

TPR's final draft funding code released ahead of new regime coming into effect

What you need to know

- The Pensions Regulator's (TPR's) final draft defined benefit funding code of practice (the code) was laid before Parliament on 29 July 2024. The code is TPR's interpretation of how trustees can comply with the legislative requirements set out in the funding and investment strategy (FIS) regulations that will apply to all valuations with effective dates on or after 22 September 2024.
- Although the code itself is not legally binding, the FIS regulations delegate certain matters to TPR such as the duration used to define significant maturity. Codes of practice are taken into account when determining whether legal requirements have been met, including by TPR when considering how to use its powers for non-compliance.
- TPR has also responded to its Fast Track consultation and released the parameters which will apply from September.
- In due course, we expect TPR to publish its response to the consultation on the form and content of the statement of strategy, more information on its twin track regulatory approach and a consultation on updated covenant guidance. In addition, further guidance may follow as TPR reviews its existing DB funding and investment-related guidance.

Actions you can take

- **Understand the new legislation and code** and how these may impact your scheme. Identify when you will first need to comply and determine your duration and the likely timeframes for achieving low dependency.
- **Consider any potential impact on your investment strategy** – trustees and sponsors will need to agree a notional low dependency investment allocation and journey plan.
- **Review the process followed for your previous valuation** to identify gaps that need to be filled in order to comply with the new regime.
- **Plan now for how you will assess your employer covenant** in line with the new requirements.
- **Look out for further guidance** still to come, including detailed covenant guidance and requirements for schemes when submitting their statement of strategy to TPR.

The horizon for your new funding and investment strategy

29 July 2024

Final draft code laid before parliament

22 September 2024

New regulations come into force

TPR's code finalised

Delays due to the general election will leave a time gap between the regulations coming into force and the code being finalised, however this final draft code can be relied upon in the interim

Further guidance expected on:

- Statement of strategy
- TPR's twin track approach and regulatory filters
- Covenant
- Investment matters

New pension schemes bill

Expected in the first year of the new Parliament

The finer detail: Key developments

All schemes are now required to have a long term funding and investment strategy. Central to this is the requirement to be fully funded on a low dependency basis when significantly mature, with an objective to invest in a low dependency asset allocation.

	Legislative requirements	TPR's guidance from the funding code	Minimum requirements for Fast Track
Low dependency funding basis	Further employer contributions would not be expected to be required when fully funded and invested in the low dependency investment allocation.	Assumptions not prescribed but guidance given , including for expenses. Trustees not expected to carry out detailed modelling of probabilities.	Discount rate of gilts plus no more than 0.5% pa. Some other minimum requirements are set out while others remain scheme-specific.
Low dependency investment allocation	Value of assets relative to liabilities is highly resilient to short-term adverse changes in market conditions with sufficient liquidity to meet cash flow requirements.	Clarity provided that this target allocation is notional and does not compromise trustees' existing investment duties (and powers). TPR expects a minimum hedging target of 90% and resilience testing to be carried out. Liquid assets which exhibit low volatility are one of the ways to meet cash flows .	Fast Track does not define an investment strategy that must be followed. However, TPR has disclosed the notional investment strategy it has used to determine the parameters.
Duration, significant maturity and relevant date	Maturity measured by duration calculated using 31 March 2023 market conditions on the low dependency basis. The relevant date for targeting at least 100% funding on the low dependency basis is no later than the scheme year end in which significant maturity is reached, or the actuarial valuation date if already significantly mature.	Duration for significant maturity is 10 years for schemes with no cash balance benefits and 8 years for schemes with only cash balance benefits. Duration must be calculated by the Scheme Actuary for the purpose of assessing significant maturity, and details are given on the possible calculation methodologies.	Duration must be calculated based on economic assumptions at 31 March 2023 as if that were the valuation date . Duration for significant maturity is 10 years for all schemes (i.e. including cash balance only).
Technical provisions	Technical provisions to be calculated in a consistent way with trustees' funding and investment strategy.	Assumptions should be consistent with the planned evolution of the notional investment allocation , and the same or stronger than the low dependency funding basis after the relevant date.	Technical provisions to be an increasing percentage of the low dependency liabilities, varying by duration. 83.5% at 20 year duration and 100% at significant maturity (i.e. 10 year duration).
Investment risk and journey plan	Schemes must plan progress towards the funding and investment strategy as the scheme moves towards its relevant date. Risk should be dependent on strength of covenant with the level of dependency potentially reducing as a scheme gets closer to its relevant date.	Interconnected journey plans for funding and the notional investment allocation. Split over two separate time periods ; the reliability period, when employer cashflows can be predicted with reasonable certainty, and the post reliability period when they cannot. Risk taken should reduce as the relevant date approaches and risk analysis can be proportionate, for example less detail required when employer is very large relative to the scheme.	Risk is assessed using a stress test of the funding level using the 2024/25 PPF stress test (roughly a one year 1-in-6 VaR stress test) with some simplifications. The tolerated reduction in funding level (and hence risk) is smaller for more mature schemes.

The finer detail: Key developments

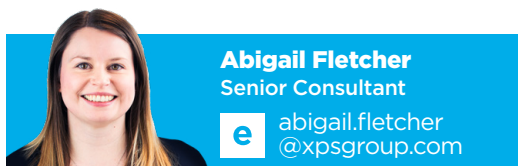
	Legislative requirements	TPR's guidance from the funding code	Minimum requirements for Fast Track
Open schemes	No legislative carve out for schemes open to new entrants or with ongoing accrual, so the same requirements to set a low dependency target still apply.	Open schemes can allow for accrual and new entrants but the period over which future accrual is allowed for must be supported by the covenant. This results in a longer time before open schemes can be expected to reach significant maturity than for comparable closed schemes, and hence lower technical provisions .	The allowance for future accrual and new entrants cannot exceed nine years and should not exceed the average level of new entrants over the preceding three years.
Recovery plans	Overriding principle that deficits should be recovered as soon as the employer can reasonably afford . Trustees should consider the impact on the sustainable growth of the employer.	Trustees should assess future reasonable affordability at least on a year by year basis . Further detailed guidance on matters to consider is also provided.	Six years or less if the valuation date is before the relevant date, or three years or less if after . Some other restrictions apply, but post valuation experience can be taken into account.
Covenant	Must be assessed relative to the funding position on the low dependency and solvency bases . Explicitly sets out several items to consider, including expected future cashflows, development and resilience.	Assessed at least at each valuation, with depth and frequency thereafter to be proportionate . Guidance provided in the code, but more to follow from TPR in due course .	Although Fast Track does not explicitly take account of covenant strength, covenant assessment is still required for schemes going down this route to satisfy the requirements of the code and the FIS regulations.

More detail on Fast Track approach

- **Fast Track is not a benchmark** but acts as 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 estimates, at 31 March 2023, that **62% of schemes** meet all the parameters of Fast Track and a further 19% "could change their funding approach at no extra cost" and meet all the parameters.
- **Scheme actuaries will be expected to certify** that valuations meet the Fast Track parameters.
- Some proportionate measures have been mentioned for smaller schemes, which TPR sets as **200 members or less**, for this purpose.

Find out more

For further information, please get in touch with **Abigail Fletcher** or **Pauline McConville** or speak to your usual XPS Group contact.



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