

Pensions Team Bulletin

March 2023

Welcome to the spring bulletin. In this bulletin we look at the draft Funding and Investment Regulations and the Pensions Regulator's draft DB Funding Code of Practice. We also provide a brief update on the status of the Single Code, the Pensions Dashboard System and proposed changes to the Notifiable Events regime.

Please do get in touch with your usual contact in the Wrigleys' pensions team if you would like to discuss any of the legal developments raised in this bulletin.

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The draft Funding and Investment Regulations and the draft DB Funding Code of Practice

Background

Section 221A of the Pensions Act 2004 makes provision for a new requirement for trustees of defined benefit occupational pension schemes to determine a funding and investment strategy.

The strategy must take account of the matters and principles contained in the draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023 (Regulations).

The draft DB Funding Code of Practice (Code) explains how trustees can comply with the new requirements whilst meeting the Pensions Regulator's expectations.

Consultation has now closed on the draft Regulations and the Code. The earliest date on which the Regulations and Code are expected to come into force is 1 October 2023. Actuarial valuations falling before the effective date of the Regulations will not be subject to the new requirements, but trustees should be mindful of them as they may wish to take some preparatory steps to align their processes with the new regime. Although there may be some changes to the draft Regulations and the draft Code to take account of responses received during consultation, we are not expecting significant revisions to be made to either draft.

The Regulations and the Code at a Glance:

Under the Regulations and the Code, trustees will need to plan for the long term funding of their pension scheme. This means identifying a point in time – referred to as “the relevant date” - by which the scheme will be fully funded on a low dependency basis (with no expectation of further employer contributions) and agreeing the funding and investment strategy which will deliver this long term funding objective.

A low dependency funding basis is one which assumes the scheme's assets are invested in line with a strategy under which:

- the cash flows from the investments are broadly matched with the payments of benefits under the scheme, and
- the value of the assets relative to the value of the liabilities is highly resilient to short term adverse changes in market conditions.

The funding and investment strategy must be agreed with the employer and recorded in a Statement of Strategy.

The Statement of Strategy is a new valuation document and must be submitted to the Pensions Regulator. As well as the funding and investment strategy, the Statement must record various supplementary matters including the actuary's estimate of the maturity of the scheme, the current level of investment risk, the funding level of the scheme, and an assessment of the strength of the employer covenant.

The funding and investment strategy must include a journey plan, explaining how the pension scheme will get to fully funded on a low dependency basis. It is a requirement of the Regulations that trustees consider the strength of the employer covenant in setting the investment risk element of the journey plan. For the first time, employer covenant assessments will be a legal requirement.

The strength of the employer covenant is a determining factor in how quickly the trustees are able to de-risk the investments. The stronger the employer covenant, the more risk that can be taken.

According to the Regulations, the strength of the employer covenant means (1) the financial ability of the employer to support the scheme and (2) the level of support from any contingent assets. In assessing the financial ability of the employer, trustees should consider cash flow, likelihood of insolvency and any other factors likely to affect the performance or development of the business.

With regards to contingent assets, trustees should assess the value of the contingent asset by reference to its enforceability and the level of support it provides to the scheme. The Regulator makes some interesting comments in the draft Code with regards to guarantees. Trustees should consider whether the terms of their guarantee fit the criteria of a “look through” guarantee, essentially allowing them to look through to the guarantor for affordability purposes. This will be the case where the guarantee allows the trustees to claim in respect of all amounts owed by an employer to the scheme and the guarantee cannot be revoked without trustee agreement. A guarantee which falls short of these requirements will need to be carefully considered to determine the level of support it provides in practice, i.e. its tangible value.

Key takeaways:

- Trustees will need to determine the long term funding objective for the scheme and plan a funding and investment strategy which achieves that objective within the timescales set out in the Regulations. The strategy must be agreed with the employer.
- For valuations which take place after the date on which the new Regulations come into force, trustees will be required to submit a Statement of Strategy alongside the other valuation documents. The Statement must be reviewed and revised from time to time and the employer should be consulted in relation to its preparation and revision.
- For the first time, it is a statutory requirement to take account of the employer covenant in setting the investment strategy. The draft Regulations and Funding Code contain detailed requirements for covenant assessments, suggesting a key role for the covenant adviser under the new regime.
- Before taking account of a contingent asset in their assessment of the strength of the employer covenant, trustees will need to scrutinise the level of support provided by the contingent asset and keep it under review.
- The earliest date on which the draft Regulations and Funding Code are expected to come into force is 1 October 2023. For schemes with valuations due this autumn, these could be subject to the new requirements.

General Code of Practice

The Single Code of Practice has been renamed as the General Code of Practice and is due to be published in the spring. The General Code is the refresh and consolidation of ten existing codes of practice. Some new content is expected including a requirement to carry out an “own risk assessment” on the scheme’s governance systems within 12 months of the commencement date of the code. This is expected to be a significant piece of work for most schemes, essentially requiring a detailed audit of a scheme’s existing policies and procedures.

Pension Dashboards

The Department for Work and Pensions has announced their intention to “reset” the Pension Dashboard programme. New connection deadlines will be put in place; a further update is expected in the coming months. The pension dashboard framework will remain unchanged.

Notifiable Events (Amendments) Regulations 2021

These regulations - introducing new employer notifiable events – are not yet in force. Their publication has been delayed and, at time of writing, it is not known when they will come into effect.

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