

TPR publishes first part of consultation on revised code for scheme funding

Alert | 03 March 2020



Introduction

Today, TPR published the first stage of a “major” [consultation on its revised code of practice for DB funding](#). Running to 175 pages, this first consultation sets out TPR’s initial proposals for a “clearer, more readily enforceable funding framework, which implements the new requirements set out in the Pension Schemes Bill”.

Key points

- TPR acknowledges that this is a lengthy consultation and does not expect all respondents to read the whole document. With this in mind, it has also issued a [companion guide](#) running to (a more manageable) 15 pages.
- Under the proposals, trustees will be able to choose either a “Fast Track” or a “Bespoke” approach to completing and submitting their scheme valuation. As the more straightforward (and prescriptive) approach, the Fast Track will only be available to schemes whose valuation meets certain guidelines.
- TPR does not expect its “new proposed approach to be too onerous for most schemes to implement”, but appreciates that “there could be significant impact for some schemes, particularly those that have been running excessive and unjustifiable levels of risk”.
- At this stage, TPR anticipates that “the final code will be shorter and more focused, simply outlining the twin-track compliance structure, proposed Fast Track parameters and the principles for those following Bespoke”.

Background

In its 2018 White Paper, “Protecting [DB] Pension Schemes” (see our [Alert](#)), the Government identified a range of issues relating to scheme funding. Its proposals included strengthening TPR’s ability to enforce DB scheme funding standards, through a revised DB funding code of practice, focusing on how prudence is demonstrated when assessing scheme liabilities, what factors are appropriate when considering recovery plans, and ensuring a long-term view is considered when setting the SFO.

The Pension Schemes Bill (see our [Alert](#)), which is currently making its way through Parliament, will implement some of those proposals. For example, the new requirement for trustees to determine, review and, if necessary, revise a “funding and investment strategy” to ensure pension and other benefits can be

provided over the long term.

TPR's revised code is intended to address these new statutory requirements, as well as TPR's evolving approach to regulating DB funding.

New regulatory approach: Fast Track and Bespoke

TPR puts forward a twin-track compliance route to carrying out scheme funding valuations. Under the "Fast Track" approach, trustees can expect "minimum regulatory involvement on DB funding". In contrast, the "Bespoke" approach may mean more scrutiny, but will offer greater flexibility. Schemes will be able to switch approaches from valuation to valuation, as appropriate.

In both cases, trustees will have to submit evidence to TPR (to a greater degree when using the Bespoke route) demonstrating their approach to managing their funding and investment risks as part of the new statement of strategy being introduced by the Pension Schemes Bill.

Fast Track

TPR will "set a series of objective and quantitative compliance guidelines and parameters", covering key aspects of funding and investment arrangements, such as:

- the funding target (the long-term objective or "LTO") and timing to reach this
- technical provisions ("TPs") including discount rates and possibly other assumptions
- the length and structure of the recovery plan
- investment risk
- future service contribution rates (open schemes).

Potential options are set out in the consultation and their respective advantages and disadvantages assessed.

Trustees will use the guidelines and parameters (which will be reviewed and updated, as necessary) to assess whether TPR would consider their valuation to be compliant with the legislation. To be able to use the Fast Track, schemes would have to satisfy all the requirements individually. However, as the Fast Track framework represents a baseline of "tolerated risk" (both scheme and employer related) in different circumstances this would not be a risk-free position; trustees would still be expected to exercise judgement, assess and manage their own scheme and covenant specific risks, and plan for adverse conditions.

Bespoke

TPR does not consider that this route should be an "opt-out" from the new regime. It is intended to complement the Fast Track, with both applying consistent methodology for legislative compliance.

Trustees who take this approach will be expected to fully articulate their position and decisions to TPR, and to provide tangible supporting evidence.

Key principles

TPR has identified, and is seeking views on, a number of overarching principles which it believes should

stand behind all scheme valuations. These are:

- **Compliance and evidence** – TPR expects trustees and employers to understand their scheme-specific funding and investment risks and to be able to objectively evidence how these risks have been assessed as remote or minimal, or can otherwise be properly managed.
- **LTO** – TPR proposes that schemes should seek to progressively reduce their reliance on the employer covenant over time to reach a position of low dependency, with investments that are highly resilient to risk, by the time they are significantly mature.
- **Journey plans and TPs** – Trustees are expected to develop a journey plan to achieve their LTO. TPs should have a clear and explicit link to the LTO and the two should converge over time.
- **Scheme investments** – The actual investment strategy and asset allocation over time should be broadly aligned with the scheme’s funding strategy. Trustees “must” ensure their investment strategy has sufficient security, sufficient quality, and can satisfy liquidity requirements based on expected cash flows as well as a reasonable allowance for unexpected cash flows.
- **Reliance on the employer covenant** – TPR notes that schemes with stronger employer covenants can take more risk (and assume higher returns), but states that trustees should assume a reducing level of reliance on covenant over time, depending on its visibility.
- **Reliance on additional support** – schemes can account for additional support when carrying out their valuations if it: provides sufficient support for the risks being run, is appropriately valued, and is legally enforceable and realisable at its “necessary value” when required.
- **Appropriate recovery plan** – Deficits on a TP basis should be recovered as soon as affordability allows, while minimising any adverse impact on the employer’s sustainable growth.
- **Open schemes** – notably, TPR considers that members’ accrued benefits in open schemes should have the same level of security as members’ accrued benefits in closed schemes.

Next steps

The consultation closes on 2 June 2020. During the next three months, TPR plans to meet with the industry to discuss its proposals, including at stakeholder events to be held during March.

Following TPR’s consultation, the DWP intends to draft regulations on the detailed requirements set out in the Pension Schemes Bill (relating to the funding and investment strategy, statement of strategy and the clarification of key terms, such as “prudent” and “appropriate”). TPR will use the legislation, and the industry’s feedback to this first consultation, to inform its second consultation on the draft funding code itself. This second consultation is scheduled for the end of the year.

TPR currently expects the revised code and the associated legislation to come into force at the end of 2021.

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