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Summary

- 'Endgame' planning has become an integral part of trustees' psyche, but techniques on how to manage a scheme's flightpath has divided the industry.
- The Pensions Regulator is driving schemes' focus towards a long-term funding target, while its incoming funding code will put more emphasis on integrated-risk management.
- Those looking to scrap the triennial process want a more 'real-time' and flexible approach to scheme monitoring.
- Triennial advocates still regard the process as vital to trustee and sponsor negotiations.

The triennial sideshow

With more tools and techniques at trustees disposal, as well as improvements in technology and a shift in focus to the long-term journey planning of schemes, is there a danger that the long-standing triennial valuation process is becoming a dangerous sideshow? Theo Andrew investigates

There is little doubt that the UK pensions industry is growing up. As many defined benefit schemes set into maturity, some are able to cope with the ageing process in a more dignified manner than others.

As the ageing process takes hold, inevitably, things just might not work like they used to. The rituals and routines that you would normally swear by may have become outdated, or replaced by more thorough and frequent techniques than hadn't previously been available.

For years the triennial valuation framework has been an essential part of understanding the overall funding health of a scheme, but as trustees start to plan for their twilight years, the focus has shifted towards an integrated approach to determine a scheme's position.

Generally, schemes have 15 months to submit their valuations to The Pensions Regulator (TPR) and are required to do so every three years, but with the focus shifting longer term, many are questioning whether this is still necessary.

Scheme horizon lines are also a lot closer than we might think, so is it time to wave goodbye to the 'outdated' and 'irrelevant' triennial valuation process, or is it still a vital negotiating tool, enabling trustees to get the best possible deal for their pension scheme?

A dangerous sideshow

In March, the regulator set out what it expected of schemes when planning their long-term funding target (LTFT), suggesting that they put an investment strategy in place and issuing guidelines for trustees, depending on the health and maturity of the scheme.

With schemes being encouraged to think longer term and with more mechanisms in place to manage the scheme, some experts feel the triennial process helps to drive the wrong behaviours.

"Since the requirement came into force 20 years ago quite a few things have happened to make it appear out of date and almost irrelevant," says Independent Trustee Service (ITS) director, Rachel Croft.

"DB funding and risk management has gone hugely up the corporate agenda, in some cases you might have needed a valuation even just to get people round the table, but now I don't think that's the case anywhere."

Croft cites the LTFT, as well as "huge strides" in technology and industry efforts to improve data, meaning that "the basis of the valuation is more and more accurate every time we do it".

According to Barnett Waddingham partner, Oliver McMulloch, the technology is available for pensions schemes to measure their funding position on a daily basis.

Despite this, Aon partner, Lynda Whitney, believes the valuation process is still an essential tool to ensure that trustees get as much as possible when it comes to negotiating with their sponsor.

"It is the chance for company and trustees to really negotiate with each other to determine what contributions are and what security packages sit around the scheme," she says.

"There is an absolute need for company and trustees to negotiate those items, and having a three-year period that says to stop and have a full assessment, allows them to work on all the other items they need to in the rest of the cycle."

However, Dalriada trustee representative, Chris Roberts, argues that in the world of interactive modelling tools and tracking software, it feels "like a lot of effort" to submit a valuation, but that it does have its benefits.

"I do feel it has some drawbacks, but in terms of focusing peoples' minds and getting them round the table on a regular basis, it is a bedrock of the process. I don't feel they could regulate real-time monitoring to the same extent."

Pensions and Lifetime Savings Association policy lead for LGPS and defined benefit, Tiffany Tsang, agrees, and believes that without the valuation it isn't really possible for the trustees or the regulator to safeguard members' benefits.

But, if the tools are there to continuously manage the funding health of the scheme, Croft states that there is no need for the regulatory requirement for a triennial valuation.

If not then what?

While Croft believes that we may have moved past the point of triennial valuations being a regulated requirement, she concedes that some sort of framework would have to be put in its place.

The regulator's incoming funding code, its recently published Annual Funding Statement (AFS) and investment consultants' constant drive towards the 'endgame' are all set to give trustees clearer guidelines on maintaining the funding health of the scheme, but it is not clear how the triennial framework will sit in this process.

According to Lane Clark and Peacock's 2019 pensions de-risking report, 75 per cent of schemes surveyed will expect to reach their long-term goal over the next decade, which has left many wondering the best way to manage the process.

Croft says: "We need to be sure that we monitor progress against that long-term plan, and have the ability to review and discuss the funding target at the appropriate point."

Roberts agrees: "If you had a regime that monitored and considered funding and kept track of it, then there could be a framework in there, but it would be a fundamental shift and hard to get corporates to engage."

However, the regulator's ability to oversee real-time approach to valuation would also prove difficult to achieve. Herein lies the problem.

On top of this, Whitney believes that just because the focus has shifted to having a LTFT does not mean that the goal posts have to be moved.

"I'm very supportive of TPR's AFS, particularly around having a long-term funding target, then having a valuation which you test how you are doing in terms of a short-term plan to get us to a long-term plan is a very good thing.

"The conversation at a valuation is an integrated risk one, the conversation is not and shouldn't be focused on the detail, it should be a big picture conversation."

So despite calls from some areas within the pension industry to replace the valuation, with the Department for Work and Pensions track record for pensions reform, is it even a possibility?

Tsang concludes: "I've worked in policy enough to say you can never say never, but at the moment I think it is important to continuously review the governance structure, to work closely with trustees to ensure they have the right tools to make the right decisions for its members."

A growing trend has been to focus on managing the scheme through its final days. Whether it be a scheme's 'flight path', or maybe it's entering 'endgame' territory, developing a strategy to ensure the scheme grows old with dignity, is paramount for success.

Written by Theo Andrew