In Touch technical update

Consultation on scheme funding regulations

The Pension Schemes Act 2021 includes provisions to strengthen the existing scheme funding regime by requiring defined benefit (DB) occupational pension schemes to have a funding and investment strategy, set out in a statement submitted to the Pensions Regulator. The Department for Work and Pensions has now released a consultation on draft regulations to expand upon those provisions.

At a glance…

- By the time schemes reach "significant maturity" they must have adopted a low dependency investment allocation and be fully funded on a low dependency funding basis
- A statement of strategy needs to be produced at least as part of each actuarial valuation, detailing the scheme's journey plan to the low dependency state
- The level of risk that can be taken along the journey plan is dependent on the strength of the employer covenant and the timescales for reaching significant maturity
- Further detail will be set out in TPR's revised funding Code of Practice

Background

The Pension Schemes Act 2021 introduces a new requirement for DB pension schemes to have a funding and investment strategy for ensuring that benefits under the scheme can be paid over the long term, and for progress against this strategy to be reported to the Pensions Regulator (TPR) in a statement of strategy. The Act is supplemented by regulations and DWP's latest consultation seeks views on the draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023.

The legislation will be supported by a revised DB funding Code of Practice, on which TPR will consult.

The DWP's consultation reiterates that the DB scheme funding regime will remain scheme specific, but that the proposed measures aim to ensure that outliers follow best practice.

Why bring you this note?

The consultation is seeking views on the regulations that put the Pension Schemes Act 2021 funding regime into effect.

Next steps

DWP's consultation closes on 17 October 2022.

TPR will consult on the Code of Practice to build on these regulations.

According to TPR's indications, the Code is planned to become operational during 2023.

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Funding and investment strategy

A key principle to be followed when trustees set or revise their scheme's funding and investment strategy is that the scheme must be in, at least, a state of low dependency on the sponsoring employer by the time it is significantly mature. This would require scheme assets to be invested in a low dependency investment allocation and to be fully funded on a low dependency funding basis. The draft regulations and consultation define these terms:

- The draft regulations link reaching 'significant maturity' to reaching the duration of liabilities that will be specified in the revised Code of Practice. (TPR's 2020 consultation, on the principles for the revised Code, proposed that schemes would be regarded as significantly mature when they reach a duration of liabilities of 12 to 14 years. The DWP suggests that TPR's second consultation may propose a duration of liabilities of 12 years.)

  The draft regulations provide flexibility to allow the characteristics of an open scheme to be taken into account when projecting scheme maturity, and the DWP expects that the revised Code will give further guidance on this.

- 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 without expecting to need further employer contributions under reasonably foreseeable circumstances (other than for further accrual for active members). For this purpose a scheme must be fully funded, on a low dependency funding basis; the draft regulations allow the trustees to determine the assumptions used for this.

The regulations set out the level of detail to be included in the strategy and the process for review and revision. The strategy must be reviewed as part of each actuarial valuation and as soon as reasonably practicable in some circumstances, including following a material change in the strength of employer covenant.

The draft regulations define the strength of employer covenant for this purpose (being the financial ability of the employer to support the scheme, combined with any contingent assets that are legally enforceable by the trustees). The strength of the employer covenant should be assessed in relation to the size of the deficit (or surplus), including on a solvency basis.

The draft regulations set out the matters and principles that the trustees should take into account when determining or revising the scheme's funding and investment strategy.

- The matters include the actuary's estimate of: the date that the scheme is expected to reach significant maturity (or when it did reach this).
- The principles include minimum requirements for a scheme once it reaches the significant maturity date: to have sufficient and appropriate assets for full funding on a low dependency funding basis; and for the assets of the scheme to be invested in accordance with a low dependency strategy.

They also provide for ‘supportability principles’ to apply to the level of investment risk that trustees can take as the scheme moves along its journey plan to maturity, and for those principles to apply to the level of risk that can be taken by the trustees when determining the actuarial assumptions used for calculating the liabilities of the scheme as it moves along its journey plan. The assets of the scheme must be in investments with sufficient liquidity to enable the scheme to meet expected cash flow requirements, although “sufficient liquidity” is not defined.

Statement of strategy

The Pension Schemes Act 2021 provides for the chair of trustees to sign off a written 'statement of strategy' relating to the scheme's long-term objectives, detailing:

1. The scheme's 'funding and investment strategy' for ensuring that benefits can be provided over the long term, including the funding level the scheme is intended to achieve as at relevant dates and the high-level asset allocation intended to be held on those dates; and
2. Supplementary matters including the extent to which the strategy is being successfully implemented, the main risks faced in doing so, and the trustees' reflections on any significant decisions taken relevant to the strategy.

The first part of the statement must be agreed between the trustees and sponsor (unless sponsor agreement is not required to set contributions). The second part requires consultation with the sponsor.

The policy aim of the statement of strategy is to facilitate better trustee engagement, and better understanding and accountability between trustees and TPR. These requirements are closely linked to the development of TPR’s revised funding Code, with its increased focus on long-term objectives.

The draft regulations require that Part 2 of the statement includes a section setting out what action the trustees intend to take if the risks materialise (for example, trigger points to manage risks and contingency plans), and a section setting out details of the proportion of assets allocated to different categories of investment and the level of risk relating to each.

Other aspects that must be addressed in the statement are: maturity, including how this is expected to change over time; investment risk; liquidity; funding level; technical provisions; risk in relation to calculation of liabilities; and employer covenant.

The legislation requires a chair of the trustee board to sign off the statement of strategy and where the board does not have a chair, they must appoint a trustee as a chair. The draft regulations list the requirements for the new chair. (Schemes that already have a chair can continue with the same chair and only their successors will need to meet the requirements in the draft regulations.)

TPR will set out the format of the statement of strategy that must be submitted.

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