The Pensions Regulator

Annual Funding Statement 2023
for defined benefit pension schemes

Key risks trustees and employers should focus on and actions to take

April 2023

Contents

Key risks and our expectations

The table below should assist trustees in matching their specific scheme circumstances with our expectations. Select the page number of your group below to be taken to your specific group table.

‘Find your group’

Employer strength	Strong/tending to strong employer				Weaker employer with limited affordability				Weak employer unable to provide support	
Funding characteristics	• Funding level on track to meet LTFT or ahead		• Funding level behind plan and/or		• Funding level on track to meet LTFT or ahead		• Funding level behind plan and/or		Stressed scheme with limited or no ability to use flexibilities in funding regime	
	• TPs strong		• TPs weak and/or		• TPs strong		• TPs weak and/or			
	• RP shorter than six years		• RP longer than six years		• DRCs reducing deficit at affordable pace		• RP longer than six years			
Maturity	Immature	Mature	Immature	Mature	Immature	Mature	Immature	Mature	Immature	Mature
Group	A1 page 5	A2 page 6	B1 page 8	B2 page 10	C1 page 12	C2 page 14	D1 page 17	D2 page 20	E1 page 24	E2 page 26

In each of the tables, which can be accessed via the links in the table on page 3, we have identified the key risks we expect you to focus on, and features of the funding plans we expect you to develop, depending on your scheme and employer characteristics. Our feedback from trustees and advisers is that this approach has been helpful in guiding trustees to develop their plans. Our guidance from earlier years on the key long-term risks remains relevant for T18 valuations and is reiterated in the tables which have been updated to reflect the current market environment and generally improved funding positions.

You should first determine the strength of your current funding position relative to your long-term plans. Although you are not required to do so yet, we encourage you to consider the general direction of travel in the draft DB funding code and set your long-term funding target (LTFT) accordingly. You should make an assessment of the strength of the employer covenant and understand broadly where your scheme is in the maturity spectrum (open schemes should generally be at the immature end of this spectrum). This will enable you to find the table closest to your circumstances, which should help you determine the direction and magnitude of change to your funding and investment strategies, the risks you need to focus on, and the actions we expect. You should then set about preparing your recovery plans to balance affordability with other reasonable uses of cashflow for the employer.

These tables are not intended to be exhaustive for each category, nor are they a substitute for reading the **Annual Funding Statement** or taking independent professional advice.

Glossary

ABCs = Asset-backed contributions

DRCs = Deficit repair contributions

IRM = Integrated risk management

LTFT = Long-term funding target

RP = Recovery plan

TPs = Technical Provisions

Key risks and expectations for Group A1 as stated in the table on page 3

Group	**A1**
Characteristics	• Strong or tending to strong covenant. • Scheme's funding position is on track to meet the LTFT or ahead. • TPs are strong and recovery plan is shorter than average (less than six years). • Scheme is relatively immature.
Key risks	• Employer exposed to market risk if scheme is not cash flow matched/hedged. • Covenant weakens at the same time as investments underperform. • Lack of long-term covenant visibility and possibility of sudden material covenant deterioration. • TPs may not be aligned to the scheme's LTFT.
What we expect from trustees and employers	
Covenant	• Where there is a high level of covenant leakage, consider proportionately increased DRCs and shorter recovery plans. • Proportionate covenant monitoring. • Understand longer term risks including ESG factors. • Clear IRM strategy, with realistic contingency planning for key downside risks.
Investment	• Set a long-term asset allocation consistent with the scheme's LTFT. • Establish a journey plan to move towards the long-term asset allocation. • Review the LDI strategy and assess it for operational resilience – see our recently issued guidance. • Quantify the impact on funding of adverse investment performance. • Test and evidence the ability of the covenant to support downside investment risk (supportable investment risk) by means of additional cash and non-cash funding, without extending the length of the recovery plan.
Funding	• Agree your ultimate goal for the scheme and set a consistent LTFT. • Establish a plan for progressing from your current TPs to your LTFT within a realistic timescale. • Ensure TPs can be evidenced to be consistent with the journey plan to reach the LTFT. • If concerned about risk of trapped surplus, consider using escrow, ABCs, and contingency planning.

Please note: If you need to check another scheme, please refer back to the table on page 3

Key risks and expectations for Group A2 as stated in the table on page 3

Group	A2
Characteristics	• Strong or tending to strong covenant. • Scheme's funding position is on track to meet LTFT or ahead. • TPs are strong and recovery plan is shorter than six years. • Scheme is relatively mature.
Key risks	• Employer exposed to market risk if scheme is not cash flow matched/hedged. • Covenant weakens at the same time as investments underperform. • Lack of covenant visibility and possibility of sudden material covenant deterioration. • TPs may not be aligned to the scheme's LTFT. • Increased risk to employer from greater sensitivity to investment volatility and shorter timescales for correction.
What we expect from trustees and employers	
Covenant	• Where there is a high level of covenant leakage, consider proportionately increased DRCs and shorter recovery plans. • Proportionate covenant monitoring. • Clear IRM strategy, with realistic contingency planning for key downside risks. • Focus on the resilience of the employer to withstand downside risks over a shorter time horizon.
Investment	• Set a long-term asset allocation consistent with the scheme's LTFT. • Establish a journey plan to move towards the long-term asset allocation. • Review the LDI strategy and assess it for operational resilience – see our **recently issued guidance**. • Quantify the impact on funding of adverse investment performance. • Test and evidence the ability of the covenant to support downside investment risk (supportable investment risk) by means of additional cash and non-cash funding, without extending the length of the recovery plan. • Investment and funding plans to be structured to recognise the shorter time horizon, as well as the interplay between volatility in asset prices, investment returns and benefit outflows. • Consider your forward-looking liquidity requirements in the light of expected transfer value activity, cash commutation and benefit payments.

Funding	• Agree your ultimate goal for the scheme and set a consistent LTFT. • Establish a plan for progressing from your current TPs to your LTFT within a realistic timescale. • Ensure TPs can be evidenced to be consistent with the journey plan to reach the LTFT. • If concerned about risk of trapped surplus, consider using escrow, ABCs, and contingency planning. • Schemes close to surplus on the TP basis should test adequacy of TPs against assets needed to satisfy your LTFT. • Any recent funding gains should be applied to strengthen LTFT, if appropriate, and reduce investment risk. • Extending recovery plan end dates to make good any negative investment returns is unlikely to be acceptable, given the strength of the employer.

Please note: If you need to check another scheme, please refer back to the table on page 3

Key risks and expectations for Group B1 as stated in the table on page 3

Group	B1
Characteristics	• Strong or tending to strong covenant. • Scheme's funding is behind plan/TPs are weak and/or recovery plans are longer than six years. • Scheme is relatively immature.
Key risks	• Employer exposed to market risk if scheme is not cash flow matched/hedged. • Covenant weakens at the same time as investments underperform. • Lack of long-term covenant visibility and possibility of sudden material covenant deterioration. • TPs may not be aligned to the scheme's LTFT.
What we expect from trustees and employers	
Covenant	• Proportionate covenant monitoring. • Where there is a high level of covenant leakage, proportionately increased DRCs and/or shorter recovery plans should be the norm. • In addition to enhancements to the recovery plan, strengthen short-term security through other means such as contingent assets and guarantees where available. • Understand longer term risks including ESG factors.
Investment	• Set a long-term asset allocation consistent with the scheme's LTFT. • Establish a journey plan to move towards the long-term asset allocation. • Review the LDI strategy and assess it for operational resilience – see our recently issued guidance. • Quantify the impact on funding of adverse investment performance. • Test and evidence the ability of the covenant to support downside investment risk (supportable investment risk) by means of additional cash and non-cash funding, without extending the length of the recovery plan. • A focus on trustees to understand, quantify and justify the reliance on investment returns versus DRCs to repair a worse than anticipated deficit.

Funding	• Strengthen TPs, increase DRCs and reduce recovery plan lengths. • Review your ultimate goal for the scheme and set a consistent LTFT. • Establish a plan for progressing from your current TPs to your LTFT within a realistic timescale. • Ensure TPs can be evidenced to be consistent with the journey plan to reach the LTFT. • If concerned about risk of trapped surplus, consider using escrow, ABCs, and contingency planning. • Extending recovery plan end dates to make good any negative experience is unlikely to be acceptable, given the strength of the employer.

Please note: If you need to check another scheme, please refer back to the table on page 3

Key risks and expectations for Group B2 as stated in the table on page 3

Group	B2
Characteristics	• Strong or tending to strong covenant. • Scheme's funding is behind plan/TPs are weak and/or recovery plans are longer than six years. • Scheme is relatively mature.
Key risks	• Employer exposed to market risk if scheme is not cash flow matched/hedged. • Covenant weakens at the same time as investments underperform. • Lack of covenant visibility and possibility of sudden material covenant deterioration. • TPs may not be aligned to the scheme's LTFT. • Shorter timeframe to align with LTFT. • Increased risk to employer from greater sensitivity to investment volatility, and shorter timescales for correction.
What we expect from trustees and employers	
Covenant	• Proportionate covenant monitoring. • Where there is a high level of covenant leakage, proportionately increased DRCs and/or shorter recovery plans should be the norm. • In addition to enhancements to the recovery plan, strengthen short term security through other means such as contingent assets and guarantees where available. • The priority is to ensure the scheme is receiving sufficient cash contributions to meet its needs and is being treated fairly, plus a greater imperative to bolster security through contingent assets and contingency plans.

Investment	• Set a long-term asset allocation consistent with the scheme's LTFT. • Establish a journey plan to move towards the long-term asset allocation. • Review the LDI strategy and assess it for operational resilience – see our recently issued guidance. • Quantify the impact on funding of adverse investment performance. • Test and evidence the ability of the covenant to support downside investment risk (supportable investment risk) by means of additional cash and non-cash funding, without extending the length of the recovery plan. • Investment and funding plans to be structured to recognise the shorter time horizon, as well as the interplay between volatility in asset prices, investment returns and benefit outflows. • Consider your forward-looking liquidity requirements in the light of expected transfer value activity, cash commutation and benefit payments. • The priority is to protect the scheme and employer from further downside while improving funding position by further cash and/or contingent assets.
Funding	• Strengthen TPs, increase DRCs and reduce recovery plan lengths. • Agree your ultimate goal for the scheme and set a consistent LTFT. • Establish a plan for progressing from your current TPs to your LTFT within a realistic timescale. • Ensure TPs can be evidenced to be consistent with the journey plan to reach the LTFT. • If concerned about risk of trapped surplus, consider using escrow, ABCs, and contingency planning. • Extending recovery plan end dates to make good any negative investment returns is unlikely to be acceptable, given the strength of the employer. • A stronger focus on improving TPs and recovery plans to align with the scheme's LTFT.

Please note: If you need to check another scheme, please refer back to the table on page 3

Key risks and expectations for Group C1 as stated in the table on page 3

Group	C1
Characteristics	• Weaker employer with limited affordability. • Scheme funding on track to meet LTFT and contributions are reducing deficits at a slower but affordable pace. • Scheme is relatively immature.
Key risks	• Employer exposed to market risk if scheme is not cash flow matched/hedged. • Weaker covenant, may be more susceptible to adverse future events. • Covenant weakens at the same time as investments underperform. • Lack of long-term covenant visibility and possibility of sudden material covenant deterioration. • TPs may not be aligned to the scheme's LTFT. • Risk of the employer being unable to pay increased contributions if a downside investment event occurs, or in the event of sustained adverse investment experience.
What we expect from trustees and employers	
Covenant	• Maximise DRCs without risking sustainable growth plans of the employer. • Ensure fair treatment of scheme over all sources of covenant leakage. • Consider non-cash funding options, eg ABCs, or guarantees to strengthen security. • Proportionate covenant monitoring, with documented evidence of whether trustees consider independent covenant advice is necessary. • Where employer is part of a stronger group, seek wider group support through cash and non-cash support.

Investment	• Set a long-term asset allocation consistent with the scheme's LTFT. • Establish a journey plan to move towards the long-term asset allocation. • Review the LDI strategy and assess it for operational resilience – see our recently issued guidance. • Quantify the impact on funding of adverse investment performance. • Test and evidence the ability of the covenant to support downside investment risk (supportable investment risk) by means of additional cash and non-cash funding, without extending the length of the recovery plan. • Review the extent to which investment risks are expected to be rewarded and reduce where appropriate through suitable hedging/risk mitigation strategies and/or changes to asset allocation. • Focus on diversification to reduce downside investment risk. • Use funding level improvements to reduce the level of risk that is not supported by the covenant (set funding-based triggers/flags to monitor). • Where there is no (or inadequate) group support, consider reducing the current level of investment risk and running it for longer to slowly reduce the deficit over time. • Monitor transfer value activity and consider liquidity issues for the scheme if accompanied by a fall in market value of investments.
Funding	• Review your ultimate goal for the scheme and set a consistent LTFT. • Establish a plan for progressing from your current TPs to your LTFT within a realistic timescale. • Ensure TPs can be evidenced to be consistent with the journey plan to reach the LTFT. • If concerned about risk of trapped surplus, consider using escrow, ABCs, and contingency planning. • Recognise that the employer may have less resilience to cope with volatile contributions – stress and scenario testing will help you to understand exposures.

Please note: If you need to check another scheme, please refer back to the table on page 3

Key risks and expectations for Group C2 as stated in the table on page 3

Group	C2
Characteristics	• Weaker employer with limited affordability. • Scheme funding on track to meet LTFT and contributions are reducing deficits at a slower but affordable pace. • A relatively mature scheme.
Key risks	• Employer exposed to market risk if scheme is not cash flow matched/hedged. • Weaker covenant, may be more susceptible to adverse future events. • Covenant weakens at the same time as investments underperform. • Lack of covenant visibility and possibility of sudden material covenant deterioration. • TPs may not be aligned to the scheme's LTFT. • Risk of the employer being unable to pay increased contributions if a downside investment event occurs, or in the event of sustained adverse investment experience. • Increased risk to employer from greater sensitivity to investment volatility, and shorter timescales for correction.
What we expect from trustees and employers	
Covenant	• Maximise DRCs without risking sustainable growth plans of the employer. • Ensure fair treatment of scheme over all sources of covenant leakage. • Consider non-cash funding options, eg ABCs, guarantees to strengthen security. • Proportionate covenant monitoring, with documented evidence of whether trustees consider independent covenant advice is necessary. • Where employer is part of a stronger group, seek wider group support through cash and non-cash support. • Acknowledge the additional constraint of a shorter time horizon.

Investment	• Set a long-term asset allocation consistent with the scheme's LTFT. • Establish a journey plan to move towards the long-term asset allocation. • Review the LDI strategy and assess it for operational resilience – see our **recently issued guidance**. • Investment and funding plans to be structured to recognise the shorter time horizon, as well as the interplay between volatility in asset prices, investment returns and benefit outflows. • Quantify the impact on funding of adverse investment performance. • Test and evidence the ability of the covenant to support downside investment risk (supportable investment risk) by means of additional cash and non-cash funding, without extending the length of the recovery plan. • Consider your forward-looking liquidity requirements in the light of expected transfer value activity, cash commutation and benefit payments. • Review the extent to which investment risks are expected to be rewarded and reduce where appropriate through suitable hedging/risk mitigation strategies and/or changes to asset allocation. • Focus on diversification to reduce downside investment risk. • Use funding level improvements to reduce the level of risk that is not supported by the covenant (set funding-based triggers/flags to monitor). • Ensure asset allocation provides sufficient income and liquidity to cope with expected and unexpected benefit cash flows. • Consider the volatility of the assets used to provide liquidity to avoid significant selling of assets at lower than expected prices. • If expecting high transfer value activity, take action now to protect the scheme against liquidity issues in the event of a market downturn.

Funding	• Review your ultimate goal for the scheme and set a consistent LTFT. • Establish a plan for progressing from your current TPs to your LTFT within a realistic timescale. • Ensure TPs can be evidenced to be consistent with the journey plan to reach the LTFT. • If concerned about risk of trapped surplus, consider using escrow, ABCs, and contingency planning. • Recognise that the employer may have less resilience to cope with volatile contributions – stress and scenario testing will help you to understand exposures. • Acknowledge the additional constraint of a shorter time horizon. Therefore, the LTFT and consistency with TPs is even more important.

Please note: If you need to check another scheme, please refer back to the table on page 3

Key risks and expectations for Group D1 as stated in the table on page 3

Group	D1
Characteristics	• Weaker employer with limited affordability. • Scheme's TPs are weak and/or recovery plans are longer than six years. • Scheme is relatively immature.
Key risks	• Employer exposed to market risk if scheme is not cash flow matched/hedged. • Weaker covenant, may be more susceptible to adverse future events. • Covenant weakens at the same time as investments underperform. • Lack of long-term covenant visibility and possibility of sudden material covenant deterioration. • TPs may not be aligned to the scheme's LTFT. • Risk of the employer being unable to pay increased contributions if a downside investment event occurs, or in the event of sustained adverse investment experience. • More urgent need to improve funding and reduce member risk.
What we expect from trustees and employers	
Covenant	• Maximise DRCs without risking sustainable growth plans of the employer. • Ensure fair treatment of scheme over all sources of covenant leakage. • Consider non-cash funding options, eg ABCs, guarantees to strengthen security. • Proportionate covenant monitoring, with documented evidence of whether trustees consider independent covenant advice is necessary. • Where employer is part of a stronger group, seek wider group support through cash and non-cash support. • A greater focus on securing wider group support where available. • Prioritise the scheme over all forms of covenant leakage. • Trustees should give serious consideration to obtaining independent covenant advice to assist them in maximising the support available for the scheme. If trustees decide not to do so, they should be prepared to justify why such an approach is appropriate.

Investment	**If adequate formal group support has been conferred, treat as follows:** • Set a long-term asset allocation consistent with the scheme's LTFT. • Establish a journey plan to move towards the long-term asset allocation. • Quantify the impact on funding of adverse investment performance. • Test and evidence the ability of the covenant to support downside investment risk (supportable investment risk) by means of additional cash and non-cash funding, without extending the length of the recovery plan. • Trustees should understand, quantify and justify the reliance on investment returns versus DRCs to repair a worse than anticipated deficit. **Otherwise, if there is a reasonable likelihood of the employer continuing as a going concern, treat as follows:** • Set a long-term asset allocation consistent with the scheme's LTFT. • Establish a journey plan to move towards the long-term asset allocation. • Quantify the impact on funding of adverse investment performance. • Test and evidence the ability of the covenant to support downside investment risk (supportable investment risk) by means of additional cash and non-cash funding, without extending the length of the recovery plan. • Review the extent to which investment risks are expected to be rewarded and reduce where appropriate through suitable hedging/risk mitigation strategies and/or changes to asset allocation. • Focus on diversification to reduce downside investment risk. • Use funding level improvements to reduce the level of risk that is not supported by the covenant (set funding-based triggers/flags to monitor). • Where there is no (or inadequate) group support, consider reducing the current level of investment risk and running it for longer to slowly reduce the deficit over time. • Monitor transfer value activity and consider liquidity issues for the scheme if accompanied by a fall in market value of investments. • Where there are concerns over the financial position of the employer, ensure there is an appropriate investment structure and sufficient liquidity to reduce investment risk quickly if the covenant deteriorates further.

Funding	**If adequate formal group support, treat as follows:** • Focus on strengthening TPs, increasing DRCs and reducing RP lengths. • Review your ultimate goal for the scheme and set a consistent LTFT. • Establish a plan for progressing from your current TPs to your LTFT within a realistic timescale. • Ensure TPs can be evidenced to be consistent with the journey plan to reach the LTFT. • If concerned about risk of trapped surplus, consider using escrow, ABCs, and contingency planning. • Extending recovery plan end dates to make good any negative investment returns is unlikely to be acceptable, if adequate group support is available. **Otherwise, treat as follows:** • Seek best possible funding outcome for members in the circumstances. • Consider the appointment of a professional trustee with experience of stressed schemes. • Be prepared to show evidence of appropriate measures, including review of any generous options and discretionary benefits, cessation of future accrual, consideration of winding up, managing your conflicts, awareness of future funding risks and ability to manage them. • Monitor transfer value activity, the assumptions and consider any reductions you believe are appropriate to protect all members.

Please note: If you need to check another scheme, please refer back to the table on page 3

Key risks and expectations for Group D2 as stated in the table on page 3

Group	D2
Characteristics	• Weaker employer with limited affordability. • Scheme's TPs are weak and/or recovery plans are longer than around six years. • A relatively mature scheme.
Key risks	• Employer exposed to market risk if scheme is not cash flow matched/hedged. • Weaker covenant, may be more susceptible to adverse future events. • Covenant weakens at the same time as investments underperform. • Lack of covenant visibility and possibility of sudden material covenant deterioration. • TPs may not be aligned to the scheme's LTFT. • Risk of the employer being unable to pay increased contributions if a downside investment event occurs, or in the event of sustained adverse investment experience. • More urgent need to improve funding and reduce member risk. • Increased risk of sudden or sustained adverse investment performance and shorter timeframe for correction.

What we expect from trustees and employers	
Covenant	• Maximise DRCs without risking sustainable growth plans of the employer. • Ensure fair treatment of scheme over all sources of covenant leakage. • Consider non-cash funding options, eg ABCs, guarantees to strengthen security. • Proportionate covenant monitoring, with documented evidence of whether trustees consider independent covenant advice is necessary. • Where employer is part of a stronger group, seek wider group support through cash and non-cash support. • A greater focus on securing wider group support where available. • Prioritise the scheme over all forms of covenant leakage. • Trustees should give serious consideration to obtaining independent covenant advice to assist them in maximising the support available for the scheme. If trustees decide not to do so, they should be prepared to justify why such an approach is appropriate. • A focus on maximising support for the scheme and prioritising scheme liabilities over all forms of covenant leakage.

Investment	• Focus on minimising unsupported risks. **If adequate formal group support has been conferred, treat as follows:** • Set a long-term asset allocation consistent with the scheme's LTFT. • Establish a journey plan to move towards the long-term asset allocation. • Quantify the impact on funding of adverse investment performance. • Test and evidence the ability of the covenant to support downside investment risk (supportable investment risk) by means of additional cash and non-cash funding, without extending the length of the recovery plan. • Trustees should understand, quantify and justify the reliance on investment returns versus DRCs to repair a worse than anticipated deficit. **Otherwise, if there is a reasonable likelihood of the employer continuing as a going concern, treat as follows:** • Set a long-term asset allocation consistent with the scheme's LTFT. • Establish a journey plan to move towards the long-term asset allocation. • Quantify the impact on funding of adverse investment performance. • Test and evidence the ability of the covenant to support downside investment risk (supportable investment risk) by means of additional cash and non-cash funding, without extending the length of the recovery plan. • Review the extent to which investment risks are expected to be rewarded and reduce where appropriate through suitable hedging/risk mitigation strategies and/or changes to asset allocation. • Focus on diversification to reduce downside investment risk. • Use funding level improvements to reduce the level of risk that is not supported by the covenant (set funding-based triggers/flags to monitor). • Where there is no (or inadequate) group support, consider reducing the current level of investment risk and running it for longer to slowly reduce the deficit over time. • Monitor transfer value activity and consider liquidity issues for the scheme if accompanied by a fall in market value of investments. • Where there are concerns over the financial position of the employer, ensure there is an appropriate investment structure and sufficient liquidity to reduce investment risk quickly if the covenant deteriorates further.

Funding	• Focus on improving scheme funding. **If adequate formal group support, treat as follows:** • Review your ultimate goal for the scheme and set a consistent LTFT. • Establish a plan for progressing from your current TPs to your LTFT within a realistic timescale. • Ensure TPs can be evidenced to be consistent with the journey plan to reach the LTFT. • If concerned about risk of trapped surplus, consider using escrow, ABCs, and contingency planning. Strengthen TPs, increase DRCs and reduce recovery plan lengths. • Extending recovery plan end dates to make good any negative investment returns is unlikely to be acceptable, given adequate group support. **Otherwise treat as follows:** • Seek best possible funding outcome for members in the circumstances. • Consider the appointment of a professional trustee with experience of stressed schemes. • Be prepared to show evidence of appropriate measures, including review of any generous options and discretionary benefits, cessation of future accrual, consideration of winding up, managing your conflicts, awareness of future funding risks and ability to manage them. • Monitor transfer value activity, the assumptions and consider any reductions you believe are appropriate to protect all members.

Please note: If you need to check another scheme, please refer back to the table on page 3

Key risks and expectations for Group E1 as stated in the table on page 3

Group	E1
Characteristics	• Weak employer unable to provide support. • Stressed scheme with limited or no ability to use flexibilities in the funding regime. • Scheme is relatively immature.
Key risks	• Crystallisation of unsupported investment risk and/or employer affordability weakening further.
What we expect from trustees and employers	
Covenant	• Where trustees consider that further support is possible (from the employer or wider group), independent covenant advice can support the trustees in negotiations to improve the scheme's position. • Focus on mitigations against further covenant weakening, including cessation of dividend payments, and maximisation of non-cash support (be prepared to show the evidence). • Proportionate covenant monitoring using independent experts able to advise on areas where mitigation could be sought, and appropriate mechanisms to detect early signs of further deterioration. • If there is a high risk of employer insolvency, trustees should fully explore their options and consider which ones might be deployed to best enhance member outcomes. PPF guidance on insolvency and restructuring should help.

Investment	**Where there is a reasonable likelihood of the employer continuing as a going concern:** • Set a long-term asset allocation consistent with the scheme's LTFT. • Establish a journey plan to move towards the long-term asset allocation. • Quantify the impact on funding of adverse investment performance. • Test and evidence the ability of the covenant to support downside investment risk (supportable investment risk) by means of additional cash and non-cash funding, without extending the length of the recovery plan. • Review the extent to which investment risks are expected to be rewarded and reduce where appropriate through suitable hedging/risk mitigation strategies and/or changes to asset allocation. • Focus on diversification to reduce downside investment risk • Use funding level improvements to reduce the level of risk that is not supported by the covenant (set funding-based triggers/flags to monitor). • Where there is no (or inadequate) group support, consider reducing the current level of investment risk and running it for longer to slowly reduce the deficit over time. • Monitor transfer value activity and consider liquidity issues for the scheme if accompanied by a fall in market value of investments. **Where there is a reasonable likelihood of the employer not continuing as a going concern:** • Where there are concerns over the financial position of the employer, ensure there is an appropriate investment structure and sufficient liquidity to reduce investment risk quickly if the covenant deteriorates further.
Funding	• Seek best possible funding outcome for members in the circumstances. • Consider the appointment of a professional trustee with experience of stressed schemes, especially in circumstances where the company is already distressed even without the pension scheme. • Be prepared to show evidence of appropriate measures, including review of any generous options and discretionary benefits, cessation of future accrual, consideration of winding up, managing your conflicts, awareness of future funding risks and ability to manage them. • Monitor transfer value activity, the assumptions and consider any reductions you believe are appropriate to protect all members.

Please note: If you need to check another scheme, please refer back to the table on page 3

Key risks and expectations for Group E2 as stated in the table on page 3

Group	E2
Characteristics	• Weak employer unable to provide support. • Stressed scheme with limited or no ability to use flexibilities in the funding regime. • A relatively mature scheme.
Key risks	• Crystallisation of unsupported investment risk and/or employer affordability weakening further but limited time for recovery.
What we expect from trustees and employers	
Covenant	• Where trustees consider that further support is possible (from the employer or wider group), independent covenant advice can support the trustees in negotiations to improve the scheme's position. • Recognising the time horizon is shorter, focus on mitigations against further covenant weakening, including cessation of dividend payments, and maximisation of non-cash support (be prepared to show the evidence). • Proportionate covenant monitoring using independent experts able to advise on areas where mitigation could be sought, and appropriate mechanisms to detect early signs of further deterioration. • If there is a high risk of employer insolvency, trustees should fully explore their options and consider which ones might be deployed to best enhance member outcomes. PPF guidance on insolvency and restructuring should help.

Investment	**If there is a reasonable likelihood of the employer continuing as a going concern:** • Set a long-term asset allocation consistent with the scheme's LTFT. • Establish a journey plan to move towards the long-term asset allocation. • Investment and funding plans to be structured to recognise the shorter time horizon, as well as the interplay between volatility in asset prices, investment returns and benefit outflows. • Quantify the impact on funding of adverse investment performance. • Test and evidence the ability of the covenant to support downside investment risk (supportable investment risk) by means of additional cash and non-cash funding, without extending the length of the recovery plan. • Consider your forward-looking liquidity requirements in the light of expected transfer value activity, cash commutation and benefit payments. • Review the extent to which investment risks are expected to be rewarded and reduce where appropriate through suitable hedging/risk mitigation strategies and/or changes to asset allocation. • Focus on diversification to reduce downside investment risk • Use funding level improvements to reduce the level of risk that is not supported by the covenant (set funding-based triggers/flags to monitor). • Ensure asset allocation provides sufficient income and liquidity to cope with expected and unexpected benefit cash flows. • Consider the volatility of the assets used to provide liquidity to avoid significant selling of assets at lower than expected prices. • If expecting high transfer value activity, take action now to protect the scheme against liquidity issues in the event of a market downturn. **Where there are concerns over the financial position of the employer:** • Ensure there is an appropriate investment structure and sufficient liquidity to reduce investment risk quickly if the covenant deteriorates further.

Funding	• Recognising that the time horizon is shorter, seek best possible funding outcome for members in the circumstances. • Consider the appointment of a professional trustee with experience of stressed schemes. • Be prepared to show evidence of appropriate measures, including review of any generous options and discretionary benefits, cessation of future accrual, consideration of winding up, managing your conflicts, awareness of future funding risks and ability to manage them. • Monitor transfer value activity, the assumptions and consider any reductions you believe are appropriate to protect all members. • Be prepared to evidence good reasons for not reducing transfer values for underfunding.

Please note: If you need to check another scheme, please refer back to the table on page 3

Annual Funding Statement 2023 for defined benefit pension schemes
Key risks trustees and employers should focus on and actions to take

www.tpr.gov.uk