Protecting Defined Benefit schemes – A new funding code

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Agenda

• DB White Paper’s key objectives
• Our approach to the DB White Paper’s remit
• Group breakout – Defining prudence
• Group breakout – DB funding principles
• Timeline for DB code work
TPR to be provided with the ‘right powers to do its job’

- New powers to gather information and punish wrong doing
- Better oversight of corporate transactions
- **Revised funding code with greater clarity on expectations**
- Authorisation and accreditation regimes for consolidation approaches
No funding crisis but improvements needed to ensure
- Trustees focus on the long-term view and risk management
- Greater accountability and transparency
- More efficient and effective regulation of funding

Revised code of practice providing greater clarity on
- prudent technical provisions
- appropriate recovery plan
- setting SFO in the context of a long-term objective

Chair’s statement submitted with valuation

Legislative change to support the code and enforcement

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What this means in practice

- Setting clarity *for the whole landscape*
- ‘Comply or explain’

**CODE**

**COMPLY**
Funding is code compliant

→ *No TPR action*

**EXPLAIN**
Not code compliant but may be Part 3 compliant

→ *Further TPR engagement (unless explanations in statement satisfactory)*

**FAILURES**
Not code or Part 3 compliant

→ *Potential TPR intervention*

2004 PA PART 3

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Defining prudence?

Government has asked TPR to provide greater clarity on prudent technical provisions.

- No clear definition in legislation
  - Scheme funding regulations: assumptions must be chosen prudently/based on prudent principles
  - Investment regulations: prudent person rule
- Common law: little case law and goes back to 19th Century:
  - A trustee sufficiently discharges the common law duty of care if, when managing trust affairs, he takes all those precautions which a prudent man of business would take in managing similar affairs of his own (Speight v. Gaunt (1883) 9 App. Cas. 1 HL).
  - As the role is fiduciary, the trustee will be expected not to do what an ordinary prudent man of business would do if he had only himself to consider, but what he would do if he had a moral obligation to provide for others (Re Whiteley (1886) 33 Ch. D 347 at 355).
- English dictionary: ‘acting with or showing care and thought for the future’
Defining prudence – what do you think?

• Exercise:
  – Assume you are a trustee to a pension scheme (so expected to act as a prudent person)
  – Set aside current practices for setting prudence – start with a clean sheet.
  – Your ‘business plan’ for delivering member’s benefits involves
    a) An investment strategy
    b) Setting technical provisions
    c) A recovery plan
    All underpinned by the employer’s covenant, and exposing members to some risk.
  – Your task: rank where you think it would be most appropriate to build prudence among these three strategies.
Approach to prudence

• Prudence in the round – a methodology, a way of thinking.
Prudency methodology in practice

- Example: setting TPs
- Two approaches to demonstrating prudence
- Evidencing risk taking over and above risk-free/low-risk position is more transparent and objective.

- Start from a relative risky position and work down to a level of risk which is prudent
- Start from a conservative position and add mitigated/managed risk to reach a prudent position

- Covenant
- Time
- Low risk
- Buy-out

Best estimate – current investment strategy

Future strategy changes

Prudence margin
Principles for funding framework

- Many principles come directly from the White Paper proposals
- Initially developed with closed schemes in mind
- Operating in a “comply or explain” regime
## TPR principles for developing framework

<table>
<thead>
<tr>
<th>Aspect of the framework</th>
<th>Principle (for consultation)</th>
</tr>
</thead>
<tbody>
<tr>
<td>LTO (Long Term Objective)</td>
<td>Scheme to have a <strong>long-term funding objective</strong> which is <strong>clear</strong>, <strong>measurable</strong> and <strong>time-based</strong>.</td>
</tr>
<tr>
<td>Journey Plan/ Technical Provisions (TPs)</td>
<td>TPs should reflect the long-term funding objective and the level of all risks over time (<strong>explicit link</strong> between TPs and LTO).</td>
</tr>
<tr>
<td>Journey Plan/ Technical Provisions (TPs)</td>
<td>Schemes should <strong>plan</strong> for the level of scheme-based <strong>risks</strong> to member benefits to <strong>decrease over time</strong>, with the appropriate level being linked to <strong>scheme maturity</strong>.</td>
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## TPR principles for developing framework

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<td>Risk taking and reliance on covenant</td>
<td>Schemes can account for <strong>contingent security</strong> in their asset base but under <strong>strict criteria</strong> (appropriately valued, realisable).</td>
</tr>
<tr>
<td>Risk taking and reliance on covenant</td>
<td>Schemes with <strong>stronger employer</strong> covenants can afford to take <strong>more risk</strong> and so <strong>assume higher investment returns</strong>. However, full reliance on covenant strength <strong>should be time limited</strong> to the period over which there is good covenant visibility - for most schemes, practical considerations will limit visibility to the <strong>medium-term</strong> (i.e. 3 to 5 years). So schemes' funding strategies should reflect <strong>some future weakening of the covenant</strong> (depending on its <strong>visibility</strong>).</td>
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### Break-out session – Framework principles

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<td>Recovery plan: Reliance on covenant</td>
<td>Deficits should be recovered... Recovery plans are expected to be...</td>
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**Exercise:**
- We have removed some words in the principle above.
- In your tables, discuss what key messages you would want to include.
### Break-out session – Framework principles

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<td>Recovery Plan / Reliance on covenant</td>
<td>Schemes should be fully funded on their technical provisions, and <strong>deficits should be recovered as soon as possible based on affordability.</strong> Recovery plans expected to be <strong>time-limited</strong> to <strong>short to medium term.</strong></td>
</tr>
<tr>
<td>Compliance</td>
<td>In the context of a <strong>comply or explain regime</strong> where trustees can explain why they are ‘not compliant’ (for all aspects of the framework).</td>
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Timeline for DB funding work

Doing things differently

Set out a clear framework

Legislate

Codes Guidance

Business as Usual

DWP consultations
Summer: TPR powers
Autumn: consolidation and CDC

Pensions Bill?

Royal assent?

Now

Develop

Spring 19

Consult on options

Summer 19

Draft code

Autumn 2019

Consult on code

Spring 2020

New DB code

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Key takeaways

• Key objectives for DB review flow from DB White Paper remit:
  1) better long-term risk management
  2) transparency and accountability
  3) enforceability
• Comply or explain regime
• Prudence in the round (methodology)
• Objective and transparent risk taking
• Developing principles and framework
• All to be consulted on (Spring 2019)

If you have any ideas or comments, please get in touch at dbchange@tpr.gov.uk.
Questions