



**Your Funding and
Investment Strategy
Companion**

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We are at the dawning of a new era for pension scheme funding and investment strategies

Let the XPS FIS Companion be your go-to handbook for getting to grips with the key elements of the new requirements and the actions you should be taking.

The Pensions Regulator (TPR) has long been stressing its expectation for all schemes to plan for the long term but the new funding regulations go a step further, making it a legal requirement. For a defined benefit (DB) pension scheme's first triennial valuation on or after 22 September 2024, the scheme's trustees and employer must agree a plan for ensuring that the scheme's benefits will be provided for over the long term. This requirement is set out in the Pension Schemes Act 2021 and DWP's Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2024. Associated guidance has been provided through TPR's 2024 defined benefit funding code of practice.

This will, for the majority of pension schemes, give rise to extra steps in the valuation process, including material preparatory work, and in most cases require earlier and greater collaboration between trustees, sponsoring employers and advisers.

Our six-part 'FIS Companion' series will help trustee boards and employers approach their first valuation under the new funding regime in a logical, practical order, while highlighting the key considerations for both.

1 Setting a long-term strategy

Your scheme **must set a long-term strategy** that is agreed between the trustees and employer and that targets a state of low dependency on the employer within a certain timeframe.

2 The covenant assessment

Set out in law for the first time, **formal consideration of employer covenant** is now a requirement. There are new covenant concepts for you to consider and measure.

3 Scheme investments under the new regime

You are required to agree a **low dependency investment allocation (LDIA)** and target investing in it within a certain timeframe.

4 The funding valuation and journey plan

By significant maturity, your scheme's **technical provisions (funding) basis** must be at least as strong as the low dependency basis. More risk can be taken by less mature schemes and those with stronger covenants

5 Fast Track versus Bespoke

Many schemes will want to **assess their valuation against the Fast Track parameters**. We explore the conditions that must be met and the pros and cons of both a Fast Track and Bespoke valuation submission.

6 Key questions and challenges

To round off the series we **address some of the common questions** that have arisen as we have discussed the new requirements.





XPS FIS Companion

Part One: Setting a long-term strategy



Setting a long term strategy: Introduction

Your scheme must set a long-term strategy that is agreed between the trustees and employer and that targets a state of low dependency on the employer within a certain timeframe.

Your long-term plan for the scheme, low dependency position, technical provisions and funding requirements, the journey plan including current and future investment allocations and reliance on covenant will all form part of your funding and investment strategy.

Achieving in principle agreement between the trustee and employer at outset will make the valuation process more efficient meaning a smoother process towards ensuring compliance with the new funding requirements.

What do the regulations and guidance say?



Regulatory requirements:

- **Long-term objective:** The way in which the trustees of the scheme intend pensions and other benefits under the scheme will be provided over the long term.
- **Low dependency test:** The funding and investment strategy must aim to achieve low dependency on the employer by significant maturity (at the latest), which means intending to be fully funded on a 'low dependency funding basis' and having an objective of a 'low dependency asset allocation' such that further employer contributions would not be expected to be required.
- **Relevant date:** Target for reaching low dependency. It must be on or before significant maturity (which for most schemes is when the duration reaches ten years).
- **Consultation and agreement:** For most schemes, the employer must agree the headline long-term strategy and be consulted on regarding some of the finer detail.
- **Written record:** The strategy must be recorded in the statement of strategy which is submitted to TPR, meaning TPR's requirements for it are legally binding.



Code guidance:

The funding code helpfully reinforces key components of the regulations, noting that for the purposes of determining their funding and investment strategy, trustees must determine:

- a. how they intend the scheme to provide benefits over the long term (their long-term objective)
- b. the low dependency funding target, which will include the funding level they intend the scheme to have reached on a low dependency funding basis at the relevant date
- c. the investments they intend to hold at the relevant date
- d. the funding journey plan from the current funding position to the low dependency target, where the relevant date is in the future

The funding code also provides practical guidance on how trustees might comply with the regulatory requirements.

- **Low dependency funding basis:** The funding code sets out guidance rather than prescription on how it expects this to be set. Assumptions should be chosen prudently and the risk in the basis should be understood sufficiently so that trustees can be confident they can pass the 'low dependency test'.
- **Low dependency investment allocation:** The code provides guidance on the types of analysis it expects trustees to carry out and evidence, to prove adherence to the legal requirements of the low dependency investment allocation. It notes that TPR generally expects a minimum hedging target of 90%, and resilience testing to be carried out. The code also provides clarity that the investment allocation is a target and should not interfere with trustees' existing investment duties (and powers).

In this first part of your FIS Companion, we explore the common long-term objective options and delve into the detail of the guidance around setting the low dependency funding basis.





Setting a long term strategy: Common options for pension schemes



What's new...

Trustees must set a strategy for ensuring that benefits under the scheme can be provided over the over the long term. The first part of this is the long-term objective.

The regulations and code do not constrain schemes to any particular long-term objective. The most suitable long-term objective for your scheme will ultimately come down to trustee and employer preferences and, possibly, negotiations. Scheme circumstances and individual preferences evolve over time, as can the pros and cons of the options themselves, and therefore the long-term objective must be kept under review. We explore the most common options below.

Long-term objective	In a nutshell	Most suitable for
Run-on	A scheme runs on over the long term, perhaps with a specific aim to generate surplus. Members and the employer may be able to share any surplus generated. Can include future accrual of benefits for members. All risks remain within the scheme. Option remains open to settle liabilities at a later date.	Open schemes, larger schemes and those with stronger covenants. Employers that wish to maintain contact with and continue to support members. Immature schemes who can reassess their options when more mature. All schemes should consider if run-on is suitable - remember there is no insurer premium to pay with this option.
Buy-in	Primarily an investment decision, an insurance policy is purchased and held as an asset of the scheme. Removes many risks, such as inflation, longevity and investment risk for members covered under the policy. Option to move to buyout at a future date.	Employers who want similar risk reduction that buyout brings but do not want to commit to buyout or wish to maintain contact with members. Well-funded schemes, approaching or past the point of significant maturity.
Buyout	Premium paid to a regulated insurance company to secure all members' benefits and associated risks. The employer and trustees are discharged from their responsibilities to the scheme and the scheme can be wound-up.	Well-funded schemes, approaching or past the point of significant maturity. Many other pension schemes, regardless of their current funding position, whose trustees have buyout as their preferred ultimate goal.
Superfund / consolidator	A regulated pension scheme that another scheme can transfer into. The superfund provider will run the scheme and may later consider securing the benefits with an insurance company. The employer and trustees are discharged from their responsibilities once transferred to the superfund.	Those who meet the following 'Gateway criteria': - Buyout unlikely to be affordable within five years, and in transferring to a superfund, the likelihood that members receive full benefits is increased. - Scheme must be sufficiently well funded to qualify (typically 90% to 95% funded on buyout).





Setting a long-term strategy: Low dependency funding basis



What's new...

The funding and investment strategy must include the intention of having low dependency on the employer by significant maturity.

Low dependency means, that once fully funded on a 'low dependency funding basis' and invested in a 'low dependency asset allocation', further employer contributions would not be expected to be required. This is the 'low dependency test'.

The code provides details on how TPR believes the low dependency funding basis should be set, with the key principle being that assumptions are chosen prudently. It also reaffirms that trustees should ensure the low dependency test is met under most reasonably foreseeable circumstances.

The code provides detailed guidance on many of the assumptions to consider when setting your low dependency funding basis and a summary of these is set out below.

Assumption	TPR guidance on the low dependency funding basis.
Discount rate	Two main approaches are considered in detail: a risk-free rate plus a margin and a discount rate directly linked to a scheme's investments.
Expense reserves	Where there is no requirement under the scheme rules for the employer to pay expenses, TPR expects a reserve for all non-investment related expenses incurred on and after the relevant date to be included. This reserve should be consistent with the scheme's long-term objective. For schemes where there is a requirement under the rules for the employer to pay expenses, there is strong encouragement for trustees of those schemes to consider including an expense reserve.
Inflation	Consistent with approach taken for discount rate. There should be no inflation risk premium and if such an adjustment is made, TPR may ask for justification.
Mortality	All schemes to consider a mortality study to tailor standard tables. If not carried out, uncertainty must be reflected with increased prudence.
Cash commutation	Proportion commuted should be prudent and commutation factors should not be lower than the current or agreed future rates.
Other assumptions	Draw on scheme experience where statistically credible analysis of recent experience is available.



We expect trustees to take a proportionate approach in setting their low dependency funding basis..... we expect more careful analysis in determining the assumptions to meet the low dependency test as a scheme approaches its relevant date.

The Pensions Regulator, Defined benefit funding code of practice





Setting a long-term strategy: Statement of strategy



What's new...

Trustees and employers are required to record the agreed long-term funding and investment strategy in the statement of strategy and submit it to TPR within the usual 15-month deadline for submission of an actuarial valuation.

It is helpful to know where this all ultimately leads in terms of what trustees are obliged to submit under the statement of strategy. The statement of strategy replaces the valuation submission of the previous funding regime. It is a much bigger beast than the old valuation submission, weighing in at somewhere between 84 and 265 questions to answer depending on a scheme's circumstances.

The key question regarding the long-term strategy that you must answer in the statement of strategy is the following somewhat open and broad question that asks for a free text narrative answer.

What is the way the trustees intend benefits to be provided over the long-term?

TPR's guidance: A description of the way the trustees intend to provide benefits over the long term (known as the long-term objective). In describing the long-term objective, we would usually expect trustees to include a summary of the desired funding target within the description.

This is a question from the part of the statement of strategy that must be agreed between the trustees and the employer, so it is imperative that setting the strategy is a collaborative undertaking. If the considerations in your XPS FIS Companion are reflected on, answering this question should be straightforward!

Related questions that must be answered in the statement of strategy concern the funding level on low dependency, details of the low dependency basis and the low dependency investment allocation, and an estimate of when the scheme is expected to reach significant maturity.



Trustees should not underestimate the support they may need to complete the statement of strategy. Having a clear understanding of the requirements from the start means it is more likely that you cover them all through your valuation discussions. This will lead to a much smoother experience when completing the valuation and the statement of strategy.



Pauline McConville
Senior Consultant



pauline.mcconville@xpsgroup.com





Setting a long-term strategy: Potential pitfalls

Why this is a problem

Potential pitfall: Confusing the requirement to define how you intend the scheme to provide benefits over the long term with the minimum low dependency requirement.

Rather than itself being an approach for providing benefits over the long term, low dependency is a minimum requirement - it is a funding target with a specified timeframe. The trustee and employer must agree the long-term objective for the scheme and set out how this complies with the low dependency funding target.

For example, a scheme with run-on as its long-term objective will also need to target being at least fully funded on a low dependency basis by the relevant date.

Another example might be a scheme that ultimately intends to secure the benefits with a third-party insurer. This scheme may have buyout as its long-term objective for providing benefits, but this does not mean an intention or commitment to be fully funded on buyout by the relevant date. The trustee and employer can agree on a low dependency target they do intend to reach by the relevant date and then seek to bridge the gap from low dependency to the insurance cost later through, for example, investment outperformance.

If trustees and employers do not agree both elements it may lead to anomalies such as trying to agree a second funding objective recorded outside the new framework and then challenges in describing the strategy in the statement of strategy.

Solution

Trustees and employers should agree the long-term objective and agree a separate low dependency funding target. There may be challenges in this - for example not wanting to commit to a long-term objective of buyout due to potential accounting impacts. The solution to this challenge could come in how the long-term objective is described. For example, describing the objective as run-on with the potential to transfer benefits to a third party if affordable at a future date.

It is important to understand that low dependency is the only funding target that comes with a specified timeframe under the regulations.

Ensuring the distinction between the two can also help with understanding how to allow for benefits such as underpins and discretionary benefits. For example, a long-term objective of run-on may incorporate the intention to pay discretionary benefits only where future surplus generation allows. The associated low dependency funding basis would not necessarily fund for discretionary benefits.

To eliminate any concerns, trustees and employers should work with their advisors to make sure that the agreed long-term objective is expressed appropriately in the statement of strategy alongside the low dependency funding target, both as part of the overall funding and investment strategy.





Setting a long-term strategy: Potential pitfalls

Why this is a problem

Solution

Potential pitfall: The trustee and employer don't have a common broad objective for the scheme

The trustee and employer must agree the scheme's long-term objective. For some schemes this will be challenging, particularly if there has been a gap between trustee and corporate ambitions for the scheme in the past.

Trustees and employers should come together to discuss and explain their objectives for the scheme, ideally prior to the valuation date. The goal is to agree a strategy that both are comfortable with, so concessions may be needed by one or both parties to find a middle ground to agree upon. Subsequent work carried out for the valuation will then be reflective of an agreed joint goal avoiding surprises and rework further down the line.

Potential pitfall: No preparatory work is undertaken before the valuation date

Despite the valuation being a more involved process with additional steps, the 15-month deadline still applies.

Trustee should prepare for the valuation several months before the valuation date, engaging with the employer and advisers to ensure the key elements of each valuation step can be given sufficient thought.

Potential pitfall: Advisers aren't aligned to the trustee and company's joint objectives

The long-term objective is a key element of the new funding regime. If inappropriate advice is given, then the suitability of this long-term objective will be in question.

Trustees and employers need to understand how the advice given to them by their advisers is relevant to their objectives and, where necessary, challenge them accordingly.

Potential pitfall: The valuation process isn't co-ordinated effectively

A poorly co-ordinated valuation process will result in an inefficient, protracted process with higher adviser fees than necessary.

Trustee should ensure that broad timescales, and process, are agreed between all parties. Oversight during the process is recommended.



Engaging early on when setting strategy will be key to an effective valuation process this time around. We're encouraging obtaining in principle agreement on strategy with your employer, ideally well in advance of your valuation date where time permits. Don't forget that the strategy includes elements of actuarial, investment and covenant, so it is productive to get all parties together to discuss this topic.



Heidi Webster
Senior Consultant



heidi.webster@xpsgroup.com





Setting a long-term strategy: Next steps

Checklist for trustees

Prepare for your first valuation under the new funding regime

✓	Download your FIS Companion.
✓	Get up to speed with the new requirements. Training on the regulations and funding code is advised for all trustees.
✓	Review the statement of strategy templates to get to grips with the extent of the information TPR is asking for, and to determine where the gaps are compared to your previous valuation.
✓	Include the employer early on in long-term strategy conversations to support agreement and avoid any surprises further down the line.
✓	Draw up an action plan ahead of your first valuation under the new funding regime. Work backwards to set out a timetable of actions, which might mean starting work well ahead of the valuation date.
✓	Consider your scheme's governance framework. The new requirements on trustee boards emphasise the importance of ensuring your scheme has suitable governance which facilitates strong and informed decision-making and risk management. This will be key when setting strategy but also managing the journey to achieving your scheme's objective.

Talk to your advisers

✓	Your strategic adviser (which may be your covenant, investment or actuarial adviser) will help you consider the range of strategy path options available to you, taking account of changes to the rules around use of surplus, and determine how this aligns with a low dependency target.
✓	Engage a covenant adviser, perhaps for the first time, to carry out the formal assessment of covenant that is now required. This will be discussed in more detail in Part 2 of your XPS FIS Companion.
✓	Understand the range of options that could be considered a low dependency investment allocation and how this ties into your long-term strategy path. These will be discussed in detail in Part 3 of your FIS Companion.
✓	Consider what legal advice you may need to ensure compliance with the new funding requirements.





Setting a long term strategy: Next steps

Checklist for employers

Prepare for your first valuation under the new funding regime

✓	Download your FIS Companion.
✓	Get up to speed with the new requirements. Training on the regulations and funding code is advised for all relevant employer representatives.
✓	Perform a 'Health Check' on long-term funding assumptions, investment strategy and covenant to help you understand how your scheme's current position compares to the new regime.
✓	Proactively engage with your trustees as early as possible to set the future strategy and ensure outcomes are aligned with your corporate objectives.

Discuss strategy with your advisers

✓	Involve your corporate pensions adviser from the start to make sure that any long-term strategy discussions are mindful of your broader corporate objectives. This should include understanding the pros and cons of different long-term strategy options.
✓	Consider whether independent covenant advice is required to allow you to successfully present your covenant and cash position to the trustees. Part 2 of your XPS FIS Companion will cover the new covenant requirements in detail.
✓	Determine the level of investment risk the business is comfortable supporting now and as your scheme matures, including the downside risk you can fund. Part 3 of your XPS FIS Companion will cover the new investment requirements in detail.
✓	Consider what legal advice you may need to ensure compliance with the new funding requirements.





XPS FIS Companion

Part Two: The covenant assesment

The covenant assessment

Set out in law for the first time, formal consideration of employer covenant is now a requirement. There are new covenant concepts for you to consider and measure.

Undertaking a formal covenant assessment will be a step change for many trustee boards. Instead of a single covenant rating, there are a number of new covenant metrics that need to be produced and reported. Assessing covenant early in the valuation process is key; the strength of the employer covenant must be considered in all aspects of the funding and investment strategy, from setting an appropriate long-term objective to choosing a suitable low dependency investment allocation and funding basis, and to developing a journey plan to move to a low dependency funding position.

Trustees should engage with employers early; employer input will undoubtedly be required to allow an adequate assessment to be undertaken. Trustees will need to consider whether they have the expertise to assess the employer covenant or need to appoint a professional adviser, and employers may also wish to consider appointing their own independent covenant adviser.

What do the regulations and guidance say?



Regulatory requirements:

- **Journey plan risk:** As a scheme moves along its journey plan to low dependency, the level of risk that may be taken is dependent on the strength of the employer covenant.
- **Covenant considerations:** An assessment of the employer covenant must consider the financial ability of the employer to support the scheme and any additional contingent asset support. Covenant must be assessed relative to the funding position on the low dependency and solvency bases.
- **Covenant assessment:** The regulations explicitly set out several items to consider including cashflow, future development and resilience of the employer's business, as well as the timeframes over which these should be considered. Covenant strength includes support from any contingent assets that are legally enforceable and will be sufficient to provide that support at such time as it may be required by the scheme.
- **Valuation submission:** Covenant information must be submitted to The Pensions Regulator (TPR) within the scheme's statement of strategy. This includes documenting the covenant timeframes and the value of contingent assets.
- **Reasonable affordability:** Deficits should be recovered as soon as the employer can reasonably afford.



Code and detailed covenant guidance:

The code states that covenant should be assessed at least at each triennial valuation. The scope and frequency of any further assessments should be proportionate, considering factors including the scheme's funding level, its maturity, and the level of funding and investment risk within the journey plan.

The code also introduces and provides detailed direction on some key concepts including reliability and longevity periods, reasonable affordability, maximum affordable contributions and supportable risk.

The covenant guidance provides further direction on these concepts including worked examples to illustrate how the assessment of the reliability period and covenant longevity might be undertaken in given circumstances.

In this second part of your FIS Companion, we explore what the regulatory requirements and guidance from TPR might mean in practice for your scheme.





The covenant assessment: Reliability and longevity



What's new...

The single covenant rating (e.g. tending to strong or weak) that was used to describe covenant strength under the previous funding regime has been replaced. In addition to considering forward looking cash flows and prospects, trustees need to consider the timescales over which they can rely on the covenant; this is critical to the pace of funding and the evolution of the journey plan.

Trustees must consider the reliability period and the longevity period of the employer.

- The **reliability period** is the timeframe during which trustees have reasonable certainty over the employer's cash flow to fund the scheme. Reliability is determined by considering an employer's cash flow and prospects.

TPR recognises that most employers will only have reliability in the short to medium term i.e. three to six years, but this may be extended based on employer-specific circumstances.

- The **longevity period** is the timeframe during which the trustees can be reasonably certain that the employer will be able to continue to support the scheme.

Longevity may be finite for some schemes, for example, if an employer provides a product or service that will no longer be required within a few years, longevity will be limited to this period. TPR considers that for most employers, longevity will not exceed 10 years but that some may be able to demonstrate a longer period. Longevity is determined by an employer's **prospects**.

We explore the roles of cash flow and prospects in the table below:

Consideration	Why is this important?	How is this assessed?
Cash flow	The strength of the employer's cash flows will help trustees understand the level of financial support the employer can provide to the scheme. This includes the level of cash that could be paid into the scheme in a downside scenario as well as what deficit reduction contributions (DRCs) are affordable.	Focus on forward looking forecast information, including appropriate downside scenarios. Assessed based upon cash flow expected to be generated by the employer after allowing for reasonable operational and committed finance costs, but before DRCs (or accrual) and other possible uses of free cash. Consider the reasonableness of the forecast assumptions used and any sensitivity to change.
Prospects	An understanding of the employer's prospects will help determine the extent and duration of reliance that can be placed on the employer to support the scheme. The assessment of prospects feeds into the determination of the covenant reliability and longevity periods.	Consider market outlook for the industry the employer operates in as well as the employer's position within that industry. This also includes the diversity of operations, reviewing the employer's strategic importance within any wider group, the corporate strategy, and environmental, social and governance (ESG) strategy as well as more general market commentary. Assess the resilience of the employer including the likelihood of insolvency.





The covenant assessment: Affordability and supportable risk



What's new...

As part of journey planning, trustees need to consider the level of risk in the scheme and whether that risk can be supported by the employer.

The regulations and the code introduce the following concepts:

Reasonable affordability	• Under the regulations, deficits must be recovered as soon as the employer can reasonably afford • Reasonable affordability should be assessed by reference to an employer's available cash, comprising cash flows and liquid, or readily recoverable, balance sheet assets • Trustees must also consider the employer's reasonable alternative uses of cash including investment for sustainable growth, covenant leakage, discretionary payments to other creditors and payments to other DB schemes.
Maximum affordable contributions	• Defined as the employer's cash flow after adjustments for reasonable alternative uses of cash and DRCs payable to the scheme and other DB schemes sponsored by the employer. • To the extent the employer has agreed to pay DRCs from its liquid assets, these amounts should also be included. This will prevent maximum affordable contributions being understated once DRCs are deducted.
Supportable risk	• Trustees need to consider the employer's capacity to support risk by assessing the maximum affordable contributions over the reliability period that would be available to fund a deterioration in the deficit, and any contingent assets which would be available to fund the scheme in a scheme related stress event. • Where contingent assets meet the relevant criteria they can be used to support additional risk taking or a longer recovery plan.

If the assessment of supportable risk shows that the risk in the scheme is unable to be supported, trustees should consider whether to change the funding and investment strategy or seek other forms of covenant support.

Assessment of the supportable risk should allow for investment risk and return and include the impact of a stress test; TPR expects schemes to consider the impact of a 1-in-6 downside level event over the reliability period as a minimum.



It will be key for trustees to perform covenant assessments early in the valuation process as this is integral to the scheme's journey plan. Trustees will also need to document and evidence how covenant has been assessed and considered as part of the statement of strategy.



Bessie Hamilton Consultant

 elizabeth.hamilton@xpsgroup.com



The covenant assessment: Contingent asset value



What's new...

Covenant strength includes support from any contingent assets that are legally enforceable and will be sufficient to provide that support at such time as it may be required.

Contingent assets can provide valuable support to schemes who may be unable to rely on employer covenant. Contingent assets could potentially lead to reduced requirements for cash contributions. This may be attractive for employers with considerable assets but minimal ongoing cash flow generation (for example, charitable entities).

To factor contingent assets into the covenant assessment, they must satisfy the 'relevant criteria', meaning they must be:

Legally enforceable: This is determined by the terms and conditions of the agreement and by the law. It is important to receive legal advice where reliance is placed on the asset.

Sufficient to provide support when required, considering: the scenario in which it can be called upon (e.g. funding triggers or employer insolvency) and the realisable value in that scenario.

Examples of contingent assets

- Charges over cash or property
- Letters of credit and bank guarantees
- Guarantees (including parent company guarantees)
- Contingent funding mechanisms (which allow for cash to be paid into the scheme based on pre-agreed triggers)

Asset backed contributions should not be used to take additional funding/investment risk as they are typically already used to increase the scheme's asset position.

Further details on guarantees

Guarantees provide a scheme with legal recourse to a party other than its employer in a pre-defined situation. This is a common type of contingent asset that many schemes benefit from. The code sets out how guarantees should be valued and distinguishes between look through and non-look through guarantees, with further examples provided in the guidance.

Definition	Implications for covenant assessment
Look through guarantee • Legally binding clause to look through to the guarantor for affordability • Replicate the obligations placed on a statutory employer • Trustees able to claim against guarantor for all monies owed by the employer to the scheme without restrictions or qualifications once a trigger event has taken place • No time limit and cannot be revoked without trustee agreement • No onerous conditions attached • Includes an information sharing protocol	• Guarantor can be considered in determining covenant reliability and longevity and its cashflows used to support additional risk
Non-look through guarantee • Does not include specific contribution mechanism • May be limited in time or value or contain other restrictions	• Could be used to justify a longer reliability or longevity period, but unlikely to be taken into account for supportable risk unless trustees can ascribe a value with reasonable certainty to the level of support it can provide when required





The covenant assessment: Journey planning and proportionality

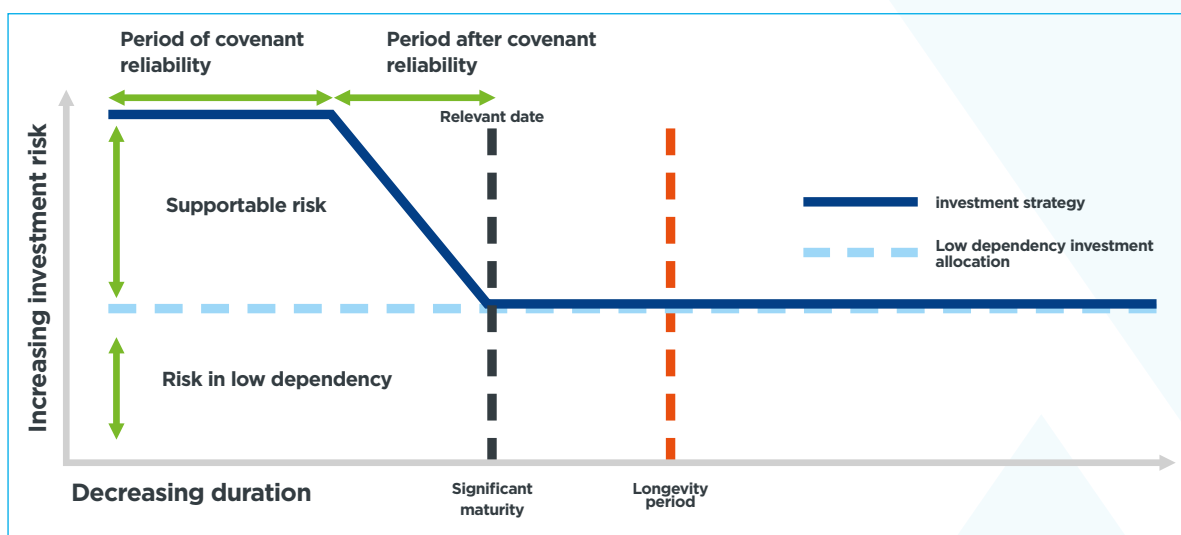


What's new...

Trustees must reflect employer covenant in their journey plan. Naturally, as a scheme approaches its relevant date, its reliance on the employer will need to reduce.

Covenant should be a key consideration within the journey plan. The differing characteristics of each scheme and its employer covenant will mean that the shape and timeframe of the journey plan to low dependency will vary.

Below is an illustrative journey plan demonstrating how the level of risk can evolve based on covenant characteristics and should reduce over time as the scheme approaches significant maturity.



What is proportionate?

TPR emphasises proportionality to ensure trustees consider the right level of detail in the covenant assessment, based upon the covenant support provided and the scheme's position. It is reasonable for a scheme with minimal covenant reliance to take a light-touch approach compared to a scheme with greater reliance.

TPR has outlined its expectations regarding proportionality, and examples are summarised below.

Examples where a light-touch assessment may be appropriate

- The scheme has fully bought in with an insurer
- The scheme is fully funded on its low dependency basis, noting that a scheme does still remain exposed to covenant risk if funding levels decline or there is an employer insolvency event
- The size of the employer is very large in comparison to the scheme
- The journey plan relies on a small amount of funding and investment risk being taken before the relevant date

Examples where a more involved assessment may be appropriate

- The scheme has a funding deficit
- Covenant has not been formally assessed previously
- The trustees have concerns about the viability of the sponsoring employer

Ultimately, trustees have discretion in determining what is proportionate, but they should be able to justify their approach when required. Trustees should also take a proportionate approach to documenting explanations in the statement of strategy taking into account the size, maturity and funding level of the scheme as well as the level of investment risk. Where there is greater risk and complexity, a greater level of detail and explanation will be required.



The covenant assessment: Next steps

Checklist for trustees

Engage early



The more formalised covenant requirements will mean additional support from the employer is required. Starting conversations before (or shortly after starting) the valuation process is key.



Information should be obtained from the employer in order to assess covenant.

Be proportionate



Trustees should consider how proportionality looks in the context of their scheme.

Agree who will undertake the assessment



Trustees should consider whether they have the expertise to assess the employer's covenant; if they do not, then professional covenant advice should be sought.



Trustees who have already appointed a covenant adviser should engage with them to understand how their approach has developed due to new regulatory environment.



If trustees do not appoint a covenant adviser, they will need to adequately document how they have assessed covenant and reached their conclusions.

Reflect covenant in your journey plan



If trustees are unable to obtain sufficient covenant information, prudence and safeguards will need to be built into the journey plan.



For schemes that are fully funded, trustees should still ensure the employer can financially support the scheme in the event of downside scheme risks crystallising.



Review contingent assets and how they are being factored into your covenant assessment.



Consider the certainty of cash flows and the period over which these can be relied upon.

Document the process



Ensure that sufficient analysis is performed to support documenting the covenant in the statement of strategy.





The covenant assessment: Next steps

Checklist for employers

Engage early and provide information promptly



Review the new guidance and consider how elements of the covenant can be presented to promote understanding and better align the objectives of the employer and the scheme.



Employers are required to support trustees with the information needed to undertake their covenant assessment, including cash flow forecasts and supporting assumptions. Insufficient information may result in a more prudent assessment by the trustees.

Be prepared to engage in discussions on cash flow usage and capacity to support risk



The reasonableness of the employer's proposed use of free cash flow for purposes other than funding the scheme or supporting risk, and the employer's ability to adapt its plans, will influence the pace and quantum of funding required. An early discussion clarifying the employer's plans will help to align expectations.

Consider the role of contingent assets



Review any guarantees or other contingent assets to understand the value they provide and consider taking legal and covenant advice on guarantees.

Discuss strategy with your advisers



Consider whether to engage an independent covenant adviser to support the successful presentation of the employer's covenant position to the trustees.



Employers will also need to familiarise themselves with the new guidance. We believe the first valuation under the new FIS regime represents a significant opportunity for employers to engage with the trustees on their long-term strategies and align them with the wider corporate objectives.

Kelvin Xu Partner

 kelvin.xu@xpsgroup.com





XPS FIS Companion

Part Three: Scheme investments under the new regime

Scheme investments under the new regime

You are required to agree a low dependency investment allocation (LDIA) and target investing in it within a certain timeframe.

Investment considerations are a crucial part of the new funding and investment strategy regulations. Trustees and sponsoring employers are required to agree an LDIA and how they intend to transition from the current investment strategy to the LDIA over a certain timeframe – this is known as the investment journey plan.

The LDIA and journey plan set out a notional long-term investment strategy that the trustees and sponsoring employers agree that they intend to target. Trustees retain the power to invest in different ways if they believe it is in the best interests of members. Notwithstanding this point, the LDIA and investment journey plan have very important and real-world implications for scheme funding, and it is important that they are given due consideration.

What do the regulations and guidance say?

Regulatory requirements:

- **Funding and investment strategy:** As part of this, trustees must determine the investments they intend to hold at the relevant date, which is no later than significant maturity.
- **Minimum requirement:** Trustees need to set an objective that, on and after the relevant date, the assets supporting at least a fully funded low dependency position are invested in accordance with a low dependency investment allocation. This objective does not apply to surplus assets.
- **High resilience:** Under the LDIA the value of the assets relative to the value of the scheme's liabilities (assessed on a low dependency funding basis) must be *'highly resilient to short-term adverse changes in market conditions so that further employer contributions are not expected to be required'*. High resilience is not defined in the regulations.
- **Liquidity:** Scheme investments must have sufficient liquidity to enable the scheme to meet expected cash flow requirements and make a reasonable allowance for unexpected cash flow requirements.

Code guidance:

- The code makes it clear that both the investment strategy used to support a scheme's current funding assumptions and the LDIA are intended to be 'notional' investment allocations
- Targeting the LDIA therefore, does not interfere with trustees' duty to invest in the best interests of members nor does it interfere with their investment powers. TPR notes that it expects most schemes' actual investment allocation will be the same or similar to schemes' notional investment allocations but understand that they may differ in some circumstances.
- TPR expects schemes' LDIA's to target at least 90% hedging on interest rates and inflation (on the low dependency funding basis), gives some steer on testing 'high resilience' and sets out requirements for the liquidity of the LDIA.

In this third part of your FIS Companion, we focus on the LDIA and how adherence to regulatory requirements can be achieved alongside adopting an LDIA appropriate for your scheme. The fourth part will cover the investment journey plan in more detail.



Scheme investments under the new regime: LDIA



What's new...

Trustees must set a funding and investment strategy and as part of this determine the investments they intend to hold at the 'relevant date' which is no later than significant maturity.

The regulations require trustees to specify the proportion of assets that they intend to allocate to different categories of investments on the relevant date. The long-term objective, which in most cases must have been agreed between the trustee and the employer, should be taken into account when considering an appropriate LDIA for the scheme. Long-term objectives are discussed in detail in Part 1 of your XPS FIS Companion

The regulations and the code provide trustees with sufficient flexibility to set an LDIA that is consistent with their long-term objective with TPR recognising that there is no 'one size fits all' approach. We explore the key factors below which trustees should consider when setting their LDIA.

Factor	Commentary	Questions for trustees
Long-term objective	The LDIA should reflect the trustees' long-term objectives. For example, schemes looking to buy out may wish to target an LDIA comprised of liquid assets that are easy to disinvest when required. They may also, to the extent possible, choose assets which complement the way insurers price pensions. However, thought also needs to be given to whether the LDIA is expected to generate sufficient returns to achieve buy out without further support from the employer. On the other hand, schemes whose long-term objective is run-on may wish to invest in a greater proportion of growth assets and exploit their longer time horizons by investing in less liquid assets.	Does the scheme's proposed LDIA reflect its long-term objective? If not, what changes could be made to address this?
Proportionality	TPR expects schemes to take a proportionate approach when setting the LDIA. It expects a greater focus on the granularity of the investment allocation and risks as a scheme approaches its relevant date.	How can you determine the right level of detail / depth of analysis?
Surplus assets	TPR acknowledges that after the relevant date, any surplus assets (when measured against the low dependency funding basis) do not need to be included in the LDIA. They will, however, give schemes the option to record how surplus assets are invested in the statement of strategy. TPR also notes that schemes with a material surplus may be able to invest all assets, not just the surplus, in a manner different from the LDIA. This could help very well funded schemes target higher risk adjusted returns, for example if they are looking to run on to target distributing surplus.	





Scheme investments under the new regime: High resilience



What's new...

Under the LDIA the value of the assets relative to the value of the scheme's liabilities (assessed on a low dependency funding basis) must be highly resilient to short-term adverse changes in market conditions.

The regulations do not define 'highly resilient', leaving it to trustees and their advisers to interpret what this means. The code does give a steer though, with TPR suggesting that trustees consider whether, following adverse changes in market conditions, the LDIA will allow the scheme to return to full funding on low dependency in a reasonable timeframe.

When carrying out this 'test' to demonstrate high resilience, trustees are expected to assume that their scheme is fully funded on the low dependency funding basis. Then, looking at the change in funding level from a subsequent stressed or downside scenario, trustees need to satisfy themselves that the scheme can recover back to full funding within a reasonable timeframe with low dependency on the employer (i.e. assuming no employer contributions or limited contributions if the stress applied is much stronger than the example in the code).

Detailed guidance on how high resilience can be demonstrated is not provided but the code gives an example. This involves applying a 1-in-6 likelihood one year stress, with high resilience being achieved if full funding is expected to be restored within 6 years. We explore this 'bounce-back' test in more detail on the next page.

One observation of a bounce-back test is that it tends to favour higher returning (and hence higher risk) investment strategies. This is not necessarily consistent with the general consensus on what would be suitable for the low dependency investment strategy.



TPR's guidance on high resilience favours higher risk and return investment strategies than would historically have been thought to be suitable for schemes fully funded on low dependency. Trustees need to consider the level of risk in their LDIA to ensure their investment strategy is suitably robust



Adam Rouledge
Senior Consultant

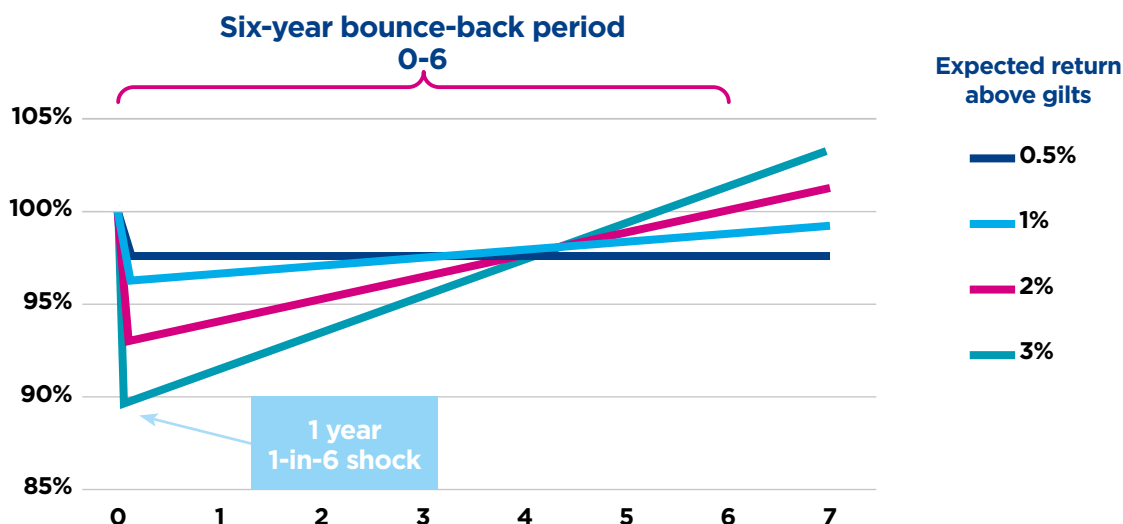


adam.rouledge@xpsgroup.com



Scheme investments under the new regime: High resilience

Illustration of TPR's bounce-back test with varying levels of investment return target (underlying gilts + 0.5% low dependency basis)



The chart above shows the impact of a short-term adverse change in market conditions and subsequent “bounce-back” for investment strategies targeting a range of investment returns from gilts + 0.5% p.a. to gilts +3.0% p.a. The higher risk and return investment strategies suffer more than the lower risk and return strategies during the initial “shock” but their higher expected returns mean they recover quicker than the lower returning strategies, and recover in less than 6 years. So, higher risk and return investment strategies pass the bounce-back test whereas low risk and return strategies, more typical of low dependency, do not.

Following the code rigidly would suggest that an LDIA targeting an investment return of gilts + 1.5% p.a. or higher is acceptable. However, our view is that, in many cases, such high risk and return invest strategies are not consistent with the concept of low dependency. To ensure that excessively risky investment strategies are not adopted for the LDIA, we suggest that a test of downside risk is carried out in addition to the bounce-back test to demonstrate high resilience.

The other concern with the bounce-back test is that investment strategies dominated by government or corporate bonds, which are typical of the investment strategies long adopted by schemes targeting a low dependency state, would not be expected to pass the bounce-back test. This is because such investment strategies may not be able to demonstrate that they could generate sufficient investment returns to ‘bounce-back’ within 6 years. Although part of this is due to current market conditions that may change in the future, it highlights an issue that must be considered by trustees and their advisers.



Trustees wishing to take relatively low levels of investment risk in their LDIA may want to adopt a low dependency discount rate that is consistent with the assets underlying the LDIA. In simple terms, this would result in the liabilities moving more in line with the assets following a ‘stress event’. The ‘stress-event’ modelled can also be structured to be more true-to-life as to the expected impact on the assets underlying the LDIA.

Tom Fallon Consultant

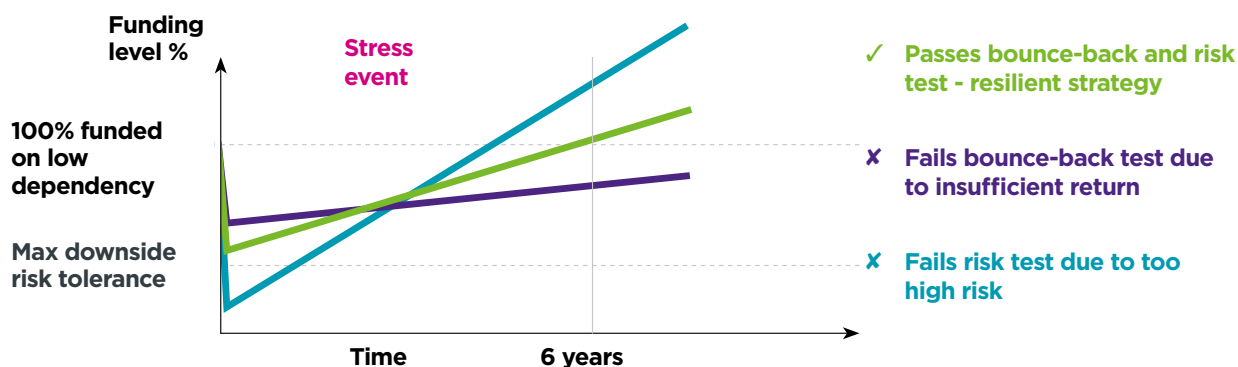


tom.fallon@xpsgroup.com



Scheme investments under the new regime: High resilience

More effective test of high resilience



As shown in the chart above, testing downside risk in addition to the bounce-back test will render some of the higher risk investment strategies unsuitable as an LDIA.

However, there are several options available to trustees to address the issue that lower risk investment strategies, (such as those invested significantly in government and corporate bonds or assets with similar characteristics) fail the bounce back test. We explore two options below.

Approach one: Structure of low dependency discount rate

For the low dependency discount rate, TPR expects trustees to use one of two main approaches (or a combination of both); a risk-free rate plus a margin, or a discount rate directly linked to a scheme's investments. In the latter approach, schemes whose LDIA's include an allocation to lower risk assets such as corporate bonds may include the return on corporate bond yields in the definition of the low dependency discount rate. This would result in the value placed on the low dependency liabilities falling more in line with the expected movement in the LDIA in a 'stress event', and a lesser net reduction in the funding level. This allows lower returning strategies to bounce-back in a suitable timeframe.

Approach two: A greater emphasis on credit-based assets

A more realistic approach can alternatively be taken in the high resilience test itself by allowing for enhanced returns on some of the lower risk assets making up the LDIA, following the downside events. Corporate bonds, for example, exhibit this behaviour in the real world and so such an approach may be appropriate. In a stress event the price of credit assets like corporate bonds might fall because companies are deemed more likely to fail and default on their debt. However, if the stress event does not result in insolvency, the debts will ultimately be paid in full and the assets will recover, resulting in increased returns soon after a downside event.

Approach one has the advantage that it seems sensible for a pension scheme's liabilities to be measured based on the yields available on its the assets and so might be a more durable approach over the long run. However, it does involve a fundamental change in the approach to valuing the scheme's liabilities. Approach two may therefore be easier to adopt in practice. It should also be more helpful in allowing low risk investment strategies with material allocations to corporate bonds pass the bounce back test.





Scheme investments under the new regime: Liquidity and liability hedging



What's new...

Scheme investments must have sufficient liquidity to enable the scheme to meet expected cash flow requirements and make reasonable allowance for unexpected cash flow requirements. The code also specifies a minimum level of interest rate and inflation hedging.

Factor	Commentary	Questions for trustees
Interest rate and inflation hedging	The LDIA should target a minimum interest rate and inflation hedge of 90% of the low dependency liabilities. While the code states that trustees should consider their scheme's hedge against the shape of its liabilities (as well as the absolute amount of hedging), TPR expects the depth of analysis to be proportionate to the size of the scheme and the time to the relevant date.	Is your hedge target sufficient?
Liquidity	Trustees must consider whether a potential LDIA provides appropriate liquidity to meet expected and unexpected payments like pensions, transfer payments and collateral calls. The code also says that trustees should undertake cashflow forecasts over at least 3 to 6 months. Smaller schemes should consider cashflow issues around the impact of retirement plans for members with larger benefits. More immature schemes may have greater scope to invest in illiquid assets. However more mature schemes can also invest in illiquid assets as these can help generate cashflows to match benefit payments. Consideration also needs to be given to retaining liquid assets to meet cash calls from liability hedging and other derivative based assets.	Will the scheme have sufficient liquidity to meet all expenses and payments to members?





Scheme investments under the new regime: Next Steps

Checklist for trustees

Engage with the employer



Trustees and employers should work closely to ensure sufficient time is given to each of the additional requirements introduced under the funding and investment strategy regulations. Investment considerations should feed into wider discussions regarding long-term objectives.

Determine your proposed LDIA



Trustees should ensure their chosen LDIA aligns with their long-term objective.

Is the proposed LDIA highly resilient?



Take advice on a suitable test of high-resiliency. This may include the LDIA passing both a “bounce-back” test and a test that the low dependency funding level would not fall by more than the trustee’s maximum tolerance in response to short-term adverse changes in market conditions.

Does the proposed LDIA meet the other requirements of the code?



Does the proposed LDIA hedge at least 90% of the interest rate and inflation risk relative to the low dependency liabilities? Is the LDIA suitably liquid to be able to meet known and unknown future cashflow requirements?





Scheme investments under the new regime: Next Steps

Checklist for employers Determine your objectives



How would you like the trustees to provide the scheme's benefits over the long-term? Do you want to buy out or would you prefer to run the scheme on? What are your views on the scheme's current investment strategy – are you comfortable maintaining the current level of investment risk / return for as long as possible or would you prefer to incorporate some immediate de-risking?

Determine your investment risk and return preferences



How much investment return would you like the trustees to target? How much investment risk can you tolerate? Consider your preferences both now and how they might change in the future

Engage with the trustees



Trustees and employers should work closely to ensure sufficient time is given to each of the additional requirements introduced under the funding and investment strategy regulations





XPS FIS Companion

Part Four: The funding valuation journey plan

The funding valuation and journey plan:

By significant maturity, your scheme's technical provisions (funding) basis must be at least as strong as the low dependency basis. Whilst on the journey to low dependency, more risk can be taken where the employer covenant is stronger and subject to covenant, more risk can be taken where a scheme is a long way from reaching its relevant date.

The new regulations and funding code direct trustees to adopt a long-term approach to scheme funding, placing greater emphasis on strategic planning than ever before. The triennial actuarial valuation will play a crucial role in assessing that a scheme's journey plan is on track to achieve low dependency on the employer by the relevant date.

What do the regulations and guidance say?

Regulatory requirements:

- **Journey planning:** Trustees are required to set a funding and investment strategy that includes a journey plan outlining how their scheme will move from its current funding position to being fully funded on a low dependency basis by its relevant date. The level of risk reflected in the funding assumptions along the journey plan should be appropriate to the strength of the employer covenant and the scheme's proximity to its relevant date.
- **Technical provisions:** A scheme's technical provisions must be calculated in a way that is consistent with the scheme's funding and investment strategy. This means that the assumptions used to calculate the technical provisions should be supportable by the planned evolution from its current investment strategy to its low dependency investment allocation.
- **Scheme deficits:** Any funding deficit must be recovered as soon as reasonably affordable for the employer although, among other things, trustees must now also take account of the impact of a recovery plan on 'the sustainable growth of the employer'.

Code guidance:

- TPR expects trustees to consider the funding valuation and the funding and investment strategy together as one, and to work collaboratively with the sponsoring employer during the valuation process. Assumptions used to calculate the technical provisions must be consistent with a scheme's funding and investment strategy, and these assumptions should be the same as or stronger than the low dependency funding basis after the relevant date.
- Detailed guidance is provided on how trustees should determine a scheme's technical provisions, along with the key considerations for ensuring an appropriate recovery plan is in place, where applicable.
- The detailed guidance on journey planning helps trustees set out how they expect to progress from the scheme's current funding position to its low dependency target. This includes support on determining a suitable evolution of the investment allocation throughout all stages of the journey plan, and on how covenant considerations should be taken into account.

In this fourth part of your FIS Companion, we explore how the valuation process has evolved under the new regulations, and the key elements of the journey plan.



The funding valuation and journey plan: The valuation process

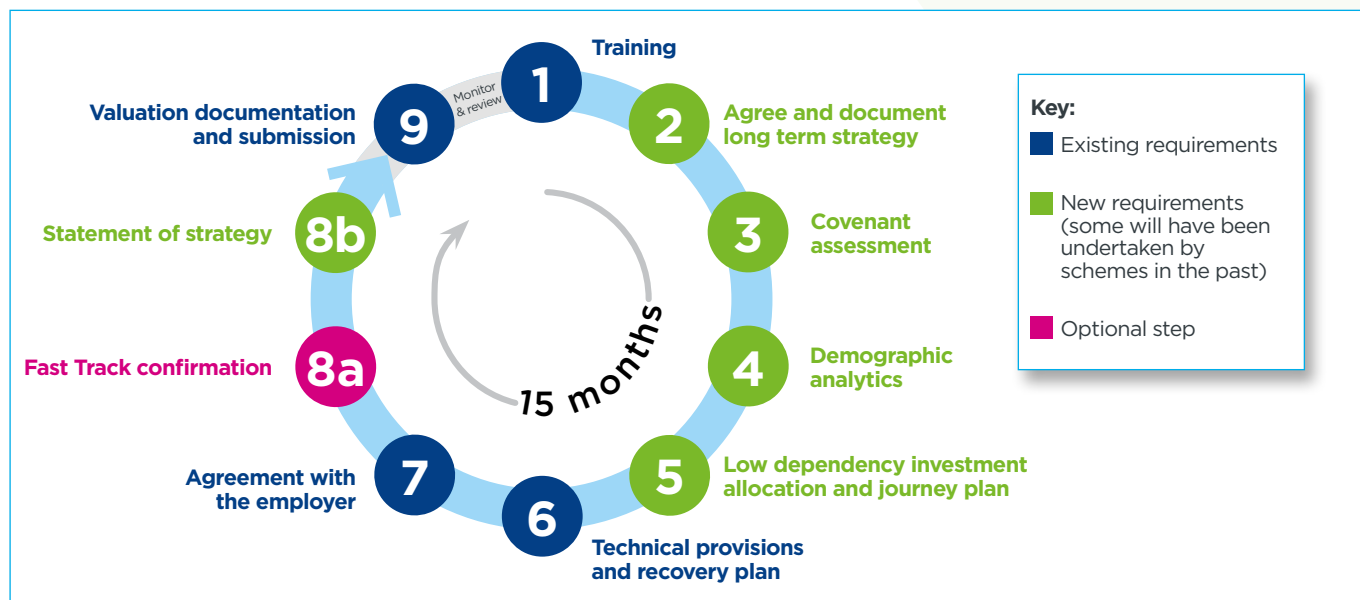


What's new...

TPR expects trustees to consider the funding valuation and the funding and investment strategy together as one, and for trustees and employers to work collaboratively during the valuation process.

To adhere to the new funding regulations, the valuation process introduces a key additional requirement; planning for the long-term funding of the scheme. This is in addition to the continuing requirement to assess the current funding position of the scheme and, where necessary, put a recovery plan in place. Long-term planning involves setting the funding and investment strategy, which includes determining: the long-term objective, the low dependency funding target, the low dependency investment allocation and the journey plan to low dependency. At the very least, this strategy will need to be reviewed and, if necessary, revised as part of each subsequent formal valuation.

The valuation process includes more steps under the new regulations as shown below.



A scheme's funding and investment strategy must be agreed as part of its first valuation under the new regulations. Despite the additional steps, the 15-month deadline to complete the valuation remains unchanged. To help manage this, some preparatory work can be undertaken prior to the valuation date, such as: initial discussions on the long-term strategy, early covenant analysis, consideration of the low dependency investment allocation and exploring journey planning options.



Planning will be key to completing everything on time - particularly for a scheme's first valuation under the new funding regime. Trustees will need to carry out the additional steps and submit their statement of strategy within the usual 15-month deadline for actuarial valuation submission. Where time permits, I encourage trustees to begin preparing well ahead of the valuation date.

Pauline McConville, Senior Consultant





The funding valuation and journey plan: Valuation requirements



What's new...

A scheme's technical provisions must be calculated in a way that is consistent with its funding and investment strategy. The technical provisions assumptions should be the same as or stronger than the low dependency funding basis after the relevant date.

The valuation process has evolved considerably under the new funding regulations. The emphasis has shifted towards ensuring schemes reach full funding on a low employer dependency basis - a position where further employer contributions are not expected to be necessary.

Below, we summarise how the key valuation requirements have changed under the new funding regulations and code.

Valuation component	Previous regime requirements	New requirements under the funding and investment strategy regulations and funding code
Setting a long-term objective	Trustees were encouraged to set a long-term objective that focused on maximising the security of members' benefits.	Trustees formally document a long-term objective which must include achieving full funding on a low-dependency basis by the relevant date. In most cases, the employer must agree the strategy. This is covered in further detail under Part 1 of your XPS FIS Companion.
Covenant assessment	Trustees were expected to form a view and produce a single employer rating.	Formal consideration of covenant is a legal requirement with new covenant concepts to consider. This is covered in detail under Part 2 of your XPS FIS Companion.
Technical provisions	Assumptions chosen prudently with regard to the employer covenant and taking into account the degree to which adverse events could be supported.	Trustees must set assumptions which are consistent with the scheme's funding and investment strategy. This means that in the period before the relevant date, technical provisions assumptions must be consistent with the journey plan to low dependency. In the period after the relevant date, technical provisions assumptions must be at least as strong as those used in the low dependency funding basis.
Journey planning	Although journey plans were not mandatory, many schemes had one in place.	Trustees formally set a journey plan that outlines how the scheme will move from its current funding position to being fully funded on a low dependency basis by its relevant date. Wider factors, including employer covenant, will need to be considered.
Recovery plan (if funding shortfall)	Trustees were required to agree a recovery plan with the employer which targeted full funding on a technical provisions basis.	Trustees must take additional considerations into account including covenant metrics and they must also take account of the impact of a recovery plan on the sustainable growth of the employer.
Statement of strategy	Not applicable	Trustees must submit the statement of strategy to TPR as part of each formal valuation. This statement outlines the trustees' plan for how they will deliver benefits to members over the long term and contains lots of supplementary information.
Role of the Scheme Actuary	Provide advice on assumptions and certify the calculation of the technical provisions (and in some cases qualify this certification).	In addition to previous requirements, the Scheme Actuary is expected to report to TPR where they do not believe that the assumptions chosen for technical provisions could be considered consistent with the funding and investment strategy.





The funding valuation and journey plan: An introduction to journey planning



What's new...

Trustees are required to set a journey plan that outlines how their scheme will move from its current funding position to being fully funded on a low-dependency basis by its relevant date.

While encouraged under the previous funding regime, the new regulations require trustees to set a journey plan which must, as a minimum, be expected to achieve full funding on a low dependency basis by the relevant date. Over time, trustees should monitor their scheme's progress against the journey plan and take corrective action where required.

Factors to consider

The code gives trustees detailed guidance on factors to consider when setting their journey plan, including:

- **Determining an appropriate level of supportable risk.** It is important to consider how risk evolves over time, how funding and investment risk is expected to change as the scheme moves towards a position of low dependency and also how the level of risk that the employer can support might change over time. For example, schemes supported by a strong employer covenant may choose to run with a higher level of funding and investment risk within their journey plan. Contingent assets can be taken into consideration when setting the journey plan.
- **Ongoing risk management.** The journey plan should reflect expected levels of risk now and in the future, and ensure they remain supportable. Trustees should also have a plan in place in case the scheme deviates materially from the journey plan. This includes identifying key risks or challenges that could impact the scheme's ability to meet its long-term objective and put appropriate contingencies in place.
- **Evolution of notional investments.** This is how the trustees intend to transition from their current asset allocation to the low dependency investment allocation by the scheme's relevant date. The assets held now and over the journey plan should be driven by the level of supportable risk. TPR suggests various de-risking mechanisms and expects the timing and pace of de-risking to be particularly relevant during the post-reliability period and suggests various de-risking mechanisms.
- **The nature of the scheme.** Significant maturity (or earlier relevant date), and therefore the rate at which low dependency must be reached, is influenced by a scheme's membership. Schemes open to new entrants and/or future pension accrual can reflect this by pushing out their journey plan, since continued pension accrual tends to slow a scheme's rate of maturing.
- **Proportionality.** TPR recognises that trustees can, under certain circumstances, adopt a proportionate approach. For example, if the size of the employer is very large in comparison to the scheme, if the scheme is very well funded, if the scheme has bought-in, or the scheme is already adopting a very low risk strategy, then the trustees may be able to conclude that the risks being run are supportable without much analysis.

A journey plan of two halves

TPR expects the journey plan to consider the reliability and post-reliability period, with key factors for trustees:

During the reliability period

- Trustees are expected to assess whether their scheme has access to sufficient employer cashflows and contingent asset support to recover any existing deficit and one that could arise from a scheme-related stress.
- If the assessment shows the risk cannot be supported, trustees should consider changing their funding and investment strategy or seek additional forms of covenant support.

After the reliability period

- This is the period when trustees are expected to transition to low dependency by the relevant date; the pace and shape of de-risking depends on covenant support.
- Trustees should establish how far into the future the employer could support the scheme (i.e. covenant longevity). This includes support from contingent assets. Stronger covenant support could justify running higher risk for longer.
- In addition to covenant considerations, trustees could also justify running higher risk for longer if their scheme is immature.

On the following page we explore how the journey planning process could function in practice.



The funding valuation and journey plan: The journey planning process

Once trustees have established their long-term objective, they must then address the question “How do I set a journey plan?”. We have outlined how to develop this in practice. As the employer will need to agree to their journey plan, trustees should be sure to collaborate through the whole process.

1	Set your long-term objective and low dependency funding and investment allocation - The journey plan must facilitate low dependency by the relevant date - If there is longer term objective (e.g. run-on or buyout), the journey plan should aim to facilitate this too
2	Understand your employer covenant - The employer's ability to support risk now and in the future is key to setting the journey plan - TPR expects trustees to consider covenant reliability and longevity when setting a journey plan - Affordability may be important if cash is required as part of the journey
3	Determine when you need to reach low dependency - Low dependency must be reached by significant maturity (or earlier relevant date), this puts a limit on the duration of the journey plan - Trustees can aim to reach low dependency earlier, this can provide more flexibility if the journey plan needs to be adjusted in future - A journey plan that targets low dependency after covenant longevity may be difficult to justify for some schemes. However, where covenant longevity is not driven by a specific event or limitation to the covenant, and the trustees can reasonably expect covenant longevity to be extended, or 'roll' at subsequent valuations, trustees are not expected to plan to move to low dependency by the end of covenant longevity, providing they can demonstrate that the level of risk being run after longevity is appropriate
4	Consider journey plan options - There are various routes schemes can take to get from their current position to low dependency (and beyond) - It can be helpful to set out a number of journey plan options at this stage to assess against. For example, options with a different pace of de-risking or cash contributions
5	Evaluate journey plans against requirements and the trustees' and employer's objectives - The journey plan must achieve low dependency by significant maturity (or earlier relevant date), risk taken must be supportable and cash contributions due to be paid by the sponsoring employer must be affordable. If these things are not achieved the journey plan is not a viable option - Consider trustee and employer objectives, for example desire to de-risk quickly or to limit cash contributions
6	Consider implication for longer term or other objectives The requirement is to reach low dependency, but there may be other objectives to consider too. For example, does the journey plan facilitate a subsequent journey to run-on and extract surplus or to buyout? Might there be wider implications such as facilitating continued accrual?
7	Potential refinements to the journey plan - Once journey plan options have been assessed, refinements may take place before the journey plan is agreed - Trustees may need to reconsider their long-term objective or consider options for strengthening covenant before a journey plan can be agreed
8	Agree and document the journey plan The journey plan must be agreed and documented in the statement of strategy
9	Monitor, take action and review the journey plan - Progress against the journey plan should be assessed and corrective action taken where required - The journey plan must be reviewed at least at every valuation - Any Integrated Risk Management frameworks in place should be reviewed and updated to reflect changes made under the new funding regime

Setting the journey plan may be an iterative process





The funding valuation and journey plan: What does a good journey plan look like?

A journey plan should be unique and reflect each scheme's own circumstances.

While there is no 'one size fits all' approach to journey planning, the illustration below sets out what journey plan may be appropriate depending on the funding and maturity of the scheme.



We have considered two case studies for how a journey plan can be developed and how it might be structured as a scheme matures below.

Case study 1 – developing a journey plan

A relatively mature scheme, which is not well funded against its low dependency basis took the following steps:

- 1 Strengthened technical provisions to align with new code. Calculated the level of underfunding on new technical provisions basis and the gap to low dependency and considered recovery plan scenarios.
- 2 Measured current level of funding and investment risk.
- 3 Assessed covenant. This concluded that the employer could not provide any additional cash, but the existing cash contributions could reasonably continue beyond the end date of the existing recovery plan. The existing risk in the scheme was not supportable by the employer, but being part of a wider group meant that cash to support the risk was available and existing contingent support might provide access to that funding.
- 4 Considered various funding and investment journeys and evaluated each against the requirements.

Outcome: following negotiation between the trustees and employer a journey plan was agreed that:

- ✓ Extended the existing recovery plan to reach full funding on a strengthened technical provisions basis, with investment returns anticipated to bridge the gap to low dependency a few years ahead of reaching significant maturity.
- ✓ Included derisking of the investment strategy at stepped intervals, if the journey remained on track.
- ✓ Put in place additional contingent support to (a) support existing risk level and a higher level of investment risk on the journey and (b) provide funding if the journey plan became materially behind target.



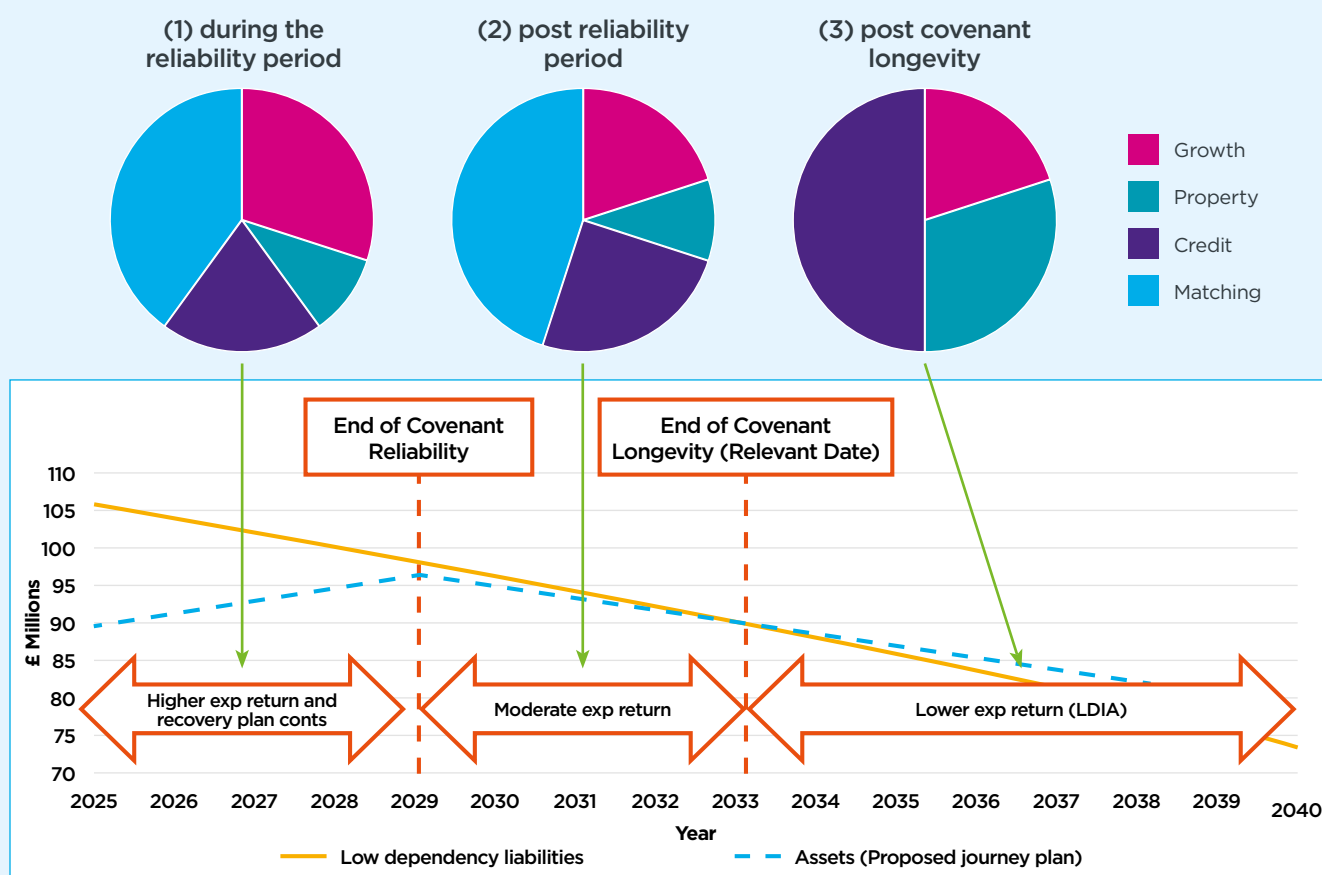


The funding valuation and journey plan: What does a good journey plan look like?

A journey plan can have several phases. TPR suggests that these phases may reflect covenant metrics, such as covenant reliability (the timeframe during which trustees have reasonable certainty over the employer's cash flow to fund the scheme) and covenant longevity (the timeframe during which the trustees can be reasonably certain that the employer will be able to continue to support the scheme). The case study below illustrates how this might look for a scheme.

Case study 2 – structuring a journey plan as a scheme matures

The journey plan for the below relatively immature scheme was split into 3 phases;



During reliability period

- Higher investment risk, but risk is supportable by covenant
- Cash from existing recovery plan is being paid

Outcome: funding gap to low dependency closes relatively quickly, but gap remains at the end of the period

Post reliability period

- Investment risk steps down
- Investments more cash generative to fund pension payroll
- Recovery plan ceases

Outcome: takes significantly longer to close the remaining funding gap to low dependency, but downside risk reduced

Post covenant longevity

- Investment risk steps down again to align with low dependency asset allocation
- Invests in more cash generative and liquid assets to fund pension payroll

Outcome: low dependency achieved. Some asset outperformance maintained to facilitate move to a longer term target

The above is just one example of the shape that a journey plan might take. Alternative de-risking strategies, such as 'Horizon' where the risk taken is initially lower but stays at this level for longer, are common and equally as valid. Trustees should adopt a journey plan that suits their scheme's specific characteristics.



The funding valuation and journey plan: Next Steps

Checklist for trustees

Develop a journey plan

- ✓ Reflect key objectives and parameters within the journey plan, such as the end point (i.e. low dependency or other long term objective) and required timeframe (i.e. significant maturity or earlier relevant date)
- ✓ Understand covenant and its impact on the journey plan, such as the supportable level of risk now and in the future, key covenant metrics (reliability and longevity periods) and whether contingent support might be available to strengthen the covenant.
- ✓ Evaluate various journey planning options and refine where required to ensure the best plan for your scheme circumstances and the trustees' and employer's objectives is chosen.
- ✓ Ensure that any journey plan facilitates an effective onward journey beyond reaching low dependency, for example run-on or buyout.

Complete the valuation

- ✓ Ensure that the relevant preparatory work has been completed, such as having set a low dependency funding and investment strategy, and reflect any new requirements or TPR guidance such as scheme-specific demographic analyses or incorporating expense reserves.
- ✓ Ensure that the valuation and the wider funding and investment strategy stacks up. The process may be iterative.

Agree and document the valuation and journey plan

- ✓ The valuation and journey plan needs to be agreed with the employer and documented in the statement of strategy which will need to be submitted 15 months after the first valuation date under the new regime.

Monitor and review the journey plan

- ✓ Put in place mechanisms to allow the trustees to actively take corrective action if the journey plan goes off track. The journey plan will need to be reviewed following any material change in the circumstances of the scheme or its employer, and as a minimum every 3 years.





The funding valuation and journey plan: Next Steps

Checklist for employers

Engage early



There are only 15 months to agree the first valuation under the new regime and to agree the funding and investment strategy and accompanying journey plan. Engage early to facilitate effective and proactive collaboration with the trustees.

Consider the employer's objectives



The journey plan in particular will be fairly flexible so can reflect the employer's (and trustees') objectives, such as preference for risk taking, cash contributions and timeframe for reaching the target. Being clear with the trustees upfront about the employer's objectives means they can be fed into the journey plan.



The journey plan will be designed to meet the funding and investment strategy (e.g. low dependency) but there may be subsequent journey, for example run-on or buyout. The journey plan should ideally facilitate an efficient transition to the longer term target, so the employer should consider its long term preference for the scheme too.

Consider offering contingent support



Contingent assets may allow employers to improve their covenant strength and this might allow the trustees to accept more risk in the journey plan, meaning a quicker timeframe to reach the target or potentially less cash contributions.

Engage your own independent advisor



Trustees will be taking professional advice when setting the journey plan, and employers should consider asking for support from their own advisors on this.





XPS FIS Companion

Part Five: Fast Track versus Bespoke

Fast Track vs Bespoke

Many schemes will want to assess their valuation against the Fast Track parameters. We explore the conditions that must be met and the pros and cons of both a Fast Track and Bespoke valuation submission.

Under The Pensions Regulator's (TPR) new twin track regulatory approach, trustees will submit a valuation under one of two frameworks; Fast Track, providing they meet the specified parameters set by TPR or Bespoke.

Fast Track represents TPR's view of tolerated risk and is intended to act as a filter for TPR's assessment of actuarial valuations. TPR has noted that it is unlikely to engage with a scheme in respect of a valuation if it meets the conditions of Fast Track. Bespoke provides trustees with enhanced flexibility and a broader range of options to choose an approach tailored to the unique needs of their scheme.

According to TPR's 2025 Annual Funding Statement, it is estimated that around 80% of schemes already meet (or are close to meeting) Fast Track requirements.



Both Bespoke and Fast Track are equally valid, following one or the other does not automatically equate to compliance. The legislation and code principles will need to be followed.

The Pensions Regulator

What do the regulations and guidance say?



Regulatory requirements:

- **Statement of strategy:** While the regulations have no mention of Fast Track or Bespoke, they do direct TPR to specify the form that the statement of strategy must be submitted in and the level of detail required within the submission. Trustees are therefore obliged to follow TPR's guidance when preparing the statement, including any templates provided by TPR.



Code and additional guidance:

- The code is TPR's interpretation of how trustees can comply with the legislative requirements, and it follows that there is no mention of Fast Track or Bespoke valuation submissions within it either.
- **Statement of strategy:** TPR has confirmed the level of detail that schemes must submit to them in the statement of strategy and the form it must take. They have provided four templates which differ depending on whether a scheme is submitting under Fast Track or Bespoke, and whether the scheme is before or after its relevant date.
- **Fast Track parameters:** TPR has set out the tests and conditions that a scheme valuation must meet in order to satisfy the requirements of and submit under Fast Track.
- **Scheme Actuary Confirmation:** The Scheme Actuary must confirm that a scheme's valuation submission meets the requirements of Fast Track in order to submit a valuation under Fast Track.

In this fifth part of your FIS Companion, we explore the requirements of the TPR's Fast Track approach and the pros and cons of using this approach compared to Bespoke.





Fast Track vs Bespoke: Conditions for meeting Fast Track



What's new...

TPR has set out the tests and conditions that a scheme valuation must meet in order to satisfy the requirements of and submit under Fast Track.

The requirements set out below apply to each assumption individually and all must be met to pass Fast Track.

Conditions/Tests	Minimum requirement for Fast Track submission	Comments
Low dependency funding basis assumptions	Gilt-based yield curves. 'Small' schemes may use a spot rate. Discount rate addition not greater than + 0.5% pa. No inflation risk premium. Gap between RPI and CPI of no greater than 0.8% pre-February 2030 and 0% thereafter. Adopt a recent CMI core or extended mortality improvement table or equivalent. Proportions married and age difference assumptions (where no evidenced based scheme specific assumption is adopted) must be at least as strong as those set out in PPF guidance for section 179 purposes. Expense allowance in line with your long-term strategy (unless there is a legal obligation for expenses to be paid by the employer). 'Small' schemes can consider calculating an expense allowance in line with PPF guidance for section 179 purposes if suitable. All other assumptions should be based on the code's principles and expectations. For example, demographic assumptions such as the mortality base table and cash commutation should be based on scheme specific analysis/experience or include additional prudence to reflect uncertainty.	It should be clear whether your scheme complies or not.
Technical provisions test	The ratio of a scheme's technical provisions liabilities to its low dependency liabilities must be at least a minimum level. The minimum level increases as the scheme matures. For example, a scheme with a duration of 12 years must have technical provisions liabilities which are at least 98% of its low dependency liabilities.	Calculations are required to determine if a scheme passes these tests.
Funding and investment stress test	When assets and liabilities are stressed, the funding level must not fall by more than a specified percentage. The tolerated reduction in the funding level is smaller for more mature schemes.	
Recovery plan	No longer than six years (or three years where the valuation date is already on or after the relevant date). Measured from the valuation date. Increases to deficit repair contributions must be no greater than the CPI inflation assumption, or fixed at 3% p.a. with no back-end loading. No additional investment outperformance is permitted above the technical provisions discount rate. Post-valuation experience can be taken into account.	It should be clear whether your scheme complies or not, but affordability will determine if a compliant recovery plan is possible.
Scheme Actuary confirmation	Fast Track submissions must include confirmation from the Scheme Actuary that the valuation meets the Fast Track conditions and tests. The Scheme Actuary confirmation does not include an opinion on whether or not the regulatory requirements are being complied with, nor is it an endorsement of the suitability of the trustee's valuation submission.	The confirmation wording has been provided by TPR.





Fast Track vs Bespoke: Advantages and challenges of Fast Track



What's new...

Fast Track represents TPR's view of tolerated risk. TPR has noted that it is unlikely to engage with a scheme in respect of their valuation if it meets the conditions of Fast Track.

Advantages

TPR intervention unlikely	If the scheme meets Fast Track, regulator engagement is unlikely (but not a guarantee). This can save time and resources for trustees and employers.
Clarity	Fast Track provides clear guidelines and parameters, offering trustees direction on acceptable levels of risk. This clarity can help trustees and employers understand regulatory expectations more easily.
Efficiency	Clear parameters and guidelines make it straightforward to confirm Fast Track compliance. Fast Track acts as a regulatory filter for actuarial valuations. Meeting the Fast Track criteria means trustees can expect to provide less information in the statement of strategy, potentially reducing the administrative burden.
Consistent criteria	The Fast Track parameters are predefined and so planning and aligning the funding strategy both now, and in the future, may be simpler.

Challenges

The allure of the minimum requirements	The minimum requirements for Fast Track will not be appropriate for every scheme. For example, TPR notes that the approach might present excessive risk in situations where the employer's covenant is weak. While Fast Track parameters outline minimum requirements, certain schemes will benefit from adopting stronger assumptions that better accommodate their specific circumstances.
Loss of flexibility	Trustees of schemes who submit under Fast Track may feel constrained by the parameters in subsequent valuations and could become somewhat hesitant to tailor funding strategies to the unique needs of their scheme in the future.
Additional work required	While the statement of strategy is expected to be less onerous under Fast Track, trustees will need actuarial confirmation that Fast Track is met, including that the two tests have been passed.



While the potential time-saving and lack of TPR engagement with Fast Track may be enticing, trustees should independently evaluate their scheme's funding and investment strategy based on its specific needs and circumstances, rather than simply aiming to meet Fast Track criteria.

Charles Smith, Consultant





Fast Track vs Bespoke: Advantages and challenges of Bespoke



What's new...

Bespoke provides trustees with enhanced flexibility and a broader range of options to choose an approach tailored to the unique needs of their scheme.

Advantages

Flexibility	Trustees have the flexibility to tailor the funding and investment strategy specifically to the circumstances of their scheme. This is particularly beneficial for schemes that require a unique approach due to specific employer circumstances or wish, when supported by covenant, to take on more risk than allowed under Fast Track. There can also be additional strategic flexibility which may include the use of credit-based discount rates.
Principle-based approach	Bespoke submissions allow schemes to follow legislative requirements and the code's principles while selecting a funding strategy that best suits their needs, encouraging innovative scheme-specific solutions. This might be particularly relevant for open schemes, those with complex employer structures or those allowing for contingent assets for example.
Adaptable to employer constraints	Bespoke is suitable for schemes that cannot meet Fast Track parameters due to employer affordability constraints or other unique circumstances necessitating a different approach.
Less disruption	For schemes who already have an established funding and investment strategy, Bespoke may allow an approach that is more consistent with the previous valuation.

Challenges

Increased scrutiny	By its own admission, TPR is more likely to engage with schemes who submit a Bespoke valuation. Trustees must ensure that their funding and investment strategy meets the regulatory requirements. This may be more challenging than under Fast Track where the minimum requirements are well known.
Increased information requirement	Trustees must submit a substantially greater amount of both quantitative and qualitative information in their statement of strategy, meaning greater cost and resources for schemes.
Perception	Fast Track offers a clearer pathway with less regulatory scrutiny, which could lead trustees to favour it over Bespoke even when a scheme's unique circumstances necessitate a tailored approach. The valuation approach should not be chosen based on the perception that one is better than the other. TPR clearly states that both are equally valid.

The Bespoke approach provides trustees with the flexibility to tailor their funding and investment strategy to fit the specific circumstances of their scheme, allowing for a more customised approach than Fast Track. However, it requires careful attention to ensure that the chosen strategy adheres to the legislative requirements and has considered the principles set out in the code.





Fast Track vs Bespoke: Impact on the statement of strategy submission



What's new...

TPR has confirmed the level of detail that schemes must submit in the statement of strategy and the form it must take. They provided four statement of strategy templates which differ depending on whether a scheme is submitting under Fast Track or Bespoke, and whether the scheme is before or after its relevant date.

The statement of strategy is a new valuation document that replaces the valuation submission of the previous funding regime. It is intended to be a useful long-term planning and risk management tool for trustees. Less information is required in the statement of strategy for schemes that are submitting a Fast Track valuation.

The below table indicates the number of questions that can be expected under the four statement of strategy templates

- There are up to 18 fewer compulsory questions to answer under a Fast Track submission compared to Bespoke.
- There are significantly fewer conditional questions under Fast Track. Whether conditional questions must be answered can depend on scheme-specific circumstances (for example, whether a scheme has contingent assets, or whether it is classified as a 'small scheme' or a 'low risk' scheme).

	Fast track		Bespoke	
	Pre relevant date	Post relevant date	Pre relevant date	Post relevant date
Compulsory	84	82	102	88
Conditional	83	84	163	156
Total	167	166	265	244

When submitting a valuation under Fast Track, trustees are not required to provide the same level of detail as under a Bespoke submission. Key differences include:

- **Detailed covenant information:** There is no requirement to submit detailed evidential information if the scheme meets specific Fast Track criteria. For small or low risk schemes, ([see jargon buster](#)), requirements are reduced further.
- **Complex risk assessments:** Extensive risk assessments or analyses beyond the parameters defined by Fast Track are not included. The approach is designed to simplify requirements and eliminate the need for additional scrutiny related to risk tolerance.
- **Evidence and justification for valuation approach:** Unlike Bespoke submissions, Fast Track does not require detailed evidence or justification for the chosen valuation approach. This aligns with the goal of reducing complexity and the administrative burden on schemes opting for Fast Track.

These exclusions help streamline the submission process under Fast Track, focusing on compliance with predefined conditions rather than exhaustive documentation.

When noting what falls away under Fast Track, we must also remember that additional calculations and analysis are required to establish if a scheme's valuation complies with Fast Track, as is confirmation from the Scheme Actuary confirming the Fast Track requirements have been met.





Fast Track vs Bespoke: Valuation submission

Valuation submission checklist

TPR has introduced a 'Submit a Scheme Valuation' digital service, that valuations with an effective date on or after 22 September 2024 must be submitted through, within the 15-month valuation deadline.

Below is a list of documents and information that you will need to complete the valuation submission through this digital platform.

All Schemes

✓	The completed statement of strategy spreadsheet
✓	A copy of the actuarial valuation report
✓	The date the funding and investment strategy was completed following employer consultation
✓	The date the statement of strategy was signed by the chair of the trustees

Schemes in deficit

✓	A recovery plan
✓	A schedule of contributions

These must be included within the actuarial valuation report and submitted as one document

Schemes following the Fast Track approach

✓	Confirmation that the Scheme Actuary has provided the required scheme actuary confirmation for Fast Track
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Other requirements

✓	A summary of the trustees' analysis of maximum affordable contributions
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More likely for schemes submitting a Bespoke valuation but needed for some under Fast Track

✓	A summary of the trustees' assessment of maximum supportable risk over the reliability period
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Most non-segregated non-associated multi-employer schemes will need this



With the expanded submission requirements, trustees should be aware that the valuation submission process is now more onerous and preparation is key. Ensuring every necessary document and approval is in place before starting will help avoid delays.

Pauline McConville, Senior Consultant





XPS FIS Companion

Part Six: Key questions and challenges

Key questions and challenges

The Funding and Investment Strategy (FIS) regulations came into effect on 22 September 2024, introducing a new framework for how defined benefit pension schemes plan for the long-term. Now, more than a year after the effective date, many schemes have completed or are nearing completion of their first valuation under the new regime, while others are at various stages in the valuation process.

This period has revealed practical challenges and raised key questions as trustees and employers work to interpret and implement the requirements of the regulations, The Pensions Regulator's (TPR's) funding code, and further direction provided through TPR's detailed covenant guidance and its annual funding statement 2025.

Parts one to five of the FIS Companion were designed to guide trustees and employers through their first valuation under the new funding regime in a structured and practical way, highlighting key considerations for both parties. As a reminder:

- Your scheme **must set a long-term strategy**, agreed between the trustees and employer, that targets a state of low dependency on the employer within a certain timeframe. This was explored in **Part 1 - Setting a long-term strategy**.
- Set out in law for the first time, **formal consideration of the employer covenant** is now a requirement. There are new covenant concepts to consider and measure, as discussed in **Part 2 - The covenant assessment**.
- You are required to **agree a low dependency investment allocation (LDIA)** and target investing in it within a certain timeframe. This was explored in **Part 3 - Scheme investments under the new regime**.
- By significant maturity, your scheme's **technical provisions (funding) basis** must be at least as strong as the low dependency basis. More risk can be taken by less mature schemes and those with stronger covenants. This was explored in **Part 4 - The funding valuation and journey plan**.
- Many schemes will want to **assess their valuation against the Fast Track parameters**. We explored the conditions that must be met and the pros and cons of both a Fast Track and Bespoke valuation submission in **Part 5 - Fast Track versus Bespoke**.

Since the new regulations became effective, we have engaged in debate and discussions - including with TPR - on a wide range of topics where queries have arisen.

Part 6 of your FIS Companion consolidates responses to the most common queries we've seen on covenant, low dependency funding and investment strategies, and the valuation process to help trustees and employers apply the regulations and guidance effectively.

In the following pages, we first address the key questions that have emerged under each part of the FIS Companion, sharing our responses informed by practical experience and insight. We then turn to scheme-specific scenarios, examining the main challenges and concerns these situations present.





Key questions and challenges: Setting a long-term strategy

In Part 1 of your FIS Companion, we explained that schemes must set a long-term strategy that targets low dependency on the employer within a certain timeframe. Whilst the regulations formalised the requirement to have a long-term objective, many schemes will already have had a formal or informal one in place. The obligation to achieve low dependency within a specific timeframe however, and the additional documentation required, introduced a fresh challenge for most schemes.

Question	Response
I've had a long-term objective in place for several years; do I need to do anything different this valuation?	Yes. Under the new regulations, your funding and investment strategy must explicitly include achieving low dependency by the relevant date which must be on or before significant maturity. This requirement is probably not reflected in your existing long-term objective, so it will need to be reviewed and updated accordingly. There are also extensive additional reporting requirements.
How do I determine my scheme's long-term objective?	The ultimate goal is to provide members with their benefits in full, so a scheme's long-term objective should ensure this is achieved. Key considerations when setting this objective should include the scheme's maturity, funding position and employer support. TPR guidance on options for DB pension schemes published in June 2025 explicitly states that trustees must consider the full breath of options for their scheme's long-term objective including insurance, superfunds/condolidators and run-on.
How much flexibility I have in setting a long-term objective?	The regulations and code do not constrain schemes to a prescribed long-term objective, so trustees and employers have a lot of flexibility! The long-term objective also can and should be reviewed periodically and updated when necessary.
The employer is hesitant to formalise buyout as the long-term objective, (perhaps for corporate accounting reasons). Can trustees overrule this?	The funding and investment strategy, which includes the long-term objective, must be agreed with the employer. It is understandable that employers may be hesitant to commit to buyout in writing, for many reasons. Trustees and employers, with guidance from their advisors, can frame the long-term objective in a way that reflects the trustees' intentions while avoiding any premature commitments that the employer is uncomfortable with. Employers can add comments to the statement of strategy if they wish to.
Does having buyout as the long-term objective mean the scheme must be fully funded on buyout by the relevant date?	No - you can have buyout as the long-term objective without committing to being fully funded on buyout by the relevant date. The trustee and employer can agree on a low dependency target to achieve by the relevant date and then plan to bridge the gap to buyout later, for example through investment outperformance.
What is the difference between the long-term objective and the low dependency requirement?	The long-term objective defines how the scheme intends to provide benefits over the long term, such as running on and paying benefits from the scheme or securing benefits with an insurer or superfund. The low dependency requirement, on the other hand, is a regulatory minimum funding target with a specified timeframe. Low dependency is not an approach to providing benefits but rather a baseline that must be met.
What is the difference between 'technical provisions' and 'low dependency'?	Technical provisions are set assuming that the scheme will continue to run with employer support. Any technical provisions deficit must be addressed through a recovery plan. In contrast, a low dependency funding basis uses actuarial assumptions aimed at ensuring that no further employer contributions are expected if the scheme is fully funded and its assets are invested according to a low dependency investment allocation, targeting minimal reliance on the employer. There is also the requirement for technical provisions to be consistent with low dependency basis from the relevant date onwards so they will converge in the long run.





Key questions and challenges: Covenant

In Part 2 of your FIS Companion, we discussed the requirement for trustees to formally assess employer covenant and explored what the regulatory requirements and guidance from TPR might mean in practice for schemes.

Question	Response
Do we need to undertake a formal covenant assessment?	Yes. While there is no legal obligation to appoint an external covenant adviser, trustees are legally required to assess the employer covenant. If considering an internal assessment, a trustee board need to take a clear cold look at its ability to review the covenant and be objective. For added assurance, you may ask an external covenant expert to review an internal covenant assessment.
I have a well-funded scheme. How does this impact my covenant assessment?	TPR expects trustees to be proportionate when assessing employer covenant. Where schemes are well-funded and have less reliance on the employer, the expectation is that a lighter-touch assessment would be more appropriate than if the scheme was poorly-funded with a greater reliance on the employer.
Are contingent assets useful?	Contingent assets, if enforceable and accessible, can strengthen scheme security in addition to that provided from the employer, provide an extra layer of security for members, and may be essential to support the overall funding and investment strategy. They may help schemes with large shortfalls relatively to employer size or allow trustees to take slightly more risk where appropriate. Trustees and employers should consider their use during valuations, and review any existing contingent assets to establish what support they can provide under the new regulations.
Can trustees place any reliance on Pension Protection Fund standard guarantees?	PPF standard guarantees have historically been quite common but under the new funding regime, such guarantees may not be as valuable as they once might have been. Non-look-through guarantees (such as a PPF standard guarantee) triggered only by insolvency or missed contributions cannot easily support investment risk in the journey plan because assessments of affordable contributions rely on statutory employer cashflows. However, they can still help. For example, supporting the assessment of the longevity period based on that of the guarantor and the reliability period towards the higher end of the range for the employer.
Can my scheme run an investment strategy that is not supported by the covenant?	TPR recognises that some schemes may not be able to fully demonstrate that the level of risk taken is 'supportable' over the reliability period. Trustees may take investment risk not supported by the covenant if it benefits members, but should seek to maximise covenant support by: • Restricting value outflows (e.g. dividends) • Preventing detriment from corporate events (e.g. employer debt financing) • Improving scheme's security • Providing contingent assets or wider group support Trustees must justify decisions as being in members' best interests.
Do covenant considerations differ for alternative business models, such as those in regulated industries or not-for-profit organisations.	Yes. TPR allows some flexibility in how trustees assess affordability and supportable risk. For example, in regulated industries it may be appropriate to consider the employer's maximum debt capacity. Trustees must justify their approach, demonstrate compliance with the code and covenant guidance and will likely need professional advice when assessing supportable risk for unique business models. TPR guidance is based on an average business model, therefore external covenant assessment can be particularly important here.





Key questions and challenges: Investment - the LDIA

In Part 3 of your FIS Companion, we focused on the low dependency investment allocation (LDIA) and how adherence to regulatory requirements can be achieved alongside adopting an LDIA appropriate for your scheme.

Question	Response
What is the purpose of an LDIA?	The LDIA is a notional investment strategy to be targeted by the relevant date designed to ensure that the value of a scheme's assets relative to its liabilities remains stable and resilient against short-term adverse market conditions, reducing the likelihood of requiring further employer contributions. The LDIA is expected to be biased towards liquid assets that match the scheme's liabilities albeit some allocation to growth assets or illiquid assets can be acceptable.
How do we determine if our assets are 'highly resilient'?	The expectation is that a 'highly resilient' LDIA must withstand unexpected, short-term market shocks without compromising the ability for trustees to make payments to members. Trustees have the flexibility to determine how to consider the resilience of their scheme's LDIA. TPR has suggested a '1-in-6' stress test followed by a six-year 'bounce-back' period for the funding level to recover. Details of how this works in practice can be found in Part 3 of your FIS Companion.
Have there been any challenges with the high-resilience test?	Low-risk strategies may fail bounce-back tests when they lack sufficient return to restore full funding in time. Adopting higher-risk strategies to pass resilience tests goes against the spirit of the regulations if it's not in the scheme's best interests. Counter intuitively, surpluses cannot be considered in high-resilience tests, which assume funding is at 100% before the stress is applied. Trustees, with advisor support, should explore appropriate methods for testing resilience based on their scheme's circumstances.
When testing high resilience, do we need to use the bounce-back test set out in TPR's code	The resilience test set out in the funding code is just an example. Trustees must demonstrate high resilience using a sensible test for their scheme, with clear decision making. Advisors should apply judgment and are not be bound to a specific test.
The LDIA (and current investment strategy) are 'notional'. What does this actually mean?	Notional means a theoretical or anticipated allocation of a scheme's assets at the relevant date. The current investment strategy and the LDIA are used to derive a scheme's technical provisions and low dependency discount rates. While the actual investment allocations may differ, it is expected that trustees will aim to align the real investments closely with the notional strategies to effectively manage risks and meet long-term objectives.
When could schemes deviate from their notional investment strategy?	Trustees may deviate from the notional LDIA if they believe it is in members' interests to do so. Circumstances could include: • Taking advantage of favourable market conditions or avoid being a forced buyer/seller, providing doing so doesn't compromise funding member benefits; or • The scheme reaches surplus under a low dependency funding basis. This could allow Trustees to adopt a different asset allocation which further reduces the need for employer contributions in the future whilst still meeting the scheme's long-term objective.
What is a 'material surplus' where deviating from the LDIA is acceptable?	This has not been quantified, but larger surpluses can be stipulated as a reason to justify greater deviation from the LDIA into riskier assets.





Key questions and challenges: Valuation requirements

In Part 4 of your FIS Companion, we explored how the valuation process has evolved and introduced journey planning under the new funding regulations.

Question	Response
Is a scheme-specific demographic analysis required as part of the valuation process?	While not mandatory, trustees are expected to give serious consideration to scheme-specific demographic analysis, and TPR anticipates many schemes will undertake one. Without an evidence-based best estimate for mortality, it is difficult to gauge prudence in assumptions or confirm compliance with the low dependency test. TPR stresses that the assumption for mortality is particularly likely to be a material source of uncertainty for smaller schemes - for those schemes a scheme specific analysis provides a means of quantifying the prudence in their chosen assumption. Exceptions may apply where schemes are fully bought-in or have negligible demographic risk (e.g., cash-only schemes), where such analysis may add little value.
Is a journey plan required?	Many schemes will need both an investment and a funding journey plan, while some may require only one or none. Schemes that are already significantly mature or have set their relevant date to the valuation date, should already be assumed to be invested in their LDIA and adopting technical provisions at least as strong as low dependency, so a journey plan may not be necessary. However, even these schemes may choose to have a plan to stay on track toward their long-term objective or may need one in future should they fall into deficit on low dependency.
Do we still require a recovery plan?	A recovery plan is required if your scheme remains in deficit on a technical provisions basis. Schemes in surplus do not need one.
Do we need to include an allowance for expenses in the low dependency liabilities?	Legislation does not explicitly mandate an expense reserve. However, TPR interprets low dependency as including an expense reserve in its guidance. Trustees can consider an expense reserve and decide not to include one if they believe it is appropriate and justifiable for their scheme, but this may invite significant challenge from TPR. For schemes where there is a requirement under the rules for the employer to pay expenses, TPR nonetheless encourages trustees to consider an expense reserve.
We plan to buy out prior to significant maturity, so surely, we don't need to include an allowance for expenses?	In this case, the projected expenses are expected to be incurred before the relevant date, so technically they fall outside TPR's guidance. However, trustees and employers may still wish to include a reserve. Given the short timeframe, expenses can be estimated more accurately, reducing the risk of overfunding. To mitigate this risk further, TPR suggests options such as setting up a separate account for expenses.
What happens if on its first effective date, a scheme is already at significant maturity and there is a deficit on the low dependency funding basis? Is there a transitional period for running off that deficit?	Schemes that are already past their relevant date must adopt a technical provisions basis that is at least as strong as the low dependency basis. Any deficit on this basis should be recovered as soon as the employer can reasonably afford. While these schemes may not be able to achieve full funding on a low dependency basis immediately - as they ought to be given they are beyond significant maturity - TPR expects the deficit to be eliminated in short order. Covenant, investment, and actuarial advice will be essential to determine what is affordable and to develop a practical, workable recovery plan. It may be worth noting that TPR has new enforcement powers linked to the funding and investment strategy, but these are powers on amending strategy not funding.





Key questions and challenges: Valuation requirements

In Part 5 of your FIS Companion, we explored the conditions of a ‘Fast track’ valuation submission and how this might compare to Bespoke. We also considered the statement of strategy.

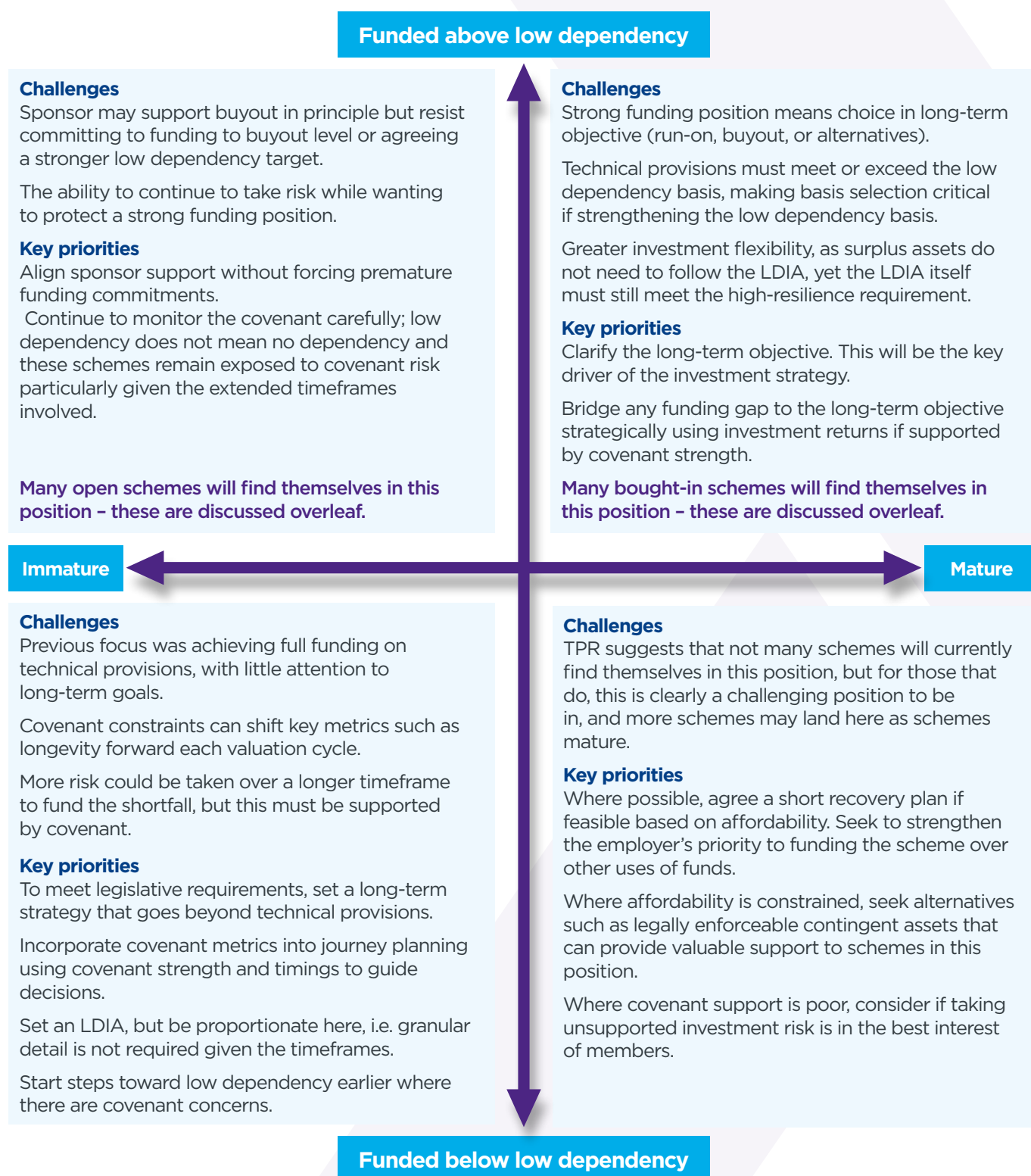
Question	Response
What does the scheme actuary need to confirm for a Fast Track submission?	The scheme actuary must confirm that the Fast Track guidance is being followed for all aspects where there is a clear requirement beyond the principles in the funding code. This means confirming that the scheme meets all Fast Track parameters and that assumptions for the low dependency funding basis, along with other items specified in TPR’s actuarial confirmation wording, are satisfied.
Is the scheme actuary required to confirm compliance with legislation or the funding code principles?	No. The scheme actuary is not being asked to confirm whether Fast Track is appropriate or whether legislation and principles in the code are complied with. They are confirming matters of fact, not matters of judgment and it is the trustees that ultimately must be satisfied that the valuation is compliant.
What are the additional documentation requirements for a Bespoke valuation?	There is no additional specific documentation, but trustees and employers should expect to provide more detail, both quantitative and qualitative, in the statement of strategy. However, for schemes that meet the criteria of a ‘small scheme’ or ‘low risk scheme’ the level of detail required is reduced, even under a Bespoke valuation submission.
What factors should I consider when deciding between a Fast Track or Bespoke valuation approach?	Many trustees will not commit to either Fast Track or Bespoke at the outset of the valuation. Instead, they will concentrate on agreeing a funding and investment strategy suited to their scheme, without reference to either approach. Only later, typically towards the end will they assess whether Fast Track requirements are met or could be achieved with minor adjustments. However, for some trustees, the appeal of reduced complexity and lower TPR engagement makes Fast Track an attractive goal from the start. Conversely, many trustees will conclude early on that Bespoke is the only option, either because Fast Track is unattainable or because the greater flexibility aligns more closely with their scheme’s needs.
I want to set the relevant date equal to the valuation to have a less onerous statement of strategy. At the next or subsequent valuations would it be problematic to change this?	It is possible to change the relevant date at future valuations and make it later than it was previously. This includes moving it away from being set at the valuation date, to a later date, as long as the new relevant date is no later than the end of the scheme year in which the scheme is expected to reach significant maturity.
Once I’ve received all the valuation advice and made decisions, is the statement of strategy easy to complete?	Not necessarily, The level of detail required depends, among other things, on whether the valuation is Fast Track or Bespoke, and whether the scheme is before or after its relevant date. Even with all the advice and decisions to hand, the statement of strategy can still involve significant effort and coordination, particularly the first time round given this is a new document for the trustees and employer to agree. It will be vital to understand who takes ownership of the collation, completion and submission of the statement of strategy. This may be secretarial support, or a lead advisor such as the scheme actuary who will have provided much of the advice needed throughout the valuation process.
Has the deadline to complete the valuation changed?	No. Schemes must still complete their valuation within 15-months of the valuation date, including all the additional steps under the new requirements.



Key questions and challenges

Scheme-specific circumstances

Trustees and employers often struggle to know where to start with the new legislation and funding code. If this is you, a practical first step might be to understand your scheme's position in terms of funding and maturity.





Key questions and challenges Scheme-specific circumstances

Trustees of open schemes (in particular those that are open to new entrants as well as future accrual of benefits) and fully bought-in schemes, often question the relevance of the new regulations. However, compliance is still required.

Open schemes

Question	Response
Why is there frustration with adhering to the regulations for some open schemes?	Because these schemes - some government-backed or with very strong employers - are required to comply even though they are likely to continue indefinitely with the same investment strategy and overall approach. The perceived upshot of compliance can be increased liabilities and higher accrual costs without any practical benefit for the scheme.
Can the relevant date be beyond covenant longevity for these schemes?	Provided longevity is not defined by a specific covenant event and you expect to extend it at the next valuation, then you don't have to plan to be fully de-risked to low dependency by longevity. In these cases, the relevant date may extend beyond longevity. However, extending this period by more than three years (a valuation cycle) could be problematic because you must demonstrate that risk run post longevity is appropriate - this may be difficult.
What difficulties arise from the code's approach to discount rates?	Using a gilts plus approach for the low dependency discount rate can conflict with technical provisions discount rates derived differently, e.g., inflation plus, which is common on open schemes. This can lead to volatility and results that don't make sense under changing market conditions. TPR's guidance notes alternative approaches (asset led or inflation plus for example) that trustees can adopt for low dependency as long as they can evidence legislative compliance.

Bought-in schemes

Question	Response
Do schemes with a buy-in still need to comply?	Yes, the regulations must still be followed. The good news is that compliance is generally more straightforward because these schemes should be "low-risk," reducing the number of questions to answer in the statement of strategy. If submitted under Fast Track, reporting requirements may be further reduced.
How can having a buy-in simplify the scheme's liability valuation?	The scheme actuary may advise trustees to set technical provisions and low dependency bases equal to a buyout basis. This means only one valuation is needed instead of three separate ones, reducing workload.
Can a scheme qualify as Fast Track low-risk if GMP equalisation is incomplete?	Yes, provided the scheme has fully bought-in benefits with an insurer, holds sufficient reserves for GMP equalisation, and meets all other Fast Track requirements.
A question in the statement of strategy asks if the scheme is fully bought-in. Should the answer reflect the status at the valuation date or the submission date?	When completing the statement of strategy, the question regarding whether the scheme is fully bought-in should be answered as at the effective date of the valuation.

We will continue to discuss our experiences of completing valuations under the new funding regime with clients, internally, and with TPR. These conversations shape and challenge thinking, and we'll share valuable insights as they emerge.





Conclusion

As trustees and employers work through their first valuations under the latest DB Funding Code, one thing has become clear: the new Funding and Investment Strategy requirements are a big shift in how DB schemes are expected to plan for the long term. The XPS FIS Companion set out to provide practical guidance, broken into manageable parts, to help you navigate the new regime step by step.

Our guide explored the core elements that now sit at the heart of every scheme's journey. We started with **setting a long-term strategy**, which is no longer just a “nice to have”, but instead a regulatory obligation requiring early and meaningful collaboration between trustees and employers. **Covenant assessment**, now formalised in law, brings a new level of rigour to evaluating the employer's ability to support the scheme, both now and over time. With the introduction of **low dependency investment allocations**, schemes must adopt a forward-looking investment mindset that places resilience at its core. We walked through how the **funding valuation and journey plan** require trustees to align technical provisions and low dependency assumptions alongside investment intentions and covenant metrics. We also explored the two approaches a valuation can be completed under; **Fast Track and Bespoke**. Both are valid, but each comes with different flexibilities, requirements and levels of scrutiny, especially when it comes to the new Statement of Strategy, which must be submitted to the Pensions Regulator. Finally, we looked at the real-world **questions and challenges** arising as schemes complete their first valuations, offering practical insight into how the regulations work in practice and how schemes are managing these.

The new regime places collaboration at the heart of the valuation process. Successful outcomes will come from trustees and employers working together, supported by aligned actuarial, investment, and covenant advice. Early preparation, good governance processes, setting realistic timelines and the clear articulation of objectives, both short-term and long-term, are central to a successful valuation process. Schemes that engage proactively will not only meet the regulatory requirements, but also shape strategies that are robust, well-evidenced and genuinely aligned with their members' best interests.

Your first cycle through the new regime will naturally feel like the steepest part of the learning curve. However, subsequent valuations will become more straightforward as you are more familiar with all the elements and concepts.

Our hope is that your FIS Companion has made the process clearer, more manageable and more intuitive. And as the regulatory landscape continues to evolve, we'll continue to support trustees and employers every step along the way.



We trust that our six-part 'FIS Companion' series has helped trustee boards and employers navigate their first valuations under the new regime in a logical, practical way and that it remains a go-to resource for tackling these requirements.

Pauline McConville, Senior Consultant



Appendix



Jargon buster

The table provides definitions of some of the technical terms found in the funding and investment strategy (FIS) regulations and The Pensions Regulator's (TPR's) funding code and other accompanying guidance. The definitions below are not regulatory definitions or industry standards in all cases, but more an attempt to provide lay explanations for these terms. The terms defined in this document all refer to the new FIS requirements and may have slightly different definitions in other circumstances.

Term	Definition
Bespoke	TPR proposes a twin track approach to assessing valuations – bespoke and Fast Track. The bespoke approach provides trustees with the flexibility to agree a funding and investment strategy tailored to the unique characteristics and needs of their specific scheme.
Covenant longevity	Timeframe whereby the trustees can be reasonably certain that the employer will be able to continue to support the scheme.
Covenant reliability	Timeframe whereby trustees can be reasonably certain that they can rely on an assessment of the employer's cash flows and prospects.
Duration	The weighted mean time until all pensions and other benefits have been paid out under a scheme, with the weighting based on the discounted value of those payments.
Employer covenant	The financial ability of the employer to support the scheme and the expected level of support for the scheme from any legally enforceable contingent assets that would be expected to provide support when needed.
Fast Track	TPR proposes a twin track approach to assessing valuations – bespoke and Fast Track. Fast Track is a regulatory filter for TPR's assessment of actuarial valuations. If a valuation submission meets the parameters, TPR is unlikely to scrutinise it further and is less likely to engage with trustees. Schemes that meet Fast Track can also expect to provide less information in the statement of strategy. TPR will review the Fast Track parameters every three years.
Funding and investment strategy	A plan determined and periodically reviewed by the trustees or managers of a pension scheme, specifying how they intend to ensure that pensions and other benefits under the scheme can be provided over the long term, including targeted funding levels and investment allocations.
Funding journey plan	For schemes that have not yet reached the relevant date, the plan for how trustees intend the scheme to reach its low dependency funding target from the current funding position. Trustees should plan for how the scheme will reach a position of being at least 100% funded on a low dependency funding basis on and after the relevant date. Forms part of the overall funding and investment strategy.
Long-term objective	The way in which it is agreed that pensions and other benefits under the scheme are to be provided over the long term. Forms part of the overall funding and investment strategy.



Low dependency funding basis	A basis such that, once fully funded on this basis and invested in the low dependency investment allocation, no further employer contributions are expected to be required under most reasonably foreseeable circumstances. This is the low dependency funding test.
Low dependency funding target	The funding level the scheme is intended to achieve on a low dependency funding basis at the relevant date. Forms part of the overall funding and investment strategy.
Low dependency investment allocation (LDIA)	A notional investment strategy where the value of the assets relative to the liabilities is highly resilient to short-term adverse changes in market conditions with sufficient liquidity to meet cash flow requirements. Forms part of the overall funding and investment strategy.
Low dependency test	See 'Low dependency funding basis.'
Maximum affordable contributions	Defined as the employer's cash flows after reasonable adjustments have been made for alternative uses of cash and deficit reduction contributions (DRCs) payable to the scheme and other DB schemes sponsored by the employer. To the extent the employer has agreed to pay DRCs from its liquid assets, these amounts should also be included.
Reasonable affordability	Deficits must be recovered as soon as the employer can reasonably afford. Reasonable affordability should be assessed by reference to an employer's available cash, comprising cash flows and liquid, or readily recoverable, balance sheet assets.
Relevant date	No later than the scheme year end in which significant maturity is reached, or the actuarial valuation date if already significantly mature.
Scheme stress event	Example stress events would be a significant economic downturn that negatively impacts the scheme's funding level, or corporate restructures that would have an impact on the strength of the employer covenant.
Significant maturity	The duration at which schemes reach significant maturity is ten years for schemes without cash balance benefits and eight years for those with only cash balance benefits. Mixed schemes should use a weighted average. The duration must be calculated on a scheme's low dependency funding basis, except with economic assumptions as at 31 March 2023 market conditions.
Smaller schemes	Defined to be schemes with 200 members or fewer.
Statement of strategy	A formal submission made by trustees to TPR as part of the valuation process within the usual 15-month deadline for submission of an actuarial valuation. It will include detail on all elements of the agreed funding and investment strategy including the long-term objective, how the trustees intend to reach low dependency by significant maturity, and assumptions in the low dependency funding basis. Other matters that must be commented on include the key covenant, investment, and funding risks inherent in the strategy, and associated mitigations.
Supportable risk	The maximum affordable contributions over the reliability period that would be available to fund a deterioration in the deficit and any contingent assets which would be available to the scheme in a scheme stress event.



About us

XPS Group is a leading UK consulting and administration business specialising in the pensions and insurance sectors. A FTSE 250 company, XPS combines expertise and insight with advanced technology and analytics to address the needs of over 1,300 pension schemes and their sponsoring employers on an ongoing and project basis. We undertake pensions administration for c. 1.2 million members and provide advisory services to schemes and corporate sponsors in respect of schemes of all sizes, including 83 with assets over £1bn. We also provide wider ranging support to insurance companies in the life and bulk annuities sector.

During 2024, our bulk annuity team completed 30 transactions and insured more than 20,000 members' benefits.

Find out more

To discuss any of the issues covered the FIS Companion series, please get in touch with **Pauline McConville**, **Heidi Webster** or **George Sullivan**. Alternatively, please speak to your usual XPS contact.

 Pauline McConville Senior Consultant e pauline.mcconville@xpsgroup.com	 Heidi Webster Senior Consultant e heidi.webster@xpsgroup.com	 George Sullivan Senior Consultant e george.sullivan@xpsgroup.com	 xpsgroup
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