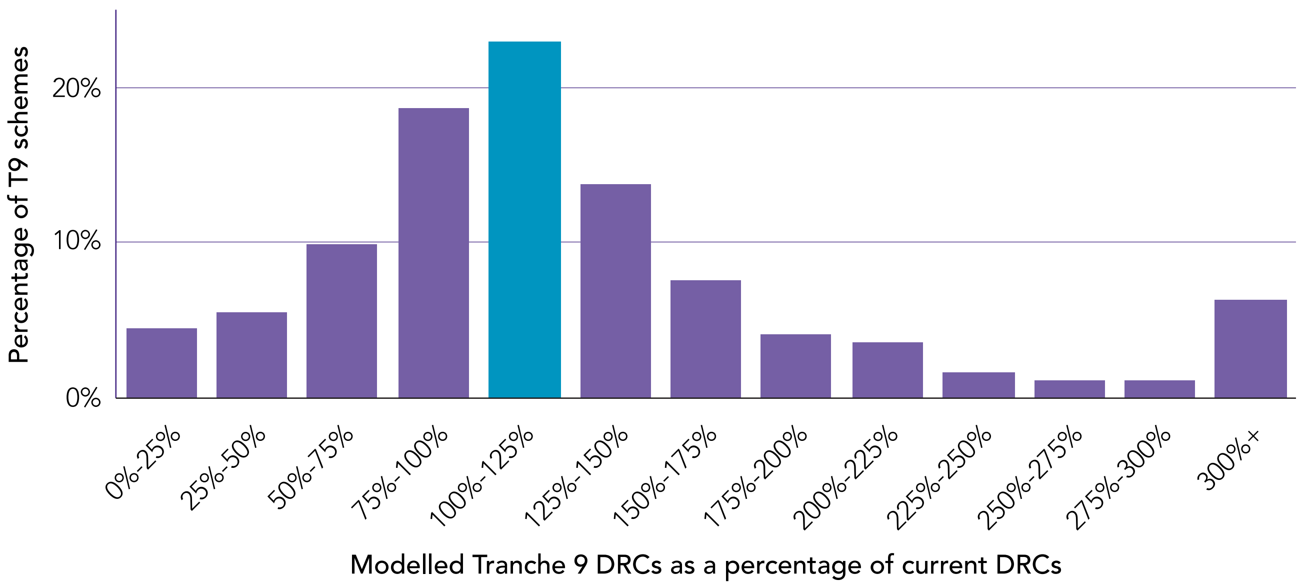
## Potential impact on scheme recovery plans (RPs)

Our analysis in Figure 8 shows that schemes' estimated funding positions will generally have deteriorated over the period from Tranche 6 to Tranche 9. However, actual schemes' positions will depend on their specific circumstances.

Figure 10 illustrates the potential impact on DRCs for Tranche 9 valuations, expressed as a percentage of the level of current DRCs (ie what was agreed at Tranche 6 valuation date). The analysis also assumes, for the purpose of illustration, that some of the potential flexibilities have been used:

- an increase of 0.25% a year in the discount rate for the technical provisions relative to gilt yields; and
- an extension of three years to the end date of the current RP.

**Figure 10: Proportion of current DRCs – based on additional three years to existing recovery plan end date and discount rate outperformance increased 0.25%**




Source(s): The Pensions Regulator

**0-100%**
After using the modelled flexibilities, around 40% of schemes would not need to increase contributions from current levels. These schemes may not therefore need to make full use of these modelled flexibilities.

**100-125%**
After using the modelled flexibilities, the median increase in DRCs from those agreed in Tranche 6 is 10%.

**Greater than 300%**
Under the modelled scenarios, some schemes may need to increase DRCs to three or more times their current level in Tranche 9. However, for a large majority of these schemes, the current level of DRCs is very small likely due to a small deficit at their last valuation. However at their Tranche 9 valuation, the deficit is likely to have increased substantially in percentage terms. As a result the modelled level of DRCs will have likewise increased substantially in percentage terms.

**Table 1**
**Modelled Tranche 9 DRCs as a percentage of PBT where Tranche 6 DRCs are estimated to increase by at least 300%**

| Modelled Tranche 9 DRCs as percentage of PBT | No of schemes |
|---|---|
| 0-25% | 32 |
| 25-50% | 11 |
| 50-75% | 3 |
| 75-100% | 1 |
| Greater than 100% | 10 |
| Negative PBT | 15 |
| Insufficient data | 19 |
| **Total** | **91** |

Table 1 illustrates for these schemes and their sponsors the potential Tranche 9 DRCs as a percentage of PBT. In practice this large percentage increase may be easily affordable for many of these sponsors. However, there are others where this is likely to prove significantly challenging, and trustees and employers will need to work together in order to use the available flexibilities to agree appropriate recovery plans.

## Additional notes

- The baseline for estimating the deficit is based on the last valuation, adjusted approximately for contributions paid and movements in gilt yields, inflation and assets to 31 March 2014
- Calculations are highly sensitive to the valuation date used and other scheme-specific characteristics
- About 24% of schemes anticipated to be conducting a valuation in Tranche 9 have been excluded due to reporting a surplus of assets over TPs, or zero DRCs, at their Tranche 6 valuation and/or have an estimated surplus of assets over TPs as at 31 March 2014.

# Comparing these impacts to the sponsor's affordability

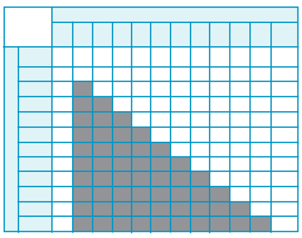
The previous chart highlighted the potential increase in DRCs for schemes under the modelled scenario. A key driver in trustees and employers agreeing appropriate contributions is the affordability position of the sponsor and the impact the contributions may have on its plans for sustainable growth.

Table 2 shows how significant DRCs are compared to sponsors' PBT. This analysis in based on about 40% of schemes and sponsors.

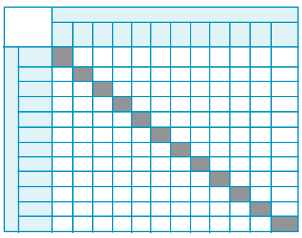
**Table 2 – DRCs compared to sponsors' PBT in Tranches 6 and 9**

| | | Modelled Tranche 9 DRCs as a percentage of latest available PBT | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 0 | 0-10% | 10-20% | 20-30% | 30-40% | 40-50% | 50-60% | 60-70% | 70-80% | 80-90% | 90-100% | 100%+ |
| Tranche 6 DRCs as a percentage of 2010 PBT | 0 | - | - | - | - | - | - | - | - | - | - | - | - |
| | 0-10% | - | 186 | 46 | 14 | 7 | 8 | - | 2 | - | - | - | 10 |
| | 10-20% | - | 40 | 33 | 32 | 3 | 5 | 8 | 2 | 1 | 1 | 1 | 7 |
| | 20-30% | - | 16 | 16 | 16 | 13 | 3 | 3 | 2 | 2 | 1 | - | 5 |
| | 30-40% | - | 11 | 7 | 9 | 5 | 4 | 2 | 6 | - | 2 | 3 | 4 |
| | 40-50% | - | 3 | 4 | 6 | 7 | 2 | 2 | 1 | 1 | 1 | 3 | 5 |
| | 50-60% | - | 2 | 3 | 3 | 3 | 2 | 1 | 1 | 1 | - | - | 8 |
| | 60-70% | - | - | 2 | 3 | 3 | 2 | 2 | 1 | 1 | 1 | 2 | 1 |
| | 70-80% | - | - | 1 | 4 | 2 | 2 | 4 | - | - | - | - | 8 |
| | 80-90% | - | - | - | - | - | - | - | 2 | 1 | 3 | 1 | 7 |
| | 90-100% | - | 2 | 1 | 1 | - | - | 1 | 1 | - | - | - | 6 |
| | 100%+ | - | 5 | 8 | 6 | 3 | 9 | 4 | 2 | 6 | 6 | 1 | 62 |

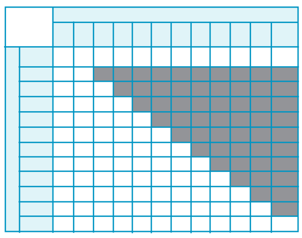
Group A



Group B



Group C



Source(s): The Pensions Regulator, FAME published by Bureau van Dijk

In Table 2:

- the left hand column shows the DRCs agreed in Tranche 6 as a proportion of the three year average PBT of the sponsor up to 2010 (the information that would have been available at Tranche 6 valuation dates)
- the row at the top shows the modelled DRCs for Tranche 9 as a proportion of the three year average PBT of the sponsor up to the latest available date.

For example, our modelling estimates that 32 schemes agreed DRCs in Tranche 6 that were in the band 10-20% of the employer's PBT and, under the modelled scenario for Tranche 9, the new DRCs for these schemes are estimated to be between 20-30% of the employer's PBT.

- those schemes in Group A are those where the modelled Tranche 9 DRCs as a proportion of the sponsor's PBT are estimated to be less than those agreed in Tranche 6. This represents 28% of schemes shown in the table
- those schemes in Group B are those where the modelled Tranche 9 DRCs as a proportion of the sponsor's PBT are estimated to be in the same range as that agreed in Tranche 6. This represents 40% of schemes shown in the table
- those schemes in Group C are those where the modelled Tranche 9 DRCs as a proportion of the sponsor's PBT are estimated to be greater than those agreed in Tranche 6. This represents 32% of schemes shown in the table.

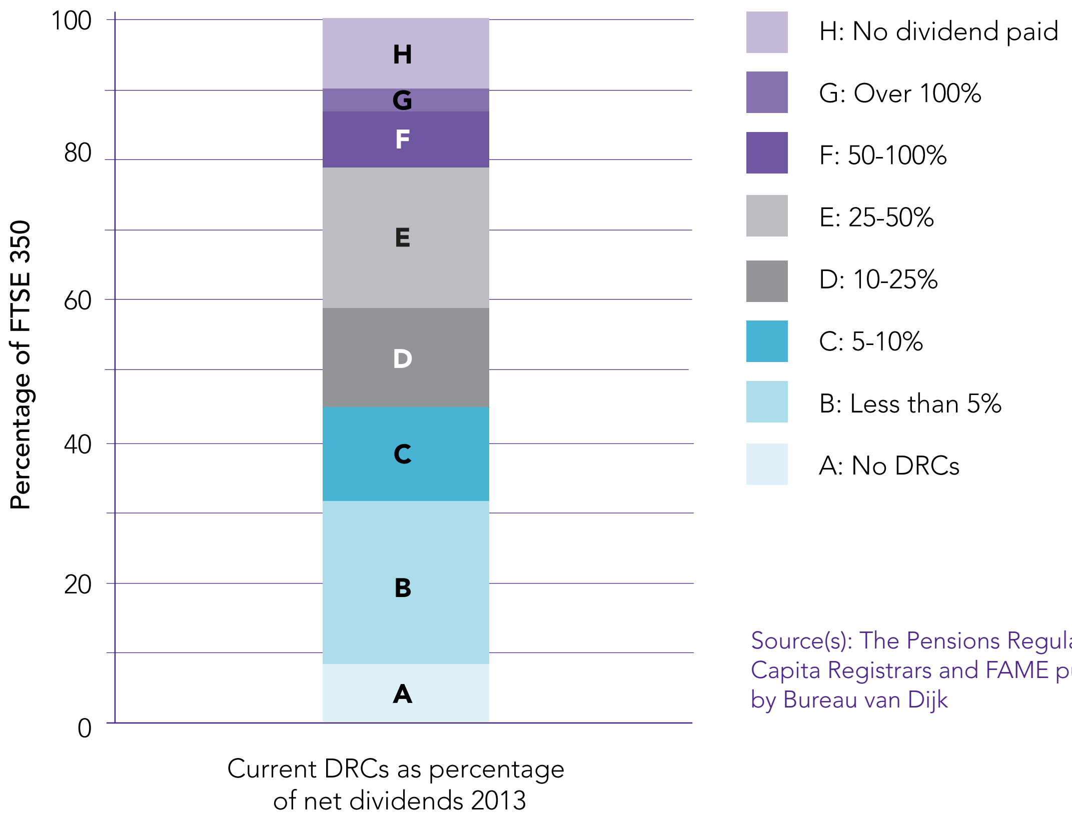
This analysis highlights that for the majority of schemes where we have PBT data, the modelled Tranche 9 DRCs do not represent a significantly higher proportion of the sponsor's PBT and may therefore be affordable without impacting adversely on the sponsor's plans for sustainable growth.

However, there are some schemes where the change in the modelled DRCs is significant. Consequently trustees and sponsors may not be able to agree these increases due to the affordability position of the sponsor and the impact such an increase may have on its plans for sustainable growth. These schemes may need to make greater use of the flexibilities to agree appropriate outcomes.

## Additional notes

- PBT is calculated net of pension financing items on an accounting basis. This has not been accounted for in this analysis and would serve to reduce the ratio of DRCs to PBT for the majority of schemes
- PBT is after depreciation and payment of interest so provides a reasonable approximation for cash generation after debt service and maintenance capital expenditure (CAPEX). In practice other measures of employer cash flow may be more appropriate since trustees need to balance their demands against other essential calls on the sponsor's business, including investment for sustainable growth
- Schemes have been excluded due to reporting a surplus of assets over TPs, or zero DRCs, at T6 valuation and/or have an estimated surplus of assets over TPs as at 31 March 2014
- Some schemes have sponsors who reported negative (2010 and/ or latest available) three year average PBT and these have been excluded from the analysis. We recognise that many of these schemes and employers may face significant challenges to the extent that PBT adequately reflects cash generation
- Schemes have been excluded due to insufficient PBT data. Insufficient PBT data is most prevalent in the smaller scheme population representing a limited proportion of total liabilities
- As a result only about 40% of schemes anticipated to be conducting a valuation in Tranche 9 are included in this analysis
- The latest available PBT data is drawn from accounts with 2013 year ends for approximately 30% of employers and 2012 year ends for the remaining 70%, owing to Companies House filing requirements.

**Figure 11: DRCs as a percentage of net dividends paid for FTSE 350 companies supporting DB pension schemes**




Source(s): The Pensions Regulator, Capita Registrars and FAME published by Bureau van Dijk

Figure 11 compares the gross DRCs to net dividends. We have used the gross DRCs which is the value the scheme receives but this does not take into account any tax benefit the company may receive. This potentially overstates the net cost of DRCs to the employer by a margin that is dependent on the employer's rate of corporation tax at the time.

Given that many companies support more than one scheme, not all conducting valuations in Tranche 9, we have considered all schemes supported in aggregate by these companies to give a more accurate and realistic picture. This means in practice we have included:

- DRCs for schemes who are anticipated to be conducting valuations in Tranche 9, which are those shown as the modelled Tranche 9 DRCs analysed earlier in this analysis (see Figure 10 and Table 2); and
- DRCs for schemes who are not anticipated to be conducting valuations in Tranche 9 (ie Tranche 7 and Tranche 8 schemes), is the average annual DRC in the first four years of the most recent recovery plan submitted to the regulator.

This analysis shows that approximately 45% are estimated to be currently paying DRCs which are less than 10% of the value of net dividends paid to shareholders in 2013, and for a further 14% of companies this ratio is less than 20%.

Approximately 4% are estimated to be presently paying DRCs which are more than 100% of the value of net dividends paid to shareholders in 2013, with a further 8% paying DRCs between 50 and 100%. 10% paid no dividend at all.

## Additional notes

- The analysis includes 208 companies in the FTSE 350 (estimated as at 31 March 2014) that support – through direct participation or ownership of participating employers – UK defined benefit pension schemes. Ownership is defined as where a FTSE 350 company is the DUO of a directly participating employer, where the minimum percentage that must characterise the path from a subject company up to its DUO is 50.01%. In some cases the regulator does not have sufficient data to identify the DUO of a subject company (employer)
- In total there are over 500 schemes in this analysis, comprising approximately 45% of the estimated total TPs for all schemes as at 1 April 2014. The data is informative, but should not be assumed to be representative of employers outside of the FTSE 350 such as privately-held companies.
- Dividends shown are total dividends paid in 2013, including any special dividends, and are a 'net' amount, ie they do not include a notional 10% tax credit treated as a deemed payment of tax to HMRC, which is only used when calculating a shareholders personal tax liability.

# Limitations

## Limitations of actuarial analysis

Compared with the more robust calculations carried out for formal valuation and recovery plan reporting by scheme trustees, the rollforward techniques we have used to estimate aggregate and individual funding positions involve various assumptions and simplifications.

Many of these assumptions or simplifications have been driven by data limitations. For example, we have used index-tracking of major asset classes, made no allowance for hedging instruments to mitigate risk and have made assumptions about scheme liabilities in aggregate that may not accurately reflect the underlying liabilities of individual schemes.

This is not an exhaustive list of assumptions. The assumptions we have made may be a significant source of difference when compared with formal valuation results at the individual scheme level.

## Limitations of employer analysis

Reconciliation of our universe of c.14,000 unique statutory employers (and additional connected/associated entities, where relevant), with third party data sources in order to acquire the requisite corporate financial measures underpinning certain aspects of the analysis, is an evolving process which requires expert judgement, and unavoidably introduces errors/uncertainty which cannot be fully mitigated.

We have used the latest published corporate financial data available from our sources as at 1 April 2014 in respect of statutory employers (as reported to us in a scheme's annual return) – with the most recent data primarily relating to accounting years ending in 2012 to 2013 but in some cases relating to earlier years.

Certain data for certain schemes was not available – this tends to be concentrated in: smaller schemes; and, particular sectors (eg SMEs, public/third sector or overseas companies); and therefore the analysis may not be representative of these schemes and/or sectors.

Compared with the more detailed and contemporary information available to trustees and their advisers, the techniques we have used to estimate available covenant support involve various assumptions and simplifications. Many of these assumptions or simplifications have been driven by: data limitations or availability; the reconciliation of third party data with our own; and the methodological approaches necessitated by a heterogeneous universe of employers with – in many cases – multiple scheme associations both within and across corporate groups.

The main examples (though the items below are far from an exhaustive list) of such assumptions/simplifications are:

- where an employer participates in more than one scheme or the scheme is sponsored by more than one employer, we have made assumptions about the division of an employer's financial support among the pension schemes in which it participates
- where corporate financial information for statutory employers was not available individually, we have used consolidated accounts for the relevant group, thus potentially overstating the covenant support available; and
- where corporate financial information was not available for all statutory employers to a scheme, we have used information aggregated over only those employers for whom the relevant data was available, thus potentially understating the covenant support available.

Any of these assumptions due to data limitations and interpretations may be a significant source of error at the individual scheme/sponsor level.

Moreover, accounting-based metrics may be poor indicators of formally assessed covenant strength and accordingly this analysis should not be seen as a substitute for such bespoke assessments.

# Glossary

**Tranches**

'Tranche' refers to the set of schemes which are required to carry out a scheme-specific funding valuation within a particular time period. Schemes whose valuation dates fell from 22 September 2005 to 21 September 2006 (both dates inclusive) were in Tranche 1, from 22 September 2006 to 21 September 2007 were Tranche 2 (both dates inclusive) etc. Because scheme-specific funding valuations are generally required every three years, schemes whose valuations are in Tranche 1 will also be likely to carry out valuations in Tranches 4, 7 and 10.

**Technical provisions (TPs)**

The funding measure used for the purposes of Part 3 valuations (see above). The 'TPs' are a calculation undertaken by the actuary of the assets needed at any particular time to make provision for benefits already considered accrued under the scheme using assumptions prudently chosen by the trustees – in other words, what is required for the scheme to meet the statutory funding objective. These include pensions in payment (including those payable to survivors of former members) and benefits accrued by other members and beneficiaries, which will become payable in the future.

**Recovery plan (RP)**

Under Part 3 of the Pensions Act 2004, where there is a funding shortfall at the effective date of the actuarial valuation, the trustees must prepare a plan to achieve full funding in relation to the TPs. The plan to address this shortfall is known as a RP.

**RP length**

The RP length is the time that it is assumed it will take for a scheme to eliminate any shortfall at the effective date of the actuarial valuation, so that by the end of the RP it will be fully funded in relation to the TPs.

**Deficit repair contributions (DRCs)**

These are contributions made by sponsors to the scheme in order to address any asset to TPs deficit, in line with the Schedule of Contributions and the RP.

**Section 179 liabilities (s179)**

This refers to a valuation of PPF compensation benefits under section 179 of the Pensions Act 2004, for PPF levy purposes. This measure is designed to be a close approximation to the liability measure that would be used to decide whether the PPF would need to take on the scheme were the employer to become insolvent. In contrast to TPs, the assumptions to be used in an s179 valuation are prescribed by the PPF and are standard across all schemes. They are designed such that s179 is close to the cost of securing the value of PPF compensation level of benefits with an insurance company at the valuation date.

## Shareholders' funds and profit before tax

These are measures as reported in the corporate accounts before any adjustment to remove the impact of pension accounting items. Shareholders' funds are an estimate of a firm's total assets minus its total liabilities. Profit before tax is a profitability measure that looks at a company's profits before the company has to pay corporate income tax. This measure deducts all expenses from revenue including interest expenses and operating expenses, but it leaves out the payment of tax.

These have been used here for illustration, recognising that in practice other measures may be more appropriate for analysis of individual scheme employers since trustees need to balance their demands against other essential calls on the employer's business.

## How to contact us

Napier House
Trafalgar Place
Brighton
BN1 4DW

T 0845 600 0707
F 0870 241 1144
E customersupport@thepensionsregulator.gov.uk

www.thepensionsregulator.gov.uk
www.trusteetoolkit.com

**Scheme funding analysis**
A look forward to schemes with valuation dates between September 2013 and September 2014 (Tranche 9)



The Pensions Regulator