XPS Pensions Group

XPS Insights

July 2022

DWP's consultation on new regulations for DB scheme funding and investment

What you **need to know**

- The Department for Work and Pensions (DWP) has released its consultation on draft regulations supporting the forthcoming new requirement for trustees of defined benefit (DB) schemes to have a funding and investment strategy, as introduced by the Pension Schemes Act 2021. The closing date for responses is 17 October 2022.
- The draft regulations provide further detail on how to set the strategy and how this is to be reported to The Pensions Regulator (TPR). Whilst a scheme specific approach has been retained, all DB schemes will be expected to achieve full funding on a low dependency basis and be invested in low risk assets by the time they reach significant maturity. A key point that is unclear from the consultation is whether any deficit that persists at that date, or emerges after, can still be funded over time based on affordability.
- The proposals include, for the first time in legislation, regulations around matters to be considered when assessing covenant, and the consultation also considers whether removing deficits as soon as is affordable should be the primary factor for setting recovery plans.
- Details are also given on the forthcoming new requirement to appoint a chair of trustees, who would be responsible for signing the written statement of strategy.

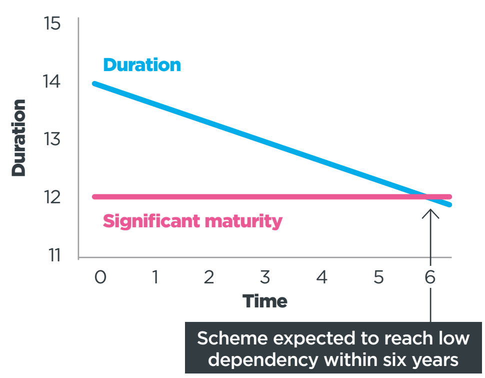
Actions you can take

- **Understand how the new regulations may impact your scheme** to inform discussions about funding and investment strategies and understand the likely timeframes for achieving low dependency.
- **Start discussions** between relevant parties so employers and trustees can review or start to agree their low dependency funding and investment targets and journey plan.
- **Review funding and investment strategy in light of current economic conditions**, which might mean your scheme is closer to significant maturity than previously thought.
- **Look out** for the final regulations and TPR's second consultation, due later this year, which is expected to provide greater detail on complying with the new funding requirements.

Key implications on journey plans

Key concept	Implications
What is maturity?	Maturity is a measure of how far a scheme is through its lifetime.
When does a scheme reach significant maturity?	DWP proposes to measure maturity in years using duration. Generally, immature schemes will have a longer duration. DWP proposes that the duration for significant maturity is set by TPR, but suggests 12 years might be appropriate.
What are the requirements for significantly mature schemes?	By the time a scheme reaches significant maturity, they will be expected to have achieved full funding on a low dependency funding basis and be invested in low risk assets.

Illustrative time to significant maturity



The finer detail: DWP's draft new funding regulations

Expected timeline for new funding regime

February 2021	July – October 2022	Later in 2022	Late 2023
Pension Schemes Act 2021 received Royal Assent	DWP consultation on draft regulations	TPR expected to consult on new DB funding code of practice	New DB scheme funding regime expected to come into force

On the journey to significant maturity

Funding and investment strategy	Trustees will be required to **set and report their funding and investment strategy to TPR as part of the next actuarial valuation**. The draft regulations set out the level of detail required but the format of the written statement of strategy and how it is to be reported is still to be set out by TPR.
Actuarial valuations	Technical provisions (valuation liabilities) will be required to be **consistent with how the trustees intend benefits to be provided over the long term**. The actuary will need to assess the expected progression of a scheme's maturity, the expected time to reach significant maturity and the funding level on the low dependency funding basis.
Recovery plans	DWP is consulting on adding affordability as a factor that trustees must take into account when setting recovery plans, and whether this new factor should have primacy, meaning funding deficits will need to be recovered **as soon as the employer can reasonably afford**.
Covenant assessment	Covenant strength, including taking allowance for contingent assets, will **determine the level of risk in a scheme's journey plan**. The draft regulations define covenant strength and factors to be considered as part of the covenant assessment. The assessment must also be set out in the statement of strategy.

For schemes at or past significant maturity

Low dependency funding basis	**Schemes are expected to be fully funded on a low dependency basis by the time they reach significant maturity (at the latest)**. How TPR will regulate the choice of low dependency basis (which can be set using a scheme specific approach) is expected to be set out in the new funding code. A key point that is unclear from the consultation is whether any deficit that persists at significant maturity or emerges after can still be funded over time based on affordability.
Low dependency investment allocation	Schemes **must have a low risk investment allocation**, with sufficient cash flow matching and must provide a good degree of matching against short-term adverse movements in market conditions. The draft regulations would require the high level information on expected categories of investment included in the statement of strategy to be agreed by the employer.
Additional risk taking	The draft regulations provide for schemes to stay at low dependency after significant maturity. However **DWP is consulting on whether more risk taking could be permitted after significant maturity is reached**, up to a certain limit (e.g. a percentage of total liabilities) and subject to additional covenant support.

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