Defined benefit funding code of practice

Consultation questions

March 2020

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Responding to the consultation

We would encourage you to respond to the consultation by completing this online response form. You can also send responses to us by email at: **DB.Consultation@tpr.gov.uk**.

Our preference is for responses in electronic format but alternatively, you can post your response form to:

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The Pensions Regulator
Napier House
Trafalgar Place
Brighton BN1 4DW

If you wish to submit supplementary materials electronically, please note they will be subject to a 20mb limit (any larger documents will therefore have to be sent in batches). If you have any queries about this consultation, please call Sarah Harvey on 01273 349355.

We may need to share the feedback you send us within our own organisation or with other government bodies. We may publish this feedback as part of our consultation response. If you want your comments to remain anonymous or confidential, please state this explicitly in your response and we will take the necessary steps to meet your request.

However, please be aware that, should we receive a formal request under the Freedom of Information Act, we may be required to make your response available. When responding, please advise whether you are responding as an individual or on behalf of an organisation (and, if the latter, which organisation).

Defined benefit funding code of practice: Consultation questions

This form is interactive. Please save the whole consultation pdf to your computer, fill in your response to the questions as appropriate and return it to the following email address: **DB.Consultation@tpr.gov.uk**

Your details

Your name:

Organisation (if applicable):

Job title (if applicable):

Postal address:

Telephone:

Email:

Which category best describes you or your organisation?

Select one:

Please select one category from the scrollable list above.

Confidentiality

Please confirm whether you would like us to list your organisation on our list of respondents to this consultation:

☐ Yes, I wish my organisation to be included on the list of respondents.

We may need to share the feedback you send us within our own organisation or with other government bodies. We may also publish this feedback as part of our response to the consultation. If you wish your response, in whole or in part, to remain confidential, please tick the box below:

☐ Yes, I wish my response to remain confidential.

If so, please specify which part of your response you wish to remain confidential and why:

Consultation questions and response form: Chapter 3: Proposed regulatory approach

1. **Twin-track compliance**
   Do you think twin-track compliance is a good way of introducing objectivity into a scheme-specific regime? What are your views on the proposals set out above? If you disagree, what do you propose instead?

Chapter 4: Employer covenant

2. Insolvency risk and reliance on covenant
Do you think the risk of member benefit reductions on insolvency is an acceptable part of the existing regime and that trustees should be able to place some reliance (whether implicit or explicit) on the employer covenant? To what extent do you think this should be the case? Do you think this risk is well understood by scheme members?

3. Integrating covenant into funding

a. Do you think it is better to keep the Fast Track route simpler by only factoring covenant into Bespoke (TPs and/or RP)?

b. If you think covenant should only feature in Bespoke, how do you think it should be done?

c. If we were to integrate covenant into Fast Track guidelines, do you prefer option 1, 2 or 3 or some other approach for reflecting the employer in scheme valuations, and why? If another approach is appropriate, what do you think this should be?

4. Covenant assessment

a. Should a holistic approach to assessing employer covenant be retained (but with further guidance to assist trustees), or should we seek to define a more prescribed, formulaic approach?

b. If the former (holistic approach), what amendments/clarifications to our existing guidance on covenant do you consider may be necessary? Do you agree with the ones suggested above? Is the structure and content of our existing employer covenant guidance helpful and accessible to trustees? If not, what would make it better?

4. Covenent assessment continued...

c. If the latter (formulaic approach), what do you think of the proposed RACF approach? How would you propose that covenant could be explicitly defined in a clear, consistent and measurable manner? What other metric(s) may be appropriate?

d. Alternatively, would it be appropriate to require employer covenant to be assessed in a prescribed (formulaic) way for Fast Track purposes, and only allow for a more holistic approach under the Bespoke framework?

5. **Reliance on indirect covenant**
   Do you think that the strength of the wider commercial group should be factored into the sponsoring employer's assessment? If so, how, and to what degree?

6. **Covenant grades**

   a. Should we use a greater range of covenant grades to set guidelines in the code and assess schemes and, if so, what would be an appropriate number of grades?

   b. Would there be sufficiently different characteristics between a greater number of grades, such that a set of trustees could reasonably and reliably assess covenant strength without requiring professional advice?

Chapter 5: General principles

7. **Low dependency LTO**
   Should all DB schemes have a low level of dependency on the employer by the time they are significantly mature? If not, what do you think would be an appropriate expectation to ensure trustees manage the run-off phase for their scheme effectively and efficiently?

8. **Timing of the LTO**
   What factors should influence the timing of reaching the LTO? Do you think that the timing should be linked to maturity?

9. **High resilience to risk at the LTO**
   Do you think that the investment portfolio should be highly resilient to risk when schemes reach their LTO? If not, what do you suggest?

10. **Risk-taking for immature schemes**
    Is it reasonable for less mature schemes, which would have more time to reach low dependency funding, to assume and take relatively more investment risk than a mature scheme?

11. Journey planning
What are your views of the rationale above for the journey plan? Do you think there is there a better way for trustees to evidence that their TPs have been set consistently with the LTO?

12. Relevance of investments for funding
Do you agree that the actual investments and investment strategy are a relevant factor for scheme funding?

13. Broad consistency between investment and funding strategy

a. Should the investment strategy be broadly consistent with the level of current and future investment risk assumed in the funding strategy? If not, why not?

b. If it is not broadly consistent, for instance where trustees want to take additional investment risk (than that assumed in the TPs), should trustees have to demonstrate that the investment risk taken can be managed appropriately? If not, why not and what would you suggest?

14. Liquidity and quality at maturity

Do you think that security, quality, and liquidity become more important as a scheme becomes significantly mature? In particular, do you think that the scheme's asset allocation at significant maturity should have a high level of liquidity and a high average credit quality?

15. Covenant visibility

a. Do you think it is prudent for reliance on employer covenant to be reduced beyond the period over which there is reasonable visibility? If not, why not?

b. How much visibility do you think most trustees can have over the employer covenant? In the absence of evidence to the contrary, do you think it is reasonable for most schemes to assume there is reduced visibility beyond 3-5 years?

16. Use of additional support
Should additional support, such as contingent assets and guarantees, be allowed in scheme's funding arrangements provided they are sufficient for the risk being supported, appropriately valued, legally enforceable and realisable at their necessary valued when required?

17. Appropriateness of RPs and affordability as key factor

a. Should employer affordability be the key factor to determine the appropriateness of a RP? If not, what should it be?

b. Is it reasonable to require schemes with a stronger employer covenant (and a resulting reduction in prudence in the assumed TPs and size of deficits) to have a commensurately shorter RP?

18. **Open schemes, past service**
Should past service have the same level of security, irrespective of whether the scheme is open or closed?

19. **Open schemes, future accruals**
Do you think it would be good practice for trustees to ensure that the provision of future accruals does not compromise the security of accrued benefits?

Chapter 6: Other issues

20. Other issues

Do you agree with our assessment of the issues above and do you have any further comments?

Chapter 8: Setting the long-term objective (LTO)

21. Fast Track low dependency discount rate
What are your views on our proposal that the appropriate low dependency funding basis for Fast Track should be with a discount rate somewhere in the range of Gilts +0.5% to Gilts +0.25%? Where in the range do you think it should be and why? If you disagree, what do you think would be a more appropriate basis and why (please provide evidence)?

22. Options for defining other assumptions for Fast Track low dependency funding basis
Which of these options should be used to set assumptions for low dependency funding under Fast Track? Are there any other options we should consider? Are there any other pros and cons we should consider?

23. Defining assumptions for Fast Track low dependency funding basis

a. What are the most significant assumptions (other than discount rates) for the calculation of the Fast Track low dependency liabilities?

b. If we were to specify some or all of the assumptions to calculate the level of Fast Track low dependency liabilities, which assumptions should we specify and how should we do this? Do you have views on the suggested benchmarking factors in the table above?

c. If we determined mortality assumptions, how could we balance the scheme-specific nature of mortality with the desire to ensure a level of consistency in the assumptions used by different schemes?

24. Low dependency basis – verification that other assumptions meet the best estimate principle

a. Which of these options do you prefer to verify that other assumptions used for low dependency liabilities under Fast Track meet the 'best estimate' principle and why? Are there any other pros and cons we should consider? Are there any other options we should consider?

b. If we decided to require schemes to provide additional information about their assumptions, what information should we require schemes to provide compared to the current requirements?

25. Other assumptions for Fast track low dependency basis – prudence

a. If we specified certain assumptions, should we aim for those to be best estimate or to be chosen prudently?

b. Given the uncertainty around assumptions such as future improvements in mortality should we: i) define these assumptions in Fast Track and ii) set the assumptions prudently?

26. Low dependency liabilities – reserve for future ongoing expenses

a. Should the low dependency liabilities carry an expenses reserve? If so, should this only be a requirement for schemes that self-fund their expenses?

b. To what extent should we define the reserve for future expenses under Fast Track? Should we just provide guidance on how to calculate an appropriate reserve? As part of that, what level of ongoing expenses is it reasonable to allow the employer to pay directly without any reserve?

c. If we defined guidelines on expenses for Fast Track, how should we reflect the proportionally different level of expenses incurred by schemes of different sizes? Could we adopt a sliding scale of percentages of liabilities based on the size of the scheme or a fixed element and proportionate element of expenses?

27. Definitions of maturity

a. Should maturity be defined as duration for the purpose of prescribing significant maturity under Fast Track? If not, which measure would you favour and why? Note that whatever measure we use, it needs to be applicable not only to the time at which we would expect a scheme to reach significant maturity but also at all earlier times in the scheme's life.

b. Whichever method is used to determine maturity, we need to use actuarial assumptions to make the calculation. Should we require that the Fast Track low dependency assumptions are used for this purpose? What other assumptions could be used?

28. Defining the timing point for significant maturity

What are your views on our proposal to set significant maturity (used to define the timeframe for reaching the LTO) for Fast Track to be in the range of a scheme duration of 14 to 12 years (or equivalent on a different maturity measure)? If you disagree, what would be a more appropriate timeframe and why? Please provide evidence.

29. Points or ranges for low dependency funding basis and timing point

Do you think our proposal to set a particular level for the low dependency funding basis and/or a range for the significant maturity timing associated with the LTO would be helpful to schemes to manage volatility and allow some smoothing? If not, what would you suggest?

Chapter 9: Technical Provisions (TPs)

30. Journey plan shape for Fast Track TPs

a. Which shape of journey plan is most appropriate to define for calculating the Fast Track TPs and why? Does this vary depending on the circumstances of the scheme?

b. Are there any other journey plan shapes we should consider?

c. What unintended consequences might arise from adopting the linear de-risking or horizon method journey plans for Fast Track?

31. Key factors for Fast Track TPs

Should other scheme-specific factors other than covenant and maturity be considered to define the journey plan and TPs in Fast Track?

32. Extent of reliance on covenant in Fast Track TPs

a. Should we define a maximum period of acceptable full covenant reliance for Fast Track TPs? For example, a general guideline of five years? Or should covenant reliance be assumed to decline in the much shorter term (or immediately)?

b. What level of covenant support should subsequently be assumed? Should there be an assumption of a single covenant grade reduction (eg CG1 to CG2), a reduction to assumed returns in line with a weak covenant, or something else?

c. Over what period should any reduction in reliance take place? Should this be immediate (eg a reduction to a lower covenant reliance in the sixth year) or more gradual (eg over the subsequent five years)?

d. Does the need for a covenant visibility overlay depend on the approach taken for the journey plan to low dependency? For example, is this a more relevant consideration where the horizon journey plan shape is used?

33. How Fast Track TPs should be expressed
Which option do you think is preferable for defining TPs/journey plans under Fast Track and why? What are the practical issues associated with each option? If you disagree with these options, what would you suggest and why?

34. Method to derive Fast Track TPs

a. Do you prefer a particular approach? If so, why? Is there another approach that would be suitable?

b. Do you have ideas as how to best approach each option?

34. Method to derive Fast Track TPs continued…

c. How do trustees incorporate considerations about covenant strength into their TP assumptions/discount rates?

d. If a stochastic approach is adopted, what would you consider to be an appropriate confidence level against which to mark the results?

e. Do you have any data or modelling results which you think would provide useful evidence for the baseline TPs or covenant overlay? Please provide full details of methodology/data limitations.

Chapter 10: Investments

35. Which reference point from which to measure investment risk in Fast Track

a. Would a measure of the liabilities be an appropriate position to measure investment risk from? If not, why not?

b. Do you prefer a liability measure on the low dependency basis (Gilts +0.5% to +0.25%) or a Gilts flat basis? Why? Are there any other liability measures that would be suitable?

35. Which reference point from which to measure invetment risk in Fast Track continued...

c. Would a liability reference portfolio approach (as a proxy for liabilities) for smaller schemes be more proportionate and practical? If so, how should a small scheme be defined for this purpose (number of members, assets or liabilities)? What would be an appropriate threshold?

d. Would a reference portfolio consisting of gilts and inflation-linked gilts with a duration similar to the liabilities be appropriate as a proxy for the liabilities for smaller schemes? If not, how would you go about constructing a reference portfolio as a reference point from which to measure risk for smaller schemes?

36. Methodology to measure investment risk in Fast Track

a. Would a simple stress test to measure investment risk in Fast Track be the most preferable option? If not, why not? Are there other measures of investment risk that are more suitable, taking account of the desire for a relatively simple and objective measure?

b. Do you agree with the proposed principles for an appropriate pensions stress test, namely a fall in growth assets and a fall in interest rates? If not, what do you suggest?

36. Methodology to measure investment risk in Fast Track continued...

c. What are your views on which stress test we should use? Do you think the PPF stress test (Bespoke and simple approach) would be a good starting point?

d. Which of the ways to measure the impact of the stress would you prefer and why? Is there an alternative method not listed that would work better? If so, please describe it.

37. Approach to defining maximum levels of investment risk for schemes of different maturities in Fast Track

a. What are your views on the proposed methodology for setting maximum thresholds for investment risk for significantly mature schemes in Fast Track? If you disagree, what would you suggest?

b. In relation to acceptable portfolios and consistency with discount rates, is it reasonable to use a best estimate return premium for growth assets over long-term gilts in the range of 3-5% pa?

37. Approach to defining maximum levels of investment risk for schemes of different maturities in Fast Track continued...

c. Should the allowance for prudence be higher for an investment portfolio with a higher level of risk?

d. What are your views on the considerations we have set out to determine investment limits for immature schemes (journey plan shape, downside risk and covenant)? In particular, should the maximum level of investment risk for immature schemes vary by covenant under Fast Track?

38. Defining guidelines for liquidity and quality of the investment portfolio in Fast Track

a. Do you think we should define some guidelines around liquidity and quality in Fast Track?

b. If so, what are your views on the options outlined above? Are there other approaches you favour?

38. Defining guidelines for liquidity and quality of the investment portfolio in Fast Track continued...

c. What limits would you set on the above criteria and why?

d. How would the above change for a more immature plan?

Chapter 11: Recovery plan (RP)

39. Fast Track guidelines on RP length

a. What are your views on the principles set out above in relation to RP length under Fast Track? In particular, do you have views on what may be appropriate RP length thresholds for different covenant strengths? Is it helpful to frame these in terms of the typical multiple of valuation cycles (ie three years)?

39. Fast Track guidelines on RP length continued...

b. Do you consider it would be more appropriate to have a single maximum guidance RP length and to expect trustees (under the Bespoke framework) to justify any plans that are longer than this?

c. Do you think Fast Track RP lengths should be shorter for schemes nearing and/or at significant maturity? If so, to what extent?

40. Fast Track guidelines on RP structure

Should the extent of back-end loading be limited to increases which are in line with inflation (in the absence of appropriate additional support such as a contingent asset being provided)? Or should there be more flexibility subject to a significant proportion of DRCs being committed in the early years of the plan? If inflation-linked increases are acceptable, what measure of inflation do you consider would be an appropriate benchmark?

41. Fast Track guidelines on investment outperformance
Should investment outperformance not be allowed in Fast Track RPs? What do you think the impacts may be?

42. Fast Track guidelines on future RPs

In what circumstances should/could outstanding RP payments be re-spread at subsequent valuations? In particular:

a. If a scheme's funding deficit has reduced (at least) in line with the expectations at the previous valuation, would it be appropriate to maintain the same end date? Or would it be pragmatic to re-spread the remaining deficit over a renewed period?

b. If a scheme's funding deficit is higher than expected, what guidelines should apply for the appropriate length of the new RP?

c. Would the idea of 're-spreading' be more acceptable where a scheme has a long period before it becomes significantly mature?

43. Equitability

What are your views on the concept of 'equitability' in respect of how a scheme is treated compared with other stakeholders? Should any requirements be qualitative (in line with the commentary above) or should trustees also be expected to consider a specific metric? If so, what might be an appropriate measure of equitability (for example, comparing the ratio of DRCs to dividends, or the size of scheme deficit to the 'stake' of other stakeholders) and how could this reflect a scheme's superior creditor status over shareholders?

Chapter 12: Open schemes

44. Treating past service and future service liabilities separately in Fast Track
What are your views on our proposed approach to outlining code guidelines for open schemes. Should any other approach to calculating future service liabilities be considered?

45. Fast Track LTO for open schemes
Should the LTO (low dependency at significant maturity) for an open scheme be the same for a closed scheme? If not, how should they differ?

46. Fast Track TPs for open schemes
What option do you favour and why? Are there other options we should consider?

47. Fast Track guidelines for calculating future service costs

a. Which options do you favour and why? Are there any other options for calculating future service costs which should be considered, for example pre-and post-retirement discount rates?

47. Fast Track guidelines for calculating future service costs continued...

b. If Option C (best estimate) were adopted, how should the best estimate return assumption be determined? Are there any options other than those described above that we should consider?

c. Would our preferred approach (Option B) make it difficult for scheme actuaries to certify schedules of contributions?

48. Funding future service using past service surplus
Do you think that this approach to funding future service using past service surplus is reasonable? If not, why not? What else would you suggest?

49. Criteria for assessing Bespoke arrangements
What are your views on the criteria we propose to use to assess Bespoke arrangements? If you disagree, what would you change and why? What else should we consider?

Chapter 13: Bespoke framework key features

50. Bespoke examples

a. Do you have any comments on the assessments we have made in the examples above?

50. Bespoke examples continued…

b. Could you provide other examples (relevant to your own scheme experience or that of schemes you advise) of arrangements which you think will follow the Bespoke route? Why do you think these arrangements would be compliant?

c. In example 2 (LTO–CDI strategy), could it be appropriate, in your view, to be able to use a higher discount rate/lower value of TPs (low dependency basis) than in Fast Track? If so, in what circumstances and by how much?

51. Stressed schemes

a. Assuming that affordability is genuinely constrained, are very long RPs 'appropriate' and therefore compliant with the Act?

b. Alternatively, should we make an exception to the principles and allow the trustees of stressed schemes to take unsupported investment risk, or more risk investment risk than other CG4 schemes (schemes with weak employers)? What checks and balances should we put in place in addition to those mentioned above (equitable treatment, risk management)?

51. Stressed schemes continued...

c. For schemes with unviable RPs, should an exception be made for them in terms of the level of acceptable investment risk?

d. Are you aware of situations other than stressed schemes where the trustees and employer would have difficulties meeting the Bespoke compliance principles?

Chapter 14: Additional support

52. Trustees' assessment of additional support in Bespoke arrangements
Do you have any views on the framework we set out for trustees to assess the appropriateness of additional support in Bespoke arrangements? If you disagree, what do you suggest?

53. Accessing additional support
When do you think trustees should be able to access the additional support? Does it depend on the Bespoke arrangement and the type of risk that it supports?

54. Assessing the value of additional support
Should trustees be required to assess the stressed value of any contingent asset? What other guidance do you think we should set out on the recoverable value of contingent asset support?

55. Independent valuation

Should trustees always be expected to seek an independent valuation of continient assets, or should it depend on asset value and/or type? If this should be based on value thresholds, how should these be defined? How frequently should we expect trustees to seek an independent valuation? Should trustees be expected to regularly monitor contingent asset value in the intervening period?

56. Guarantees

a. Should we treat guarantee support differently to asset backed support?

b. Should trustees rely on guarantee support to change the covenant grade assessment or do you think in these circumstances the supporting entity should become a statutory employer instead?

57. Other mitigations
Can you think of any other types of arrangements which can help trustees mitigate risks?

58. Reporting information on additional support
Is there any reason why it would be unreasonable to expect trustees to undertake the analysis and provide the information outlined above? Is there additional information that should also be provided to us?

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www.trusteetoolkit.com
Free online learning for trustees

Consultation questions
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