



In Touch technical update

TPR consults on DB funding code

The Pensions Regulator (TPR) has [published](#) its long-awaited consultation on a new Defined Benefit funding code, along with a separate consultation on 'Fast Track and our regulatory approach'. Fast Track is now a risk tolerance level TPR is likely to accept without further investigation.

At a glance...

- The proposed Defined Benefit funding code sets out how schemes can comply with the new legislative requirements for long-term planning and setting recovery plans consulted on earlier this year
- A separate consultation on 'Fast Track and our regulatory approach' sets out the parameters for the Fast Track approach – however, unlike the original proposals in 2020, Fast Track will not be a benchmark for schemes adopting a Bespoke approach.

An outline of the funding regime

The Code starts by summarising the requirements for long-term planning as set out in the Pension Schemes Act 2021 and the (draft) scheme funding regulations consulted on earlier this year. It explains the interaction between the requirements to:

- Plan for long-term funding; and
- Carry out valuations showing the current funding position.

The subsequent sections explore these two issues in more detail.

The Code itself does not mention 'Fast Track' (see separate consultation below).

Why bring you this note?

The Pensions Regulator has published two consultations - on a new Defined Benefit funding code and on 'Fast Track and our regulatory approach'.

Next steps

The consultation runs until 24 March 2023.

The earliest date the new Code of Practice is expected to come in to force is 1 October 2023 – impacting valuations with effective dates on or after this date.

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Long term planning

Trustees must have a 'funding and investment strategy', with a journey plan to reach full funding on a 'low dependency funding basis' with a 'low dependency asset allocation' by the time they are significantly mature.

The Code indicates that the legislative requirement for 'broad cashflow matching' in a scheme's **low dependency asset allocation** can be achieved using a mix of 'growth' and 'matching' assets, and schemes should seek to have a minimum level of interest rate and inflation hedging of 90%. It expects schemes to test resilience using a one-year, 1-in-6 stress scenario as a minimum, with the change in funding level for a fully funded scheme limited to 4.5%. In the consultation document TPR suggests that schemes with growth assets of up to 25%-30% might satisfy the requirements.

The **low dependency funding basis** should be set so that no further employer contributions are expected to be required. The **expense reserve** should cover all expenses expected to be incurred after significant maturity, unless the scheme's rules require expenses to be paid by the employer (where a reserve is still encouraged).

Significant maturity is based on a duration of 12 years, as expected. This is based on the approach set out in the draft regulations – the consultation document also considers alternative approaches to defining significant maturity.

Trustees are required to carry out an **employer covenant** assessment although this should be proportionate. The assessment should be forward looking and consider visibility, reliability and longevity. There are 10 pages devoted to assessing the employer's cash flow, prospects, and factoring in contingent assets (including guarantees) and security. TPR is also planning to consult on additional covenant guidance in 2023.

The **journey plan** should reflect the level of risk that can be supported by the covenant and the period to significant maturity. During the 'period of covenant reliability' TPR would expect trustees to consider the ability of the employer to repair additional deficit from a 1-in-6 downside level event. In the 'period after covenant reliability' trustees will need to consider the appropriate level of risk. The Code sets out a range of de-risking strategies (linear, horizon, stepped).

The Code also outlines the requirement for schemes' **Statement of Strategy**. TPR intends to engage with the industry on the form of the statement to be submitted to it.

Valuations

This section includes information from the current Code and we focus on the new aspects.

For **open schemes**, allowance can be made for future accrual and/or new entrants – and the impact this is likely to have on the scheme's maturity – allowing risk to be taken for a longer period.

When determining **recovery plans**, allowance for post valuation experience and/or investment outperformance over the recovery period can be considered before assessing whether the resulting contributions are affordable – although allowance for outperformance should only be made where this is supportable by the covenant

The Code outlines three steps to determining what contributions the employer can reasonably afford:

- Available cash
- Reliability of available cash
- Reasonable alternative uses

Possible alternative uses include investment in sustainable growth of the employer, covenant leakage such as distributions to shareholders and discretionary payments to creditors.

Trustees are expected to take into consideration the funding ratio and maturity of the scheme in assessing whether alternative uses of cash are reasonable. In general, contributions to the scheme are expected to be prioritised over alternative uses of cash the lower the funding ratio and / or the more mature the scheme.

Special provisions apply in employer stress scenarios – such as where the situation is fundamentally incompatible with the funding regime.

Fast Track and regulatory approach

A separate consultation sets out TPR's twin track approach to assessing valuations – Bespoke and Fast Track. Both these approaches are equally valid. One reason Fast Track is now deliberately not included in the Code is greater flexibility to change it without needing to amend the Code of practice.

Fast Track provides more direction and clarity on TPR's view of a level of risk that it will tolerate, and will act as a filter for its assessment of submitted actuarial valuations – if a valuation submission meets a series of parameters, it is unlikely to be scrutinised further.

The approach is a significant change from the 2020 consultation, which proposed that Fast Track would be a benchmark against which to assess Bespoke valuations.

The Fast Track parameters cover:

- the low dependency funding and investment strategy –TPR expects a low dependency discount rate to be Gilts+0.5%.
- technical provisions (TPs) - with a minimum funding level based on a percentage of low dependency liabilities: ranging from 72% at 30 years duration, through 85% at 20 years duration to 100% at 12 year duration.
- investment risk - prior to significant maturity the scheme's funding level must not fall, under a prescribed stress test, by more than a set percentage (which increases with duration, allowing more growth assets for less mature schemes).
- recovery plans - no longer than six years, or three years for significantly mature schemes. Post valuation experience can be allowed for but not investment outperformance.

The Fast Track parameters do not vary by covenant strength.

TPR intends to review the parameters on a regular basis – every three years and perhaps yearly.

Illustrating behaviour changes

The Fast Track consultation paper sets out commentary on TPR's analysis of potential implications of implementing the new regime. TPR estimates that as at 30 September 2022 about 50% of schemes would meet all the Fast Track parameters and 76% already meet the majority of the parameters.

Related comments are included at the end of the consultation on the Code, on the risk of herding. This notes that, in aggregate, trustees now invest around 72% of scheme assets in bonds, and indicates that TPR expects schemes to be able to retain a proportion of their asset portfolios in growth assets: 15% under Fast Track and, TPR suggests, up to 25% to 30% under bespoke.

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