Institute and Faculty of Actuaries

23 September 2020

Defined Benefit Funding Code of Practice Consultation

IFoA response to the Pensions Regulator

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

The Institute & Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Pensions Regulator's Defined Benefit Funding Code of Practice Consultation.

We acknowledge the work that the Pensions Regulator has undertaken leading up to the publication of the consultation, in particular the time they have spent engaging with various stakeholder groups and refining the consultation document to incorporate feedback received in those fora. The Pensions Board of the IFoA held dedicated meetings with the Pensions Regulator, and our members attended the wider stakeholder events. This engagement contributed to a more streamlined response process and gave us the opportunity to jointly explore and debate the proposals put forward in the Consultation before it was published.

Key points

In principle, the IFoA is supportive of the Pensions Regulator's twin-track approach. We welcome that the Fast Track option provides clarity, for smaller schemes in particular. However, we think it is essential that sufficient flexibility should be retained for those schemes for whom adopting a Bespoke funding and investment strategy is in the best interests of the scheme and its members.

Whilst we support the overarching twin-track approach, we have highlighted areas which, in our view, require further consideration, including those where unintended consequences may well arise. These unintended consequences could include:

- an increase in the cost of compliance without improving member security;
- a 'levelling down' of funding strategies;
- schemes reducing their achievable investment returns too quickly, leading to worse long-term outcomes;
- undue pressure on corporate finances, leading to insolvencies; and
- the closure of otherwise viable open schemes.

The key areas we have identified in order to mitigate these consequences are as follows:

1. It is important to ensure that the new Code does not lead to the unwinding of sensible and innovative funding strategies which have been designed to be in members' best interests. Therefore, **we strongly believe the 'Bespoke' framework should be genuinely bespoke, and should enable consideration of each case on its own merits.** We are concerned that the 'Bespoke' examples provided relate to situations where a scheme is largely compliant with Fast

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Track, but with some limited and specific exceptions. In our view, the range of Bespoke outcomes should be much broader, with the key test being compliance with the funding legislation. This is particularly relevant for schemes that are still open to new entrants, which we consider merit a highly bespoke approach.

2. We support the principle that there should be a link between the Technical Provisions and the Long Term Objective, however we do not support detailed prescription on the assumptions that may be used to determine either metric. **We are strongly in favour of an approach whereby Fast Track Technical Provisions are benchmarked as a proportion of the Long Term Objective.** The individual assumptions adopted for the technical provisions should then be left to each scheme to agree, based on their own specific circumstances. This reduces the ability to 'game' the choice of individual assumptions and also moves away from a prescriptive 'Minimum Funding Requirement' type regime, with all the drawbacks that would bring.

3. **'Investment return' should not be used as a proxy for 'investment risk'**. It is entirely possible to generate higher or lower investment returns for a given level of risk, and so those schemes adopting an appropriate risk managed strategy should not be required to reduce the expected return on their portfolio. In some cases, reducing expected investment return could well lead to an increased risk of failing to meet members' benefits in full over time. In our response we have also highlighted areas where investment risk for schemes adopting a CDI strategy could be considered in a different way from that set out in the consultation.

4. **We would encourage the use of the existing reporting infrastructure wherever possible**, in order to reduce the regulatory cost associated with implementing the new Code, for smaller schemes in particular. Where reasonable analysis can be conducted based on information already being provided through the Scheme Return or elsewhere, we would suggest that this is used, rather than asking for additional metrics to be provided.

5. There may be a need for **transitional periods within Fast Track** for those schemes where the difference between the existing funding strategy and that required to comply with FastTrack is significant. This will allow a higher proportion of schemes to reach full FastTrack compliance over time.

Whilst our response to the consultation reflects a broad consensus view of the IFoA, we recognise that it will not capture individual views of all our members, which may vary considerably depending on their experience and the schemes or sponsoring employers they work with. We also recognise the difficulties in striking a balance between security and affordability, and continue to view that as, primarily, a matter for the Government. We have encouraged our members and their firms to respond directly to the consultation, in order that as wide a range of viewpoints as possible can be considered when developing the draft Code. We would welcome further dialogue with TPR as the consultation progresses further, and we look forward to considering the Impact Assessment, and responding to the second consultation once this is published. In the meantime, we confirm we are happy for the IFoA to be listed publicly as a respondent to this consultation.

Should you want to discuss any of the points raised in our response, please contact Catherine Burtle, Policy Manager (catherine.burtle@actuaries.org.uk / 0207 632 1471) in the first instance.

Yours sincerely,

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Answers to specific consultation questions

Q1. 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?

1. We agree in principle with the concept of a 'Fast Track' approach that would enable well-managed schemes, including smaller schemes and others not requiring complex funding and investment approaches, to agree a funding strategy within certain parameters and expect less scrutiny from TPR in return.

2. The principles of setting and agreeing a Long Term Objective (LTO), understanding how the investment and funding plan will enable the scheme to reach that goal, while ensuring the covenant supports the risk being taken, are also sensible.

3. However, in practice, the level at which the Fast Track bar is set will determine how many schemes can meet its requirement, along with the extent of prescription over individual Fast Track assumptions. We urge TPR not to be overly prescriptive to ensure that Fast Track can become a genuinely pragmatic and cost-effective option for a wide range of well-managed schemes. This would leave the Bespoke route open for schemes where their financial situation (in particular affordability of contributions) is challenging, as well as those where there is a need, or appetite, for more complex funding and investment strategies. Moreover, we do not agree that the Fast Track approach should become the benchmark against which the funding arrangements of all schemes are measured (that would be akin to the minimum funding requirement (MFR), which is widely accepted to have failed, and go directly against the scheme specific funding principles enshrined in legislation).

4. Too much prescription could lead to trustees being incentivised to unwind existing appropriate funding arrangements, to ensure compliance with each individual component of Fast Track. It will also make explanation of a departure from Fast Track more onerous (as there are likely to be more points of detail on which explanation is required).

5. An appropriate solution, in our view, would be for the Code to require schemes to agree an end-point – the LTO – and to require there to be a journey plan (which would be communicated in the Statement of Strategy), but to retain flexibility regarding the shape of that journey plan, and regarding the discount rates and other assumptions used. If all schemes in Fast Track have a suitable, agreed LTO that they are required to target, that would be a very positive, workable and proportionate outcome. We would also encourage TPR to explore ways to include secure and measurable forms of additional support, such as escrow accounts, in the Fast Track approach; we would not wish for the Code to dis-incentivise the use of these commonly-used and secure forms of additional support.

6. TPR itself highlights the benefits of the flexibility in the current regime, and the Government's support for this was set out in the DWP White Paper; our proposal for a 'lightly-prescribed' Fast Track should enable many more schemes to easily comply with and use this option. The Bespoke route would then be used for schemes that have more challenging circumstances and those that, for example, are sufficiently large and sophisticated, and/or that have sufficiently robust governance arrangements, to justify a more complex approach along with additional regulatory scrutiny. The current proposal risks leaving many schemes in an unenviable position: unable to comply fully with the detailed provisions required by Fast Track and unable to afford the regulatory costs and professional advice of the Bespoke approach. Reducing prescription in the Fast Track approach would make it available to a wider variety of schemes, of all sizes and with sponsors in different sectors (including schemes or sponsors with atypical structures), and thereby lead to a more robust and sustainable regime.

7. Regarding the Bespoke approach, we believe Bespoke must be genuinely bespoke, not just a small variation on Fast Track. If the Fast Track bar is set appropriately, Bespoke would cater for schemes with more challenging circumstances, and those that need or choose to take a more sophisticated approach, and are equally able to produce the necessary evidence that they remain complaint with the funding legislation. As above, we do not believe that Fast Track should be the benchmark (or MFR) for the Bespoke approach.

8. The premise of the proposed twin-track regime is that there needs to be a single objective standard (the Fast Track) for TPR to regulate and enforce against. TPR acknowledges in paragraph 53 of the consultation that there is a range of acceptable or reasonable outcomes, but nevertheless believes a single objective standard is necessary for enforcement purposes. We note that when considered in totality, TPR's proposed prescribed Fast Track is not an objective measure – it includes a number of parameters based on TPR's subjective judgement.

9. For smaller schemes, especially those that are well-funded, clarity regarding TPR's expectations may reduce regulatory and compliance costs and may make interaction with sponsors more straightforward, but only if the sponsor can afford the higher contributions that may be necessary. Although TPR notes that the proposed approach should not be too onerous for most schemes, we expect the majority of schemes will not be able to satisfy all the proposed Fast Track requirements (albeit we recognise the parameters are illustrative at this stage). Based on the current proposals, many schemes are therefore likely to see an increase in regulatory scrutiny, and consequent increases in advice needed. In our experience smaller schemes tend to receive a relatively low level of regulatory scrutiny under the current regime, and hence Bespoke may represent a significant step-change in the level of interaction with TPR. A concern is that this will draw regulatory resources away from the problem schemes that do need expert help, albeit there are often no easy solutions for such cases. In effect, the proposals will place significant implementation costs on the schemes for which the existing regime works well, in order to deal with those for which it doesn't. A simplified, less prescriptive FastTrack proposal, together with appropriate transitional arrangements, would allow many more such schemes to fall within the FastTrack regime.

10. We would also note that, wherever the Fast Track bar is set, there are likely to be significant implementation costs for schemes at their next valuation, even in Fast Track. These costs will fall disproportionately on smaller schemes. This makes it all the more important to ensure Fast Track is inclusive and achievable, such that the majority of schemes can continue to meet its requirements and potentially claw back the additional costs through regulatory and advice savings in later years.

11. For the same reason, we would expect TPR to pursue light touch regulation and light touch information requirements for schemes in Fast Track, so that ongoing regulatory costs are not excessively more than current costs, especially for smaller schemes.

12. Lastly, it seems highly likely that contributions overall would need to increase as a result of the proposals, and that this could put pressure on businesses, especially in the current climate where economic conditions may be pushing up contribution requirements. A robust business impact assessment is needed before a final decision is made about a twin-track approach or the detail of any Fast Track (and we acknowledge that the parameters put forward in the consultation are only illustrative). We suggest that this should be assessed and peer reviewed by independent parties.

Q2. 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?

13. Yes, accepting some risk of benefit reductions on insolvency is a fundamental part of the UK defined benefit pensions regime that should continue. Under this regime, the vast majority of pensioners of UK DB pension schemes have, and continue to, receive their promised benefits in full. The balance struck when the PPF was established on the level of compensation that should be provided to DB pension schemes, remains appropriate and is a demonstrable success of the post-2005 UK pensions regime.

14. Accepting some element of benefit risk is also what has made it possible for the majority of UK pension schemes to continue to provide DB benefits at a relatively efficient and affordable cost (with PPF backup for cases where the employer becomes insolvent and full recovery is not available).

15. Trustees should be able to place some reliance on employer covenant especially where:
    - there is good covenant visibility;
    - there are structural reasons to believe the covenant is enduring; and
    - there are good expectations that future deficits could be funded, and/or that the full Section 75 debt could be met by the employer if needed.

16. Whilst we believe there has been an improvement in scheme member understanding of benefit security, we acknowledge this remains variable. We consider there is a strong case for improvements in the format and content of key communications (e.g. Summary Funding Statements) to make clearer the position for members, and provide relevant and understandable information. We would welcome further engagement on this point as the implementation details of the Code are considered. Importantly, whilst we agree it is important for scheme members to understand the key risks in relation to their benefits (e.g. that they may receive lower benefits following employer insolvency), these risk warnings need to be balanced so as not to push members towards taking inappropriate actions (e.g. transferring their benefits out where it is not in their best interests, or even falling prey to pensions scammers).

Q3a. Do you think it is better to keep the Fast Track route simpler by only factoring covenant into Bespoke (TPs and/or RP)?

17. Covenant should feature in the FastTrack regime, as it is valid and appropriate for trustees to take into account employer strength in setting funding requirements. The proposed Fast Track approach, but without allowance for covenant, would, in our view, significantly increase the number of schemes choosing or forced to use a Bespoke approach to keep contributions affordable and/or to reach agreement with sponsors.

Q3c. 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?

18. Option 3, while theoretically attractive and robust, is simply not workable and scalable, especially for smaller schemes or those with ‘unusual’ covenants.

19. Options 1 and 2 are both possible. However, we understand that the legislative requirement will be for consistency between Technical Provisions and the scheme’s long-term strategy. In our view this favours Option 1 over Option 2.

20. Our strong preference is for the Technical Provisions within FastTrack to be benchmarked as a percentage of the LTO, rather than prescribing discount rates (and a whole range of other assumptions). We consider that it would be relatively straightforward to develop a framework where this percentage of the LTO is specified based on a matrix of covenant and maturity. In our view this would be a simple and appropriate way in which to take into account covenant within Technical Provisions.

Q4a. 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?

21. We are in favour of a holistic approach. A more prescribed, formulaic approach would not work when assessing the covenant for many sponsors, and would have the downside of *appearing* to be objective, but in reality still having significant subjectivity and risk. For example, employer-provided cashflow forecasts need to be independently scrutinised by someone sufficiently knowledgeable to confirm whether they are realistic. A holistic approach is also more likely to be proportionate for smaller schemes.

Q4b. 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?

22. We note that the typical approach is currently to assess a scheme's deficit relative to the Section 75 deficit rather than LTO deficit, especially to assess balance sheet strength. This would be our preference. The Section 75 deficit has the advantage of being a relatively objective and employer covenant-independent yardstick (unlike the LTO which, at least indirectly, may still reflect a view on covenant). We also note that flexibility is needed for small and unusual employers and those with complex group structures.

Q4d. 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?

23. Requiring a prescribed approach for Fast Track (and more flexibility for Bespoke) is highly likely to limit the number of schemes for whom the Fast Track approach is attractive or achievable. Moreover, given the limited time horizon being suggested for reliance on covenant for Fast Track purposes, a highly prescribed approach to covenant assessment would be unnecessary and over-engineered. Also, one of the benefits of the current regime is that it requires trustees to have a better (though proportionate for smaller schemes) understanding of their covenant; adopting a formulaic approach may erode this understanding, leading to trustees seeing covenant assessment as more of a 'black box'.

Q5. 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?

24. The reliance that can be placed on the wider group varies from scheme to scheme. The strength of the wider commercial group is often a material element of the covenant provided to a scheme, for example where the wider group has historically supported the scheme and continues to do so (even if not underpinned by any formal guarantees or contingent arrangements). So, for example, where an overseas parent has historically funded deficit contributions and continues to do so, even without a formal legal obligation, it is not unreasonable for trustees to expect such support to continue in future, with monitoring and mitigations in place to react if at any point that situation looked likely to change. However, where the practice has been, and continues to be, that the local entity is expected to fund deficit contributions from its own cash flows only, then such reliance on the overseas parent and group would not be warranted. Such considerations should, at the very least, be part of the Bespoke regime. Furthermore, where the wider group has provided formal, PPF compliant guarantees to the scheme, it would be reasonable for this to be reflected in the covenant assessment, to enable such schemes to comply with FastTrack if possible.

Q6a. 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?

25. For regulatory purposes and Fast Track, the current four-grade system is relatively well understood and, in our view, sufficient. However, when considering Bespoke proposals, nuances in covenant (such as balance sheet versus cash flow strength, structural strength due to nature of business, long term nature of covenant, quasi government support etc.) are all relevant to the package of appropriate funding, investment and covenant agreed between the Trustee and sponsor, and hence a more nuanced approach to regulation of Bespoke schemes is likely to be necessary.

Q7. 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 run-off phase for their scheme effectively and efficiently?

26. We are supportive of the concept of schemes targeting a position in which they have a low level of dependency on the employer. Long-term objectives are already in common use across many UK schemes. In principle, we think that explicitly requiring a long-term objective enhances the funding regime and provides a consistent framework for decision making. It is positive that TPR recognises that schemes may have different long-term objectives (e.g. buy-out, commercial consolidation, continuing to run the scheme on a 'low risk' basis); however we have concerns that the range of LTO proposed does not fully reflect this (see our answer to Q21). As noted below, there are also additional challenges for schemes which remain open to new entrants.

27. In some cases, a stronger LTO may be appropriate, for example if the trustees and employer have an ambition to buy-out the scheme within an agreed timeframe, but it is not necessary to require this for all schemes. A low-dependency position is more flexible and likely to be more achievable (albeit still ambitious) for many schemes. It is also likely to provide sufficient security in most situations. There is also another unintended and undesirable consequence of an LTO which is set higher than needed, in that it may force schemes to take much higher levels of shorter term investment risk than would be required for a more moderate LTO. Overall, this may actually reduce rather than improve security for members.

28. We broadly agree that as a scheme matures it would be desirable for it to move closer to its LTO. However, in terms of the detailed shape of this 'journey' we would be supportive of a flexible approach being taken based on general principles, rather than requiring adherence to narrow quantitative parameters. As described in our response to Q3c we would support the Technical Provisions being benchmarked as a percentage of the LTO, with individual schemes having the flexibility to shape their journey plan to suit their individual circumstances.

29. Moreover, it is difficult to set a suitable quantitative measure of 'maturity'. Linking maturity to the point at which all or most of the liabilities are in respect of pensioners, is likely to be over-simplistic and lead to some anomalies in practice. For example, some schemes with a majority of pensioners' liabilities may be less mature than a scheme with a majority of deferred pensioners' liabilities, depending on the history of the scheme, retirement patterns, take-up of member options etc.

30. If timescales for reaching the LTO were to include some quantitative measure of maturity, a preferable option from an actuarial perspective would be to determine maturity by reference to a more sophisticated metric, such as the duration of the liabilities (as assessed on the LTO assumptions). For example, giving guidance that schemes should target achieving a low dependency LTO by the time the duration of the liabilities reaches 10-15 years (say), may better reflect the diversity of scheme circumstances, while still providing some consistency across the industry. Under the Bespoke model at least, there should also be flexibility for schemes to set later target dates for the LTO where the schemes already uses sophisticated processes to manage their liquidity requirements.

31. As an aside, we support the fact the consultation does not use the term ‘self-sufficiency’, which we believe to be misleading (we consider ‘low dependency’ is a more appropriate description of the dynamic between the scheme and employer when the LTO is reached).

Q8. What factors should influence the timing of reaching the LTO? Do you think that the timing should be linked to maturity?

32. The factors to consider in determining the timescales to reach the LTO are similar to those to consider in setting the Recovery Plan length (see our response to the questions in Chapter 11), in that they are a complex balance between ensuring security of the scheme’s benefits, considering the development of the investment strategy and liquidity requirements over time, and maintaining the sustainability of the employer. However, with the LTO the timescales involved are longer and a greater degree of flexibility is needed.

33. The important thing here is that there is a workable plan to reach the LTO, *not* its precise details. General guidance and examples of good practice could be provided to support smaller schemes and those where governance is weaker.

34. As covered in our response to Q7, while we support the view that the maturity of the scheme is a relevant factor in determining a plan to reach the LTO, our preference would be for this to be encouraged through general guidance rather than (potentially crude) quantitative parameters.

Q9. Do you think that the investment portfolio should be highly resilient to risk when schemes reach their LTO? If not, what do you suggest?

35. Yes. We consider that schemes should ensure that, under a low-dependency approach, its funding position and ability to meet cash flows are sufficiently resilient to movements in investment market conditions. (We note that it is the volatility of the funding position that is important here, not the quantum of investment risk taken per-se.)

36. However, there is a wide range of ways of achieving this, which may or may not involve investing solely in ‘low risk’ assets. There has been considerable innovation in this space across the industry over the past decade or so, with many alternative solutions that are designed to broadly indemnify the scheme’s funding position from adverse outcomes while still taking some investment risk. This development – which has in part been driven by TPR’s (in our view) successful ‘Integrated Risk Management’ framework – has been very positive and has led to the adoption of some robust funding strategies which should provide strong long-term outcomes.

37. We note that TPR has no legal role in setting the investment strategy for schemes. We also believe a greater range of investment portfolios could qualify as “highly resilient to risk”. The size of the Sterling credit market (and indeed the UK gilt market) are too small to allow all schemes to adopt an investment strategy consistent with the LTO as currently defined. It will therefore be important for those schemes able to manage a diversified range of assets to be allowed to do so.

38. We are keen that the new Code does not stifle this innovation or result in schemes adopting sub-optimal strategies in order to conform to the requirements or to force themselves into Fast Track. Therefore, we feel it is important that the guidance remains flexible, essentially continuing (or slightly augmenting) the current IRM framework.

Q10. 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?

39. While we broadly support the principle of schemes defining and working towards an LTO, we do not support prescribing the path that schemes should take in order to get there, as they should be free to

choose the level and way in which they take risk over time. DB schemes and their sponsors have myriad differing circumstances and objectives which would be impossible to capture satisfactorily in prescriptive guidelines.

40. While we may expect a ‘typical’ less mature scheme to invest in a higher proportion of return-seeking assets than a ‘typical’ more mature scheme, this may not always be the case. For example, less mature schemes which have adopted a constant-risk approach for the period until they reach their LTO and more mature schemes that are taking more risk as part of a clear strategy (for example those who are trying to meet members’ reasonable expectations in relation to discretionary pension increases).

Q11. 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?

41. The overall rationale set out for the journey plan is reasonable, and consistent with those that many schemes have already established. Journey plans may encompass a wide range of elements including, for example:
    - Employer contributions
    - Contingent security / funding
    - Planned evolution of the investment strategy (sometimes involving ‘trigger points’)
    - Liability management initiatives
    - Purchase of bulk annuities

42. It is important that journey plans are monitored over time, with a clear plan for what happens if the scheme is significantly behind or ahead of the plan.

43. We agree that there is a need to demonstrate that full funding on the Technical Provisions basis, together with the agreed contributions and investment strategy, is expected to result in achieving the LTO at the target date.

44. One way a scheme *could* achieve this would be to have the Technical Provisions assumptions explicitly transition to the low-dependency assumptions over time. In the case of the discount rate this could, somewhat crudely, involve setting the post-target date discount rate to be the low-dependency discount rate. However, this could in a number of circumstances be an overly prudent approach or lead to undesirable unintended consequences. For example, schemes may choose a lower LTO simply because it is easier to include in Technical Provisions, or may adopt a higher short-term discount rate (and take higher short-term investment risk) in order to cover the additional prudence required by embedding the target in the Technical Provisions. There are other ways this can be managed, including the use of some or all of the journey plan elements listed above and/or an expectation that actual investment returns will be higher than those assumed for (prudent) funding purposes.

Q15a. 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?

Q15b. 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?

45. Pension scheme funding involves making assumptions about all manner of factors which may not be able to be reliably predicted in the short-term, let alone the long-term. The ‘funnel of doubt’ typically expands the further into the future you go, justifying a more cautious approach.

46. This usually applies to the employer covenant and therefore we agree that it is not appropriate for trustees to rely on covenant and conduct their long-term planning without considering how the covenant may evolve over the short, medium and long term. However, in our view, a lack of visibility over longer-term covenant does not mean that trustees should assume the covenant disappears after a short term.

47. As previously noted, we are supportive of schemes closed to new entrants planning for a reduction in reliance on the employer covenant over time, consistent with moving towards a low-dependency LTO. However, we do not favour a simplistic quantitative approach to assess this 'covenant visibility', noting the wide range of scheme and employer circumstances. A period of 3-5 years is short for some employers, whose business plans may extend way beyond that period. For some employers, such as regulated utilities, there are clear structural reasons why they may be expected to continue well into the future. Conversely, for some employers 3 years may be too long.

48. This is an area where general guidance should be provided, together with encouragement to trustees to seek professional independent covenant advice where appropriate and proportionate to do so. Scenario testing could play a useful role here. Where appropriate, it may be worthwhile for trustees to extend the range of adverse covenant scenarios they consider and the consequential impact on the scheme. This is especially pertinent at the current time in the light of the COVID-19 pandemic.

49. We also refer here to our responses to Q2 to Q6.

Q16. 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?

50. Yes, we are fully supportive of this approach. For more detail please see our responses to Q52 to Q56.

51. Where possible we would encourage as much consistency as possible between TPR's requirements and the approach taken by the PPF. This would provide clarity and strengthen the 'business case' for trustees of small schemes incurring the cost and effort to put these arrangements in place.

Q17a. Should employer affordability be the key factor to determine the appropriateness of a RP? If not, what should it be?

52. We support the principle that the period over which deficits are recovered should generally be based on affordability, subject to not jeopardising the 'sustainable growth' of the employer (where relevant).

Q17b. 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?

53. We agree that we would generally expect schemes with a stronger employer covenant to be able to recover deficits more quickly. However, it is important that the funding framework reflects the wide range of scheme and employer circumstances and allows flexibility in this regard. An employer that has structural and/or balance sheet strength may not necessarily have high short term cashflows. In our view it is not practical to prescribe the recovery plan periods that may apply to schemes with different covenant strengths. We cover this in more detail in our response to the questions in Chapter 11.

Q18. Should past service have the same level of security, irrespective of whether the scheme is open or closed?

54. We draw an important distinction between schemes that are open to accrual but closed to new entrants (or that are open to new entrants in only very restricted circumstances) and those that are fully open to new entrants.

55. For those that are open to accrual but closed to new entrants we broadly agree with this principle. These schemes have a clear finite lifespan (albeit potentially a longer one than closed schemes) and therefore it is reasonable to apply broadly the same level of security to the past service benefits.

56. However, we do not agree with the principle for schemes that are fully open to new entrants. Any employer that has kept their DB scheme open to new entrants will have done so as a very conscious choice, and typically with strong support from employees and associated trade unions. This will usually have involved complex discussions and decisions on levels of funding and contribution rates, all with the end game of ensuring the scheme remains open and also has an agreed level of funding. We do not agree that the only option for schemes which are genuinely open to new entrants and do not expect to mature in future should be to fund on the assumption that they will mature and reach a closed scheme LTO. Therefore, we consider that a more bespoke approach can be justified in these cases.

57. For further detail, please see our response to the questions in Chapter 12.

Q19. 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?

58. We broadly agree with this principle. However, we think there are a range of ways to achieve this. For example, we do not consider that this would necessarily require the same assumptions to be used for past and future service. We discuss this in more detail in our response to Q47.

59. The Government has indicated that they do not want further DB schemes to close unnecessarily. In order to achieve this, in our view it is very important that the new Code of Practice is not designed in such a way to cause yet more employers to replace their future DB accrual with DC provision. Otherwise, in terms of the impact of the new Code on UK pensions provision as a whole, this negative outcome may negate positive outcomes that may arise from other aspects of the new Code of Practice.

Q20. Do you agree with our assessment of the issues above and do you have any further comments?

60. We certainly agree that the schemes mentioned in paragraph 219 will need thorough assessment to identify where the proposals will not work, although we would like to see that assessment taking place in the context of a lightly-prescribed Fast Track, as described in our response to Q3.

61. **Schemes with unusual employers/benefits structures**: It would be preferable to identify exemptions and replacement provisions where feasible, rather than forcing schemes onto the Bespoke approach because, for example, their sponsor does not fit the standard. Partnerships, for example, may need special provisions concerning the covenant assessment (or they may need to rely less on the covenant if it cannot be assessed), and there may need to be additional guidance for other examples of atypical structures. The lightly prescribed Fast Track we favour, possibly in conjunction with some guidance on how atypical structures can be taken into account, should enable more schemes to avoid the need for a Bespoke approach.

62. **Trapped/ongoing surplus**: We would not expect a well-funded scheme to have to take a Bespoke approach purely because there are concerns about trapped surplus. There should be sufficient flexibility in Fast Track to allow schemes to take reasonable action to address this concern

(contingent assets, for example). As noted in our response to Q3, we are of the view that secure and measurable forms of additional support can be accommodated in a Fast Track approach.

Q21. 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)?

63. The liability measure under Fast Track could be set as 'gilts plus a spread'. However, in our view the proposed specification of 0.25-0.5% as a fixed spread may lead to sub-optimal outcomes.

64. We are concerned that, if the discount rate (and timeframe) proposed is too onerous, it may mean schemes are incentivised to take more risk than necessary in the short to medium term to fund the high target at the required date. A long-term target that captures the spread on a broader fixed income portfolio, rather than using a fixed margin above gilts could allow schemes to reduce risk earlier in the journey plan.

65. The proposed LTO discount rate will be more onerous in particular market conditions than others. TPR's own comments in the consultation, and subsequent blogs, suggest that TPR recognises that the discount rate may not be appropriate under all potential investment market conditions. The discount rate mechanism should be designed in such a way as to be able to appropriately reflect a wide range of market circumstances.

66. Specifically, we believe some element of linkage to corporate bond spreads should be allowed within the LTO framework, with suitable adjustment for fees and defaults – i.e. gilts plus a proportion of credit spreads, rather than gilts plus a fixed margin. Such an approach would align better with the type of highly resilient portfolio that most schemes would likely hold in run-off, and also with likely insurance pricing (where relevant). It would also reduce the procyclicality of 'gilt plus' funding measures (e.g. being forced to de-risk against rises in credit spreads).

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?

67. Some assumptions, particularly demographic assumptions, should be set specific to the circumstances of the scheme (approach 1): mortality base tables, early retirement, commutation and proportion married assumptions can all vary significantly between schemes depending on underlying population and specific benefit design. There are objective methods (e.g. postcode studies, experience analysis) that can be used by many schemes to derive suitable assumptions. Schemes that are too small for these approaches can still typically use their knowledge of the benefit design (e.g. early retirement and commutation terms, spouse / dependant definitions and benefits) and the membership (e.g. earnings levels, location and industry) to guide the choice of adjustments to standard assumptions and tables.

68. We support greater consistency (approach 2) for the limited assumptions which are less clearly scheme-specific (e.g. long-term mortality improvements, the smoothing parameter within the CMI model). However, we still prefer a principles-based approach for other assumptions, rather than mandating specific numeric values, to better able to deal with variations in scheme benefits and duration.

69. Defining all assumptions (approach 3) would not eliminate gaming. It would also make it much more likely that many more schemes will choose a bespoke route, even if the overall level and prudence in their funding approach is consistent with FastTrack.

Q23a. What are the most significant assumptions (other than discount rates) for the calculation of the Fast Track low dependency liabilities?

70. Which assumptions are most significant for a given pension scheme will depend on the specifics of that scheme – in particular the provisions of scheme rules and the balance of liabilities between different categories of members. However, in general we expect that the most significant assumptions are likely to be:
    a) Pension increase and deferred revaluation assumptions
    b) Mortality
    c) Commutation
    d) Retirement ages
    e) Family statistics (especially for smaller or very mature schemes)

Q23b. 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?

71. As set out above, we prefer a principles-based approach, rather than mandating specific numeric values for assumptions for the Fast Track LTO.

72. Assumptions for RPI inflation are commonly derived from the curve implied by fixed-interest and index-linked gilts, and it may be appropriate to require this as a starting point for the low dependency pension increase calculation. Whether or not allowance for an inflation risk premium is appropriate, and the extent of any such allowance, will be scheme specific. A scheme which intends to fully hedge inflation risks when it reached low dependency would, in general, not make any allowance for an inflation risk premium.

73. Although there are some forms of pension increase that are commonplace across many schemes (e.g. RPI or CPI inflation up to a maximum of 5% p.a.), pension schemes incorporate a wide variety of different pension increase provisions. Due to this variety, it will be unhelpful, for TPR to seek to specify pension increase assumptions.

74. Commutation assumptions will include the assumed proportion of members who commute their benefits as well as the terms they would be offered (both now and in the future). These assumptions will vary between schemes – in part driven by the specific commutation provisions in each scheme, in part driven by the commutation factors applied, and in part driven by the experience of the scheme. Assumptions are sometimes specified as a percentage of the maximum possible (which, in turn, varies between schemes) and sometimes as a percentage of the pension that is commuted. In our view, it is appropriate for commutation assumptions to be specific to the circumstances of the scheme.

Q23c. 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?

75. The Continuous Mortality Investigation (CMI) model is in widespread use across the industry. TPR could reasonably specify (at least principles for) which CMI model to use and the key parameters to calibrate in the CMI model (e.g. S-kappa, long term trend rate).

76. We would not support TPR specifying the base table as this needs to be scheme specific. Our members are well placed to advise appropriately in this technical area.

Q24a. 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?

77. Our preference is towards approach 2 or approach 3. We recognise that approach 3 is potentially circular. Employer accounting numbers may not be available, but also may not be comparable as they reflect the employer's view of best estimate assumptions, which may differ from the trustees' view. There is also a common view that accounting assumptions should not be affected by (reversible) investment decisions, which can lead to substantial differences between funding and accounting valuations (for example in the approaches taken to the inflation risk premium and to longevity hedging). There is often a time lag in updating CETV and accounting assumptions following a valuation, which means the comparison may be flawed.

78. Actuarial guidance previously required the actuary to provide advice around their 'neutral estimate' of the liabilities, intended to have margins for prudence removed. A neutral estimate was never required to be disclosed, and is no longer required, but could be reinstated as a form of 'best estimate' measure for the purpose of the comparison under approach 3.

Q25a. If we specified certain assumptions, should we aim for those to be best estimate or to be chosen prudently?

Q25b. 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?

79. Without additional assets allocated as a 'risk margin' above best estimate, the overall basis needs to have a degree of prudence overall. As we have previously suggested, the best way to achieve this would be to specify a minimum percentage target for the Technical Provisions as a whole when compared with the LTO, taking into account covenant and maturity.

80. Including prudence in each assumption will heighten the risk of excessive prudence (given that the degree of prudence of each assumption is hard to assess and may contribute to excessive prudence overall and hence delay de-risking or lead to unintended consequences).

Q26a. Should the low dependency liabilities carry an expenses reserve? If so, should this only be a requirement for schemes that self-fund their expenses?

Q26b. 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?

Q26c. 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?

81. A low dependency target should incorporate an expense reserve, as the scheme is not truly in a low dependency state if it remains reliant on the employer to meet expenses. We feel that a principles-based approach should be taken towards the expense reserve, e.g. based on recent evidence of scheme fees (adjusted as appropriate for any one-off costs).

Q27a. Should maturity be defined as duration for the purpose of prescribing significant maturity under FastTrack? 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.

Q27b. 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?

82. On balance, we support the use of duration as a measure of maturity for the Fast Track low dependency assumptions.

83. Duration is relatively easy to calculate as a measure of maturity and is commonly used in discussions around investment strategy and choice of assumptions; however, it does have a number of potential flaws. In particular, different schemes can have similar durations for different reasons: low duration could be a result of low life expectancy or low levels of pension increases, rather than higher maturity.

84. It is also not always straightforward to understand how duration changes over time. Duration can change rapidly, in particular for smaller schemes (e.g. if one member with a large pension dies or transfers out). Even in schemes closed to accrual, duration does not always reduce: it may increase if there are significant deaths or if the assumptions become more prudent.

85. There is an argument for basing 'significant maturity' with the proportion of pensioner members, for simplicity and to provide some alignment with insurance buy-out pricing (where relevant). However, this approach is less sophisticated and has a number of important shortcomings; for example it can be significantly affected by the relative assumptions adopted for pensioner and non-pensioner members and by the age at which members retire (in certain circumstances a scheme with mostly pensioners may actually be less mature than one with mostly deferred pensioners).

Q28. 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.

86. As a rule of thumb, a duration of 12 to 14 years is likely to be representative of a scheme which is mostly pensioners; however (as noted above) this will vary to some extent from scheme to scheme.

87. Where the target is set will be a driver of how many schemes are able to adopt the Fast Track approach, but could also have other unintended consequences. Expecting schemes to meet their LTO quickly, by setting a higher duration for the definition of 'significant maturity' may mean that few schemes are able to reach their LTO in time, which in turn will mean a significant number of schemes need to go down the Bespoke route. Such an approach could also lead trustees to retain higher levels of risk for longer, increase volatility in funding requirements, increase the risk of overfunding and exacerbate capacity constraints in gilt and investment grade credit markets.

88. The definition of 'significant maturity' needs to be considered fully in the second consultation, in the context of the other parameters being considered for the LTO.

89. We note that schemes that are already significantly mature (or close to being such) may need to be given additional time to achieve the LTO, for example through explicit transitional arrangements.

Q29. 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?

90. We are supportive of the flexibility afforded by ranges and this will be important as schemes approach significant maturity to avoid incentivising a high level of investment risk being retained to hit full funding level at an increasingly proximate date.

91. For many schemes, the LTO will be a considerable number of years away, and a number of assumptions are required around what will happen over that period – assumptions that may not be borne out in practice. In this context, it may be spurious to become too dogmatic about the precise point that schemes meet the LTO level – indeed, accepting deferral may be preferable in terms of overall risk management / reduction.

Q30a. 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?

92. TPR has been advocating the adoption of an LTO and journey plan for some time. It should be unnecessary to impose additional burdens on trustees (and other stakeholders) that have already adopted what TPR has long advocated as good practice.

93. Given the consultation acknowledges that all three methods have advantages and disadvantages, we do not see why TPR needs to specify only one method, not least because this could force schemes to unwind existing journey plans. Flexibility is key to getting as many schemes as possible onto a Fast Track route, with minimum compliance costs and optimal member security.

Q30b. Are there any other journey plan shapes we should consider?

94. It does not seem appropriate, or a good use of regulatory resources, to force a scheme through the Bespoke route simply because a scheme has a journey plan which is different to TPR's preferred shape, especially where, when viewed over time, the alternative shape is no riskier than the prescribe approach. We do not believe the shape should be prescribed and do not see the merits of prescription in terms of member (or PPF) protection.

Q30c. What unintended consequences might arise from adopting the linear de-risking or horizon method journey plans for Fast Track?

95. It could have an unintended impact on investment strategy and require step changes from current journey plans. It could also impose unnecessary compliance costs on schemes that are already adhering to best practice (and which will not, by definition, benefit from regulatory change).

96. TPR itself notes in paragraph 304 that it wants most schemes to be able to choose Fast Track without making material changes to their current approach (although we assume it only means those schemes that already have an LTO and journey plan, which will be the minority). Once again, in our view forcing schemes that have already implemented an appropriate journey plan to move to a particular shape would be imposing additional compliance costs for no particular benefit.

97. Moreover, restricting the shape of the journey plan could drive schemes to take inappropriate levels of risk at inappropriate times and hence result in poorer outcomes. This is particularly relevant where the shape of the journey plan has been designed to fit with the Trustees' understanding of the covenant risk over time. Given there will be countless circumstances in practice, we would see good governance and effective integrated risk management as being more important than a prescribed journey plan shape.

Q31. Should other scheme-specific factors other than covenant and maturity be considered to define the journey plan and TPs in Fast Track?

98. No, because we believe the Technical Provisions should be prescription-light and that the journey plan shape should not be prescribed.

Q32a. 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)?

Q32b. What level of covenant support should subsequently be assumed? Should there be an assumption of a single covenant grade reduction (e.g. CG1 to CG2), a reduction to assumed returns in line with a weak covenant, or something else?

Q32c. Over what period should any reduction in reliance take place? Should this be immediate (e.g. a reduction to a lower covenant reliance in the sixth year) or more gradual (for example, over the subsequent five years)?

Q32d. 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?

99. We believe this proposal is too complex for a Fast Track approach. The proposal also overlooks that the trustees' covenant assessment should, by its nature, be an assessment over time, rather than simply an assessment of strength at the valuation date.

100. We also previously noted that, if possible, contingent assets could be accommodated in the FastTrack approach. One way this could be done, is for this to recognised when deciding on the time period for covenant visibility.

Q33. 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?

101. We would strongly prefer the approach of benchmarking the Technical Provisions as a percentage of the LTO. Conceptually this is transparent and easy to understand and communicate. It also allows the FastTrack target to be clear and simple, while providing schemes with flexibility. We concur with the 'pros' listed in the table.

Q34a. Do you prefer a particular approach? If so, why? Is there another approach that would be suitable?

102. We prefer deterministic modelling, the key reasons being practicality, simplicity and transparency. However, there should be sufficient external (to TPR) input on the choice of assumptions. The data driven approach, in particular, would not be robust and could invite unwelcome perceptions that actuaries are 'proving themselves right'.

Q35a. Would a measure of the liabilities be an appropriate position to measure investment risk from? If not, why not?

103. Yes, this is appropriate.

Q35b. 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?

104. We have commented in our response to Q21 on the specific measure proposed for the low dependency basis.

105. We prefer the low dependency basis. Some spread above gilts flat is appropriate given the long-term investment strategy, and also reflects that the liability cash flows are also not 'risk free' relative to gilts (due to factors such as longevity risk and inflation linkage). Schemes will already have four

or five different liability measures to consider (LTO, Technical Provisions, PPF section 179, Solvency, possibly Neutral); it seems unnecessarily complicated to introduce a sixth measure for risk measurement.

Q35c. 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?

106. In our view this would not be beneficial. Schemes vary widely in terms of benefit design and profile. Average inflation linkage may be 70%, but some will have zero and some 100%. The difficult part is in measuring investment risk relative to the liabilities, not in measuring the sensitivity of the liabilities to interest rates and inflation (which we would expect to be done as standard by the actuary as part of their advice to their client on the valuation results).

Q35d. 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?

107. Fixed and index-linked gilts might be appropriate for a gilt-flat liability measure, but we believe the reference portfolio should allow for a credit spread linked to the spread on a suitable broad-based sterling corporate bond index (but without necessarily restricting this to only investment-grade corporate bonds).

Q36a. 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?

108. Yes, in our view the simple stress test is the preferable option. For the avoidance of doubt, we would be uncomfortable with the approach which considers the percentage of growth assets held by the scheme. This is because interest rates and hedging levels will also have a significant impact on pension scheme funding progression. For instance, a scheme with 30% in equities and a full interest rate and inflation hedge will, in aggregate, be running less risk than a scheme with 20% in equities and no hedge.

Q36b.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?

109. A fall in growth assets alongside a fall in interest rates will cover the major risks that pension schemes are exposed to, however the following additional considerations might provide better insight into the financial risk being run:
    - The stress test could include the impact of changes in inflation expectations
    - The stress test applied to credit assets in the portfolio could incorporate consideration of the impact on the credit spread net of expected losses (probability of default x loss given default) rather than a mark to market stress.
    - The stress test could include exposure to unhedged foreign exchange moves.

Q36c. 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?

110. We support the principle of using the PPF test as a starting point. It was designed to meet very similar goals and uses an asset-class classification that is relatively standard across the DB industry. This would not be true for banking or insurance-based stress tests.

Q36d. 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.

111. Expressing the outcome of the stress test as a ratio could encourage focus on the wrong risks, and the wrong schemes.

112. Given that the (primary) concern here is to test whether the employer is able to underwrite investment underperformance, it would be better to express the result of the stress as the change in deficit (as a monetary amount), which can be compared against suitable metrics on affordability (e.g. deficit contributions and / or measures derived from the employer covenant assessment) to test whether the investment risks are supported.

113. High funding level volatility might be tolerable for schemes that are small relative to the employer, whereas schemes that are large relative to the employer should be encouraged to reduce risk earlier.

Q37a. 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?

114. If Fast Track requires a limit on investment risk for significantly mature schemes then we are broadly supportive of the methodology being proposed, with the following caveats:
    - Short term and long term risk can behave differently and we agree with the GAD analysis that the lowest risk portfolio assessed on a short-term risk metric may not be the lowest risk portfolio over a longer time horizon. Mandating de-risking vs a short term risk measure may therefore be detrimental to member outcomes.
    - We are cautious of the statement “In our view, an investment portfolio with a higher level of growth assets than 20% is unlikely to have a prudent expected return consistent with the low dependency funding basis at significant maturity”. This is an example of conflating investment return with investment risk. Whilst the two are related, return should not be a proxy for risk.
    - Suitable allowance for the relative size and strength of the covenant ought to be incorporated as outlined above.

Q37b. 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?

115. The retrospective approach to setting this range may seem reasonable given the historical context. However there is a danger that such an approach is not sufficiently flexible to capture future structural changes in relative risk premia.

Q37c. Should the allowance for prudence be higher for an investment portfolio with a higher level of risk?

116. This depends on the way in which risk is measured but broadly we agree with this principle.

Q37d. 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?

117. As noted in our response to Q11, we do not support prescription of the journey plan.

118. As noted in our response to Q36d, we are not convinced of the merits of expressing investment risk as a ratio. Linkage to covenant, in particular, is complicated by ratio approach; expressing risk as monetary amount is likely to make a comparison with the covenant more straightforward.

119. We do not think the simple ‘pass/fail’ set out in paragraph 403 is appropriate as currently worded. Schemes could potentially fail to satisfy Fast Track even if all benefit cashflows remain matched

(another reason supporting the admissibility of Gilts + a proportion of credit spreads as a discount rate approach).

Q38a. Do you think we should define some guidelines around liquidity and quality in Fast Track?

120. No. The focus on quality is lop-sided in favour of credit quality and should be tilted towards expected loss. The current principles appear to prioritise mark-to-market considerations rather than focusing on whether the credit portfolio is 'money good' and aligned to liabilities, thereby avoiding the need to be a forced seller.

Q38b. If so, what are your views on the options outlined above? Are there other approaches you favour?

Q38c. What limits would you set on the above criteria and why?

Q38d. How would the above change for a more immature plan?

121. Our strong preference is for a principles-based approach.

122. In our view, the other suggested approaches may lead to less than optimal outcomes. There is a danger that some approaches may nudge schemes into favouring investment grade credit over lower-rated credit. The focus appears to be on the 'probability of default' (PD) which does not sufficiently capture the risk of investing in credit. Instead, a more holistic approach would allow for both PD and 'loss given default' (LGD). This would better reflect the overall concept of 'expected loss'. Any mechanistic approach that bakes in references to credit ratings and relies on them as the primary measure of credit risk contradicts one of the major lessons emerging from the global financial crisis, when an over-reliance on credit ratings to manage risk was seen as a major shortcoming and resulted in investment decisions and investment behaviour that was sub-optimal. Specifically, it may be possible to construct a credit portfolio with a better risk-adjusted return by including counterparties with higher probabilities of default (lower ratings) but higher recovery rates.

Quality

123. We do not support a separate credit quality test; we consider that this unnecessarily complicates risk measurement and is better incorporated within the core investment stress (see Q36).

124. As noted in our response to Q38a, we think the focus on quality is lop-sided in favour of credit quality and should be tilted towards expected loss. The current principles appear to prioritise mark-to-market considerations rather than focussing on whether the credit portfolio is 'money good' and aligned to liabilities.

Liquidity

125. We feel the focus in TPR's statement in paragraph 405 ("*a high level of liquidity is important, especially when a scheme is mature*") needs to expand to capture a) the ability to deliver expected cashflows, b) the ability to generate sufficient cash at short notice to meet "unexpected cashflows", and c) the ability to transfer assets and liabilities at an unexpected time.

126. As currently worded, equities are admissible within a significantly mature scheme, but private credit is not. Private credit now constitutes a significant portion of global fixed income, is used significantly by insurers and indeed the PPF to match pension liabilities and offers the same characteristics as public credit in terms of asset-liability matching.

127. The size of the Sterling credit market (and indeed the UK gilt market) are too small to allow all schemes to adopt an investment strategy consistent with the LTO as currently defined. A greater range of assets will need to qualify when a scheme achieves its LTO, to avoid the demand for a

small pool of assets driving achievement of the LTO out of reach for most schemes. It will therefore be important for those schemes able to manage a wider range of assets to be allowed do so.

Q39a. 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)?

128. We agree that it is important that there is consistency between the approach taken to the Technical Provisions and to the Recovery Plan under Fast Track, including the allowance for the employer covenant. This mitigates the risk of a 'robbing Peter to pay Paul' situation where, in order to fit within Fast Track the Technical Provisions are strengthened but the Recovery Plan weakened (or vice-versa).

129. We don't see any particular reason why the Recovery Plan length thresholds need to be expressed as multiples of valuation cycles.

130. The suggested period of 6 years does not seem an unreasonable period to use as a threshold for spreading deficit contributions for schemes with stronger covenants (which also include strong short to medium term cashflow generation). However, care needs to be taken over when the period is counted from, given the time it takes to complete a valuation and agree contributions. For example, if counted from the valuation date, a 6-year recovery period would essentially require a deficit to be spread over 4.5-5 years, which may be unnecessarily short (i.e. may result in an unaffordable level of contributions) for many schemes. For this reason, we would suggest setting the threshold at, say, 7-7.5 years with this period being counted from the valuation date. Where there is good reason to believe strong covenant visibility extends beyond this period, it would not be unreasonable to allow a higher limit in cases where the resulting deficit contributions would otherwise be challenging for the employer.

131. We consider it would be very difficult to set appropriate Recovery Plan thresholds for schemes with weaker covenants. The CG3 and CG4 buckets are going to include a plethora of schemes and sponsors with contrasting circumstances. Setting the recovery plan period is a balanced call between allowing a longer period (and thereby mitigating the risk the employer becomes insolvent) and looking to receive cash while this is still possible. It will be hard to capture this complexity in a simple threshold; indeed, it may result on some adverse outcomes. For example, setting higher thresholds for the CG3 and CG4 groups may actually influence some schemes to agree a longer recovery plan where a shorter period would be affordable.

Q39b. 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?

132. We consider that this is a more practicable option, noting comments above regarding the wide range of circumstances for CG3 and CG4 schemes. This approach is simple for Trustees and employers to understand. It may influence Trustees of CG3 and CG4 schemes to try to reduce the recovery period towards that single maximum guidance RP length over time (thereby avoiding the adverse outcomes mentioned in our response to Q39a).

Q39c. Do you think Fast Track RP lengths should be shorter for schemes nearing and/or at significant maturity? If so, to what extent?

133. We consider that 6 years (or, indeed, 7-7.5 years) is a relatively short time period, even for a 'mature' scheme. If affordability remains a key focus for trustees in setting recovery plans and covenant visibility is good, then we do not think RP lengths should be shorter for schemes nearing

or at significant maturity. Such schemes should though, be encouraged to actively manage their sort term liquidity requirements.

134. An unintended consequence of such an approach could be that employers seek to agree the lowest possible LTO because they will be under pressure to fund it more quickly if and when deficits arise in this situation.

Q40. 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?

135. We agree that there needs to be some provision in Fast Track to prevent excessive back-end loading of the Recovery Plan. Otherwise some employers and their advisers will actively seek to utilise any potential ‘loop holes’.

136. However, it is preferable that the measure is as flexible as possible to allow for Recovery Plans that reflect different patterns of payments that, while not excessively back-end loaded overall, do not progress smoothly. For example, some Recovery Plans are structured to align with sponsor business plans and/or anticipated scheme cash requirements.

137. Therefore, we suggest that back-end loading is not restricted to inflationary increases alone.

138. However, any guidelines on the shape of the Recovery Plan length need to be carefully constructed. If the guidelines were to insist that 50% of contributions are in the first half of the period, this would be tantamount to insisting on flat contributions and hence very inflexible. On the other hand, setting the proportion at a different level (e.g. 40%) may result in schemes herding towards that as standard, whereas many would have agreed flat contributions.

139. We consider that it makes sense that the guidelines refer to the maximum length under Fast Track, rather than the actual Recovery Plan length.

140. One possibility would be to say that the proportion of the contributions in the first three years of the recovery plan period (i.e. the period to the next valuation) must be at least the same proportion as if the contributions had been spread over the recovery plan period with annual inflationary increases. Again, care would be needed to be taken over when the Recovery Plan period is counted from (see our response to Q39a).

141. If an inflation index is used within the guidelines, we suggest that the RPI is used as this maximises flexibility and in any case is expected to become similar to the CPI in due course.

Q41. Should investment outperformance not be allowed in Fast Track RPs? What do you think the impacts may be?

142. We agree that it makes sense not to permit an allowance for investment outperformance in the Recovery Plan in Fast Track. It would be very difficult to set a threshold for such an allowance without it being somewhat crude (e.g. ‘up to 0.5% p.a.) and resulting in herd behaviour towards that threshold.

143. One key advantage of not having an allowance for investment outperformance is that it increases transparency, perhaps influencing more schemes to take positive action that may reduce their deficit or contributions (e.g. through liability management or contingent security).

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 respread the remaining deficit over a renewed period?

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

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

144. We think it is too restrictive to not permit any re-spreading under Fast Track. We also do not think it is sensible to allow re-spreading ad-infinitum.

145. We consider that the '*more nuanced guidelines*' set out in paragraph 458 look broadly reasonable and practicable.

146. As addressed in our response to Q39c, we do not think that different recovery plan guidelines are needed for more or less 'mature' schemes.

Q43. 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?

147. We consider that the concept of equitability – including the dividends issue – is certainly better addressed through general guidance, rather than specific criteria. We don't think it is practical to set sensible quantitative metrics for this, without resulting in an arbitrary and crude focus on particular statistics that are likely to be irrelevant and/or prone to manipulation.

148. Importantly, we think that this whole topic of 'equitability' should be considered much more broadly. Dividends are just one aspect of equitability. There are all sorts of uses to which an employer may put their money which should be balanced against the competing needs of the pension scheme e.g. servicing debt (which may be much more significant than dividend payments).

149. Some calls on the employer's money may work in the opposite direction – in particular we are thinking here of intergenerational fairness; of enhancements to funding of benefits to past workers draining an employers' capacity to enhance salaries or benefits paid to current workers. For example, it may not make sense for an employer to reduce their DB scheme recovery plan period from 8 years to 6 years (say) while maintaining contributions to DC members at the auto-enrolment minimum. We are facing a generation of DC savers potentially not being able to retire with an adequate pension income, as highlighted in our 'Savings Goals for Retirement' project. TPR has responsibilities in relation to both DB and DC provision, and we believe this should be taken into account within the Code of Practice.

Q44. 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?

150. As a general principle, we note that there is a wide range of open schemes, from those that have very limited future accrual, to those that admit small numbers of new entrants, to those where there

are still substantial numbers of new entrants and which are, and are expected to remain, immature. A one-size-fits-all approach to funding for these schemes is therefore impractical. This is particularly the case for schemes which remain open to new entrants. Difficult discussions, for example, on the appropriate balance between member benefits and contribution rates have usually taken place and, especially for the larger such schemes, the risks inherent in DB are typically well understood not only by the employers but also by current and former members and their trade union representatives. If the FastTrack approach is to be quite prescriptive for such schemes, it is essential that the Bespoke option is flexible and encompasses more options than the example set out in the consultation document.

151. We agree with the principle of treating past and future service liabilities separately. One of the reasons for this is that future service is paid in monthly amounts over a period of time, whereas past service assumptions are being calculated at the valuation date so that the resulting liabilities can be comparable with the market value of the assets at that date. Another reason is that the legislative funding framework does not require the same level of prudence for past and future service.

Q45. 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?

152. We agree that, for schemes that are closed to new entrants, it is appropriate to set an LTO in a similar fashion to that for schemes that are closed to future accrual, as they will eventually mature and do have a finite time horizon. There are however schemes which have only recently closed to new entrants, and the suggested 14 year maximum duration may not be long enough for schemes which are currently very immature and still have sizeable future accrual. This limit should therefore be reviewed in these circumstances.

153. We do not agree that the only option for schemes which are genuinely open to new entrants and do not expect to mature in future, should be to fund on the assumption that they will mature and reach a closed scheme LTO. In practice, most such schemes are very immature compared with the average DB scheme, and therefore will have a long time horizon to reach such an LTO, should the decision be made close the scheme at some future date. Our preference would be for this to be recognised in both the Fast Track and Bespoke regimes (as this would make Fast Track more achievable for small schemes who are open to new entrants) but as a minimum it should be recognised in the Bespoke regime, where the requirement should be that an LTO is set that is compliant and justified by reference to the relevant legislation, rather than by reference to the Fast Track benchmark.

Q46. What option do you favour and why? Are there other options we should consider?

154. For schemes closed to new entrants, we support Option A, subject (as noted above) to more flexibility over the maturity time horizon as 14 years may not be long enough for some such schemes who are still very immature (for example, a new scheme created through the transfer of active members from a previous employer would be very immature at outset).

155. As noted above, we are of the view there should be more flexibility for schemes who are open to new entrants to fund in way which fits their circumstances, the nature and strength of their covenant and the agreements which have been reached between the stakeholders for how much risk is taken and how it is shared, provided such arrangements comply with the relevant legislation. It should not be a requirement for such schemes to fund on the assumption that they are closed to new members, simply because there is a risk that they may close in the future.

Q47a. 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?

Q47b. 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?

Q47c. Would our preferred approach (Option B) make it difficult for scheme actuaries to certify schedules of contributions?

156. There is a fundamental difference between the future service contribution rate and the Technical Provisions, in that the Technical Provisions need to take into account market conditions at the valuation date, for consistency with the valuation date value placed on the scheme's assets. This is not the case for future service, which will be payable in varying market conditions over the three years until the next valuation. In our view it is not reasonable to require TP and future service to be set using the same assumptions as under Option A or Option B, particularly where the valuation date conditions are unusual (as was the case, for example, at 31 March 2020).

157. We think there is however a workable compromise that is effectively a modified Option D: this would be to provide open schemes with flexibility in setting their contributions, but subject to a simple overriding requirement that could be part of the Fast Track framework (and would also make actuarial certification feasible): that is to require that the difference between the expected increase in Technical Provisions due to future accrual over 5 years (or the Recovery Plan length if longer) and the contributions expected to be received on the chosen contribution rate, should represent no more than x% of the scheme's current assets. The value of x should be chosen in such a way as to represent a reasonable, modest, asset outperformance assumption for an immature scheme over a 5-year period.

Q48. 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?

158. Yes, we would support surplus in such schemes being used to part fund future accrual, subject to the same constraints as noted in our response to Q47 above – specifically, that the current assets with modest outperformance plus whatever future contributions are agreed are expected to be sufficient to cover the Technical Provisions at the end of the Recovery Plan period.

Q49. 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?

159. The consultation implies that the Bespoke approach is treated as a 'Fast Track plus' – in other words that Bespoke must necessarily be 'better' or at least equivalent to Fast Track (meaning Fast Track is essentially a minimum funding requirement). We do not agree with such an approach and would expect that schemes opting for a Bespoke approach should be free to follow a truly Bespoke approach, if they can provide sufficient evidence that it satisfies the requirements of the funding legislation.

160. As we have noted elsewhere, we do not believe Fast Track should be so tightly prescribed that small deviations push a significant number of schemes into a Bespoke approach. For example, in our view mortality assumptions based on scheme-specific analysis, or allowance for an escrow account, should be accommodated within the Fast Track approach.

161. We would also not want to see small schemes disenfranchised by the costs associated with adopting Bespoke solutions. We believe there are some areas where it might be possible for larger schemes to develop appropriate Bespoke solutions which TPR is comfortable with. We would then like TPR to be willing to accept proposals from smaller schemes which adopt similar approaches

without requiring those schemes to ‘reinvent the wheel’. Schemes would of course need to recognise the specifics of their own circumstances and adapt solutions accordingly. One unintended consequence of current regulatory interventions can be that money that would be better spent on benefits is spent (on TPR’s insistence) on consultancy fees which do not improve understanding or management of risks.

162. The principles set out in the consultation are very broad, and the way TPR chooses to regulate against them will have a significant impact on outcomes (for example, how it chooses to assess the ‘quality’ of the supporting evidence and whether there will be flexibility according to circumstances and/or opportunity for schemes to improve their submission based on feedback)

163. It is not clear where the legal boundary will lie between a compliant and a non-compliant Bespoke approach although, to be clear, we do not believe Fast Track, or an equivalent, should form the boundary (nor that it could form a legal boundary under existing legislation).

164. Given we believe the number of schemes using the Bespoke approach will be significant if a highly prescribed approach is adopted with a high funding bar, we would expect considerable information to emerge regarding how TPR will assess Bespoke approaches and their compliance with the funding legislation. In this regard, it is s of concern that we have not yet seen any Regulations. It is important to obtain clarity on the Regulations as soon as possible, in order to assess the extent of the impact of the new regime on schemes, and to work with you and our members on how best the Bespoke approach can operate in the light of the legal requirements.

Q50a. Do you have any comments on the assessments we have made in the examples above?

165. We do not agree that an appropriate allowance for scheme-specific mortality should put a scheme onto the Bespoke approach and would expect TPR to be able to specify some conditions that would enable scheme-specific analysis to be allowed for in Fast Track (see our response to Q22).

166. We would regard secure and measurable forms of additional support, such as escrow accounts, as being capable of being accommodated within a Fast Track approach; we would not wish for the Code to dis-incentivise the use of these commonly-used and secure forms of additional support.

167. The consultation infers that taking a Bespoke approach will significantly increase the regulatory scrutiny and evidence required. However, example 1 suggests that only the element deviating from Fast Track will receive additional scrutiny (in isolation), and presumably it will also be the only element requiring enhanced disclosure? Whilst we don’t agree that Fast Track should form a benchmark for Bespoke, it nevertheless seems to us that if TPR only has concerns about certain aspects of a Bespoke valuation, then the trustees should only be subject to additional information requests for that aspect. We would generally expect a pragmatic approach to be taken by TPR to Bespoke submissions to avoid unnecessary compliance costs.

168. A commitment for TPR to confine its scrutiny in such a way would make Bespoke (or in practice ‘semi-bespoke’ or ‘Fast Track plus’) more palatable for some schemes and would be a more effective use of regulatory resources. It would help avoid a situation where schemes – and ultimately members – are effectively forced to pay a significant price (in terms of advice and trustee time) for choosing a Bespoke approach.

169. The timing of the regulatory assessment is not defined, although we interpret it as occurring during the valuation. In practice, an opportunity to seek pre-approval could be valuable (and less likely to coincide with TPR peak resource demand) in helping trustees and sponsors assess if and how a Bespoke approach will be their optimal solution.

170. The examples are somewhat simplified, and the devil will be in the detail – how will TPR manage to assess all the information provided (and presumably request more if needed) in a timely way that is efficient for schemes and TPR? Or will TPR seek to simply 'throw out' cases that are borderline or that require more justification?

Q50b. 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?

171. If Fast Track is overly prescriptive and/or the bar is set too high, we would expect a very large number of schemes to fail to meet the Fast Track requirements in some way, at least initially, and as a result will, under the current proposals, find themselves with a Bespoke approach. Some transitional provisions would be desirable for this reason (with schemes then choosing a 'route to Fast Track' that would also have minimal regulatory scrutiny), to enable TPR to focus attention on truly Bespoke, and 'challenging', cases in the early years of the new regime. The risk otherwise, is that, with a very large number of schemes taking a Bespoke approach, TPR would be unable to identify and successfully regulate the schemes that most need help. We would anticipate a finite transitional period. Whilst we are aware that TPR sees the twin track approach as already being a significant improvement on the current 'all bespoke' population of schemes, we nevertheless believe that the success of the new regime will depend on getting a suitable number of schemes into Fast Track, such that TPR can identify and devote appropriate resources to cases that will genuinely benefit from bespoke regulatory attention. This is a good reason to simplify and avoid over-prescribing Fast Track, in order to ensure smaller schemes are not precluded from it simply by virtue of their size (noting that under the current regime small schemes tend to be subject to relatively little TPR intervention, so Fast Track is likely to be closer to the status quo than Bespoke).

172. We also expect a very large number of schemes to have to make improvements to governance (e.g. formal IRM, covenant assessments) and to need to persuade the sponsor to increase contributions in order to meet Fast Track, both of which represent broadly positive outcomes.

Q50c. 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?

173. This may have been appropriate, with sufficient evidence and analysis to satisfy TPR. However, as will be clear from the rest of our response, we do not believe that Fast Track should be used to benchmark a Bespoke approach.

Q51a. Assuming that affordability is genuinely constrained, are very long RPs 'appropriate' and therefore compliant with the Act?

174. Yes, they are certainly compliant with Pensions Act 2004.

175. Yes, they may be appropriate, provided the trustees have fully explored any alternatives and are satisfied that a long Recovery Plan is in members' best interests overall.

Q51b. 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)?

Q51c. For schemes with unviable RPs, should an exception be made for them in terms of the level of acceptable investment risk?

176. This is a political decision – not about whether TPR makes an exception to its principles, but whether Government is prepared to allow stressed schemes take additional investment risk, potentially at the expense of the PPF (particularly as there is an argument that this is not consistent with the current objective to reduce risk to the PPF). The answer to this question therefore depends partly on the scheme's funding position relative to the section 179 funding level, and the PPF 'drift' which is projected to occur during the term of the Recovery Period.

177. There is also a general point that, in our view, TPR should be permitted to make exceptions.

Q51d. Are you aware of situations other than stressed schemes where the trustees and employer would have difficulties meeting the Bespoke compliance principles?

178. It is difficult to comment, as we do not yet know how TPR will judge whether Bespoke valuations are compliant. Under the proposed approach that every deviation from a highly prescribed Fasttrack approach needs to be justified, in our view many schemes could struggle to meet the proposed compliance principles. If regulation is akin to a 'tick-box' approach, we expect many schemes might be deemed non-compliant, particularly if TPR is able to use this to default them onto a Fast Track approach.

Q52. Do you have any views on the framework we have set out for trustees to assess the appropriateness of additional support in Bespoke arrangements? If you disagree, what do you suggest?

179. We agree with the framework but TPR may wish to consider allowing time-bound guarantees where the term of the guarantee is limited to the date on which the LTO is achieved. Employers will tend to shy away from a guarantee which is not time-bound and this could facilitate agreement of a valuable layer of additional security for the trustees during the time they are most exposed to the employer covenant.

Q53. 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 it supports?

180. This depends on the type of risk the additional support is designed to mitigate. For example, a guarantee on failure of the sponsor should be accessible on that event (or subject to other covenant related triggers).

Q54. 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?

181. Yes trustees should assess the stressed value of the contingent asset but note the risk relates not only to the value of the contingent asset but also the liquidity of the asset in a 'fire sale' scenario, it is also very difficult to stress some of the more esoteric contingent assets (such as Intellectual Property or brand). Trustees are likely to find guidance helpful around the broad asset categories which might be considered for contingent assets and the stress tests that TPR would like to see for each asset type.

Q55. Should trustees always be expected to seek 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?

182. Trustees should seek an independent valuation at each actuarial valuation, provided the costs of doing so are not disproportionate (for small schemes in particular), and where this is not obvious (for example, a cash based escrow).

183. Whether trustees should be expected to regularly monitor contingent asset value in the intervening period depends on the nature of the asset and the likely price volatility, as well as the proportion of the total scheme assets that this represents. We would suggest advice is taken from the valuer around how regularly the asset price should be monitored and what would cause the value to change materially. We would anticipate appropriate arrangements for monitoring contingent assets to be included in the scheme's integrated risk management framework.

Q56a. Should we treat guarantee support differently to asset backed support?

184. Yes, guarantee support acts to improve the employer covenant assessment, whereas asset backed support may directly reduce the funding required, if it has appropriate conditions attached.

Q56b. 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?

185. Requiring a group entity to become a statutory employer creates a huge barrier to trustees accessing what is a valuable additional layer of covenant support. An appropriately structured guarantee should be sufficient to change the covenant grade assessment, for example one that meets the PPF requirements.

Q57. Can you think of any other types or arrangements which can help trustees mitigate risk?

186. No, the main types/arrangements have been covered in the consultation document.

Q58. 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?

187. No, unless exceptional circumstances can be evidenced. There may conceivably be timing/confidentiality issues around being able to provide detail of the support provided but these could be considered on a case-by-case basis. The default requirement should be to provide the information set out in the consultation document.

188. The final bullet point "*any steps taken by the trustees to ensure that the value of any contingent support is being protected*" could be made clearer. Does this simply relate to monitoring/assessing the strength of the guarantor? It would be helpful to be as clear as possible in the guidance to ensure trustees provide the information required and hence minimise the requirement for follow up questions and analysis.

189. Wherever possible, it would be desirable to make the documentation around additional support consistent with the existing standards for the PPF, and to make clear where these deviate from PPF templates. There is a risk that significant legal complexity is introduced if inconsistent requirements are placed on pension schemes by TPR and the PPF in relation to guarantees and/or contingent assets.