XPS Pensions Group

XPS Insights
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Pension Schemes Bill Series

Regulator's funding consultation will drive detailed, robust pension strategies

What you **need to know**

- The Pensions Regulator (TPR) is consulting on the principles of a new funding code, with responses due by 2 June 2020. TPR expects to carry out a second consultation on the detail of the code itself later this year.
- The Pension Schemes Bill requires that all schemes set a long-term funding objective and have a plan for getting there. The consultation provides detail on how TPR proposes to regulate these new requirements.
- The consultation proposes principles to frame the new code, notably that schemes should have low dependency on employers and a high resilience to risk when 'significantly mature'. Funding and investment risks must also be managed in line with the scheme's target.
- TPR's approach does not remove existing funding flexibilities. Instead it offers a detailed funding structure for those schemes that want it and a yardstick for those that want to continue using flexibilities.
- The structured approach is called Fast Track, where schemes can expect minimal regulatory oversight. The alternate approach is called Bespoke and will need robust evidence to demonstrate compliance.
- Whichever approach is followed, trustees will need to prepare a written strategy statement demonstrating how they are complying with the new rules. More than ever, there is real value in setting detailed and robust journey plans now.

Actions you can take

- **Read** the quick guide to the consultation on TPR's website (here if viewing this online).
- **Analyse** how your scheme compares to the principles of Fast Track.
- **Review** your strategy. Do you have a clear target, a specific timeframe and robust contingency plans?
- **Progress** discussions between trustees and employers about long-term objectives and how these will be achieved.
- **Look out for** TPR's 2020 annual funding statement, which may provide further insights for current valuations.

Principles of the new funding framework

Target **low dependency** at **significant maturity**	**Understand** risks and **evidence** how they are supported
Reduce risk as scheme matures	Reflect **contingent assets** if realisable when needed
Align funding and investment strategies with your target	Remove deficits **quickly**, subject to **affordability**
Reduce reliance on **covenant** over time	**Equivalent security** of accrued benefits for **open and closed** schemes

The finer detail: Overview of the consultation

Background	The consultation sets out how TPR will regulate the new requirement for all schemes to have a long-term strategy and provides greater clarity on prudence. The overall aim is to improve security for members, making it more likely they receive their benefits.
What is in the consultation	The consultation sets out key principles that TPR believes should underlie valuations: a formal structure to prove compliance ('Fast Track') for those who want it and an outline of how TPR will regulate those who continue to use funding flexibilities ('Bespoke').
Key principles for funding valuations	TPR has set out eight key principles covering all aspects of setting and reaching a long-term target, including managing funding and investment risks in line with that target. (The key principles are summarised overleaf.)
Overview of Fast Track	
Long-term target	TPR proposes that a low dependency target – not a transaction based target such as buyout – be reached when significantly mature. TPR aims to define the approach for all assumptions with the key assumption on discount rate expected to be between gilts + 0.25% pa to gilts + 0.5% pa. It may use a fixed target or a range within that.
Timeframe – significant maturity	TPR is consulting on ways to measure significant maturity. Prominence is given to a calculated duration of liabilities, expected to be 15 to 20 years away for the average scheme. This may be less than 10 years away for more mature schemes.
Technical Provisions (TPs)	TPs determine cash funding. TPR will expect TPs to move towards the long-term target over the timeframe. TPR will set out what TPs should be, likely depending on covenant strength and maturity. Whilst the wider consultation considers various ways of allowing for covenant, TPR's preference is to reflect it in TP targets.
Investments	TPR intends to set a pass or fail test for the actual level of investment risk in a scheme relative to a stated Fast Track reference point. This may again be a range of acceptable levels of risk depending on covenant grade and maturity.
Recovery plan	TPR intends to set a maximum recovery period for meeting the Fast Track funding deficit. It illustrates a period of 6 years for stronger covenants to 12 years for weaker.
Open schemes	TPs (that relate to past benefits) should have equivalent security in open and closed schemes. A range of possible approaches, some more optimistic, for future benefits are set out.
Overview of the Bespoke route	
Approach	The Bespoke route is for schemes that cannot, or choose not to, comply with every element of Fast Track. Schemes must still meet the key principles. TPR will assess against Fast Track elements, identify additional risk and assess how this is being managed.
Evidence	Trustees will need to evidence that they have considered additional risk against the level deemed tolerable under Fast Track. If the additional risk is not remote, evidence is needed on how the risk is being managed (e.g. by contingent assets).

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