

## **DB FUNDING CODE**

The Pensions Regulator (TPR) has published the first of two consultations on the revised DB Funding Framework. This consultation sets out plans for the new framework, including its eight key principles, and its twin-track regulation approach, 'Fast-Track' and 'Bespoke'. The outcome of this consultation is intended to clarify expectations from trustees and employers, to protect schemes' long-term sustainability and members' outcomes. The consultation will be open for 12 weeks and will close on 2 June 2020. We will be engaging with members to inform the PLSA's response.

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### **BACKGROUND**

In 2018, the Government released its White Paper, "Protecting Defined Benefit Pension Schemes", which concluded that though the DB Funding Code was working largely as intended, and that there was no funding crisis, there remained areas which were in need of improvement. Severely underfunded schemes present a risk to member outcomes, the Pension Protection Fund (PPF), as well as other PPF levy payers. There was also the need for greater transparency and accountability around the risks being taken on behalf of members and employers, as well as a need for greater focus on long-term strategic issues from trustees.

In order to address these concerns, The Pensions Regulator (TPR) is consulting on a revised DB funding framework and code, which aim to provide clearer funding standards as well as provisions to ensure that trustees and employers have the right information, tools, commitment and incentives to make consistently good decisions, to protect schemes' long-term sustainability and members' outcomes.

### **THE CONSULTATION**

This is the first of two consultations TPR intends to release on the DB Funding Framework. The consultation sets out proposals and principles for the new framework, and details how they could be applied in practice. The second consultation, which is expected to be published later on in 2020, will focus on the draft code itself.

## Key Principles

TPR have identified eight key principles which are designed to underpin all scheme valuations. The table below outlines TPR's proposed principles:

Principle	Proposed Application
1. Compliance and evidence	<p>Trustees and employers are expected to understand scheme-specific funding and investment risks and objectively evidence how these risks have been assessed as remote or minimal or can be properly managed.</p> <p>Trustees should be able to compare the risks they have taken to a tolerated risk position and then demonstrate the mitigation and/or support available.</p>
2. Long-term objective (LTO)	By the time they are significantly mature, schemes are expected to have a low level of dependency on the employer and be invested with high resilience to risk.
3. Journey plans and technical provisions (TP)	<p>Trustees are to develop a journey plan to achieve the LTO.</p> <p>Trustees are to plan for investment risk to decrease as the scheme matures and reaches low dependency.</p> <p>TPs should have a clear and explicit link to the LTO, and converge to the LTO over time.</p>
4. Scheme Investments	<p>The investment strategy and asset allocation over time should be broadly aligned with the scheme's funding strategy (TPs and Recovery Plan).</p> <p>Trustees must ensure the investment strategy has sufficient security and quality, and can satisfy liquidity requirements.</p> <p>Asset allocation at significant maturity should have high resilience to risk, a high level of liquidity and a high average credit quality.</p>
5. Reliance on the employer covenant	Schemes with stronger employer covenants can take more risk and assume higher returns.

	Trustees should assume a reducing level of reliance on the covenant over time, depending on its visibility.
6. Reliance on additional support	Schemes can account for additional support when carrying out their valuations provided that it: <ul style="list-style-type: none"> <li>▶ provides sufficient support for the risk(s) being run;</li> <li>▶ is appropriately valued; and</li> <li>▶ is legally enforceable and realisable at its necessary value when required.</li> </ul>
7. Appropriate recovery plan (RP)	TP deficits should be recovered as soon as affordability allows, while minimising any adverse impact on the sustainable growth of the employer.
8. Open schemes	Members' accrued benefits in open schemes should have the same level of security as members' accrued benefits in closed schemes.

### Fast Track versus Bespoke Frameworks

TPR have put forward plans for two separate ways to comply when carrying out valuations, these are 'Fast Track' and 'Bespoke'.

<p><b>Fast Track</b></p> <ul style="list-style-type: none"> <li>• We set straightforward quantitative compliance guidelines for trustees to assess whether we would consider their valuation compliant with the legislation.</li> <li>• If all aspects are satisfied, trustees can expect minimum regulatory involvement on DB funding.</li> </ul>	<p><b>Bespoke</b></p> <ul style="list-style-type: none"> <li>• This option provides trustees and employers with more flexibility to account for scheme and employer-specific circumstances.</li> <li>• Decisions in this route will need to be fully articulated and evidenced, and may mean higher regulatory involvement.</li> </ul>
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Both routes are aimed at providing clearer expectations for trustees and employers, though the fast track route is intended to offer an easier route to compliance for smaller schemes. Trustees will be required to deliver less evidence for their valuation and will receive less regulatory supervision.

The bespoke framework, meanwhile, will see trustees required to submit their valuation with evidence explaining how and why they have differed from the fast track route, as well as how they have managed any additional risk. Those under the bespoke arrangement will also be subject to more regulatory scrutiny, compared to the fast track approach, but it is not meant to be a "bad" or "second-best" option.

TPR states that if done correctly, both approaches will be equally compliant.

## **NEXT STEPS**

The consultation will be open until 2<sup>nd</sup> June, the PLSA will be submitting a response following extensive engagement with membership.

The second consultation on the draft DB funding code of practice is expected to be published later on in 2020.

TPR will be presenting the details of the DB Funding Code at the PLSA's Investment Conference 2020. The session will be available to web-stream.

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