New DB funding (& covenant & investment!) regime

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Preparing for the new requirements and key actions for trustees

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. Following improved funding levels over recent years, the impact of the new regime for many schemes will be less significant than anticipated when the code was first drafted. However, there are still actions that all schemes can, and should, be getting on with, especially those with valuation dates later in 2024.

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.
- All schemes will need to **develop a formal "funding and investment strategy"** – that is, a formal journey plan that targets de-risking and **full funding on a low-risk basis**. In most cases this requires agreement between Trustees and sponsor.
- This low-risk state must be achieved **by the time a scheme is "significantly mature"**. This is defined as when a scheme reaches an actuarial "duration" of 10 years. For 10% of our clients this is within 6 years, but for 40% it is over 15 years away. Ask your consultant what your timeframe is. Open schemes can include some allowance for future accrual and new members in the maturity calculation.
- Trustees will need to agree a "low dependency investment allocation" with the employer. This is a low-risk strategy assumed to apply from significant maturity. The new Code clarifies that the new regime does not constrain trustees' investment powers.
- The level of supportable risk depends on employer covenant strength. **Covenant analysis is more important than ever before**, with even well-funded schemes expected to submit covenant information to TPR. Some schemes will need covenant advice for the first time, and many will need to expand current advice. 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.
- There are **two routes for TPR to assess valuations – Fast Track or Bespoke**. Fast Track is a regulatory filter, under which if you pass various tests (eg relating to your technical provisions, or recovery plan length), you can expect limited scrutiny. Bespoke is an equally valid route but you must justify your approach. You can read our summary of the Fast Track requirements here.
- There will be **more paperwork** for trustees and for advisers, including a range of new submissions by all schemes to TPR in the Statement of Strategy relating to their long-term objective, journey planning, investment strategy and covenant.

Actions for Trustees

Understand implications of new regime ahead of your next valuation

Establish formal funding and investment strategy consistent with new regime and your objectives

Determine additional steps and advice needed on covenant and new investment topics

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

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ACTION: Consider whether you need to engage a covenant advisor for the first time or expand current advice

ACTION: Valuation this year? Book in training on the new regime

ACTION: Analyse impact of Code, and extra reporting requirements.
Come to view on whether scheme should fall in Fast Track filter, and so minimise TPR scrutiny.
If likely to take Bespoke route, consider potential impact of contingent assets

Prep / Pre valuation

- Training
- Consider long-term strategy
- Initial covenant analysis

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)

VALUATION DATE

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

- Agree Relevant Date / LTO / LDIA / LDFB
- Agree technical provisions, recovery plan, contingency plans
- Agree whether to meet Fast Track tests or adopt Bespoke approach

Submit valuation to TPR

Statutory deadline – 15 months after valuation date

ACTION: Review journey plan and long-term strategy

ACTION: If not already considered, engage investment advisor early on LDIA (so this doesn't delay funding advice)

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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