first actuarial

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TPR publishes new DB funding code of practice

After years of waiting – over several prime ministerships, a global pandemic and significant shifts in the fortunes of many Defined Benefit (DB) schemes – The Pensions Regulator (TPR) has published the new DB funding code of practice.

Our **December 2022 briefing** and **February 2023 briefing** detail the background, terminology and key messages.

The new code, alongside the Funding and Investment Strategy Regulations 2024, which came into force in April, gives trustees and advisers the tools and processes to follow for DB funding valuations with a valuation date on or after 22 September 2024.

The new DB funding regime

The current funding code was published in 2014, replacing the first version published in 2006. The new code aims to reflect the current DB landscape in which most schemes are now closed and maturing.

For many years, trustees have focused on the prudent scheme-specific funding position at the valuation date, addressing any shortfalls.

However, in the new world, trustees must now also plan for the long-term funding of their scheme. Trustees will need to prepare a new document called the funding and investment strategy (FIS), which will state the trustees' planned end-game, as well as a journey plan setting out how they intend to get there from the scheme's current position.

The Government has described the principle behind this long-term plan as:

"investment risk should be supportable, and that when a scheme is significantly mature, it should not plan to need further support from the sponsoring employer."

From what date does the new code apply?

It will apply to all DB schemes with actuarial valuation dates on or after 22 September 2024.

Technically, the new code does not come into effect until it has laid before parliament for 40 days, which will be after this date. TPR has confirmed that trustees, employers and advisers can use the code in its current published form to inform their approach.

What has changed since the last draft code?

Here's a summary of the key changes following TPR's recent consultations:

Significant maturity

A scheme's duration – the average period into the future during which benefits will be paid – remains the measure for significant maturity. However, TPR has revised the point at which a scheme is deemed to be significantly mature to a duration of 10 years (previously 12) for DB schemes, and 8 years for cash balance schemes.

The duration calculation is based on the trustees' low-dependency funding basis, using market conditions as at 31 March 2023.

Notional vs actual investment allocation

Following the first draft of the code, there was concern that a scheme's actual investment allocation would be constrained by its low-dependency investment allocation (LDIA) at significant maturity.

TPR has confirmed that the actual investment allocation is not required – although it's normally expected – to follow the notional allocation set out in the LDIA at significant maturity. This provides confirmation that the sponsoring employer will not be required to agree the actual investment allocation. Note, however, that employer agreement is required for other elements of the FIS.

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Investing surplus assets

In most instances, TPR expects trustees to align their actual investment strategy with the scheme's FIS.

However, this does not apply to any surplus on the low-dependency funding basis. This will give greater investment flexibility to schemes in this position.

For schemes with a material surplus, TPR also suggests trustees may decide on a greater allocation of growth assets than just the surplus amount. TPR also suggests that members should benefit from such a strategy.

Assessing whether schemes are 'highly resilient'

A scheme's low-dependency investment allocation must be tested for high resilience. TPR has removed its prescription on how this resilience should be tested, giving trustees the flexibility to carry out a test suitable for their scheme – an example of a principle-based rather than prescriptive approach.

Open schemes

Greater flexibility has been introduced into the final draft of the code, enabling trustees to allow for longer-term future accrual and new members when considering significant maturity. Such allowance must be considered "robustly" by trustees.

The final draft includes a new section for open schemes, collating the guidance relevant to them across the code. This section is intended to support trustees with easy signposting.

Assessing employer covenant

The code has been updated to align with the final regulations, and looks to provide greater clarity on how to assess the employer covenant in terms of:

- Reliability – The period over which there is reasonable certainty of available cashflow to fund the scheme
- Covenant longevity – How long the trustees can be reasonably certain that the employer will be able to continue to support the scheme.

The updated code no longer prescribes how trustees determine the maximum level of risk that can be supported by the employer covenant. Instead, it states a number of principles, recognising the different ways trustees assess risk.

Treatment of smaller schemes

TPR has changed the definition of smaller schemes – from those with fewer than 100 members at the valuation date to those with fewer than 200 members. Although many more schemes will now be included in this definition, compliance with the code is still required. The reduction in the work required appears minimal and limited to Fast Track submissions.

We can only wait and see whether this definition of small schemes is also applied to other areas – for example, the level of detail needed in the statement of strategy.

Fast Track parameters

As expected, the code includes a *Fast Track* route to compliance, which enables TPR to automatically filter out valuations that require no further scrutiny.

The parameters for the Fast Track approach have been left relatively unchanged:

- The maximum discount rate to use at low dependency remains at gilts + 0.5% pa
- The maximum discount rate at the immature end has decreased to gilts + 1.75% from gilts + 2%
- Simplifications for smaller schemes have been extended to those with 200 members or fewer, as mentioned earlier
- The period in which open schemes can allow for new entrants and future accrual has been extended from six to nine years.

Schemes that do not meet the Fast Track requirements have to use the *Bespoke* route to compliance.

What are we still waiting for?

Although this completes most of the picture for DB scheme funding going forward, we are still waiting for information on several areas, including:

- Statement of strategy – TPR has yet to confirm exactly what schemes must submit to them when finalising a funding valuation
- Regulatory approach – TPR plans to publish a document giving further consideration as to how it will decide which DB schemes to engage with in more depth
- Updated covenant guidance from TPR

- Changes to existing DB funding and investment-related guidance.

Our view

Rohit Siqueira, Partner and Head of Trustee Actuarial, comments:

"The new DB funding code has been a long time coming. Indeed, the first consultation for the code took place against a backdrop of low yields, large scheme deficits and affordability concerns. But with so many schemes in surplus in the post mini-Budget world, complying with the requirements of the new code now seems onerous.

"There are positives.

"The move to a more principle-based rather than prescriptive approach to areas such as the low dependency investment allocation and covenant is helpful, and gives trustees some flexibility.

"The code also covers alternative approaches such as running-on, which will suit many schemes in the current environment. It recognises that schemes with a material surplus may invest in a greater allocation to growth assets. This goes some way to align with policies of both the previous and the new government, which emphasise investing for UK growth.

"Like closed schemes, open schemes will also be required to structure a plan focused on significant maturity, and can allow for any new members joining the scheme in doing so. But these schemes, especially those open to new entrants, may never reach significant maturity. It therefore feels unreasonable to ask such schemes to go through this costly compliance process."

Get in touch with our experts

Trustees and employers are now getting to grips with the details and requirements of the new funding regime in the context of their scheme.

To discuss your scheme, contact your usual First Actuarial consultant or any of our **DB consulting team**.