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XPS Express for Employers

Bringing you the latest pensions news for employers

Government finalises funding rules and consults on surplus extraction

At a glance

After extensive consultation, the final funding and investment strategy regulations for defined benefit (DB) schemes will come into force on 6 April 2024

Significant changes have been made since the first draft of the regulations, including flexibility on investment strategies for surplus assets, employer contributions and alternative means of funding

The new regulations will apply to valuations with effective dates on or after 22 September 2024

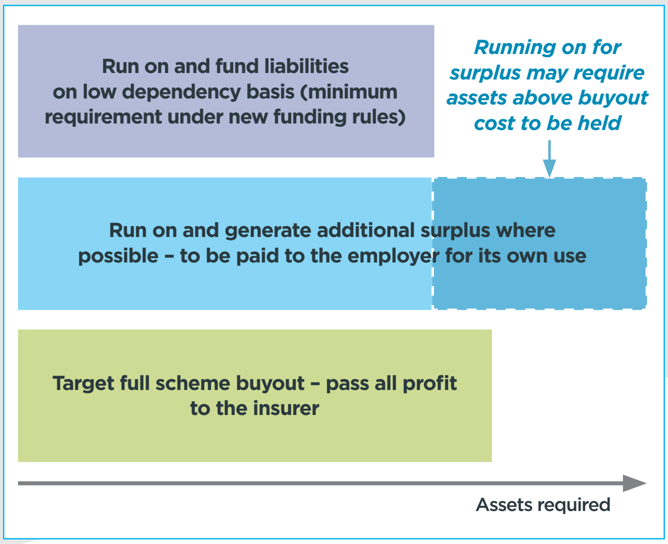
On 23 February 2024, the Department for Work and Pensions (DWP) launched a consultation on surplus extraction. This will impact decisions on setting long term targets as there is now more scope to consider alternative options

The consultation supports the Government's aim to make it easier for surpluses to be paid to employers while ensuring members are protected

This consultation, together with the changes to the funding regulations, show the Government's commitment to its growth agenda

Exploring different endgame options

DWP's proposed changes to surplus rules have the potential to create a **legitimate environment to run on for surplus,** when previously buyout may have been the main option. Different levels of scheme assets will be needed for the range of endgame options:



Getting ready to comply with the new regulations

Key questions for employers to consider:

Covenant	**How** will you demonstrate support available to schemes and **over what time horizon** do you have reasonable certainty?
Funding	Will more contributions into the scheme be needed? If so, **how much and for how long?** Could **guarantees and other contingent assets** be used rather than cash?
Investment	**How much risk** should be taken to reach low dependency? How should any **surplus assets** be invested once low dependency is reached?

Actions employers can take

1. **Understand when your schemes will need to comply with the new regulations**
2. **Determine what information you will need to provide as part of covenant assessments**
3. **Consider how different contribution options would fit in with sustainable growth of your business**
4. **Engage with your trustees on views on long-term strategy to ensure interests are aligned.**
5. **Consider responding to the surplus consultation (runs until 19 April 2024).**

Finer detail on the funding regulations

Statement of strategy

Headline strategy

Trustees must document key aspects of the long term strategy and **agree** this statement with the employer. These include:

- How benefits will be paid in the long term ✔
- Funding target and relevant date ✔
- Liquidity ✔

Supplementary

Trustees must provide additional information in Part 2 of the statement and **consult** with the employer. This includes:

- Valuation results and recovery plan ✔
- Implementation and remedial actions ✔
- Employer covenant ✔
- Scheme maturity ✔
- Investment allocation ✔

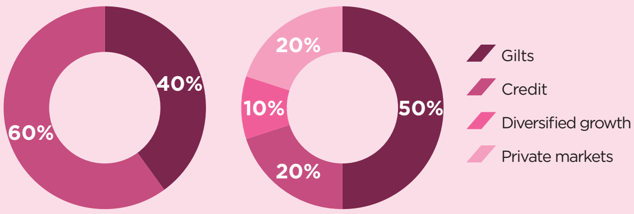
Key changes most relevant to employers

Low dependency

'Low dependency' means future employer contributions are not likely to be needed. Schemes must aim to reach full funding on a low dependency basis when **'significantly mature'.** This is now measured based on duration at a fixed point in time, with **more flexibility for open schemes** to allow for future benefit accrual, subject to covenant.

In terms of a low dependency investment strategy, the assets need to be **'highly resilient'** to short-term changes in market conditions. The requirement to be 'broadly matched' to cashflows has been removed. There are also **no longer any restrictions for how surplus assets are invested** once low dependency is reached, for example:

Matching strategy | Diversified strategy



Source: XPS Investment

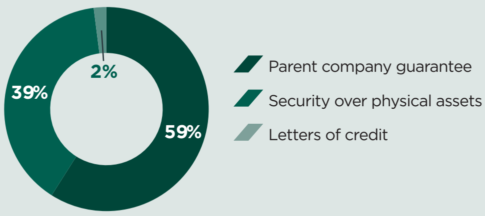
Cash funding

Deficits must be **recovered as soon as employers can reasonably afford to.** But trustees must recognise the need for employers to **grow sustainably,** including to:

Distribute dividends	Pay other creditors	Invest in the business

Contingent assets

Guarantees from a parent/group company are most common. However, other contingent assets may also be used, for example **security over physical assets** (e.g. property), letters of credit, escrow arrangements.



Source: PPF's Purple Book 2023

The new regulations mean a collaborative approach between employers and trustees will be needed to agree objectives, an appropriate long term endpoint for their schemes and a strategy for getting there.

For further information, please get in touch with **Charlotte Yuen** or **Mark Witkin** or speak to your usual XPS Pensions contact.

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