New DB funding (& covenant & investment!) regime

Preparing for the new requirements and key actions for sponsors

August 2024

The Pensions Regulator's new funding code has (finally!) been laid before parliament and we now know the vast majority of the details of the new funding regime, which is set to be the biggest shake up in DB pension scheme valuation discussions for almost 20 years. We share here the actions that sponsoring employers can, and should, be getting on with if they haven't already.

Highlights of the new funding regime

- The new regime will apply to all funding valuations with an effective date on or after **22 September 2024**.
- The final regulations set out the legal framework and the new Code covers TPR's interpretation and guidance. Our News Alert summarises Key Actions and the new funding regime.
- Sponsors will need to engage with trustees to **develop a formal "funding and investment strategy"** – that is, a formal journey plan, which generally requires sponsor agreement, that targets **full funding on a low-risk basis** by the time the scheme is "significantly mature". This is defined as when a scheme reaches an actuarial "duration" of 10 years.
- **This is the first time a formal funding and investment strategy has been required. Sponsors should be proactive to ensure the strategy aligns with their own broader objectives, rather than waiting for trustees to anchor at prudent positions on both investment and funding.**
- The **implications of long-term strategies** need to be carefully considered, for example the potential accounting implications of a formal target to buy-out if that is the preferred target.
- The level of supportable risk depends on employer covenant strength. **Covenant analysis is more important than ever before and you should consider being proactive in presenting the strengths of your covenant to the trustees.** Covenant reliability and longevity factors may constrain scheme journey plans – so are central to the new regime.
- **Deficits must be repaired "as soon as the employer can reasonably afford"**, taking account of the sustainable growth of the employer. Sponsors may wish to proactively put forward views on key areas such as free cash flows, covenant reliability and longevity periods to best position the employer covenant.
- There are **two routes for TPR to assess valuations – Fast Track or Bespoke**. Fast Track is a regulatory filter, under which if the scheme passes various tests (eg relating to the technical provisions, or recovery plan length), it can expect limited scrutiny. Bespoke is an equally valid route but the scheme must justify its approach. Bespoke may be particularly attractive where there is a desire to minimise assets above the low dependency level to avoid trapped surplus. You can read our summary of the Fast Track requirements here.

Actions for sponsors

Assess how best to align funding and investment strategy with broader corporate objectives

Proactively outline objectives and covenant with Trustees ahead of valuation

Implement optimal strategy aligned with objectives and preferred end-game destination

An example valuation under the new funding regime, and actions for sponsoring employers

ACTION: Consider how best to position covenant with the trustees, and whether you need to engage a covenant advisor to help with this

ACTION: Understand new Code requirements and how best to balance this with the needs of the business

Prep / Pre valuation

- Revisit pensions objectives
- Consider long-term strategy
- Initial covenant analysis

Trustee actions

Analysis

- Updated covenant analysis, including reliability and longevity periods

Actuarial advice

- Stress tests
- Assumptions advice
- Initial results (including significant maturity, technical provisions, LDFB, Recovery Plan)
- Proposal to sponsor

Formal documents

- Statement of strategy
- Statement of funding principles
- Schedule of contributions
- Recovery plan
- Actuary to certify Fast Track (if relevant)

Ongoing

- Risk monitoring and management

Six months before valuation date

Trustee / sponsor discussions

High level principles of:

- Long-Term Objective (LTO)
- Low Dependency Investment Allocation (LDIA)
- Low Dependency Funding Basis (LDFB)

ACTION: Input into journey plan and long-term strategy, be proactive where possible. Consider potential wider impact of LTO, eg on accounting

ACTION: Input into LDIA to ensure it is in line with sponsor preferences

VALUATION DATE

Trustee / sponsor to agree valuation (iterations may be required)

- Agree Relevant Date / LTO / LDIA / LDFB
- Agree TPs, Recovery Plan, contingency plans
- Agree whether to meet Fast Track tests or adopt Bespoke approach

ACTION: Ensure valuation outcome reflects needs of the business, adopting a Bespoke approach to do so if needed

Submit valuation to TPR

Statutory deadline – 15 months after valuation date

Want to find out more?

If there's anything further you'd like to ask, please get in touch with your usual client contact, or one of our experts.

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