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Consultation on the Regulator's draft code of practice on DB scheme funding

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The Pensions Regulator's long-awaited consultation on its updated DB funding code of practice has been published.

DB schemes will be expected to set a long-term objective and a journey plan to achieve their objective. It is expected that schemes will reduce reliance on their sponsoring employer as they reach maturity. The draft code will require trustees to improve their risk management and improve the evidencing of supportable risk taking.

The consultation, which reflects the DWP's draft regulations, runs until 24 March 2023.

Background

The updating of legislation and the Regulator's revised code of practice have been a long time coming. A DWP Green Paper in 2017 made proposals to improve the security and sustainability of DB schemes and this was followed by a White Paper in 2018 on protecting DB schemes. This then led to the Pension Schemes Act 2021 (which was first unveiled as a Bill in 2019) with supplementary regulations consulted on in July 2022.

The Regulator's consultation is the second on the revised code, with the first, setting out its proposed regulatory approach – a twin-track valuation submission route of Bespoke or Fast Track – being published in March 2020.

Unfortunately, we do not necessarily have the full picture yet, as any changes to the DWP's draft regulations, as a result of its own consultation, could lead to changes in the draft code.

What has the Regulator published?

- The consultation document setting out the questions for respondents to answer.

- The draft code of practice which is divided into three parts: an overview of the funding regime; long-term planning; and application.
- A separate parallel consultation on Fast Track and the Regulator's approach. The consultation runs for the same period as the consultation on the draft code. It was not included in the code consultation as it is not covered in the legislation.
- A response to the first consultation which proposed the twin regulatory approach of Fast Track and Bespoke along with the principles underpinning valuations under the revised code. The response includes a summary of responses to the consultation questions.

In addition, a couple of days before the consultation was unveiled, the Regulator published a blog on what to expect from the consultation.

The code of practice

The Regulator's intention is that the code will support trustees, sponsoring employers and their advisers to manage their pension schemes and will replace the current code, introduced in 2014. It includes key expectations in relation to:

- trustees setting a plan for how they will achieve low dependency on the employer;
- setting a journey plan to reach that point;
- assessing the employer covenant as a key underpin for the level of risk that is supportable on that journey – considering cash, prospects and contingent assets;
- setting funding assumptions consistently with those plans;
- open schemes allowing for future accrual where they can justify their approach; and
- assessing reasonable affordability when determining the appropriateness of recovery plans.

The twin regulatory approach

The new twin-track regulatory approach is intended to help the Regulator recognise which DB schemes require minimal engagement (which it has previously estimated to be around half of schemes) and identify and intervene when there are concerns schemes are not complying with regulations.

Fast Track is not mentioned in the legislation so is not included in the draft code itself. It is an approach set out by the Regulator to bring greater clarity to its approach to the scheme-specific DB funding regime.

Trustees following Fast Track will be asked to evidence how their scheme meets three Fast Track criteria – surrounding technical provisions, an investment stress test and prescribed recovery period. If a valuation submission meets a series of Fast Track parameters, it is unlikely to be scrutinised any further by the Regulator, meaning there will be less engagement with trustees.

Bespoke is an equally valid approach and may be more appropriate for schemes following a more complex funding and investment path but also those unable to meet Fast Track criteria. Bespoke is intended to give trustees the flexibility to select scheme specific funding solutions if the funding approach and actuarial valuation meet legislative requirements and key principles set out in the code.

What comes next?

Subject to the DWP not making any changes to its draft regulations, which may impact upon the draft code, the Regulator is planning for the code to be laid before Parliament (for 40 days) in the summer of 2023. The current expectation is for both the final regulations and code of practice to come into force in October 2023.

Ahead of the consultation, the Regulator was clear of its intention that the updated code would apply to valuations effective from when the code comes into force (i.e. October 2023). Valuations as at earlier dates will continue to be subject to the existing code of practice.

Comment

In March 2020, there was no expectation that the second consultation on the updated code would be delayed for nearly three years. Understandably, the Regulator’s thinking has moved some distance since its first consultation. The draft code shows that the Regulator has listened closely to what the industry said in response to the first consultation.

The events of the past few months have shown the importance of the need for of flexibility of approach and it is good to see that Fast Track definitions will not be hardwired into the funding code but instead be issued separately. It’s also positive to see that the Regulator has now clarified that, once low dependency has been reached, investment strategies with significant proportions of growth assets are acceptable.

It is, however, unfortunate that the draft funding code could not be published and consulted on at the same time as the DWP’s draft regulations in the summer, as the two need to work as a package. The DWP and the Regulator should be prepared to delay implementation beyond October 2023, if more time is needed to finalise a regulatory framework that the industry can have confidence in.

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