DWP Consultation on new funding framework for DB pensions

The DWP consultation published on 26 July 2022 forms part of the long running consultation exercise on the introduction of a new funding framework for DB pension schemes. This particular consultation, on the regulations that will underpin the new code of practice on funding, focuses on the principles that DB schemes will need to follow. The full detail will follow in a final consultation by TPR, expected later this year, which will set out exactly how the new funding code will be applied and what is expected of trustees and employers.

DWP's aim for the new legislation is to provide better and clearer funding standards whilst retaining the flexibility to allow a scheme-specific approach. They also say that the new regulations will allow them to target their resources more effectively.

In a nutshell

The DWP consultation confirms what we have been expecting. Schemes will be required to put in place a low dependency long term funding and investment target and have a clear journey plan that defines when and how they will get there and how risks will be managed along the way. Trustees will also be required to document their target and journey plan in a new 'Statement of Strategy'.

What you need to know

Under the consultation a number of new requirements and metrics will be introduced which trustees and employers need to understand. These include:

- Low dependency funding – this is not defined in technical terms but the consultation states that full funding on a low dependency basis would mean "further employer contributions will not be required under reasonably foreseeable circumstances". The technical detail on what low dependency means will follow in the TPR consultation but we expect that any low dependency discount rate above gilts plus 0.5% will require evidence to show that it meets the requirements.
- Low dependency investment allocation – here, the requirement is that the cashflows from the assets are broadly matched with the expected benefit outgo from the Scheme and the investment strategy is such that the scheme's funding position is highly resilient to short term adverse changes in market conditions.
- Long term plan – Schemes must have a long term plan to achieve buyout, to join a superfund, or to run on using a low dependency funding and investment basis.
- Employer covenant – the regulations introduce requirements around measuring and assessing employer covenant strength and ensuring that the level of risk taken is consistent with the covenant strength.
- Relevant date – the regulations define a new term, the "Relevant Date". This is the date by which the low dependency position must be reached. The Relevant Date must be no later than when the scheme reaches "significant maturity". This effectively sets a backstop for when a scheme must reach its long term target. For schemes which have been closed for long periods, this may not be far away.
- Significant maturity – as members retire and schemes become more mature, the average term to payment (or duration) of the future benefits reduces. The consultation proposes that significant maturity will be defined by reference to the duration, in years, of the liabilities. The consultation also states that TPR may propose that significant maturity means a duration of 12 years.
- Statement of strategy – all schemes will be required to produce a statement of strategy to describe the low dependency funding and investment target, the timescale to reach the target and, crucially, the journey plan setting out how any deficit will be removed. Levels of risk (of the assets vs. the liabilities) will need to be calculated and reported. It is also likely that the statement will include reference to employer covenant and management of risks. The statement must be signed off by the chair of trustees.

- Investment risk is dependent on the Relevant Date – the closer schemes are to the Relevant Date, the less investment risk they will be able to take. For schemes that are invested in growth assets, this implies a progressive reduction in such assets (and correspondingly more in protection assets) over time.
- Regular investment reviews – schemes will be required to review their investment strategies within 15 months of the completion of each actuarial valuation.
- Schemes in surplus – will be required to submit a copy of their actuarial valuation to TPR. Currently this is not the case and it means that the assumptions used will be subject to scrutiny to ensure they meet the new requirements.
- Open schemes – there will be flexibility to allow open schemes to avoid unnecessary de-risking and to continually move forward their "Relevant date" while they remain open with ongoing employer support.

Checklist – what can you do to prepare?

In short, trustees and employers should get ready for the new funding code, because it's coming soon and it will look very much like we expect it to look.

- Make sure you have a long term target and think about whether it is the right target.
- Consider whether your technical provisions are consistent with the long term target.
- Know when your scheme is going to reach significant maturity (expected to be a duration of 12 years) and how this fits in with your current plans.
- Make sure your funding and investment strategies are joined up – many schemes are taking much more risk than they need to. A review of investment strategy will be needed if one has not been carried out recently.
- Make sure you have a journey plan. At the very least, this involves a clear understanding of how much will be paid in and how much asset outperformance is expected to contribute to closing the long term deficit. This will have to incorporate a plan for de-risking assets between now and the Relevant Date.
- Quantify and understand the risks you are taking and how they are supported by the employer covenant.
- Make sure you have a framework for capturing short term opportunities on your way to the long term target. You have to de-risk anyway – having a framework will get you there more quickly and at a lower cost.

Jonathan Seed
Head of Pension Strategy
Jonathan.seed@cartwright.co.uk

If you would like to discuss this further, please get in touch with your usual contact at Cartwright.

Mill Pool House
Mill Lane
Godalming
Surrey GU7 1EY

T: 01483 860201

E: enquiries@cartwright.co.uk

250 Fowler Avenue
Farnborough Business Park
Farnborough
Hampshire GU14 7JP

T: 01252 894883

E: enquiries@cartwright.co.uk

Marlborough House
Victoria Road South
Chelmsford
Essex CM1 1LN

T: 01245 293300

E: enquiries@cartwright.co.uk