THE SOCIETY OF PENSION PROFESSIONALS
leading pension thinking

TPR CONSULTATION ON DEFINED BENEFIT FUNDING CODE OF PRACTICE MARCH 2020 - COMMENTS FROM THE SOCIETY OF PENSION PROFESSIONALS

INTRODUCTION TO THE SOCIETY OF PENSION PROFESSIONALS (SPP)

SPP is the representative body for the wide range of providers of advice and services to pension schemes, trustees and employers. The breadth of our membership profile is a unique strength for the SPP and includes actuaries, lawyers, investment managers, administrators, professional trustees, covenant assessors, consultants and specialists providing a very wide range of services relating to pension arrangements.

We do not represent any particular type of pension provision nor any one interest-body or group. Our ethos is that better outcomes are achieved for all our stakeholders and pension scheme members when the regulatory framework is clear, practical to operate, and promotes value and trust.

KEY POINTS

We are broadly supportive of the twin-track compliance framework and associated principles outlined in this consultation, however the precise detail of implementation is important. We summarise our main concerns below.

- There is a tension between using Fast Track for simplified compliance, and as a universal standard by which to compare all schemes against and it is not clear to us that an approach designed to address one issue is necessarily suitable for the other.
- We feel Fast Track has in general been designed well for the purpose of simplified compliance where schemes have sufficiently strong funding and financing such that TPR can prioritise its resources elsewhere. A recent poll of SPP members suggests that around half of schemes expect to initially adopt the Fast Track route as currently proposed.
- Using Fast Track as the standard for all Bespoke valuations as a 'comply or explain' regime would be a significant deviation from the current scheme-specific regime with significant implications for schemes and sponsors. Indeed, the DWP white paper suggests that the current regime works well, a view shared amongst our members, and gives no mandate for a universal switch to a universal standard. The flexibility currently provided by the scheme-specific regime must be retained.
- We also have a concern that the Fast Track target may be insufficient for many schemes (for example those that should really be targeting buy-out in the long term) and could lead to some schemes reducing the amount of prudence adopted in their valuations. We strongly suggest that TPR recognises this in the language of Code of Practice, for example by including language that reminds trustees of their overarching duties and requires them to consider whether a stronger target than Fast Track would be appropriate.
- Covenant is an integral part of scheme funding and must be retained as a central part of Fast Track. Reliance on employer covenant should be long-term and not limited to the visible period, rather than forcing schemes to fund to solvency like levels of funding in the short-term.
- A combination of low-dependence long term objective, journey planning, short recovery plan period (for strong employers), and without allowance for post-valuation experience, could easily lead to significant short-term increase in deficit contributions followed by overfunding with a significant impact on scheme sponsors. The broader economic and human impact of this needs to be considered – particularly in light of Covid-19. Increasing cash requirements is likely to lead to intergenerational fairness and affordability challenges across the industry.

The Society of Pension Professionals
Quantum House, 22-24 Red Lion Court, London EC4A 3EB T: 020 7353 1688 F: 020 7353 9296
E: info@the-spp.co.uk www.the-spp.co.uk

DETAILED RESPONSE

CHAPTER 3: PROPOSED REGULATORY APPROACH

Q1 Twin-track compliance

Do you think twin-track compliance is a good way of introducing objectivity into a scheme-specific regime? What are your views on the proposals set out above? If you disagree, what do you propose instead?

We are broadly supportive of the twin-track compliance framework and associated principles outlined in this consultation, however the precise detail of implementation is important and we have a number of concerns in this area.

In principle, we agree that providing a Fast Track framework is a good way to introduce an objective benchmark for schemes. However in our view there is a fundamental conflict between the various uses that Fast Track has been proposed for within the consultation. In particular:

- Use for simplified compliance where schemes have sufficiently strong funding and financing such that TPR can prioritise its resources elsewhere.
- Use as the standard for all schemes to be compared to with deviations needing to be rationalised, and with TPR having the ability to impose this standard where it is not satisfied with the approach agreed between the Trustees and sponsor. Effectively, 'MFR 2'.

In our view Fast track has in general been designed well with the first of these points in mind and our consultation response in the main focusses on this as the core purpose of fast track.

The second purpose causes us concern, and we believe that a truly bespoke option is a necessary alternative rather than Bespoke effectively operating as a 'comply or explain' regime. We agree with the DWP White Paper 'Protecting Defined Benefit Schemes' which stated that the existing framework works well. A move to a regime that effectively imposes Fast Track as the high bar for much of the industry would be a significant deviation from this with significant implications for schemes and sponsors.

A recent poll of SPP members suggests a widespread belief amongst our members that the new code will essentially move from one that is scheme specific to one where any deviation from Fast Track needs to be explained. Nevertheless, based on TPR’s current proposals, more than half of schemes still anticipate adopting the Bespoke route.

As such, the precise details of this framework will be important.

One approach could be to (whether explicitly or implicitly) divide Bespoke into schemes that are:

- 'Truly bespoke' – akin to using the current scheme specific funding regime with a limited or principle based comparison to the Fast Track standard.
- 'Fast Track Plus' - Close to fast track, with any deviations easily explained with proportionate compliance.

This would provide a pragmatic and proportionate approach for both TPR and schemes that narrowly miss reaching the Fast Track bar, while maintaining the flexibility required for a significant portion of schemes that do not meet an intentionally high bar where it is clear that TPR intervention will not be required.

This approach would also help manage the adaptability needs of Fast Track to extreme economic conditions such as those associated with COVID-19. It is hard to conceive that a single set of Fast Track assumptions could be devised in a flexible enough manner to meet all of the potentially competing objectives of Fast Track at a time where different schemes and sectors have experienced significantly different impacts.

CHAPTER 4: EMPLOYER COVENANT

Q2 Insolvency risk and reliance on covenant

Do you think the risk of member benefit reductions on insolvency is an acceptable part of the existing regime and that trustees should be able to place some reliance (whether implicit or

explicit) on the employer covenant? To what extent do you think this should be the case? Do you think this risk is well understood by scheme members?

Yes, we strongly believe that trustees should be able rely on the employer covenant both in scheme decisions and funding valuations, and that it is acceptable to have a risk that member benefit may be reduced on insolvency of the employer. We agree that the reliance on employer covenant should be explicit.

Employer insolvency and the relationship to member benefits, possible reductions, and PPF protection, are not well understood at all by scheme members. A level of risk is acceptable and needs to be balanced against the costs of financing pension schemes.

Q3 Integrating covenant into funding

a. **Do you think it is better to keep the Fast Track route simpler by only factoring covenant into Bespoke (TPs and/or RP)?**

No. We think that covenant is an essential part of scheme funding and should be considered as part of Fast Track to keep it a viable option for a significant proportion of schemes.

b. **If you think covenant should only feature in Bespoke, how do you think it should be done?**

n/a.

c. **If we were to integrate covenant into Fast Track guidelines, do you prefer option 1, 2 or 3 or some other approach for reflecting the employer in scheme valuations, and why? If another approach is appropriate, what do you think this should be**

We see value in all three approaches, however if a single approach is to be mandated then we have a preference for Option 1.

We also believe there is value in schemes being able to present results consistently with Option 2 – particularly where this is their existing approach. As with Option 1 this is close to current methods, technically consistent – but there are presentational reasons why schemes may wish to use one approach or another, and in particular it may help There is little selection or gaming risk. It helps trustees to understand the concept if they are able to continue to use their current method and not required to move to a new approach.

Option 3 is significantly different from the current standard approach to allow for covenant, difficult to be consistent across all schemes and employers, and hard to monitor and so would be difficult to implement for Fast Track purposes. However we see that the information it provides could be of some use to trustees within a wider process, especially as an initial assessment of covenant strength to assist decisions on the proportionate level of further assessment.

Q4 Covenant assessment

a. **Should a holistic approach to assessing employer covenant be retained (but with further guidance to assist trustees), or should we seek to define a more prescribed, formulaic approach?**

A holistic approach should be retained. There are significant risks associated with formulaic approaches, in particular miscategorising sponsors with unusual or complex business structures. We would welcome more guidance – in particular to help avoid the situation where TPR has a materially different assessment of covenant to the Trustee which as a result would lead to the Scheme failing Fast Track.

b. **If the former (holistic approach), what amendments/clarifications to our existing guidance on covenant do you consider may be necessary? Do you agree with the ones suggested above? Is the structure and content of our existing employer covenant guidance helpful and accessible to trustees? If not, what would make it better?**

Most importantly, the work needed on employer covenant assessment should be risk based and proportionate. If, after quite limited review it can be seen that an employer is clearly strong (or much stronger than the level of risk being taken), then detailed analysis should not be required.

This area is, and should continue to be, subject to well-informed judgement and subjective assessment. However, our experience is that some trustees are currently frustrated by alternate expert advisors arguing for differing gradings with no obvious means of resolution. Covenant strength is a continuum rather than being discrete and the broad labels are a helpful guide. However, the more that they are used as a definitive rating to generate cliff edge differences, the more challenging this will become.

More (prescriptive) guidance from TPR would be welcome around how findings in respect of key features of covenant find their way into the final assessed grade particularly in terms of the Fast Track approach.

With regard to the suggested areas of focus, we agree with most of them. However:

1. Whilst it is often not practical to consider forecasts beyond 3-5 years, the review of this period (along with consideration as to the future prospects for a particular sector) will help to form a view on overall covenant over the longer term. Absent any fundamental/permanent shift in the future, covenant should remain for the foreseeable future and whilst it may be imprudent to rely on this strengthening, it also feels excessive to assume a complete collapse.
2. Stress testing could be used much more effectively, although as set out at the start it is a tool that should only be used on a proportionate basis – ie if there is significant headroom on affordability in the Base Case, then perhaps stress testing is not required.

c. If the latter (formulaic approach), what do you think of the proposed RACF approach? How would you propose that covenant could be explicitly defined in a clear, consistent and measurable manner? What other metric(s) may be appropriate?

We don't think any formulaic approach should be used as a standalone test. However, as an initial assessment, we agree that the RACF approach is a suitable measurement, and one of the factors used by covenant advisors when considering future affordability. It is akin to CFADS commonly used in commercial banking arrangements, and one that lends itself to headroom % analysis.

d. Alternatively, would it be appropriate to require employer covenant to be assessed in a prescribed (formulaic) way for Fast Track purposes, and only allow for a more holistic approach under the Bespoke framework?

The challenges in setting a robust formulaic approach in general would similarly risk undermining its use for Fast Track (there is a chance that a scheme escapes scrutiny because a few key metrics did not highlight an underlying issue). Also, allowing a simplified approach for this would discourage and undermine a more thorough approach being used by trustees in general (particularly for those looking to minimise compliance costs).

Requiring trustees to specify the level of covenant on which they are basing their Fast Track submission may provide a possible solution.

Q5 Reliance on indirect covenant

Do you think that the strength of the wider commercial group should be factored into the sponsoring employer's assessment? If so, how, and to what degree?

Reliance can be placed on indirect or 'group' support where (i) that support is credible with a tangible benefit on the scheme, (such as a legally enforceable promise); and (ii) that the covenant of the group/parent has also been assessed, including in the context of other demands that may be placed on the group/parent by other group companies (which in themselves may be supporting other schemes). However, this can open up to be a very large (and costly) piece of work if you start having to look into the wider group's ability to support.

We note that if Fast Track is designed as a 'high bar' that enables minimal TPR scrutiny in a cost effective way, then it may be challenging to permit reliance on indirect covenant in a way that is consistent with this.

Q6 Covenant grades

a. **Should we use a greater range of covenant grades to set guidelines in the code and assess schemes and, if so, what would be an appropriate number of grades?**

Covenant strength is a continuum and improvement/deterioration may (and should be encouraged to) influence a scheme's approach to funding and investment without necessarily corresponding to a change in grade.

We note that Fast Track is likely to be prescriptive in its link between covenant grade and funding requirements. A risk of only four grades is that this creates cliff-edges by moving from one covenant rating to another.

Conversely, more covenant grades opens up the possibility of more frequent changes in assessment from one valuation to the next and more room for disagreement between TPR and Trustees on the assessment of the sponsor.

We therefore have no strong opinion on the suitable number of grades (as long as there is an even number and no 'middle' grade). Four grades is an accepted practice, is easy to understand for most trustees, and still provide a sufficient broad distinction between companies. However we acknowledge that there is a wide range of views within the industry on this point and these are only simplifying distinctions.

For a Bespoke approach, we expect both covenant assessors and TPR to apply a more granular scrutiny in deciding how each company's covenant may affect scheme funding, outside of these broad grades.

b. **Would there be sufficiently different characteristics between a greater number of grades, such that a set of trustees could reasonably and reliably assess covenant strength without requiring professional advice?**

Trustees opting to use Fast Track for simplicity may struggle to make finer distinctions without professional advice and more grades will lead to more differences of opinion on the appropriate allocation. Some trustees currently assess employer covenant by monitoring movements away from a 'grade' which they had previously received advice. An increase in the number of grades mean that each band is narrower, and more difficult for trustees to be confident that the covenant grade remains appropriate.

At present, many trustees recognise that this is only a high level categorisation and will vary their scheme funding approach to more specifically meet their needs.

CHAPTER 5: GENERAL PRINCIPLES

Q7 Low dependency LTO

Should all DB schemes have a low level of dependency on the employer by the time they are significantly mature? If not, what do you think would be an appropriate expectation to ensure trustees manage the runoff phase for their scheme effectively and efficiently?

While we agree that a long-term objective is a good idea reflecting the behaviours of many schemes, members of SPP have a range of views on whether this should be a 'low dependency' objective.

On the one hand, trustees and members desire a level of certainty that members will receive their pension independent of whether the sponsor is still a viable business in the future. Low dependency provides a higher level of security. A uniform approach, for all schemes, will also be easy to understand and limit gaming.

Conversely, scheme sponsors will be concerned that a firm commitment to meet a low-risk long term objective will increase their obligation to fund the scheme well beyond that envisaged in the Technical Provisions. Paragraph 181 of the consultation provides a strong basis for this concern.

Similarly, a long-term objective of low dependency is unlikely to be suitable for all schemes. For example:

- Schemes funding at a low-risk (but not at the low dependency level) strategy for the entire life span of the scheme could fail this LTO even if the strategy is more secure overall.

- Schemes targeting buyout may have a non-gilt-based matching strategy thus failing Fast Track test.
- Schemes that continue to rely on their employer far into the future, for example schemes with employers in the 'Special Category' as defined by the PPF (Scorecard 11).

As such, the code of practice should recognise alternative approaches. One such way would be for Bespoke to allow alternative journey plans where it can be demonstrated that this is appropriate, consistent with the scheme objectives and supported by the covenant, but without a separate requirement to demonstrate risk mitigation measures as a result of the departure from the Fast Track standard .

Q8 Timing of the LTO

What factors should influence the timing of reaching the LTO? Do you think that the timing should be linked to maturity?

For Fast Track, it is reasonable for this to be based on maturity.

For Bespoke, the timing should consider broader factors including maturity, affordability, and visibility of covenant.

For example, schemes close to or already arrived at 'significant maturity' but with good sponsor covenant and visibility should be able to rely on the sponsor covenant after the scheme has reached the point of 'significant maturity'.

Across both approaches, it is important that there is stability in funding targets once the scheme has reached the LTO.

Q9 High resilience to risk at the LTO

Do you think that the investment portfolio should be highly resilient to risk when schemes reach their LTO? If not, what do you suggest?

We agree that the investment portfolio should be highly resilient to risk when schemes reach their LTO.

However, the term 'high resilience' requires careful definition, especially given the volatile economic situation following the publication of this consultation.

Q10 Risk-taking for immature schemes

Is it reasonable for less mature schemes, which would have more time to reach low dependency funding, to assume and take relatively more investment risk than a mature scheme?

Yes. It is both harder and more expensive for less-mature schemes to remove risk and so a greater level of risk-taking is appropriate.

The alternative of funding to a low dependency levels well before schemes become mature, is a significant step change from today which would lead to significant costs for employers.

Q11 Journey planning

What are your views of the rationale above for the journey plan? Do you think there is a better way for trustees to evidence that their TPs have been set consistently with the LTO?

We agree in principle that schemes should have a plan to reach their LTO – noting earlier comments regarding the flexibility of the LTO under Bespoke.

However, we note that TPR's journey plan proposal is likely to require sponsors to in many cases to fund to a substantively higher bar than current TPs. The resulting deficit repair contributions could be substantially higher than the current deficit repair contributions, which are often designed to meet the legislative requirement to make good any deficit shown in the current technical provisions. The effect of the proposals is therefore to significantly increase the costs of financing DB pensions when other factors (investment returns, liability management) could reasonably bridge this gap. This could encourage suboptimal behaviours such as schemes taking significant short term risks, rather than more controlled risk over a sustained period of time.

A secondary technical concern is that the 'significant maturity' point, and hence the 'milestones' at each valuation, are moving targets, especially if duration is used as the method of calculation – careful consideration will need to be given to how maturity is assessed from one valuation to the next.

Q12 Relevance of investments for funding

Do you agree that the actual investments and investment strategy are a relevant factor for scheme funding?

Yes

Q13 Broad consistency between investment and funding strategy

a. **Should the investment strategy be broadly consistent with the level of current and future investment risk assumed in the funding strategy? If not, why not?**

The term 'broadly consistent' could be reasonable with clearer guidance. In our view extra investment risk taken in the short term to help reach the LTO more quickly meets the 'broadly consistent' requirement but this should be made clear; and can extra investment risk be taken in the longer term to bridge the gap between LTO and buyout or to build up a buffer, and still be 'broadly consistent'?

Removing the need for broad consistency is likely to have a host of unwanted effects, for example:

- Discount rates higher than expected returns leading to unrealistic funding plans
- Immediate de-risking and higher costs

b. **If it is not broadly consistent, for instance where trustees want to take additional investment risk (than that assumed in the TPs), should trustees have to demonstrate that the investment risk taken can be managed appropriately? If not, why not and what would you suggest?**

It is important for trustees and sponsors to understand the level of risk taken and for what purpose – a clear definition of broadly consistent, and what constitutes this will help this process.

More stringent requirements may be required for Fast Track and where schemes fall outside of this Trustees should be able to demonstrate that how any additional risk is being managed and supported (consistent with para 500 of the consultation).

Q14 Liquidity and quality at maturity

Do you think that security, quality, and liquidity become more important as a scheme becomes significantly mature? In particular, do you think that the scheme's asset allocation at significant maturity should have a high level of liquidity and a high average credit quality?

We agree that security and quality are important, but assets that provide a steady stream of cashflow meeting the scheme's cash payments is arguably more important than 'liquid assets'.

For example, some schemes may reasonably follow cashflow matching strategies with high proportions in illiquid assets that provide income to meet cash requirements – an obvious example is the purchase of annuity policies.

As such, schemes need to consider cashflow alongside liquidity. Based on the broader requirements of Fast Track, it is likely to be unnecessarily onerous to impose additional requirements in this area.

Q15 Covenant visibility

a. **Do you think it is prudent for reliance on employer covenant to be reduced beyond the period over which there is reasonable visibility? If not, why not?**

No. While this suggestion by itself may appear prudent, there are significant consequences:

1. True visibility is only one feature of covenant. For example, wider sector considerations will play a big role and contribute to views on longer term covenant.
2. Defined benefit schemes have a much longer time horizon than the visible future across many industries. Removing reliance on employer covenant beyond the short term in effect brings forward the LTO to within 3-5 years. Enforcing short-sighted plans will encourage

unsuitable behaviours, for example short term risky investments, or early de-risking strategies leading to sub-optimal outcomes.

3. This will significantly affect affordability of pension schemes.

It is reasonable to assess the covenant over the visible forecast period (3 to 5 years), but any assumed downgrade:

Should only be mandated for Fast Track – allowing schemes to retain flexibility in Bespoke.

- Should be a gradual process to LTO and not immediate.
- Should be considered alongside other aspects of scheme funding and the overall level of funding target. Quicker downgrades may be more appropriate if the LTO is less prudent and vice-versa.

b. How much visibility do you think most trustees can have over the employer covenant? In the absence of evidence to the contrary, do you think it is reasonable for most schemes to assume there is reduced visibility beyond 3-5 years?

Three to five year of visibility over affordability is reasonable to consider, largely because that is the period over which many companies forecast (probably closer to three than five), and for a period over this it is difficult to forecast. However, the review of this period (along with consideration as to the future prospects for a particular sector) will help to form an informed view on overall longer term covenant. Lack of visibility in terms of robust detailed forecasts does not mean the employer has reduced prospects beyond that point.

Q16 Use of additional support

Should additional support, such as contingent assets and guarantees, be allowed in scheme's funding arrangements provided they are sufficient for the risk being supported, appropriately valued, legally enforceable and realisable at their necessary valued when required?

Yes. It is critical that well-constructed alternative financing arrangements are properly recognised in the overall funding framework. Such additional support needs to be properly reflected in the scheme funding regime to make this process easier (for example allowing contingent contributions or escrow payments to be recognised). Similarly, situations where support is effectively double counted need to be actively avoided.

It is also worth noting that if covenant reliance is being reduced due to limited visibility, the financial incentive for companies to provide many forms of support will be reduced, where in practice these are often highly valuable forms of security for members. As such this is an area that requires significant consideration from TPR.

Q17 Appropriateness of RPs and affordability as key factor

a. Should employer affordability be the key factor to determine the appropriateness of a RP? If not, what should it be?

Yes, employer affordability is very important in determining any recovery contributions particularly where this is a constraint.

b. Is it reasonable to require schemes with a stronger employer covenant (and a resulting reduction in prudence in the assumed TPs and size of deficits) to have a commensurately shorter RP?

In principle, yes, particularly where weaker assumptions are being used.

However, we are wary of encouraging schemes with a weaker covenant to view longer recovery plans as acceptable in cases where they could reasonably be settled sooner and conversely of providing a disincentive for stronger covenants. Linking the length of RP to employer covenant could also encourage 'gaming', where employers might deliberately report lower covenant strengths to take advantage of longer RPs.

For Fast Track purposes we would therefore simply suggest a six year (two valuation cycles) benchmark is applied to all cases. A pragmatic, relatively light, touch could be applied in Bespoke

'Fast-Track Plus' cases where weaker employers are simply constrained by affordability and have a slightly longer RP.

Strict requirements that go beyond Fast Track need to be very carefully considered and the broader impact of contributions on employer strength needs to be taken into consideration, including the perceived strength of the employer covenant by persons other than the pension scheme, eg lenders and investors of the company.

Q18 Open schemes, past service

Should past service have the same level of security, irrespective of whether the scheme is open or closed?

Yes.

However, as open schemes are likely to be less mature than closed schemes, the current level of risk that open schemes could take may be generally higher than that of closed schemes.

We also note that an open scheme will reach significant maturity later than if the same scheme is closed to future accrual. If scheme maturity is used to define the point of reaching LTO, then the LTO will be driven further into the future, and the scheme can expect to have a higher funding level (higher investment return assumptions for longer leading to lower liabilities). This should be taken into account when setting assumptions for either the technical provisions or the future contribution rates. If open schemes are required to provide the same level of security on accruing benefits as accrued benefits, future DB benefits are likely to become unaffordable thus exacerbating inter-generational inequalities.

Q19 Open schemes, future accruals

Do you think it would be good practice for trustees to ensure that the provision of future accruals does not compromise the security of accrued benefits?

We agree this is a good principle, and we understand that TPR aims to protect benefits already accrued. We would note consideration of the consequences of this set out in Q18.

CHAPTER 6: OTHER ISSUES

Q20 Other issues

Do you agree with our assessment of the issues above and do you have any further comments?

We broadly agree with TPR's assessment.

CHAPTER 8: SETTING THE LONG-TERM OBJECTIVE (LTO)

Q21 Fast Track low dependency discount rate

What are your views on our proposal that the appropriate low dependency funding basis for Fast Track should be with a discount rate somewhere in the range of Gilts +0.5% to Gilts +0.25%? Where in the range do you think it should be and why? If you disagree, what do you think would be a more appropriate basis and why (please provide evidence)?

A discount rate towards the higher end of the range Gilts +0.5% to Gilts +0.25% is reasonable, however this needs to be kept under review. For example, in the current climate, Gilts +0.25% could be more expensive than buy-out and as such not a generally suitable aim for schemes not funding for buy-out; a figure towards the top end of the range is probably needed to encourage schemes to use Fast Track – particularly given the current economic climate.

Q22 Options for defining other assumptions for Fast Track low dependency funding basis

Which of these options should be used to set assumptions for low dependency funding under Fast Track? Are there any other options we should consider? Are there any other pros and cons we should consider?

We would prefer to see Option 2 being used. We acknowledge the risk of abuse in setting scheme-specific assumptions, but on balance this is likely to provide the most appropriate funding valuation results.

Q23 Defining assumptions for Fast Track low dependency funding basis

a. **What are the most significant assumptions (other than discount rates) for the calculation of the Fast Track low dependency liabilities?**

Financial assumptions that affect the rate of benefit increase, in particular RPI and CPI.

Mortality assumptions.

b. **If we were to specify some or all of the assumptions to calculate the level of Fast Track low dependency liabilities, which assumptions should we specify and how should we do this? Do you have views on the suggested benchmarking factors in the table above?**

If any assumptions need to be specified by TPR, financial assumptions would be the more natural ones. We have no specific views on how TPR might benchmark these assumptions, except noting that these assumptions are very often scheme specific, for example relating to investment and hedging strategies, and even providing sensible benchmarks or ranges for all situations would be very difficult.

Demographic assumptions are specific to each scheme and it is unlikely that TPR can reasonably set these assumptions to be suitable for all schemes and in particular mortality assumptions should be scheme specific and not specified by TPR.

c. **If we determined mortality assumptions, how could we balance the scheme-specific nature of mortality with the desire to ensure a level of consistency in the assumptions used by different schemes?**

If TPR were to determine mortality assumptions, indicative ranges of mortality rates for different socio-economic groups and other relevant factors would be needed. However we think mortality assumptions should be specified by individual schemes.

Q24 Low dependency basis – verification that other assumptions meet the best estimate principle

a. **Which of these options do you prefer to verify that other assumptions used for low dependency liabilities under Fast Track meet the 'best estimate' principle and why? Are there any other pros and cons we should consider? Are there any other options we should consider?**

We favour a light touch disclosure (option 2).

Our concerns with the other approaches are:

Option 1: we agree that this option is open to gaming.

Option 3: we agree that this option is unlikely to provide truly independent comparisons.

Option 4: our actuaries agree that the shift of power is an unwelcome complication to funding negotiations. However we would accept that whistle-blowing where assumptions are unreasonable may be required.

b. **If we decided to require schemes to provide additional information about their assumptions, what information should we require schemes to provide compared to the current requirements?**

TPR will need to balance information that will be quickly and readily available, with an understanding of whether this will materially contribute to schemes passing or failing the Fast Track test.

Q25 Other assumptions for Fast track low dependency basis – prudence

a. **If we specified certain assumptions, should we aim for those to be best estimate or to be chosen prudently?**

Prudence needs to be considered in aggregate across all assumptions and whether the prudence in the overall liabilities is appropriate and reflective of the level of security that is desirable. In our view, transparency is helpful and this is best achieved by adding prudence to discount rate leaving all other assumptions at best estimates.

If TPR specifies a prudent discount rate, with schemes able to set best estimate assumptions it would ensure that schemes include a minimum level of prudence in their funding calculations.

This approach would allow flexibility to individual schemes to take an approach more tailored to their circumstances by adopting specific prudent assumptions where there are specific risks.

b. **Given the uncertainty around assumptions such as future improvements in mortality should we i) define these assumptions in Fast Track and ii) set the assumptions prudently?**

We think mortality assumptions should be specified by individual schemes.

Q26 Low dependency liabilities – reserve for future ongoing expenses

a. **Should the low dependency liabilities carry an expenses reserve? If so, should this only be a requirement for schemes that self-fund their expenses?**

It is important that trustees and sponsors think about, and make an allowance for, the expenses in running the scheme in the future. Including an expense reserve is one good way to achieve this and is clearly of particular importance for schemes that self-fund their expenses.

b. **To what extent should we define the reserve for future expenses under Fast Track? Should we just provide guidance on how to calculate an appropriate reserve? As part of that, what level of ongoing expenses is it reasonable to allow the employer to pay directly without any reserve?**

Expenses are unpredictable and vary according to prevailing legislation and market practice. A broad brush approach defined by TPR for Fast Track would be helpful. Our preferred method would be a loading according to the size of liability although great care is needed to ensure that the level is proportionate such that it doesn't push many smaller schemes out of Fast Track.

While there is a risk of double counting where sponsors are paying ongoing expenses, a low dependency LTO for the purposes of Fast Track would benefit from a simple to calculate long term 'rainy day' reserve, and without any direct comparison to actual expenses.

c. **If we defined guidelines on expenses for Fast Track, how should we reflect the proportionally different level of expenses incurred by schemes of different sizes? Could we adopt a sliding scale of percentages of liabilities based on the size of the scheme or a fixed element and proportionate element of expenses?**

As described in b, a sliding scale of percentages of liabilities without reference to the existing expenses would be our preference for Fast Track.

For Bespoke, schemes should be able to consider and calculate their own reasonable expense reserve (if required).

Q27 Definitions of maturity

a. **Should maturity be defined as duration for the purpose of prescribing significant maturity under Fast Track? If not, which measure would you favour and why? Note that whatever measure we use, it needs to be applicable not only to the time at which we would expect a scheme to reach significant maturity but also at all earlier times in the scheme's life.**

We support the use of duration to describe significant maturity, provided these concerns are addressed:

- Duration is a difficult concept for trustees and sponsors to understand. For example, a scheme with current duration of 18 years might take another 12 years to reach the significant maturity at a duration of 12 years; a scheme with duration of 12 years doesn't mean at all that the scheme is expected to run off in 12 years' time. Duration does not shorten linearly either.
- A scheme's duration depends on the assumptions used to calculate the duration. In particular, a scheme using term dependent discount rates could have substantially different duration compared to a scheme using an equivalent single discount rate.
- There should be no cliff edge at reaching significant maturity; it is quite possible for schemes to be at a duration of '12 to 14 years' for a long time and drifting in and out of the 'significant maturity' bucket at successive valuations.

- This concept needs to be able to be applied to a pre- / post-retirement discount rate method favoured by many small schemes.

An alternative approach could be using proportion of liabilities relating to pensioners. This is easy to understand for trustees and sponsors, and the progression towards significant maturity is also relatively simple to calculate, especially for closed schemes.

b. **Whichever method is used to determine maturity, we need to use actuarial assumptions to make the calculation. Should we require that the Fast Track low dependency assumptions are used for this purpose? What other assumptions could be used?**

We have no strong opinion on this.

Q28 Defining the timing point for significant maturity

What are your views on our proposal to set significant maturity (used to define the timeframe for reaching the LTO) for Fast Track to be in the range of a scheme duration of 14 to 12 years (or equivalent on a different maturity measure)? If you disagree, what would be a more appropriate timeframe and why? Please provide evidence.

A scheme paying out 5%-6% of its liabilities as benefits each year can reasonably be considered significantly mature, however to us the decision to choose a duration of 12 to 14 years is as much a political decision for TPR as it is a technical one – particularly given that duration is sensitive to the chosen assumptions and will not evolve consistently with the passage of time.

Q29 Points or ranges for low dependency funding basis and timing point

Do you think our proposal to set a particular level for the low dependency funding basis and/or a range for the significant maturity timing associated with the LTO would be helpful to schemes to manage volatility and allow some smoothing? If not, what would you suggest?

We agree that setting a range for the significant maturity timing would be helpful for smoothing funding requirements, especially where the durations could change due to changes in underlying financial conditions (those using term-dependent discount rates are particularly prone to this). TPR could encourage closed schemes to set a relatively fixed date to avoid situations where schemes use the range to simply minimize funding requirements.

CHAPTER 9: TECHNICAL PROVISIONS (TPS)

Q30 Journey plan shape for Fast Track TPs

a. **Which shape of journey plan is most appropriate to define for calculating the Fast Track TPs and why? Does this vary depending on the circumstances of the scheme?**

A linear approach is often the most appropriate as this avoids funding cliff edges at significant maturity, or smaller funding cliff edges along the journey. However we recognise that different journey plans may be appropriate under different circumstances and we would be supportive of offering schemes flexibility in choosing.

b. **Are there any other journey plan shapes we should consider?**

Many small schemes use the pre- and post-retirement discount rates valuation method. While this valuation method doesn’t fit in naturally with a scheme journey plan, it is important that small schemes are not burdened with the extra cost in setting up a different calculation method. We would appreciate TPR to provide some broad brush equivalence of its position of tolerated risk.

c. **What unintended consequences might arise from adopting the linear de-risking or horizon method journey plans for Fast Track?**

If the end point is set by reference to the duration of the plan, then that end point will not change by three years every valuation. That needs to be taken into account at the next valuation in the way that fast track operates so as to avoid shifting the goal posts.

Schemes might sensibly decide to manage their liabilities through derisking exercises eg bulk transfer exercises or PIEs. This can materially change the end point and could have a knock on effect on the funding needed to meet the Fast Track requirements depending on how this was expressed. The construction of Fast Track needs to take into account these types of exercise so that they are treated fairly, and so that Fast Track does not inappropriately impede such exercises.

Fast Track should be kept as simple as possible so that the governance for Fast Track is no more than that for Bespoke, and hence no more costly.

Q31 Key factors for Fast Track TPs

Should other scheme-specific factors other than covenant and maturity be considered to define the journey plan and TPs in Fast Track?

No – simplicity is important and these are the two key factors.

Q32 Extent of reliance on covenant in Fast Track TPs

a. **Should we define a maximum period of acceptable full covenant reliance for Fast Track TPs? For example, a general guideline of five years? Or should covenant reliance be assumed to decline in the much shorter term (or immediately)?**

The principle of having a journey plan that leads to low dependency would naturally build in a decline to the reliance on covenant over the period to significant maturity. Defining a maximum period should not be necessary.

From a sponsor's point of view, if only a short period of strong covenant can be used in the calculation of TP, followed by severe downgrade, the benefit of having a strong covenant and lower TP could easily be outweighed by the undesirability to have shorter RP because of perceived affordability. This could lead to 'gaming'.

If such a maximum period must be set, then we suggest this is limited to fast track with a gradual reduction in reliance on employer covenant in line with valuation cycles; eg six years at full allowance, then reducing by one grade every three years.

b. **What level of covenant support should subsequently be assumed? Should there be an assumption of a single covenant grade reduction (eg CG1 to CG2), a reduction to assumed returns in line with a weak covenant, or something else?**

TPR needs to decide where the risks that it wants to monitor are and hence where some risk taking would be acceptable – allowing for a gradual decline, rather than a step change, in the covenant of a strong employer seems a sensible balance.

c. **Over what period should any reduction in reliance take place? Should this be immediate (eg a reduction to a lower covenant reliance in the sixth year) or more gradual (for example, over the subsequent five years)?**

Please see above.

d. **Does the need for a covenant visibility overlay depend on the approach taken for the journey plan to low dependency? For example, is this a more relevant consideration where the horizon journey plan shape is used?**

Yes. Please see above.

Q33 How Fast Track TPs should be expressed

Which option do you think is preferable for defining TPs/journey plans under Fast Track and why? What are the practical issues associated with each option? If you disagree with these options, what would you suggest and why?

Our preferred option is the second option: discount rate – full structure.

The third option: TPs as % of low dependency is a reasonable way to compare schemes (subject to some level of consistency or constraint on the underlying assumptions), but may hinder understanding by the trustees or TPR of the risks being taken. This approach may also require schemes to 'back-solve' a discount rate applicable to their scheme, this would be additional work and complexity for Fast Track. We also think that this approach becomes less useful the more complex the situation (i.e. it becomes less useful in Bespoke cases).

We think the first option is the least preferable. While this single figure provides TPR a simple monitor/ comparison tool, it goes against the concept of journey plan and reducing reliance on employer covenant over time. It either becomes an extra calculation for trustees to perform, or discourages trustees to consider the relationship between journey plan and changing discount rates.

Q34 Method to derive Fast Track TPs

a. **Do you prefer a particular approach? If so, why? Is there another approach that would be suitable?**

We think all approaches could be used in developing a robust set of Fast Track parameters: e.g. using existing data to inform a deterministic starting point, but then see what that would look like in various stochastic scenarios, eg are risks symmetrical and is median close to deterministic results.

From a scheme perspective, it is the overall parameters rather than the process that is important – and whatever assumptions are chosen, these will need to be tested against evidence and robust to changing financial conditions, and not just rely on the output from the model.

b. **Do you have ideas as how to best approach each option?**

Please see above.

c. **How do trustees incorporate considerations about covenant strength into their TP assumptions/discount rates?**

Please see above.

d. **If a stochastic approach is adopted, what would you consider to be an appropriate confidence level against which to mark the results?**

Please see above.

e. **Do you have any data or modelling results which you think would provide useful evidence for the baseline TPs or covenant overlay? Please provide full details of methodology/data limitations.**

This will be provided by individual firms’ responses and the SPP is not in a position to collate these results.

CHAPTER 10: INVESTMENTS

Q35 Which reference point from which to measure investment risk in Fast Track

a. **Would a measure of the liabilities be an appropriate position to measure investment risk from? If not, why not?**

Yes. A measure of the liabilities is an appropriate position from which to measure investment risk.

b. **Do you prefer a liability measure on the low dependency basis (Gilts +0.5% to +0.25%) or a Gilts flat basis? Why? Are there any other liability measures that would be suitable?**

As noted in the consultation, both approaches have pros and cons and the approach decided will therefore have some negative attributes. The gilts flat approach has the advantage of ensuring consistency across schemes and should not present significant challenges from a cost perspective to calculate. Any measure should be set on a basis that is (i) sensible from an actuarial perspective and (ii) would be achievable for the majority of schemes. In particular though, whichever measure is used should not become a tool to fetter the discretion of scheme trustees to invest in assets other than gilts if they hope to qualify for the fast-track (i.e. flexibility in schemes' investment strategies should still be permitted).

c. **Would a liability reference portfolio approach (as a proxy for liabilities) for smaller schemes be more proportionate and practical? If so, how should a small scheme be defined for this purpose (number of members, assets or liabilities)? What would be an appropriate threshold?**

If the liability measure is simply defined, then the cost of calculating this for small schemes may be modest in any case, compared to calculating the liability reference portfolio, so the availability of an alternative may offer limited benefit. That said, the indicated definition of a small scheme as fewer than 100 members and assets/TPs below £20m is reasonable.

d. **Would a reference portfolio consisting of gilts and inflation-linked gilts with a duration similar to the liabilities be appropriate as a proxy for the liabilities for smaller schemes? If not, how would you go about constructing a reference portfolio as a reference point from which to measure risk for smaller schemes?**

A portfolio of gilts and inflation-linked approach is reasonable – arguably, any extension of this to incorporate other asset indices, would counteract the desire for simplicity.

Q36 Methodology to measure investment risk in Fast Track

a. **Would a simple stress test to measure investment risk in Fast Track be the most preferable option? If not, why not? Are there other measures of investment risk that are more suitable, taking account of the desire for a relatively simple and objective measure?**

The stress test method is preferable over the 'blunt tool' approach of using a growth focussed measure. Given the desire for simplicity and objectivity, there is no obvious alternative.

b. **Do you agree with the proposed principles for an appropriate pensions stress test, namely a fall in growth assets and a fall in interest rates? If not, what do you suggest?**

A fall in growth assets and interest rates are the two key risks to reflect in the stress test, but it would also be appropriate to consider incorporating an inflation rate and credit spread stress within the calculation.

c. **What are your views on which stress test we should use? Do you think the PPF stress test (Bespoke and simple approach) would be a good starting point?**

For Fast Track, the PPF stress test, given its wide use and understanding, represents a solid starting point. The consultation notes the shortfalls in this approach for TPR's purpose, and the potential to work with the PPF to agree a consistent and mutually helpful method, which would clearly be beneficial (although any impact on PPF levies would need to be considered).

d. **Which of the ways to measure the impact of the stress would you prefer and why? Is there an alternative method not listed that would work better? If so, please describe it.**

Option 1 is a reasonable approach. The key is consistency and clarity, and that TPR's treatment of the results reflects the 'shortfalls' of the chosen method, so that certain categories of scheme or investment are not unduly prejudiced. For example, hedge funds is a very broad category with low stress factors in the PPF test where many common pension investments (like DGFs) are not present.

Diversification benefits are not well reflected penalising schemes who have a broad range of diversified assets.

There will need to be a way for common hedging strategies through derivatives to be reflected in a standardised test.

Q37 Approach to defining maximum levels of investment risk for schemes of different maturities in Fast Track

a. **What are your views on the proposed methodology for setting maximum thresholds for investment risk for significantly mature schemes in Fast Track? If you disagree, what would you suggest?**

An approach predicated on a maximum to growth assets of 20% (for a mature scheme) is likely to be reasonable, but the simplicity of this fails to capture the approaches that some schemes may take within their matching portfolio (e.g. a meaningful allocation to credit, for example, which straddles the growth/matching divide). While the principle is sound, the methodology needs to avoid 'directing' schemes towards a single answer.

b. **In relation to acceptable portfolios and consistency with discount rates, is it reasonable to use a best estimate return premium for growth assets over long-term gilts in the range of 3-5% pa?**

The assumption of Gilts +3-5% pa for growth assets (assuming there is distinction between pure growth assets, and assets which provide some return but also some hedging) is reasonable.

c. **Should the allowance for prudence be higher for an investment portfolio with a higher level of risk?**

Yes – this is a reasonable approach.

d. **What are your views on the considerations we have set out to determine investment limits for immature schemes (journey plan shape, downside risk and covenant)? In particular, should the maximum level of investment risk for immature schemes vary by covenant under Fast Track?**

Given the importance of covenant in determining an appropriate funding and investment strategy for schemes, it feels appropriate that this should be reflected in the assessment of investment limits, including under Fast Track. Covenant is an important factor in determining the maximum level of investment risk for all schemes (i.e. not just immature schemes).

Q38 Defining guidelines for liquidity and quality of the investment portfolio in Fast Track

a. **Do you think we should define some guidelines around liquidity and quality in Fast Track?**

Liquidity and quality are undoubtedly important, but any guidelines need to allow for the variation between schemes of the end-game – Trustees should be able to determine whether to target a long-term objective of buying out or running off without infringing. Pension schemes targeting a run-off or CDI type strategy, who may hold assets that are illiquid but generate income, should not be ruled out. Any guidelines on liquidity and quality of assets would need to be principles-based, assessed on an asset-class by asset-class basis and not be overly rigid if the expectation is that most schemes will qualify for fast-track. These could, by way of example, include principles concerning credit-rating limits in respect of debt and equity securities, an expectation that such securities are tradable on a recognised investment exchange, etc. Any guidelines would also need to leave some flexibility for investment in certain types of illiquid assets (particularly long-term infrastructure assets in which schemes are generally encouraged to invest) and in buy-in policies with high-quality providers. The concern is that the guidelines, if unduly restrictive, might have the effect of deterring trustees from taking on more risk in a scheme where it would otherwise be appropriate and advisable to do so.

b. **If so, what are your views on the options outlined above? Are there other approaches you favour?**

Options 2 and 3 are potentially restricted to the flexibility set out above, by setting minimum allocations. Options 1, 4, 5 and 6 provide sufficient flexibility.

c. **What limits would you set on the above criteria and why?**

Any limits need to retain flexibility to run a strategy targeting buy-out or run-off.

d. **How would the above change for a more immature plan?**

Any limits could reasonably be tightened as schemes become more mature.

CHAPTER 11: RECOVERY PLAN (RP)

Q39 Fast Track guidelines on RP length

a. **What are your views on the principles set out above in relation to RP length under Fast Track? In particular, do you have views on what may be appropriate RP length thresholds for different covenant strengths? Is it helpful to frame these in terms of the typical multiple of valuation cycles (ie three years)?**

We are concerned about the potential for a framework that enforces longer recovery plans for weaker covenants may encourage poor behaviours amongst schemes, particularly if there is limited credit given for covenant in determining TPs.

With that in mind, support RP length as a multiple of valuation cycles, and six years ie two valuation cycles could be appropriate to remove any emerging deficit (although this should be tested against TPR's experience on how many schemes would fail this hurdle).

Short recovery plans, especially the proposed three-year plans for CG1 schemes, can create too much volatility and there is a high risk of over funding (by definition, there is a 50% chance that the scheme will become overfunded by the next valuation if funding on a realistic basis). This could create tension between sponsor and scheme especially where large deficit contributions are paid, and would likely make any future funding negotiations much harder or simply force schemes into Bespoke unnecessarily.

At the other end a blanket acceptance of 9-12-year plans for the purposes of Fast Track is unlikely to meet TPR's stated objectives for Fast Track.

b. Do you consider it would be more appropriate to have a single maximum guidance RP length and to expect trustees (under the Bespoke framework) to justify any plans that are longer than this?

Yes. We think the maximum recovery plan length under Fast Track should be the same (six years) regardless of covenant. Differences in RP length may lead to gaming of the system as there is a natural trade-off between RP length and TP strength: for example, a CG1 employer might report itself as a weaker employer if the TP is not much affected and it allows for a longer recovery plan.

Schemes with weak employers should not have longer recovery plan periods under Fast Track, and should be required to use the Bespoke framework if affordability is the limiting factor.

c. Do you think Fast Track RP lengths should be shorter for schemes nearing and/or at significant maturity? If so, to what extent?

No. We think Fast Track RP requirements should be kept simple.

Q40 Fast Track guidelines on RP structure

Should the extent of back-end loading be limited to increases which are in line with inflation (in the absence of appropriate additional support such as a contingent asset being provided)? Or should there be more flexibility subject to a significant proportion of DRCs being committed in the early years of the plan? If inflation-linked increases are acceptable, what measure of inflation do you consider would be an appropriate benchmark?

In the short-term, Covid-19 is likely to impact sponsors' ability to fund pension schemes and lead to a desire for more back end loading and illustrates the need for some flexibility in the Fast Track requirements for back end loading.

Any rules here should be simple. For example, if the maximum RP period is set at six years, then the rule could be that at least 40% of the total DRCs must be made by the first three years. This would allow much more flexibility whilst ensuring any back-end loading is within an acceptable range.

Q41 Fast Track guidelines on investment outperformance

Should investment outperformance not be allowed in Fast Track RPs? What do you think the impacts may be?

We set out above that under Fast Track, Recovery Plans should be reasonably short. Consistent with this, there is limited scope (under Fast Track) for outperformance to have a material impact on contributions – subject to an appropriate amount of return being allowed for in the Fast Track discount rate.

With that in mind, it could be considered reasonable to exclude outperformance from Fast Track. However there are two significant considerations if this is the chosen route:

(i) RPs are generally set some time after the valuation date. Any outperformance between the valuation date and the date of agreeing and signing RPs should be considered separately here from an allowance for future outperformance. A short RP period together with no allowance for investment outperformance seen before agreeing RPs could easily lead to overfunding.

(ii) If investment outperformance is not allowed for, there is a risk that some schemes who may otherwise have used Fast Track are forced to use the Bespoke route, eg a scheme expected to be fully funded allowing for investment outperformance by the next valuation, but otherwise meet the Fast Track requirements would be forced into Bespoke.

For the avoidance of doubt, outperformance should be permissible under Bespoke.

Q42 Fast Track guidelines on future RPs

In what circumstances should/could outstanding RP payments be re-spread at subsequent valuations? In particular:

a. **If a scheme's funding deficit has reduced (at least) in line with the expectations at the previous valuation, would it be appropriate to maintain the same end date? Or would it be pragmatic to re-spread the remaining deficit over a renewed period?**

   Once a recovery plan has been agreed, a reduction in the level of contributions where the deficit has not been removed should not be permitted under Fast Track (other than to cease at full funding).

   Allowing some, limited re-spreading, is unlikely to pose material risks – however additional rules on re-spreading are likely to unnecessarily complicate the framework.

b. **If a scheme's funding deficit is higher than expected, what guidelines should apply for the appropriate length of the new RP?**

   A new RP should follow the same requirements independent of whether it is a first or subsequent RP, including the requirement that contributions previously agreed cannot be reduced.

c. **Would the idea of 're-spreading' be more acceptable where a scheme has a long period before it becomes significantly mature?**

   We think there should be no re-spreading of committed contributions under Fast Track, independent of the period before the scheme becomes significantly mature.

   However, any RP under the Bespoke arrangement should have true flexibility and not benchmarked against Fast Track RP requirements.

Q43 Equitability

What are your views on the concept of 'equitability' in respect of how a scheme is treated compared with other stakeholders? Should any requirements be qualitative (in line with the commentary above) or should trustees also be expected to consider a specific metric? If so, what might be an appropriate measure of equitability (for example, comparing the ratio of DRCs to dividends, or the size of scheme deficit to the 'stake' of other stakeholders) and how could this reflect a scheme's superior creditor status over shareholders?

Equitability is less relevant the shorter the Fast Track RP. An approach that limits the Recovery Plan under Fast Track to six years would mean that equitability is largely addressed through a prompt removal of the deficit.

Our view is that it is not possible to specify a quantitative metric whereby trustees can consider DRCs as a proportion of dividends – there are too many different corporate structures and stakeholders that such an approach would not be able to easily parameterise.

In any event, TPR should continue to expect trustees to consider this as part of negotiations.

CHAPTER 12: OPEN SCHEMES

Q44 Treating past service and future service liabilities separately in Fast Track

What are your views on our proposed approach to outlining code guidelines for open schemes. Should any other approach to calculating future service liabilities be considered?

TPR should distinguish between schemes open to new members and those open to future accrual, but closed to new members.

We consider that the Fast Track approach would not be suitable for those open to new members, particularly those with shared cost schemes, where members are impacted by change in contributions. There are intergenerational cost issues for such schemes where a new funding approach/investment strategy is forced on members and would therefore benefit from a 'truly Bespoke' approach.

On the other hand, schemes that are closed to new entrants could be treated in the same way under Fast Track whether or not they are open to future accrual. It is reasonable to treat past and future service liabilities separately in this case.

Q45 Fast Track LTO for open schemes

Should the LTO (low dependency at significant maturity) for an open scheme be the same for a closed scheme? If not, how should they differ?

For schemes closed to new joiners, yes, although the point of significant maturity will be expected to extend with each valuation.

We do not think Fast Track is necessarily suitable for schemes open to new joiners.

Q46 Fast Track TPs for open schemes

What option do you favour and why? Are there other options we should consider?

Our preference is for option A, as open schemes that are closed to new entrants should be treated in the same way as closed schemes.

Q47 Fast Track guidelines for calculating future service costs

a. **Which options do you favour and why? Are there any other options for calculating future service costs which should be considered, for example pre-and post- retirement discount rates?**

   We support TPR's preference for Option B for the reasons outlined in the consultation document.

b. **If Option C (best estimate) were adopted, how should the best estimate return assumption be determined? Are there any options other than those described above that we should consider?**

   n/a.

c. **Would our preferred approach (Option B) make it difficult for scheme actuaries to certify schedules of contributions?**

   We expect this option would create the same certification issues as the current position, and as such we don't think it would create any more difficulties.

Q48 Funding future service using past service surplus

Do you think that this approach to funding future service using past service surplus is reasonable? If not, why not? What else would you suggest?

We agree this is a reasonable approach.

CHAPTER 13: BESPOKE FRAMEWORK KEY FEATURES

Q49 Criteria for assessing Bespoke arrangements

What are your views on the criteria we propose to use to assess Bespoke arrangements? If you disagree, what would you change and why? What else should we consider?

TPR's proposed Bespoke approach, which *'will need to be assessed against the equivalent Fast Track position' [para78],* is our largest concern of the consultation – as outlined earlier in this response.

In our view, it would be reasonable for TPR to have a structure whereby it both permits a simplified route of compliance for schemes very close to Fast Track ('Fast Track Plus') who can demonstrate mitigation, and a route for 'truly bespoke' schemes.

We feel it would be inefficient, unhelpful and unwarranted for all schemes to be forced to show and justify the extent their funding arrangements diverge from Fast Track, or how each distinct 'risk' (being divergence from Fast Track) is managed. A bespoke valuation should have the freedom to be fundamentally different from the Fast Track metrics. The flexibility available in the current regime is supported by the 2018 DB White Paper: *'[It] works well on the whole and enables trustees and sponsoring employers to balance affordability and considerations of employer growth with the need to meet the employer's pension promise to members' [para71]*. We propose TPR should permit these schemes to be regulated under scheme-specific criteria.

Q50 Bespoke examples

a. **Do you have any comments on the assessments we have made in the examples above?**

   We appreciate the examples are deliberately simplified to illustrate the principles, and as such feel we cannot confidently apply the principles to real situations, especially in cases where the valuation approach is fundamentally different from the Fast Track standards (the 'truly bespoke' valuations).

   Examples to demonstrate proportionate assessments and lighter touch approach to simple situations are needed.

b. **Could you provide other examples (relevant to your own scheme experience or that of schemes you advise) of arrangements which you think will follow the Bespoke route? Why do you think these arrangements would be compliant?**

   The Society will leave individual firms to provide examples.

c. **In example 2 (LTO – CDI strategy), could it be appropriate, in your view, to be able to use a higher discount rate/lower value of TPs (low dependency basis) than in Fast Track? If so, in what circumstances and by how much?**

   CDI investment strategies are often complex and difficult to fit in to the Fast Track standard. This is one area where we feel a truly bespoke route would benefit the scheme.

Q51 Stressed schemes

a. **Assuming that affordability is genuinely constrained, are very long RPs 'appropriate' and therefore compliant with the Act?**

   It is reasonable to assume very long RPs are appropriate in these situations.

b. **Alternatively, should we make an exception to the principles and allow the trustees of stressed schemes to take unsupported investment risk, or more risk investment risk than other CG4 schemes (schemes with weak employers)? What checks and balances should we put in place in addition to those mentioned above (equitable treatment, risk management)?**

   In this situation, TPR is likely to have a tension between its statutory objectives to reduce the risk of calls on the PPF, and to minimise any adverse impact on the sustainable growth of the employer. It is up to TPR to consider individual circumstances and decide on a suitable approach.

c. **For schemes with unviable RPs, should an exception be made for them in terms of the level of acceptable investment risk?**

   It is up to TPR to consider individual circumstances and decide on a suitable approach.

d. **Are you aware of situations other than stressed schemes where the trustees and employer would have difficulties meeting the Bespoke compliance principles?**

   As outlined earlier in the document, we view Bespoke compliance as needing to be truly bespoke and similar in nature to the current scheme specific regime. On that basis, schemes should be able to meet the requirements in a consistent way to they do now.

CHAPTER 14: ADDITIONAL SUPPORT

Q52 Trustees' assessment of additional support in Bespoke arrangements

Do you have any views on the framework we set out for trustees to assess the appropriateness of additional support in Bespoke arrangements? If you disagree, what do you suggest?

We think the proposals are reasonable.

Q53 Accessing additional support

When do you think trustees should be able to access the additional support? Does it depend on the Bespoke arrangement and the type of risk that it supports?

Additional support should generally be accessible at insolvency situations.

We have seen other types of support that trustees should be able to rely on and assessed as part of scheme funding, for example additional support provided if higher-risk investment falls below a trigger point; negative and positive covenant changes.

Q54 Assessing the value of additional support

Should trustees be required to assess the stressed value of any contingent asset? What other guidance do you think we should set out on the recoverable value of contingent asset support?

Any assessment should be proportionate to the level of support provided, and stress testing should not be a requirement for all situations. For example, a guarantee that covers employer insolvency could reasonably be expected to be stress tested for insolvency events. However, a bank guarantee to pay outstanding contributions may not require stress testing.

Q55 Independent valuation

Should trustees always be expected to seek an independent valuation of contingent assets, or should it depend on asset value and/or type? If this should be based on value thresholds, how should these be defined? How frequently should we expect trustees to seek an independent valuation? Should trustees be expected to regularly monitor contingent asset value in the intervening period?

A proportionate approach is needed depending on the asset value, type, the relative size of the guarantee and guarantor. This should be a general scheme governance issue and not specific to funding valuations.

Q56 Guarantees

a. **Should we treat guarantee support differently to asset backed support?**

   Yes, the two are fundamentally different and should be treated accordingly.

b. **Should trustees rely on guarantee support to change the covenant grade assessment or do you think in these circumstances the supporting entity should become a statutory employer instead?**

   We think the supporting entities should not be required to become a statutory employer. This could discourage future guarantees.

   Guarantees can be taken into consideration as part of the covenant assessment, but reliance on such support needs to be proportionate.

c. **Other mitigations – Can you think of any other types or arrangements which can help trustees mitigate risks?**

   See Q57

Q57 Other mitigations

Can you think of any other types of arrangements which can help trustees mitigate risks?

Methods and arrangements to mitigate risks develop as the nature of risks change, and there are a range of views on what types of arrangements are suitable on different risks.

Other examples not considered in the consultation include third party asset support such as banking guarantees, surety bonds and letters of credit.

Generally speaking, this is an area that has seen a huge amount of innovation in recent years, both in cases where affordability is constrained, and in cases where sponsors are concerned about overfunding.

Q58 Reporting information on additional support

Is there any reason why it would be unreasonable to expect trustees to undertake the analysis and provide the information outlined above? Is there additional information that should also be provided to us?

It is reasonable to provide further information to TPR, but these must be proportionate.