Broadstone

# The Pension Regulator's latest Annual Funding Statement

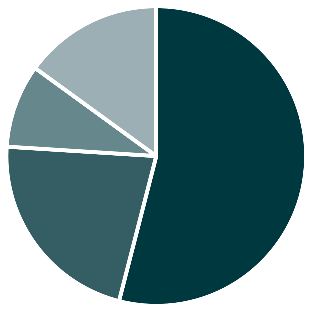
**May 2025**

## Introduction

Each year the Pensions Regulator (TPR) issues a statement on the state of the DB funding universe with key messages they want trustees and employers to understand.  This year's statement focuses on those with a valuation between September 2024 and September 2025 but, given the new funding regime, will inevitably be of much wider interest.

### Key Themes

- DB pension schemes are, in general, in a good funding position. The chart below has been created from data provided by TPR and the statement also highlights the transformed position for many schemes since their last valuation.  DB pension scheme assets have in aggregate fallen by around a third over the past three years and total pension scheme liabilities have dropped by 45% over this period.
- Key risks therefore have (for most) moved on from addressing the funding deficits within schemes, and TPR suggests trustees need to be wary of geopolitical risks and their impacts on investment strategies and the sponsoring employer. As ever, trustees should be focusing on their ability to assess and understand the risks posed and take mitigating action. Climate change, noted in last year's statement, is also highlighted again as something that trustees should be actively considering in line with recent TPR guidance.
- TPR spends a good amount of the statement discussing covenant risk, despite the issuance of extensive covenant guidance at the end of last year on top of the significant coverage given to this in the Funding Code.




# Impact on first valuations under the new regime

TPR has done some work on clarifying their expectations on the valuation process under the new regime and expects trustees to take a well-integrated and collaborative approach across the different advisory specialisms. They refer to the numerous items of guidance issued recently and we've included some of these links later in this note.

Key points made in relation to valuations:

- TPR pledge to be proportionate, risk based and outcome focused in their dealings with schemes.
- Fast Track parameters are confirmed, and such cases will require less evidence within the Statement of Strategy submission.
- They anticipate 80% of schemes will be able to proceed via the Fast Track route with minimal or no cost to the employer (perhaps unsurprising given the number of schemes they expect to be fully funded on a low dependency basis).
- Bespoke submissions allow flexibility but require more evidence, especially around the long-term supportability of the scheme.
- When describing their strategy, it will be up to the scheme to determine if they should refer to buyout or not. It will be case specific but if it is

aspirational or ill-defined at this time the interim milestone of low dependency may be more appropriate to refer to.

- There are not to be any transitional easements for Year 1 valuations. The code had been extensively consulted on and there should be few surprises on what it looks like to comply even if this is difficult for some. Those facing affordability issues are referred to the relevant section of the Funding Code.

# How is covenant assessment being approached?

In TPR's new parlance, covenant is now expressed not in four broad categories but through a calculation of supportable risk. Trustees should plan to reach low dependence on the employer before the end of the covenant longevity period, assessing the employer's prospects to identify material risks. There is no formal supportable risk formula, but schemes will need to determine this themselves based on their own circumstances.

TPR dedicates much of the funding statement to further clarifying how schemes should be assessing covenant based on early feedback to their guidance. The general approach outlined in the document emphasises a proportionate and pragmatic assessment of the employer covenant, tailored to the specific circumstances and adopting a lighter touch approach for well-funded schemes with limited risk. It highlights that ongoing monitoring of the covenant is necessary even for Fast Track schemes and those fully funded on a low dependency basis, but should focus on key risks that could lead to covenant deterioration.

When assessing the reliability period, trustees should consider employer-specific factors such as market outlook and future pipeline, rather than focusing on the scheme's funding needs. Even if cash flows are limited or negative, trustees should assess the certainty of future cash flows as it helps with planning, identifying and responding to unexpected events.

The appendices give further details such as seeking to clarify the distinction between maximum affordable contributions and available cash, with the former excluding liquid assets and being assessed after deficit repair contributions. They also expand on some of the queries around contingent assets, supportable risk, and stress testing of downside events.

# What about the use of surplus?

The statement refers to expected legislation in the summer around the potential release of surpluses in pension schemes (via the Pensions Bill) but provides no additional detail. This topic is particularly of interest to schemes not planning to buyout and wind-up in the near future but who have a healthy surplus. TPR notes that trustees of such schemes may wish to have a policy in place regarding the release of a surplus and start considering now how they might respond to a request from the employer.

# Where are you and what should you be doing?

TPR has created three groups as a helpful shorthand to understand what you should be focusing on.

## Group 1: funding level is at or above low dependency

Focus should be on end game planning. Schemes deciding to run on will need to consider the ongoing risks and put in place suitable monitoring and management strategies. They will also need to ensure the employer covenant continues to provide the necessary support.

## Group 2: ongoing funding surplus but below the low dependency funding target

Focus should be on the path to low dependency and achieving this by the relevant date.

## Group 3: ongoing funding deficit

Focus should be on addressing the deficit as soon as the employer can reasonably afford. Technical provisions should be consistent with the scheme's journey plan and the level of risk should reflect employer covenant support and scheme maturity.

# What's next?

As well as highlighting a lot of their recent publications, the Statement also flags a few upcoming or outstanding items. In relation to the new funding regime, the response to the Statement of Strategy consultation and the digital service to submit valuations should both be launched in Spring 2025. Guidance for trustees on end game solutions will be published in Summer 2025 and the upcoming Pensions Bill should set out how surplus payments can be made.

# Useful links

**TPR's Funding Code webinar** -
https://www.thepensionsregulator.gov.uk/en/media-hub/speeches-and-speakers/defined-benefit-funding-code-webinar-2024

**Assessing covenant guidance** -
https://www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/funding-and-investment-detailed-guidance/assessing-covenant-detailed-guidance

**Fast Track parameters** -
https://www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/funding-and-investment-detailed-guidance/fast-track-submission-tests-and-conditions

# Broadstone Comment

Whilst TPR warns about ongoing risks and geopolitical uncertainty, the overall message is that most schemes are now very well placed. There is talk of planning for the potential release of surplus, but also a word of warning for those considering run-on as a longer-term solution. TPR reinforces the ongoing risks and governance requirements that will make this unrealistic for most smaller schemes, although we still see its potential value as an interim measure to capitalise on potential savings in buyout price due to investment returns and insuring a more mature scheme population. In terms of surplus extraction, we await with interest how the government will balance their desires for productive finance investment and protection of member's interests in the upcoming Pensions Bill.

Whilst proportionality is referred to on almost every other page, the volume of additional work under the new funding regime does feel excessive when the masses of guidance around affordable cash flows, reliability periods etc., are likely to apply to only a small minority of underfunded schemes. The further clarifications within this statement around some of the covenant expectations demonstrate how complex this topic can be. One size does not fit all, and the statement further highlights the potential gulf between best practice aspirations and a pragmatic, risk-based, proportionate approach.

Given the extent of coverage on this, it is possible that TPR sees covenant as the most significant risk remaining in the triumvirate of funding, investment and covenant, or perhaps that it is the least well understood and monitored. It remains a potential Achillies heel to any long-term strategy, particularly in such a challenging geopolitical climate.

Ultimately good governance, clear lines of communication, transparency and openness are the key to ensuring no board is caught by any unwelcome surprises. The challenge for trustees and sponsors remains achieving this in a practical, cost-effective and proportionate way that meets all TPR's expectations.

## Find out more

**For more information on how Broadstone can help you, please contact your Broadstone consultant or use the details below.**

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