

29 July 2024

New DB Funding Code

Checklist of key issues for DB pension schemes to consider



Background

The Pensions Regulator (TPR) has published its long-awaited Code of Practice for funding defined benefit (DB) schemes. The new code sets out how TPR expects trustees to comply with the new funding regime, which requires all schemes to target a low level of dependency on their sponsoring employers in the long term.

The new funding regime and guidance in the code will apply to valuations with effective dates from 22 September 2024. While some schemes will be waiting up to three years to fall under the requirements, it is important for all trustees and sponsors to consider (at least at a high level) the requirements of the new code now to understand how their current funding and investment strategies will be impacted.



Pension scheme checklist

The checklist below sets out the key issues for trustees and sponsors of DB pension schemes to consider. Please speak to your advisers to understand the position of your scheme before making any decisions.

Long-term objective

Trustees and sponsors are required to agree how they intend to provide benefits in the long term (their long-term objective).

1. Agree the long-term objective if you haven't already

This could be to pay benefits via a [risk transfer](#) to an insurer or consolidator. Alternatively, the long-term objective may be to [run-on](#) in a low risk way and continue to pay benefits from the scheme.

2. Reassess any existing long-term objective

Where a long-term objective has previously been agreed, trustees and sponsors should consider if the objective should be reassessed in light of:

- Any significant changes (positive or negative) to the scheme's funding position and/or the strength of the sponsor's covenant.
- Recent changes - both [actual](#) and [proposed](#) - to pensions legislation.

Low dependency and significant maturity

New regulations require schemes to target “low dependency” funding and have an objective to be invested in a “low dependency asset allocation” by the time they are “significantly mature”.

3. Determine the period to significant maturity

It is important to understand how much time you have until your scheme is subject to the minimum low dependency requirements. Significant maturity is defined as when the scheme’s duration, measured on a low dependency basis using 31 March 2023 market conditions, is 10 years or less (or eight years for cash balance schemes).

4. Agree an appropriate low-dependency asset allocation

A low dependency investment strategy should lead to a funding position that is highly resilient to short-term adverse changes in market conditions.

5. Agree an appropriate low-dependency funding basis

A low dependency funding basis should be set such that once the scheme is fully funded, contributions should not be expected to be required from the employer. Assumptions should therefore be chosen prudently, using TPR’s guidance.

Schemes that already have a low dependency funding target in place should consider whether the existing basis is likely to be appropriate.

6. Consider whether a reserve for scheme expenses is needed

The code directs schemes to include an expense reserve in their low dependency basis. The exception is if the scheme rules require the sponsor to meet expenses separately, in which case including a reserve is only encouraged. Trustees should therefore consult the scheme rules to understand the position for their scheme and then consider what an appropriate reserve may be.

Journey planning

Once the long-term targets are understood, the next step is to agree a journey plan to reach this goal. When setting a journey plan, trustees should consider the employer's ability to support the scheme in the future.

7. Assess the period of covenant reliability

This represents the period where trustees have reasonable certainty over the employer's available cash to fund the scheme. This will help to inform the level of risk to take in the journey plan.

8. Assess the period of covenant longevity

This represents the period over which trustees can be reasonably certain that the employer will remain in existence. A short or uncertain covenant longevity may mean that you choose to target low dependency (or higher targets like buyout) before significant maturity. It may also affect the extent to which you allow for future benefit accrual in your assessment of significant maturity.

9. Agree a journey plan (or reassess previous discussions)

Trustees and the sponsor should agree a funding journey plan to reach the low dependency target.

Technical provisions and schemes in deficit

Once trustees and the sponsor have agreed the low dependency target and the target date, as well as a journey plan to get there, they should ensure technical provisions are set consistently with these plans.

10. Determine the impact of making the technical provisions basis code compliant

While many schemes will already set their technical provisions in a way that is broadly or fully consistent with the requirements of the new code, trustees and sponsors should understand any potential funding impact of needing to modify the technical provisions basis.

11. Schemes in deficit: assess reasonable affordability

The latest regulations introduce a new, overriding recovery plan principle, which is that deficits must be recovered as soon as the employer can reasonably afford. Therefore, if your scheme is expected to be in deficit, it will be necessary to assess the level of contributions that can be reasonably afforded.

Reasonable affordability should be considered alongside other reasonable alternative uses of available cash, which includes investment in the employer's sustainable growth.

Fast Track vs. Bespoke

Alongside publishing the new code, TPR is also introducing a new twin track approach to assessing valuations. The two valuation submission options are known as 'Fast Track' and 'Bespoke'.

12. Consider if the scheme is likely to meet the Fast Track requirements

To be eligible for the Fast Track option, schemes must:

- Set their technical provisions above a minimum prescribed level
- Have an investment strategy with measured risk below a maximum prescribed level
- If in deficit, agree a recovery plan that meets certain prescribed parameters (such as not being longer than the maximum prescribed length).

13. If necessary, decide if you are comfortable pursuing the Bespoke route

If you cannot, or do not want to, meet the Fast Track requirements then you will be required to make a Bespoke submission. Bespoke submissions are equally as valid as Fast Track ones but require additional information to be provided to TPR and will be subject to additional regulatory scrutiny.

Open schemes

There are extra considerations for schemes that are open to new members and/or future accrual.

14. Consider what constitutes a reasonable allowance for future accrual and new members

When determining significant maturity, open schemes can make an allowance for future accrual and new entrants to push back the period at which they must target low dependency.

15. Consider the impact on future service contributions

If making changes to the funding basis to ensure compliance with the new requirements, the implications for the cost of future service benefits need careful consideration.

Professional advice

Professional advisers can support trustees and sponsors with the new requirements.

16. Consider if further training is needed

It may be helpful to arrange a training session that covers the new requirements.

17. Consider appointing a professional trustee

The Code imposes more onerous requirements on trustees, which could possibly be mitigated through the appointment of a professional trustee.

18. Consider whether professional covenant advice is required

Appointing a professional covenant adviser may be beneficial in helping you consider newly introduced covenant concepts such as the periods of reliability and longevity, as well as with collecting and submitting new covenant information (which is likely to be especially relevant if going down the Bespoke submission route).

Need to know more?

For further information, or to discuss any of the issues raised in this checklist, please speak with your usual Barnett Waddingham consultant. Alternatively get in touch via the following:

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