Sackers

DWP consults on DB funding and investment strategy

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Introduction

Designed to implement new requirements set out in the PSA21 for DB schemes to have a funding and investment strategy ("the F&I Strategy"), and to submit a written statement of that strategy ("the Statement") to TPR, the DWP published its greatly anticipated consultation and draft regulations ("the Regulations") on 26 July 2022.

Key points

- DB schemes will be required to have an F&I Strategy aimed at achieving "low dependency" on their sponsoring employer by the time they are "significantly mature".
- The intention underpinning the new F&I Strategy is "to have better, and clearer, funding standards, but not to move away from the strengths of a flexible scheme specific approach". For open DB schemes, this means that the Regulations will not prevent access to "riskier investments where there are potentially higher returns, as long as the risks being taken can be supported and members' benefits are effectively protected".
- Trustees will be required to produce their first F&I Strategy no later than 15 months after the effective date of the first actuarial valuation after the Regulations come into force.
- The Regulations specify what must be covered in the written Statement.
- Further detail on the new requirements will be set out in TPR's revised DB funding code of practice ("the Code"), so this also needs to be on all DB schemes' radars.

Background

The PSA21 sets the scene for a new requirement for DB schemes to have an F&I Strategy, including the funding level which the trustees "intend the scheme to have achieved", and the investments they intend to hold, on the relevant date(s) (see below). The scheme's "technical provisions" under the statutory funding regime will need to be calculated "in a way that is consistent with" this strategy.

As soon as reasonably practicable after determining or revising the scheme's F&I Strategy, the trustees will have to prepare the Statement, capturing the detail in writing.

Employer agreement to the F&I Strategy, as set out in the scheme's Statement, must be obtained. Sponsoring employers must also be consulted on certain issues, including "the main risks faced by the scheme in implementing" the F&I Strategy, and how the trustees intend to mitigate or manage them.

F&I Strategy

The Regulations describe the matters the trustees must take into account, and the principles they must follow, in determining or revising their scheme's F&I Strategy. They also address the level of detail to be provided.

The key principle underpinning the new F&I Strategy will be a requirement for schemes, as a minimum, to be "in a state of low dependency on their sponsoring employer by the time they are significantly mature". Unsurprisingly, the principles trustees will need to follow to achieve this hone in on the level of investment and funding risk (both dependent, primarily, on the strength of the employer covenant), as well as liquidity.

While the requirement for low dependency "sets a standard that schemes must achieve", it is intended to recognise that, in practice, schemes will plan for how pension benefits will be delivered over the longer term in different ways. For example, some will "'run on' with low dependency on the employer" on reaching significant maturity, while others may target buy-out with an insurer or entering a consolidator.

Process

The DWP envisages that, in complying with the Regulations, trustees will

- firstly, determine the date of "significant maturity" on actuarial advice
- then pinpoint a relevant date, and
- finally, determine a "low dependency asset allocation" they intend the scheme to have achieved by that date, and a "low dependency funding basis" consistent with that asset allocation.

That "low dependency funding basis" will also be used by the actuary to estimate the scheme's funding level as at the effective date of the relevant actuarial valuation. The key concepts are summarised below.

Scheme maturity

Maturity is a measure of how far a scheme is through its lifetime. The Regulations provide for maturity to be measured in years using a "duration of liabilities" measure, on the basis that it is "well understood" by the pensions industry. In summary this measure is the "weighted mean time until the payment of pensions and other benefits under the scheme, weighted by the discounted payments". Guidance on its use will be provided in the Code.

Significant maturity

A scheme reaches "significant maturity on the date it reaches the duration of liabilities in years", the proposal being that this will be specified by TPR in the Code. At each valuation, the scheme actuary will be required to estimate the date on which the scheme will reach significant maturity using the methodology and metrics set out in the Regulations and the Code.

The DWP's view is that this concept would be more appropriately addressed in a code of practice (as opposed to regulations), as this will leave the detail to TPR's discretion. It understands that the second consultation on the Code may propose that a scheme is significantly mature when it reaches a duration of liabilities of 12 years.

Relevant date

The relevant date must not be later than the end of the scheme year in which the scheme is expected to, or did, reach significant maturity, as set out in the actuarial valuation to which the F&I Strategy relates. Each time the F&I Strategy is reviewed, the trustees will be required to review and, if necessary or appropriate, revise the relevant date.

Low dependency

Broadly, a scheme has low dependency on its employer when:

- it has sufficient assets invested in a low dependency investment strategy to provide for accrued pension rights, and
- it is not expected, under reasonably foreseeable circumstances, to need further employer contributions.

This definition intentionally steers clear of "self-sufficiency", given that "unexpected circumstances, which are materially different from those assumed" may prompt the need for additional employer funds.

Timing

The first F&I Strategy must be produced no later than 15 months after the effective date of a scheme's first actuarial valuation after the Regulations come into force. It must be then be reviewed, and if necessary revised:

- within 15 months of the effective date ofeach subsequent valuation, and
- as soon as reasonably practicable after any material change in the circumstances of the pension scheme or its employer.

The Statement

The Statement is intended to facilitate better trustee engagement, and better understanding and accountability between trustees and TPR.

Part one of the Statement is the F&I Strategy itself. Part two must then:

- provide an assessment of whether the F&I Strategy is being successfully implemented, including any remedial action the trustees intend to take to get the strategy back on course and details as to timing
- set out the key risks and mitigations for implementation, and the trustees' reflections on any key decisions and lessons learned.

Other details to be covered by the Statement include:

- the actuary's estimate of the maturity of the scheme as at the effective date of the actuarial valuation and (for a scheme that has not reached its relevant date) how the scheme's maturity is expected to change over time

- an explanation of the level of investment risk the trustees intend the scheme to take now and, for a scheme that has not reached its relevant date, over the course of its journey to significant maturity (known as "the journey plan")
- an assessment of the strength of the employer covenant
- an explanation of how the F&I Strategy remains appropriate
- confirmation that the sponsoring employer has been consulted when preparing or revising Part two, as well as any comments which it has asked to be included.

Part two of the Statement must be reviewed and, if necessary, revised as soon as practicable after any review of the F&I Strategy, whether or not the strategy itself is revised.

The Statement must be submitted to TPR along with the scheme's actuarial valuation. The submission process will be set out in TPR's Code.

The chair of trustees

The Statement must be signed off by the chair of trustees. (This is the new DB chair's statement we have been expecting.)

Where the trustee board does not have a chair, they must appoint one which meets certain basic requirements. Schemes which already have a chair can continue with the same chair, only their successors will need to meet these requirements.

Next steps

The consultation closes on 17 October 2022. Once it has "taken the opportunity to learn" from this consultation, TPR's second consultation on the Code will follow. While no date has been specified, the Regulations indicate that they will come into effect at some point in 2023.

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