XPS Pensions Group

XPS Insights
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TPR's second consultation on the new funding code and proposed Fast Track approach

What you **need to know**

- The Pensions Regulator (TPR) has released its long awaited second consultation on the new funding code of practice, supporting the forthcoming new requirement for trustees and employers of defined benefit (DB) schemes to agree a long-term funding and investment strategy, as introduced by the Pension Schemes Act 2021 (the Act). The closing date for responses is 24 March 2023.
- The draft code is TPR's interpretation of how trustees can comply with the legislative requirements set out in the Act and the draft regulations. Unusually, TPR is consulting on the code before the regulations are finalised. This means the new funding regime should remain on track to be in force for valuations with an effective date from 1 October 2023.
- Included with the consultation is a detailed response on TPR's first consultation and a separate consultation document on TPR's regulatory approach and Fast Track.
- Fast Track will now act as a filter for TPR's assessment of actuarial valuations. Meeting the requirements of Fast Track does not automatically equate to compliance with the legislative requirements, and trustees will still need to evidence that they have an appropriate long-term strategy based on their scheme's circumstances.
- TPR has said that in 2023 it will consult on further covenant guidance and the form of the statement of strategy which will detail a scheme's long-term strategy and must be submitted to TPR.

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 plans.
- **Decide** whether to formally respond to the consultation.
- **Look out** for the final regulations and TPR's final code, ahead of the new funding requirements coming into force, expected to be for valuations with an effective date from 1 October 2023.

Expected timeline for the new funding regime

February 2021
Pension Schemes Act 2021 received Royal Assent

July – Oct 2022
DWP consultation on draft regulations

Dec 2022 – Mar 2023
TPR consultation on new DB funding code of practice

Before Oct 2023
Finalisation of DWP regulations and TPR code

1 Oct 2023
New DB scheme funding regime expected to come into force

The finer detail: TPR's draft new funding code

	Proposed legislative requirements	TPR's guidance from the draft code consultation	Proposed minimum requirements for Fast Track
Low dependency funding basis	Further employer contributions **would not be expected to be required**, when fully funded and invested in the low dependency investment allocation.	**Assumptions not prescribed but guidance given**, including for expenses. Not expected that trustees carry out detailed modelling of probabilities.	**Discount rate of gilts plus 0.5% pa**. Some other assumptions are also specified, but some remain scheme-specific.
Timeframe	Achieve **low dependency by the time a scheme is significantly mature**. Maturity to be measured by duration, with the duration for significant maturity to be set by TPR.	**Duration for significant maturity set at 12 years**. However, TPR notes that the DWP may be considering changes to the approach to measuring maturity which will impact on the final code.	**12 years duration, as in the code**. TPR is consulting on whether the timeframe for targeting low dependency should be earlier for Fast Track than for minimal compliance.
Technical provisions	Technical provisions will be required to be **consistent** with trustees' low dependency funding basis.	Technical provisions **at least equal to the low dependency funding basis after significant maturity**. For open schemes, future accrual can be allowed for.	**Technical provisions to be an increasing percentage of the low dependency liabilities, varying by duration**. 85% at 20 year duration and 100% at significant maturity (i.e. 12 year duration).
Investment risk	**Dependent on covenant and time until significant maturity**. At significant maturity target a low dependency investment allocation.	Recommendation of a one year 1-in-6 VaR stress test on the funding level. **Investment in growth assets permitted (even after significant maturity)**.	**Stress test of the funding level using the new PPF stress test (a one year 1-in-6 VaR stress test)**. Higher funding level impact permitted for schemes with longer durations.
Recovery plans	Addition of '**reasonable affordability**' as a factor that trustees must take into account when setting recovery plans, and **consideration of giving this factor primacy** over others.	Guidance provided on factors to consider. Includes **maturity, funding level, prudence, reliability of cash in the future, reasonable alternative uses and fairness**.	**6 years or less before significant maturity, 3 years or less after significant maturity**. Some other restrictions apply, including no allowance for investment outperformance.
Covenant	**New definition of covenant strength and factors to be considered** as part of the covenant assessment included in the legislation.	**Covenant visibility a key concept for shaping the journey plan**. Some guidance provided in the draft code, but **more to follow from TPR next year**.	Fast Track **does not explicitly take account of covenant strength**. TPR notes that for very weak covenants, Fast Track may be too risky.

More detail on Fast Track approach

- Specifies parameters in three key areas; funding, investment and recovery plans **varying based on scheme duration, and irrespective of covenant strength**.
- Should not be the default approach for schemes. Scheme-specific circumstances may require a different approach, but **if a valuation submission meets the parameters, TPR is unlikely to scrutinise it further and is less likely to engage with trustees**. Where schemes miss only 1 or 2 of the key areas for compliance it is likely any engagement from TPR will be limited to those areas.
- The **Scheme Actuary must certify** that valuations meet the Fast Track parameters, which is a factual matter.
- Based on their 31 March 2021 analysis, **TPR expects around 50% of schemes to meet Fast Track**.

For further information, please get in touch with **Heidi Webster** or **Abigail Fletcher** or speak to your usual XPS Pensions contact.

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