The Pension Regulator's Defined Benefit Funding Code

Consultation Response

Prepared by: Broadstone.

March 2023

Contents

Executive Summary

We are pleased to submit our consultation response to the Draft Defined Benefit Funding Code and also attach our responses to the Fast Track consultation.

We are broadly supportive of the Code’s overall objectives although we have significant concerns with the length, level of detail and prescriptive nature. This increases complexity in valuation work beyond levels we’ve previously seen and appears disproportionate in places for the benefit (or difference in outcomes) it will bring to many of the schemes that we work with.

We can understand the Regulator and government’s desire to reduce the risk in defined benefit schemes following high profile failures, and the work done over recent years has improved the position of many schemes. Unfortunately, the Code as drafted (noting this is driven by the new draft regulations, which we also hope to see amended in places) risks overwriting much of the pragmatic and proportionate work of many good quality trustee boards.

The industry shares the Regulator’s desire for members to have high levels of benefit security and for key risks to be identified, understood and managed. We (and our fellow advisers) are willing and able to undertake more detailed analysis and modelling but doing so professionally and robustly, in a way that generates genuine insight, is likely to involve material additional cost. In our experience, most trustees and sponsors are already having informal discussions around end-game planning and setting funding approaches that move in the direction previously signposted by the Regulator. For a lot of these schemes, compliance with the new Code as currently drafted will mean a significant additional governance and cost burden, with potentially limited meaningful benefit.

Our key concern is for small schemes (i.e., less than 100 members) and other schemes with under £30m of assets who lie outside this cut off. Consideration of these schemes act as the underpin for the majority of our responses. For these cases even a ‘well-run’ scheme will generally, and understandably, have practical restrictions on overall advisory fees. They will therefore not take some of the more detailed ‘nice to have’ advice and analysis that they might otherwise have sought as they focus on proportionate governance that adds value. We are concerned that some of the new requirements would not pass this test – for example, firm quantification of covenant metrics for a very strong employer where affordability is not constraining the valuation decisions.

We fear that insisting on such measures will squeeze budgets in other areas that would otherwise offer greater insight/value for the scheme and its members, such as data work to assist buyout readiness and/or Pensions Dashboards compliance and more meaningful work on Own Risk Assessments and risk management. Given the low level of risk for some of these cases, more flexibility should be available - ideally through a less prescriptive Code or, if this is felt too risky, through explicit flexibilities for smaller schemes (and we would strongly encourage a wider definition than just the 100 members – perhaps a secondary option based on asset size).

We have not seen reference to improvements to the Trustee Toolkit and we believe a clear strategy to help Trustees understand the technicalities of the work they will be required to do is integral to the success of the Code. We question your suggested time commitment of 8 hours to get up to speed with all of the new requirements and based on our own experiences of trying to get to grips with the new proposals, suggest that for most trustees (particularly lay trustees) at least double this is likely to be necessary if you expect them to have any more than a passing understanding.

In terms of specific recommendations, our main suggestions for improving the Code are:

- **Avoid unnecessary duplication**. For example, parts of the Statement of Strategy would appear to directly overlap with SFP, SIP, valuation submissions, Schedule of Contributions and Recovery Plans. If these documents are all to remain then please allow for them to simply be appended or referred to within the Statement, rather than demanding repetition.
- **Genuinely embrace proportionality.** Whilst the word itself appears liberally in the new code, in general we believe proportionate application of the principles is needed in places, rather than requiring lots of details that you suggest can potentially be looked at proportionately. This may seem a minor distinction but determining and defending a precise number (particularly when there is uncertainty and/or subjective elements around this) is much more time consuming (and costly) than offering a broader statement.
- **Do not require unnecessary or spurious precision**. For an immature scheme several valuation cycles from significant maturity, much will change and even the best laid plans would need to adapt. Setting these out in any detail (and negotiating with the employer on them) where material re-writes are likely before they come into effect would seem unnecessary.

  Similarly, there will always be practical limitations for a small scheme, particularly where liabilities are concentrated in a few key individuals, in terms of statistically reliable experience and the availability or suitability of cash flow matching solutions.
- **Do not reduce covenant to a handful of numbers.** In many cases the precise answers to your new covenant metrics will not be imposing a restriction on the funding strategy and should not be the key focus of covenant assessment. If specific numbers are required to be included in a submission then they will generate fees and, particularly where material subjectivity is involved, costly arguments between trustees and employers but with no benefit.

  Whilst you refer to visibility, reliability and longevity periods, as long as the covenant is strong enough to support the level of risk being run then that should be sufficient. For example, trustees should be able to offer confirmation that 'our level of investment risk would need a reliability period greater than 3 years and we are confident we could justify at least 5.' Such statements will be quicker and easier for an independent adviser to confirm, thereby encouraging trustees to take independent covenant advice and opening the door for them to focus on key (scheme specific) issues rather than a handful of potentially unused (and unreviewed) figures.
- **Be practical.** We have proposed removing your maximum risk formula (or reducing it to a sense check for stronger employers / well-funded schemes) as we see significant issues in its application to schemes with recovery periods. We also are keen to better understand how 'lower for longer' risk strategies or cash in escrow could practically be applied under the new regime to ease volatility from valuation to valuation.
- **Acknowledge concerns regarding overfunding.** Whilst largely driven by the new regulations, the draft Code would appear to lead to expected overfunding in many scenarios. Requiring additional prudence may imply better short-term security and a faster path to buyout but this will have an impact on employers and, given they are unlikely to get money back, potentially hinder their longer-term prospects.

Contingent assets may not provide a cost-effective solution at the smaller end of the market and aspects such as the expense loading and variability in cashflow due to member experience are more pronounced for a smaller scheme.

In addition, if a reasonable degree of investment risk is still to (genuinely) be encouraged in maturity (as suggested by your modelling) then it is essential for you to clarify in writing that 'as soon as the employer can reasonably afford' does NOT mean immediately. To our mind, three years should generally be acceptable unless there are concerns about the employer's ability to support this time horizon.

- **Make the code shorter and clearer.** Take steps to reduce the length of the code and make it easier for a trustee to find key aspects (and skip parts that are not relevant to them). For example, we consider you could significantly shorten Chapter 2 and removing repetition (such as paragraphs 107-109).

  More careful use of the phrase 'funding and investment strategy' would also be helpful. At times this appears to refer to generic strategic considerations, at times to the treatment within technical provisions, and at times to the specific content of Part 1 of the Statement of Strategy.

- **Ensure consistency with the regulations**. We are aware from discussions within the industry that there appear to be some areas of mismatch between the Code and the regulations (both of which are still subject to change) and are concerned that this could create issues in the future. We would expect the Code or regulations to be amended to ensure there is consistency and would generally favour the more flexible, high-level principle approach to be adopted.

Finally, we recognise that there are limitations in our ability to comment in places given we do not have sight of key related information including final regulations, the covenant guidance or your sample Statement of Strategy. It is hard to confirm the code is practicable, adequate or appropriate without seeing these elements and to the extent that there are changes in the final regulations this could require significant changes to the draft Code. We apologise if we have misinterpreted any of your intentions in the absence of this additional detail.

We would welcome the opportunity to discuss further iterations of the Code with you, how it might be shortened, or to provide further clarity around any aspects of our response.

David Hamilton
Chief Actuary
T: +44 (0) 20 3869 6849
E: david.hamilton@broadstone.co.uk

The funding regime

Code chapter 2: An outline of the funding regime

1. Are there any areas of the summary you disagree with or would like more/less detail? If yes, what areas and why?	We do not believe that the summary 'acts as a short summary' given it runs to 43 paragraphs and 4½ pages. We would prefer it to be a more concise overview with each topic covered in a consistent high-level manner signposting the relevant section and could therefore be shortened considerably. For example you could reduce paragraph 26 (detail, covered later), remove paragraph 30 by simply adding 'with sufficient liquidity to enable the scheme to meet expected cash flow' to paragraph 27, and remove the bracketed section from paragraph 29 (with 31 providing the relevant link). Similarly you could remove 36 if you added '(and must be at least 100%)' to the end of 35, and paragraphs 44-49 could be cut down significantly (to one paragraph under the previous subheading). Paragraph 41-43 would benefit from a link to Chapter 8. It would also be helpful for the Code to have a contents page and for the summary to follow that logical subject order. We also believe that undefined specific terms and acronyms should be avoided in the summary where possible (or include links to their explanation). In para 39, we believe 'must ensure …. dependent on the strength of the employer covenant' could better phrased to reflect it being more of an upper bound on risk taking. For example, a lighter touch assessment may well be appropriate where covenant is clearly very strong relative to the scheme. In para 43, we believe it would be clearer if the requirement to employer agreement for Part 1 is noted in the same place. We believe the valuations section should be better worded to reflect the normal triennial cycle

	and that schemes with less than 100 members do not require actuarial reports. Given the references to covenant and recovery plans in the regulations, and significant sections within the draft code, we believe high level coverage in the summary is appropriate. Finally, while recognising that Fast Track sits outside of the Code, making no reference at all to the new twin track regulatory approach to valuation compliance (and your related guidance) seems a surprising omission.

Long term planning

Code chapter 3: Low dependency investment allocation

Broadly matched – Matching assets		
2.	**Do you agree with the principles for defining a matching asset that i) the income and capital payments are stable and predictable; and ii) they provide either fixed cash flows or cash flows linked to inflationary indices? If not, why not and what do you think is a more appropriate definition?**	We agree with the principles. It is also worth emphasising the third component, which is that the timing of the expected payments should correspond broadly with a portion of the expected liability profile (that is targeted for matching purposes).
Broadly matched – Broadly matched		
3.	**Do you agree with our approach for defining broad cash flow matching? If not, why not and what would you prefer?**	The term "broadly" is not defined, and this could be problematic from a legal perspective. For an overall asset strategy to be categorised as broadly matching an interest rate duration tolerance (relative to the liabilities being matched) could be provided, for example +- 20%.
4.	**Do you think draft adequately describes the process of assessing cashflow matching? What else would be appropriate to include in the code on this aspect?**	Yes - noting the additional comments above.
5.	**Should the code set out a list of the categories of investments into which assets can be grouped for the purposes of the funding and investment strategy? If so, what would you suggest as being appropriate?**	The asset allocation breakdown used in the Scheme Return could provide a starting template that gives a simple and consistent starting point. However, schemes should have flexibility to describe alternative/more complex strategies if they have these in place, rather than being constrained by a standard listing that may not adequately cover their approach (this will also help in future proofing the code if new investment solutions emerge).
6.	**Do you agree that 90% is a reasonable benchmark for the sensitivity of the assets to the interest rate and inflation risk of the liabilities?**	This looks like a sensible benchmark. One area that should be clarified is whether the target (90%) is relative to the size of the assets or the size of the liabilities. In practice, schemes often frame their hedging policies on one or other of these measures.
7.	**Should we, and how would we, make this approach to broad cash**	A small scheme is likely to experience greater fluctuations in their expected cash flow profile

	flow matching more proportionate to different scheme circumstances (e.g., large vs small)?	from valuation to valuation and this could potentially be more sensitive to assumptions used. They will also be likely to have less sophisticated investment strategies. It is important to recognise this when considering how quickly and frequently they should be expected to practically rebalance their portfolio.
Setting a maximum stress		
8.	**Do you agree with our approach that a stress test is the most reasonable way to assess high resilience?**	Agreed. However, we note the challenges for smaller schemes between low-cost tick box compliance (potentially just using the PPF stress test) and a more meaningful scheme-specific assessment incorporating non-investment aspects (which is likely to be more expensive and could potentially result in a conclusion that they could afford less risk, depending on the model used and their liability profile).
9.	**Do you agree that setting the limit of a 4.5% maximum stress based on a one year 1-in-6 approach is reasonable? If not, why not and what would you suggest as an alternative?**	This looks reasonable. We suspect that many schemes may look to implement a much smaller stress in maturity if the employer is required to immediately address any shortfall at the valuation date.
10.	**Do you agree that we should not set specifications for the stress test but leave this to trustees to justify their approach? If not, what would you suggest as an alternative?**	Strongly agreed.
Liquidity and proportionality		
11.	**Do you agree with our approach for not expecting a detailed assessment of liquidity for the low dependency investment allocation (LDIA) since we have set out detailed expectations in relation to schemes' actual asset portfolios?**	Strongly agreed.

Code chapter 4: Low dependency funding basis

12. Do you agree with our approach for not expecting a stochastic analysis for each assumption to demonstrate that further employer contributions would not be expected to be required for accrued rights, but rather focussing on them being chosen prudently? If not, what would you suggest as an alternative?	We strongly agree that stochastic analysis for assumption setting is not necessary – it would clearly not be proportionate for smaller schemes. Many of our clients have small (indeed some very small) schemes and we are keen that there is an appropriate balance between the benefits of detailed actuarial modelling and cost. We believe it is appropriate to recognise that these schemes will not have statistically credible experience data and even an 'evidence-based approach' to assumption setting is challenging. We are keen to understand, at a practical level, what the Regulator would expect for such schemes. The implied extra prudence for a very small scheme to be confident of requiring no further contributions from the employer in most circumstances is likely to be prohibitive and forcing such a funding level would be expected to lead to large surpluses in many scenarios.
Discount rate	
13. Do you agree that the two approaches we have set out for the discount rate for the low dependency discount rate (LDFB) are the main ones most schemes will adopt? Should we expand or amend these descriptions, if so, how?	The descriptions are sufficient for the purpose of the code. It should be clarified that actuarial advice is required.
14. Should we provide guidance for any other methodologies?	N/A
Expenses	
15. Do you agree with the guidance and principles set out in Appendix 3 and 4? Are there any specific assumptions here you would prefer a different approach? If so, which ones, why and how would you prefer we approached it?	The wording within Appendix 3 appears surprisingly inconsistent at times and excessive in places. We would suggest that most if not all the demographic assumptions could be covered by a single set of principles, such as you have suggested for 'Other assumptions': "Where statistically credible analysis of recent experience is available, and the expectation is that the past remains a good guide to future

	experience then a scheme specific assumption based on this experience can be used. Otherwise, we would expect a prudent assumption, based on standard tables where appropriate, and would generally expect this to be at least as strong as that used for a Section 179 valuation. Different groups of members may require different assumptions. At the moment, there is subtly different wording for a number of these assumptions. For example, mortality and cash commutation do not refer to 'statistically relevant' but presumably this would still be important, and the proportions married entry refers to 'reliable AND statistically credible' evidence. A single set of principles would be an easy way to both shorten the code and eliminate such discrepancies. We disagree with the principle that 'additional' prudence is required where a standard table is used. The standard table itself may already be felt to be prudent based on recent (but perhaps not statistically credible) evidence. We also disagree with the comment that the assumed commutation factor should be no lower than the current one. Given your example within this very box, of a scheme where factors reflect the actuarial valuation of pension commuted, and the encouragement to use full yield curves, it would appear there is clear potential for factors to move down as well as up. For Appendix 4, we support the inclusion of an expense allowance but are unclear what the Regulator is expecting here as there seems room for materially different interpretation. We note that under the proposals immature schemes could potentially have a significant period after covenant reliability and before the relevant date where they have no provision for expenses. In contrast, a scheme beyond relevant date has to allow for all expenses, even if a strong employer is willing and able to support them (and they have visibility over this). We are conscious that the expense figure is going to be new to many, subjective and proportionately

	higher for smaller schemes (NB we deliberately refer to smaller here as we think this goes beyond the 100 member 'small schemes' limit). We would not want to see schemes discouraged from pursuing appropriate levels of governance due to the impact this had on long term expense allowances (for example, if annual fees were estimated based on recent experience) and wonder whether schemes not yet at their relevant date might sensibly be allowed to use (a suitable multiple, e.g. 120%, of) the PPF S179 expense allowance rather than deriving and updating a bespoke figure. (Or perhaps this is appropriate for those more than 3 years from their relevant date?) In any case, the wording should be tidied so that both boxes refer similarly to a 'requirement under the rules for the employer to pay expenses'. We find it odd that there is reference here to the potential for overfunding and yet this potential is inherent throughout the proposals (through prudent funding assumptions and assumed de-risking that might regularly be pushed back) and not just for a subset of schemes in relation to future expenses.

Code chapter 5: Relevant data and significant maturity

Setting the point of significant maturity	
16. Do you agree that a simplified approach to calculating duration for small schemes is appropriate?	Duration is a simple measure to calculate, and we would recommend 'current' duration measures are based on conventional calculation methodologies. For projected duration, we suggest allowing all schemes with more than two valuation cycles expected until significant maturity (currently duration 14+) to use the 'fast track proxy' (Appendix 4 of that consultation) for their maturity date rather than requiring scheme specific estimates. Such schemes might reasonably expect to have less precise investment plans and there would appear to be limited risk in permitting a lighter touch approach.
Possible alternative approaches	
17. Do you think setting an earlier point for significant maturity within Fast Track as compared to the code (as described in option 3 in this section of the consultation document) would be helpful for managing the volatility risk of using duration? If yes, where would you set it and why?	No. We think you should focus on the other solutions around revising the duration-based trigger (as suggested) to reduce volatility in the significant maturity date. Greater clarity around the funding implications/expectations for a scheme which finds their maturity date has suddenly reduced would be useful (e.g. a small scheme that pays out a large transfer).

Code chapter 6: Assessing the strength of the employer covenant

18. Do you agree with the definitions for visibility, reliability, and longevity? If not, what would you suggest as an alternative?	We believe covenant advisers are better placed to respond to these questions, but we have heard several covenant advisers express concerns about the viability of the 'reliability' number, particularly given a hugely subjective number has a very material impact on a relatively precise formula (a change from 5 years to 6 years is very significant in percentage terms). In contrast, the definitions for visibility and longevity do not seem to have a huge impact. **Overall, our key message is that schemes should NOT be required to quantify these figures where they are not providing a limitation on their funding or investment strategy.** The current high level covenant assessment ratings are already a frequent source of contention with employers and there will be little or no value in arguing over some of these (seemingly more precise) numbers. Identifying levels that would support the funding strategy and confirming that the relevant measures are (perhaps comfortably) greater than this should be seen as sufficient for the statement of strategy. This will avoid unnecessary costs and could encourage more use of professional covenant advice as the work involved in providing such confirmation would be much lower. Engagement with a professional covenant adviser has the potential to identify issues that may otherwise have been missed, allowing suitable discussions and contingency plans to then be put in place, which would further the Regulator's objectives in a much more sympathetic manner.
19. Do you agree with the approach we have set out for assessing the sponsors cash flow? If not, what would you suggest as an alternative?	Covenant advisors will be better placed to respond.
20. Do you agree with the approach we have set out for assessing the sponsors prospects? If not, what	Covenant advisors will be better placed to respond.

would you suggest as an alternative?	
21. Do you agree with the principles we have set out for contingent assets, i.e. that i) it is legally enforceable and ii) it will be sufficient to provide that level of support? If not, what would you suggest as an alternative?	We agree this should form the basis for recognising value within the funding regime although we would note that a non-enforceable guarantee, if honoured, will still provide value for a scheme. In general, we welcome simple rules in this area as we are keen that no additional barriers are put in place for smaller schemes who have often found the costs of setting up contingent assets are prohibitive.
22. Do you agree with the approach we have set out for valuing security arrangements? If not, what would you suggest as an alternative?	We would appreciate greater clarity as to the extent that such arrangements (particularly cash in escrow) might be included within a scheme's assets for funding purposes and therefore reduce/remove the need for deficit contributions in some circumstances (e.g. where it has arisen due to a (potentially temporary) drop in equity values).
23. Do you agree with the approach we have set out for valuing guarantees? If not, what would you suggest as an alternative?	Covenant advisors will be better placed to respond.
24. Do you agree with the approach we have set out for multi-employer schemes? If not, what would you suggest as an alternative?	Covenant advisors will be better placed to respond.
25. Do you agree with the approach we have set out for not-for-profit covenant assessments? If not, what would you suggest as an alternative?	There does not seem to be any recognition that some not-for-profit organisations hold significant reserves. Is this to be ignored when deciding on affordable cash flow levels and acceptable levels of risk? Or are trustees to expect deficits to be met rapidly out of these funds?

Code chapter 7: Journey planning

Applying this approach	
26. Do you agree with how we approached how maturity has been factored into the code? If not, what would you suggest as an alternative in particular with reference to the draft regulations?	A large number of schemes would be at (or very close to) maturity if the duration measure of 12 is used. Whilst we hope this might be recalibrated, we note that large elements of the code would become irrelevant and investment flexibility would be lost for these schemes. We are currently unclear as to how quickly such schemes would be expected to move into line with the new Code or the consequences of failing (or being unable) to do so.
Journey plan – period of covenant reliability	
27. Do you agree with the way in which we have split the journey plan between the period of covenant reliability and after the period of covenant reliability? If not, what would you suggest as an alternative?	Whilst we agree this seems sensible as a broad concept for an immature scheme, we note that for many this may already extend beyond or close to their relevant date. We worry about spurious accuracy / precision in the use of this 'reliability period end date' given it appears to be a highly subjective figure and almost certain to move materially at each valuation (the period itself might remain relatively stable but as a result the end point would move forward almost three years each time). This would appear to lead to systemic overfunding over and above prudence built into funding assumptions.
For the period of covenant reliability:	
28. Do you agree that trustees should, as a minimum, look at a one year 1-in-6 stress test and assess this against the sponsors ability to support that risk?	We agree that a 1-in-6 stress test seems a sensible benchmark and agree that schemes should be given freedom to measure risk in a scheme-specific and proportionate manner, although we note that you may therefore get materially different results depending on the method, model and parameters used. We have fundamental concerns regarding the subsequent formulaic approach (see below).
29. Do you agree that if trustees are relying on the employer to make future payments to the scheme to mitigate these risks, then the trustees should assess the employer's available cash after deducting DRCs to the scheme	We see the logic of this suggestion but note that this would mean there is zero affordable contribution for the duration of the recovery plan (or the longest recovery plan for a DB scheme that the employer sponsors).

	and other DB schemes the employer sponsors?	
30.	**Do you agree that this approach is reasonable for assessing the maximum risk that trustees should take during the period of covenant reliability?**	No. We agree this would be a sensible way for a strong employer to demonstrate that they can clearly afford the investment risk being taken but have concerns that the formula is flawed and will fail in many cases. In particular, it is overengineered and heavily dependent on (and hugely sensitive to) a highly subjective number, namely the reliability period. It cannot be used in a practical way to specify appropriate investment risk on an annual basis as part of a long-term plan. Given the exemptions under 351-355 of the code for schemes that cannot pass this test, together with the impractical implications of actively trying to apply it to restrict risk, we propose that paragraphs 192 – 199 are simply removed. The earlier paragraphs cover the necessary principles. Alternatively, you could retain (just) 197 from this section if the initial wording became 'This could be achieved by the Trustees satisfying themselves of compliance with the following formula:' Removing these paragraphs should help to address concerns expressed by covenant advisers about the prominence placed on the reliability period and likelihood of (unproductive and expensive) arguments between sponsors and trustees and their respective advisers regarding the value placed on this number. To explain our concerns in more detail... Firstly, given the maximum affordable contribution is likely to fluctuate, it would seem more sensible to re-express the formula as: Stress test < Max affordable contributions over reliability period or other tangible support Indeed, we would expect many to approach your formula in this way. However, as noted, any scheme with a recovery plan equal to or longer than their reliability period and no contingent assets would then fail the

	proposed test as they would have no further affordability and investment risk will inevitably be non-zero. And for a scheme that might have a recovery period of four or five years (where no additional contributions would presumably be affordable), the subjective decision between a reliability period of potentially five, six or seven years will have a huge impact on the right-hand side of the equation. Extending this, the position one year on (if all has progressed as expected and we can now justify a further year of reliability) would allow for materially higher risk. Therefore, anyone applying this formula to cap risk would be forced to massively de-risk, then allowed to progressively re-risk each year, re-designing their de-risking profile and re-writing their statement of strategy each time, before maturity constraints start to apply. This is clearly impractical (certainly for most smaller schemes) and so some will probably ignore it. Others (trying to comply with the code) will be forced into lower risk strategies than necessary in the short term and/or to waste large amounts of time and money with no obvious benefit.
Journey plan – period after covenant reliability	
31. Do you agree with the considerations we have set out regarding de-risking after the period of covenant reliability?	In general, yes, but we believe that any 'lower for longer' type strategies that result in lower overall levels of risk than your approach must be welcomed. We worry how these are assessed at later stages / future valuations as they would appear to potentially be in breach of the code at that point. (If reliability periods do not simply extend and the line has crossed your original 'linear' diagonal.) Forced additional de-risking and resultant additional funding at that point would clearly make a mockery of the long-term planning.
32. Do you agree with our approach of not being prescriptive regarding the journey plan shape?	Agreed.

33. Do you agree with our approach that the maximum risk trustees should assume in their journey plan is a linear de-risking approach where they are taking the maximum risk for the period of covenant reliability?	In theory yes, but please see our concerns about how 'lower for longer' strategies would be assessed at future valuations (question 31). We would also emphasise that requiring any detailed analysis or planning of this de-risking journey would be disproportionate for most schemes given the end of the reliability period is likely to move at each valuation, materially altering the de-risking period.

Code chapter 8: Statement of strategy

Format of the Statement of strategy	
34. Do you agree with our explanation of the statement of strategy and are there areas it would be helpful for us to expand on in this section?	There appears to be a huge amount of information required within the Statement of Strategy and examples of a detailed (best practice) version and an acceptable proportionate light touch version would be very helpful in understanding your expectations. Our understanding is that the 'Funding and Investment Strategy' is a subsection (part 1) of the 'Statement of Strategy' although at times it is unclear whether aspects appear in part 1, part 2 or both. Indeed, the use of the phrase 'funding and investment strategy' through the code appears inconsistent and confusing at times. In some cases you appear to be talking about trustees' funding strategy and investment strategy more generally and how it should be allowed for within the valuation (e.g. ahead of paragraph 18, distinct from the subheading ahead of 41), rather than the contents of the FIS document itself. We suggest that where the content of the Statement of Strategy is mentioned, the wording could be clarified by consistently referring to either Part 1 or Part 2 of the Statement of Strategy (e.g. para 238 (which perhaps, based on para 41, is meant to be in part 2 and so be moved to the subsequent section), 239, 249). This will help reduce confusion and any implication the FIS and SoS are independent documents. As you have noted, there is a large amount of likely overlap between the required contents of the Statement of Strategy and other documents, notably the Statement of Investment Principles, Statement of Funding Principles, Schedule of Contributions, actuary's valuation submission and ESOG. We strongly urge you to allow the SoS to simply refer to those documents (and for them to be appended to a submission as needed) rather than requiring trustees to repeatedly transpose information, which is costly and inefficient and would offer no value. As noted elsewhere in this submission, the information required should be proportionate and not require calculation of precise numbers (e.g. on

	reliability periods, available cashflow) where these are not constraining the strategy. Two final very detailed points: Paragraph 237 states that trustees **must** explain how they will be fully funded by their relevant date, but we know there will be cases where this is not possible (recovery plan runs beyond that date). Also, we think the subheading above 239 could be removed and the wording above the bullets could simply say 'Trustees must record:'.

Applying this in practice

Code chapter 9: Technical provisions

Setting the assumptions for TPs	
35. Do you agree with how we have described the consistency of the TPs with the funding and investment strategy? If not, why not and what would you suggest as an alternative?	Yes, although we continue to have issue with the wording (which we understand is taken from the draft regs) that the approach should <u>depend</u> on covenant and maturity. To our mind, the approach may be restricted by (should not be riskier than can be justified by) the covenant and maturity but as you know, many schemes will already be taking a more prudent approach. In a similar vein, paragraph 264 of the code should end '...more prudent TPs' rather than specifying what might be construed as the only way in which more prudent TPs could be set up.
Open Schemes	
36. Do you agree that open schemes could make an allowance for future accrual – thereby funding at a lower level – without undermining the principle that security should be consistent with that of a closed scheme?	No response.
37. Do you agree that this should normally be restricted to the period of covenant reliability? If not, why not and what you suggest as an alternative?	No response.
38. Do you agree with our principled based approach to future service costs? If not, why not and what you suggest as an alternative?	No response.

Code chapter 10: Recovery plans

Reasonable affordability	
39. Do agree with our approach to defining Reasonable Alternative Uses? If not, why not and what you suggest as an alternative?	We believe that covenant advisers will be better placed to offer expert insight in this area. However, we did wonder where 'retaining cash for the purposes of bolstering company reserves might feed into the new approach.
40. Do you agree with the description in the draft Code of the interaction between the principle that funding deficits must be recovered as soon as the employer can reasonably afford and the matters that must be taken into account in regulation 8(2) of the Occupational Pension Schemes (Scheme Funding) Regulations 2005?	We will leave this question to lawyers. However, we believe that some messaging or reassurance regarding 'as soon as' would be helpful. We have heard comment that TPR does not consider this to mean 'immediately' but can see no recognition in the code that, for example for a scheme with a strong sponsor and good visibility, this could reasonably mean three years.
41. Do you agree that reliability of employer's available cash should be factored in when determining a scheme's recovery plan length?	Whilst it would seem reasonable that this is a consideration, it is unclear to us how this will feed in given the huge emphasis about deficits being met 'as soon as the employer can reasonably afford'. We also note the earlier concerns regarding defining a reliability period. Where schemes cannot afford a shorter recovery period, the reliability (or not) of later payments would appear to become largely irrelevant.
42. Do you agree with the principles we set out when considering alternative uses of cash? If not, which ones do you not agree with and why? What other principles or examples would it be helpful for us to include?	Again, covenant advisers will be better placed to comment on this but as noted previously we would appreciate clarity regarding treatment of companies looking to increase their cash reserves.
Post-valuation experience	
43. Do you agree with our approach to post valuation experience? If not, why not and what you suggest as an alternative?	We strongly agree that the flexibility to allow for post valuation experience in considering a funding plan should be retained. The statutory 15-month statutory period for valuation completion does mean that significant and fundamental changes in financial market conditions and covenant could have occurred post the effective date, which should be considered for agreeing a robust long-term funding plan.

	We agree with the bulleted list of factors to take into account in paragraph 291. However, we are a little unclear about assessing changes over the 'bulk of the period'. We assume this is for practical reasons to allow figures to be fixed for the final negotiation and signoff process but note that there is some potential for abuse (potentially any date that is up to six months old if signing off at the statutory deadline?). Greater clarity – perhaps an 'expectation' that this would be no more than six weeks old at point of signoff (for example) might be preferable. We note that Fast Track specifies use of the 'can be expected' schedule of contributions certification in such cases but there is no such reference in the draft Code.
Investment outperformance	
44. Do you agree with our approach to investment outperformance? If not, why not and what you suggest as an alternative?	Yes, this generally seems reasonable.
45. Should we set out more specifics around what we would expect by way of security to protect against the additional risks?	No. Unless you have specific concerns about certain approaches, then flexibility to design appropriate solutions seems more desirable.

Code chapter 11: Investment and risk management considerations

Implementing the investment strategy	
46. Do you agree with our approach that, while trustees' discretion over investment matters is not limited by the funding and investment strategy, we expect investment decisions by trustees should generally be consistent with the strategies set out in the funding and investment strategy? If not, why not and what you suggest as an alternative?	Agreed.
47. Do you agree with the examples we have given for when trustees investment strategies may not mirror their FIS? Are there other examples we should consider?	Agreed.
Employer stress scenarios	
48. Do you agree with the expectations regarding trustees with stressed employers? If not, why not and what you suggest as an alternative?	This is a difficult area, and, on balance, we agree with the expected actions in the two stress scenarios. However, we think it would be more useful if they were separated out into two distinct subheadings ('Employer stress' covering para 327-330) and ('Unable to comply' covering 331-335). Flexibility to deal with short-term covenant deterioration is helpful (indeed necessary), although clearly judgments in this area are difficult. We note that trustees may choose to preserve an existing investment strategy contingent on the employer providing additional support. The recognition that some schemes are unable to comply with the funding regime and taking unsupported investment risk in such circumstances may lead to better member (and employer) outcomes is also helpful. However, it would appear unfair for schemes barely able to comply being forced into low-risk strategies, yet those who believe they 'cannot comply' being allowed to take unsupported risk.

	While understanding that TPs should include no allowance for unsupported investment returns, we assume that appropriate investment outperformance could be considered for a recovery plan in terms of understanding the likely progression of funding.
Integrated Risk Management	
49. Do you agree with the principles we have set out regarding risk management? Are there other aspects it would be helpful for us to include?	These seem reasonable and we appreciate the emphasis that a proportionate approach to these, as set out in para 340 is important. Comments regarding content of the Statement of Strategy (such as the second half of para 346) should be included in that section rather than here.
Security, quality, liquidity and profitability	
50. Do you agree with the principles we have set out regarding liquidity? If not, why not and what you suggest as an alternative?	Agreed.
51. Do you agree with how we have approached security, profitability and quality? If not, why not and what you suggest as an alternative?	Agreed.
52. Are there other aspects it would be helpful for us to include?	Liquidity can be measured in terms of transaction costs (for investments that are realisable and not entirely illiquid). Expected friction costs when redeeming an investment can also be used a measure of liquidity.
Systemic risk considerations	
53. Do you agree with the above considerations? If not, please explain.	Herding will happen. The introduction of the new code is unlikely to generate more growth investment and there may be a short-term implementation impact (perhaps spread over three years) as the potentially significant number of schemes at or close to their relevant date are strongly encouraged to de-risk. Given the pressure for employers to immediately fund any valuation deficit (after maturity), it seems unlikely that many will be willing to run the maximum level of risk suggested, even if they are strong enough to support it. And whilst the code may allow flexibility for investment in other assets with inflation linked cash flows, the vast majority of

	smaller schemes will look for simple, liquid solutions with low trading costs and so seem likely to look first to index linked gilts in this regard.
54. Do you think there are any areas of systemic risk that should be considered further in in light of our draft code? If yes, please explain.	It is not clear whether you have managed to yet model the revised market scenario or realistically considered the likely outcomes. We think that the risk of overfunding is largely overlooked/dismissed and making it clear how potential solutions (such as escrow accounts) could realistically be used (in an affordable way for smaller schemes) would be helpful rather than employers being forced to pump in additional funding to the scheme that would appear to essentially just fast track the path to buyout.

Fast Track: response to consultation on regulatory approach

The consultation discusses the Regulator's proposal to keep Fast Track separate from the code. Set of parameters outside of the legislation to measure valuation submissions, which retain the flexibility to be reviewed and amended as required.

1.	**Do you agree with how we have positioned Fast Track relative to the code of practice?**	Yes, we believe it is much better that it is independent of the code of practice and clearly just a filtering mechanism for TPR rather than being funding requirements. We remain concerned that it could become a standard especially when positioned as a negotiating point and a light touch approach to (appropriate) bespoke solutions is critical if TPR does not want Fast Track to become a new standard or default.
2.	**Are there any aspects of this you think it would be useful for us to clarify further?**	Our understanding is that some schemes may follow fast track but could, in theory, not be compliant with the funding regulations (e.g., schemes with very weak sponsors should potentially be taking less risk). It is therefore important to note that trustees should be driven by code (and legislation), and not just assume that ‘meeting fast track is good enough’. TPR should be clear when greater scrutiny will be undertaken.
3.	**Do you agree that Fast Track should come with a lower level of burden in terms of the explanations required as part of the trustees' valuation submission?**	Only trivially so. A Fast Track submission would presumably just be the valuation documents accompanied by the actuary’s confirmation that fast track parameters are met. A bespoke submission should not require large amounts of additional work as standard – consistent with your commitment that extra work should be proportionate and your acknowledgement that a large

		proportion of these cases will not merit further engagement. The bespoke submission process must be flexible enough to allow schemes to make bespoke and proportionate explanation– for example, those that are 'close' to fast track or need to clarify only one aspect of their funding strategy should be able to offer a brief explanation purely of that element (or direct you to the explanation within their Statement of Strategy). We do not think that bespoke schemes should be required to make any comparison to fast track.
4.	**Do you see any unintended consequences from requiring the scheme actuary to confirm when a submission meets the Fast Track parameters?**	As long as the process is simple then no. The more complicated the certification process becomes, the more work/cost involved. If overly onerous then schemes could decide not to commission the certification, even if they are comfortable that conditions are going to be met. Actuaries should not be required to quantify the results of the tests, merely to confirm that they are met. This will allow the use of prudent approximations where appropriate and efficient.
5.	**Could we make Fast Track more proportionate for schemes in differing circumstances?**	See response to questions 3 and 4. In addition, we see no reason why you could not allow the use of the specified proxy for projected duration in all cases.
6.	**Are there other considerations not discussed in the consultation document we should be considering?**	We haven't identified any further items specifically. There could be more explanation of transitional arrangements – in particular schemes that find they are already significantly mature may be well short of the expected 'full funding' level. What will TPR expect of such cases? If there isn't to be any form of transitional system/understanding then TPR should explain why not.

7.	**Do you believe it would be useful to include an additional set of parameters for schemes where the employer has a high insolvency risk? If yes, how should schemes in this category be defined and where should the Fast Track parameters be set?**	No. TPR should independently identify schemes with high insolvency risk and follow up as appropriate with them based on their valuation submission to ensure a sensible approach in place, regardless of Fast Track status. They are likely to have specific issues/requirements that merit bespoke consideration by both Trustees and TPR.
8.	**Do you agree with our approach of setting the Fast Track technical provisions test as a percentage of the low dependency funding basis liabilities? If no, explain why and what would you suggest as an alternative?**	Seems sensible and pragmatic.
9.	**Do you agree with the limits we have proposed? If no, explain why and what would you suggest as an alternative?**	We have not tested these limits but based on your analysis, they do not seem obviously unreasonable.
10.	**Do you agree that for a Fast Track low dependency funding basis measure, the minimum strength of the discount rate basis should be gilts + 0.5% with no inflation risk premium?**	OK.
11.	**Do you agree that our approach to other assumptions in the Fast Track low dependency funding basis (as set out in Appendix 1) is reasonable? If no, which assumptions would you suggest are amended and how?**	The approach to demographic assumptions as set out in Appendix 1 seems odd. The focus on age difference while ignoring cash commutation entirely for example does not seem sensible. The requirement to use a "recent" CMI model but then offer no requirements on parameters also seems to add an unnecessary restriction without preventing manipulation of this assumption. Our preference would be simply to use the Scheme's low dependency funding basis, with no overrides on the discount rate and inflation assumptions and no further complications. If you believe additional restrictions are needed, then using relevant Section 179 demographic assumptions would seem reasonable.

	We believe that expenses should be part of the low dependency funding basis rather than an additional condition in relation to the wording of schedules of contributions (which would not otherwise appear to be one of the three parameters for testing). The overall messaging on expenses is quite confusing across the draft code and fast track, varying between a focus on appropriate short-term cover and building in a prudent reserve to protect the scheme (and avoid dependency on the sponsor) for the longer term. Perhaps an expense reserve at least in line with or similar to the Section 179 allowance would be a light touch solution here.
12. Should we allow more flexibility for smaller schemes in relation to any of the assumptions?	Requirements to meet a higher standard if you do not provide scheme specific evidence are unhelpful when they are unlikely to be statistically reliable for a large proportion of schemes and even for a larger scheme might not be providing a robust guide to future experience. We do not see a need for such references to be part of Fast Track.
13. Do you agree that the maximum recovery length after significant maturity should be set to three years rather than six? If no, explain why and what you would suggest as an alternative.	Yes, we see the logic of this for the purposes of granting Fast Track status although see our response to question 14 below. Given the apparent risks of overfunding and trapped surplus in the new regime we are keen to better understand how contingent assets (perhaps most obviously, an escrow account) could be credited within a Scheme's assets for valuation purposes and therefore used to support/underwrite continued investment risk without necessarily requiring short-term cash injections on the back of adverse asset movement. Please note question 9 and comment on transitional easement.
14. Do you agree with our approach of using the valuation date as the	Yes, but we suggest that the parameters should be 4 years and 7 years in order to more sensibly reflect that there is typically a one-year time lag from conducting the

starting point for the recovery plan length?	valuation before new rates are implemented. (The three-year period after revising a schedule of contributions is essentially t=1 to t=4 when measured from the valuation date, rather than t=0 to t=3.)
15. Do you agree with our approach to how to allow for post valuation experience in Fast Track recovery plans? If no, explain why and what would you suggest as an alternative?	Yes, although we found the explanation in this section confusing. It would be clearer to simply say, for the purposes of confirming whether the recovery plan length condition is met that: - It is not back end loaded (see response to question 16 below); - No allowance is included for future investment outperformance; and - Where all post valuation experience is allowed for, the certification of the schedule of contributions must be in the form as set out in Schedule 1 of the Regulations. This will give much greater clarity as to the requirements and the role of the actuary in this test.
16. Do you agree that annual increases to deficit repair contributions should not be more than CPI? If no, what would you suggest as an alternative?	Whilst we understand the desire to protect against back-end loading, we can see practical complications here, particularly given the use of the yield curve and employer preference for stability. We also note that this is an area where the best option for a given scheme may well run contrary to Fast Track compliance (e.g., if there was short term restricted affordability but the potential to make a material step up in a year or two). This helps illustrate why Fast Track testing should be a secondary issue to the design of the funding and investment strategy. We suggest that recovery plans that allow for annual fixed increases of no more than 3% p.a. should be acceptable, as well as increases 'in line with the CPI assumption' or 'in line with (actual) CPI announced each year'.

	We often see employers committing to a fixed 3% (say) increase as a proxy for inflation so that their contribution requirements are known in advance, and we do not think that this is unreasonable or should make a scheme fail to meet Fast Track. If looking to retain the current wording, would 'actual CPI' be acceptable or is it 'forecast CPI' (based on the forward yield curve at the valuation date?) that is the critical measure? We see this as an unnecessary source of potential confusion. If such a condition is part of fast track, we foresee some schemes failing only this condition (e.g. due to stepping up to a new higher rate). This would be an obvious scenario where very limited additional information should be required (and no engagement likely) under a bespoke submission.
17. Do you agree with our approach for the stress test? If no, explain why and what would you suggest as an alternative?	Yes, having an approach which is in line with PPF stress testing (albeit the assumptions may differ from those used in PPF calculations) is sensible.
18. **Do you agree with the limits we have proposed? If no, explain why and what would you suggest as an alternative?**	Yes. On balance, agree. The limits are essentially a product of the (current) PPF stresses and assumed investment strategy through the journey plan. The PPF 1-in-6 stresses have been scrutinised and reviewed as a measure of investment risk for levy calculation purposes. However, that does not mean they are necessarily appropriate for determining tolerable risk based on an assumed investment strategy. The assumed investment strategy and journey plan involve considerable judgement and, consistent with our comment to Q9 above, arguably more risk may be appropriate for very immature schemes.

19. **Do you agree with how we have allowed for schemes in surplus within the stress test?**	Yes.
20. **Do you agree it is reasonable to use the Pension Protection Fund Tier 1 asset classes? If no, what do you suggest as an alternative?**	Yes.
21. Do you agree that smaller schemes should not have to produce cash flows to calculate projected duration?	Yes – it is unclear why the cut off should be 100 members though. Is there a reason this could not just be applied more widely?
22. **Do you agree with the proxy we have proposed for smaller schemes?**	Seems practical and pragmatic.
23. Do you agree with our definition of smaller schemes for this purpose?	We do not see why it should be restricted to such an extent, particularly where schemes have longer durations so are still way off from their relevant date.
24. **Do you agree that six years is a reasonable Fast Track parameter for the allowance of extra accrual in open schemes? If no, explain why and what would you suggest as an alternative?**	No response.
25. **Do you agree with our approach for new entrants? If no, explain why and what would you suggest as an alternative?**	No response.
26. Do you think having no additional restrictions on future service cost will weaken the Fast Track approach significantly?	No, the actuarial certification of the schedule of contributions would appear to provide a degree of protection. TPR could always choose to look at a scheme if it had concerns.
27. Which of the options for reviewing our parameters do you prefer?	Generally, stability is good.
28. Do you think a different approach to reviewing our parameters is preferred?	No.
29. What further analysis do you think would be helpful to illustrate the	No response.

potential impacts of any final regulations and code?	