Department for Work & Pensions

The draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023

Public consultation

July

Contents

Ministerial foreword

In February last year the Pension Schemes Act 2021 received Royal Assent. This provides a strengthening of the existing scheme funding regime by requiring defined benefit occupational pension schemes to have a funding and investment strategy set out in and submitted to the Pensions Regulator in a statement of strategy.

Following an engagement programme with interested parties connected with a range of schemes including those remaining open and immature, I am pleased to present this consultation document seeking views on draft Regulations which expand upon and provide specific detail to the funding provisions in the 2021 Act. With millions of people still relying on defined benefit pensions, it is important that we get the right balance between ensuring those pensions are secure for members over the longer term and keeping them affordable for sponsoring employers. Whilst the majority of schemes are well run, plan for the future and manage their risks effectively, best practice is not universal. These draft Regulations detail new arrangements focussing on ensuring that pension benefits can be paid over the longer term and that all members have the best possible chance of receiving the pensions they have been promised.

Those schemes that are maturing will be required to manage their risks carefully, taking proper account of the extent to which those risks remain supportable as they move towards run-off, or securing members' benefits. But these draft Regulations also take account of open schemes which are not maturing and have adequate ongoing sponsor support. It is not our intention that such schemes should have to undertake inappropriate de-risking of their investment approaches. The intention is to have better, and clearer, funding standards, but not to move away from the strengths of a flexible scheme specific approach.

We are determined these new arrangements should work well for the great variety of schemes and sponsors, and therefore welcome responses from everyone who wishes to contribute their views.

Guy Opperman MP
Minister for Pensions and Financial Inclusion

Introduction

This consultation seeks views on proposed draft Regulations setting out the detail of the new requirements in the Pensions Act 2004, which were inserted by the Pension Schemes Act 2021, for schemes to have a funding and investment strategy and submit a statement of strategy to the Pensions Regulator. It also invites comments on the proposals to amend the Occupational Pension Schemes (Scheme Funding) Regulations 2005 (the Scheme Funding Regulations) and details of the new requirement for defined benefit schemes to appoint a Chair where they do not already have one.

Who this consultation is aimed at

This consultation is aimed at the trustees and managers of defined benefit occupational pension schemes, sponsoring employers, pension industry professionals, pension scheme members, member representative organisations, and any other interested parties.

This consultation and draft Regulations do not apply to those schemes that fall under the exemptions set out in regulation 17 of the Occupational Pension Schemes (Scheme Funding) Regulations 2005, which exempts the schemes set out in that regulation from Part 3 of the Pensions Act 2004 (scheme funding). Schemes which are exempt from this legislation, and therefore from these draft Regulations, are defined in existing regulations as set out above. Public service pension schemes, and certain other schemes, are exempt.

Purpose of the consultation

This consultation seeks views on the draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023.

Scope of consultation

This consultation applies to England, Wales and Scotland. Occupational pensions are a devolved matter for Northern Ireland.

How to respond to this consultation

Please send your consultation responses to:
Email: private.pensionspublicconsultation@dwp.gov.uk
Where possible, please send responses to the email address above.

If you are unable to email and prefer to send your response by post, please address it to:

Defined Benefit Policy: The Scheme Funding Team
DWP Consultation Coordinator
4th Floor
Caxton House
Tothill Street
London
SW1H 9NA

Government response

We will aim to publish the government response to the consultation on the GOV.UK website before or at the same time the statutory instrument is laid before Parliament.

Duration of the consultation

The consultation will run for 12 weeks, beginning on 26 July 2022 and closing on 17 October 2022.

How we consult

Consultation principles

This consultation is being conducted in line with the revised Cabinet Office consultation principles published in March 2018. These principles give clear guidance to government departments on conducting consultations.

Feedback on the consultation process

We value your feedback on how well we consult. If you have any comments about the consultation process (as opposed to comments about the issues which are the subject of the consultation), including if you feel that the consultation does not adhere to the values expressed in the consultation principles or that the process could be improved, please address them to:

DWP Consultation Coordinator
Legislative Strategy Team
4th Floor, Caxton House
Tothill Street
London
SW1H 9NA

Email: caxtonhouse.legislation@dwp.gsi.gov.uk

Data Protection and Confidentiality

For this consultation, we will publish all responses except for those where the respondent indicates that they are an individual acting in a private capacity (e.g. a member of the public). All responses from organisations and individuals responding in a professional capacity will be published. We will remove email addresses and telephone numbers from these responses; but apart from this, we will publish them in full.

For more information about what we do with personal data, you can read DWP's Personal Information Charter.

1. Chapter 1 – Background

1.1. The Pension Schemes Act 2021[1] introduces a new requirement for defined benefit pension schemes to have a funding and investment strategy for the purpose of ensuring that pension and other benefits under the scheme can be paid over the long term. They will also be required to report progress against their targets, including the main risks and mitigations, to the Pensions Regulator in a statement of strategy. The draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023 (the draft Regulations) set out the detail of these new arrangements.

1.2. This legislation, supported by a revised Defined Benefit Funding Code of Practice on which the Pensions Regulator plan to consult, will provide clearer funding standards to support trustees and employers in planning their scheme funding over the longer term, and enable the Pensions Regulator to intervene more effectively to protect members when needed.

1.3. The defined benefit scheme funding regime is scheme specific and will remain so. It applies flexibly to the particular circumstances of individual schemes and their sponsoring employers. While most employers and trustees work well together and use the flexibilities of the current funding regime reasonably, good practice is not universal. These measures aim to ensure those outliers now follow best practice, increasing the likelihood that pension schemes can meet their objectives of funding the pension benefits promised to their members.

1.4. During the passage of the Pension Schemes Act 2021, there were concerns raised that open schemes may be forced into inappropriate de-risking and that this may lead to unnecessary additional costs, and an end to such schemes. We do not want good schemes to close unnecessarily, or to introduce a one-size-fits-all regime that forces immature schemes with strong sponsors into an inappropriate de-risking journey. In developing these draft Regulations, we have aimed to ensure that they work in a way that does not prevent appropriate open schemes from investing in riskier investments where there are potentially higher returns, as long as the risks being taken can be supported and members' benefits are effectively protected.

1.5. We have engaged extensively with our stakeholder communities and the Pensions Regulator in the development of these draft Regulations. We would like to thank all those who have shared their views with us so far and look forward to continued engagement as part of the formal consultation process.

1.6. The following chapters set out a commentary on the draft Regulations. This is intended to describe the policy. It is not to be taken as an authoritative interpretation of the law. Such an interpretation can only be provided by a court.

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[1] https://www.legislation.gov.uk/ukpga/2021/1/schedule/10/enacted

2. Chapter 2 – Preliminary

2.1. Draft regulation 1 cites the title of the draft Regulations and the anticipated coming into force date (a common commencement date).

2.2. Draft regulation 2 provides an interpretation of terms used in the current draft Regulations. Key new terms are explained in context in the subsequent paragraphs of this consultation.

2.3. Draft regulation 3 gives the Secretary of State for Work and Pensions a duty to review the provisions in draft regulations 4 to 19 and publish a report setting out the conclusions of the review, in accordance with sections 28 to 32 of the Small Business, Enterprise and Employment Act 2015 (c. 26). This is to be done, no later than five years after these draft Regulations come into force, and subsequently at intervals of not more than five years.

3. Chapter 3 – Funding and investment strategy

3.1. The Pension Schemes Act 2021 inserts a new section 221A into the Pensions Act 2004 that requires trustees or managers of defined benefit occupational pension schemes to have a funding and investment strategy. The draft Regulations provide that a key principle the trustees or managers must follow when determining or revising their scheme's funding and investment strategy is a requirement for schemes to be in, at least, a state of low dependency on their sponsoring employer by the time they are significantly mature. This would require scheme assets to be invested in a low dependency investment allocation and be fully funded on a low dependency funding basis. This sets a standard that schemes must achieve but recognises that in practice schemes will plan for how the pension benefits will be delivered over the longer term in different ways. For example, some schemes will: 'run on' with low dependency on the employer when they reach significant maturity, while others may target entering a consolidator or securing buy out with an insurer.

Scheme maturity

3.2. Maturity is a measure of how far a scheme is through its lifetime. A scheme which has a high proportion of active or deferred members, will probably be immature as it will be expecting to continue significant payment of pension benefits well into the future. A scheme which has a high proportion of pensioner members, who are receiving pension benefits, will be more mature and the time horizon before the bulk of benefits have to be paid out will be shorter.

3.3. The draft Regulations provide enough flexibility to allow the characteristics of an open scheme to be taken into account in the projection of scheme maturity. We expect the Pensions Regulator's revised Defined Benefit Funding Code of Practice to give further guidance on how this can be done whilst managing the risks of ensuring benefits can be provided over the long term. For open schemes that are not maturing, the relevant date (see below) can move into the future following each review of the funding and investment strategy, in which case no investment de-risking as a result of the scheme moving closer to that date is required. The extent to which any de-risking does take place for such schemes will depend on the circumstances of the scheme, including the support available from the employer.

3.4. Draft regulation 4(1)(a) provides the maturity of a scheme is to be measured in years using a duration of liabilities measure in accordance with paragraphs (2) and (3). Draft regulation 4(2) provides that the duration of liabilities measure to be used for the purposes of paragraph (1) is the weighted mean time until the payment of pensions and other benefits under the scheme, weighted by the discounted payments. This measure is well understood by the pensions industry, although we expect guidance on its use will be provided in the revised Defined Benefit Funding Code of Practice.

3.5. A number of methods of measuring scheme maturity, along with advantages and disadvantages of each, were considered by the Pensions Regulator's first public consultation on the principles for a revised Defined Benefit Funding Code of Practice. Following DWP's informal engagement with a range of stakeholders, we think that duration of liabilities is the most appropriate measure of scheme maturity for the purposes of the funding and investment strategy.

3.6. Draft regulation 4(1)(b) provides that a scheme reaches significant maturity on the date it reaches the duration of liabilities in years specified by the Regulator in a Code of Practice. Significant maturity is the latest time by which we would expect the scheme to be invested in a low dependency investment allocation and be fully funded on at least a low dependency funding basis (see below).

3.7. As a scheme matures, it becomes more susceptible to "investment spiral" risk if it remains underfunded or continues to invest in volatile (but potentially higher returning) assets. This is because, as a scheme matures, an increasingly higher proportion of assets are sold to fund the payment of pension benefits. If the scheme is not fully funded, the deficit begins to grow in relation to its liabilities. This may be exacerbated by an investment downside event forcing trustees to sell assets in an unplanned manner and in shorter timeframes than projected. Schemes may then need to invest further in more volatile (but potentially higher returning) assets or receive additional funding, possibly substantial funding, from the employer. As a higher proportion of the assets are paid out as benefits there is a ratchet effect, and the scheme enters an investment spiral of ever-increasing required rates of return to discharge its remaining liabilities.

3.8. Whilst overall the funding regime will remain flexible and scheme specific, there are some metrics which we believe need to be clearly defined. We think that the point at which a scheme is significantly mature should be clearly defined either in Regulations or by the Pensions Regulator in a Code of Practice. It may be better for the Pensions Regulator to determine the duration of liabilities at which schemes are significantly mature. We think this level of detail regarding this metric may be more appropriate left to the Regulator's discretion, and therefore their Code of Practice rather than a matter for regulation. The Regulator's first consultation, on the principles for a revised Code of Practice, proposed that, in order to avoid risks of an investment spiral, schemes are significantly mature when they reach a duration of liabilities of 12 to 14 years. DWP's informal consultation did not identify any concerns with this range. We understand the second consultation on the draft revised Code of Practice may propose that a scheme is significantly mature when it reaches a duration of liabilities of 12 years.

3.9. Draft regulation 4(3) provides that the actuarial assumptions used for the purposes of the duration of liabilities measurement, when measuring the maturity of the scheme and when determining the date the scheme reaches significant maturity, must be actuarial assumptions used in a calculation of the liabilities of a scheme on a low dependency funding basis.

Question 1: Draft regulation 4(1)(b) provides that a scheme reaches significant maturity on the date it reaches the duration of liabilities in years specified by the Pensions Regulator's revised Defined Benefit Funding Code of Practice.

i) Do you think that it would be better for the duration of liabilities at which the scheme reaches significant maturity to be set out in the Regulations rather than the Code of Practice?

ii) If you think that the point of significant maturity should be specified in Regulations, do you agree that a duration of 12 years is an appropriate duration at which schemes reach significant maturity?

Low dependency

3.10. A scheme has low dependency on its employer when it has sufficient assets invested in a low dependency investment strategy to provide for accrued pension rights and is not expected to need further employer contributions. Such a scheme may still receive contributions from the employer for further accrual of future pension rights for any active members.

3.11. Low dependency means that under reasonably foreseeable circumstances the scheme is not expected to need further employer contributions. We do not describe this as self-sufficiency because there may be unexpected circumstances, which are materially different from those assumed, which require the employer to provide additional funds. The employer remains legally responsible for funding the benefits promised and self-sufficiency cannot be guaranteed.

3.12. Paragraph 3 of Schedule 1 to the draft Regulations sets out the principles the trustees or managers must follow in determining or revising their scheme's funding and investment strategy so that the scheme is in, at least, a state of low dependency on the sponsoring employer by the time it is significantly mature. These are:

- the assets are invested in accordance with a low dependency investment allocation; and
- the scheme is fully funded on a low dependency funding basis.

Low dependency investment allocation

3.13. Where a scheme has a low dependency on the employer, it is not expected to rely on further employer contributions to provide for accrued liabilities even where investments do not perform as well as expected or lose value relative to the value of the liabilities. To achieve this, scheme assets must be invested in accordance with a low dependency investment strategy, which means they will have a low dependency asset allocation.

3.14. Draft regulation 5 provides that for the purposes of these draft Regulations, a low dependency investment allocation, in relation to the investment of the assets of a scheme, means that:

- the assets of the scheme are invested in such a way that the cash flow from the investments is broadly matched with the payment of pensions and other benefits under the scheme; and
- the assets of the scheme are invested in such a way that the value of the assets relative to the value of the scheme's liabilities is highly resilient to short-term adverse changes in market conditions,

in a way that complies with an objective that further employer contributions are not expected to be required to make provision for accrued rights to pensions and other benefits under the scheme.

Question 2: Do you think that the definition of low dependency investment allocation provided by draft regulation 5 is appropriate and will it be effective?

Low dependency funding basis

3.15. In order to have low dependency on its employer, a scheme not only needs assets invested in a low dependency investment allocation, but also enough of those assets to provide for all accrued pension rights. It must be fully funded, or in other words have a funding level (defined as the ratio of a scheme's assets to its liabilities by section 221A(3)(a) of the Pensions Act 2004) of 1:1, on a low dependency funding basis.

3.16. A funding basis is the set of assumptions used to calculate the current value of a scheme's liabilities. These include, but are not limited to, assumptions about future investment returns on the scheme's assets, future inflation and members' life expectancies. A low dependency funding basis refers to actuarial assumptions consistent with low dependency on the employer. When choosing their assumptions, trustees or managers should work on the basis that further employer contributions will not be required under reasonable, foreseeable circumstances.

3.17. Draft regulation 6 provides that, for the purposes of these draft Regulations, the liabilities of a scheme are calculated on a low dependency funding basis. This is where they are calculated using actuarial assumptions which comply with the requirement that further employer contributions would not be expected to be required to make provision for accrued rights to pension benefits, if the following presumptions were satisfied:

(a) the funding level of the scheme is 1:1, on a calculation of the liabilities which uses those actuarial assumptions; and

(b) the assets of the scheme are invested in accordance with a low dependency investment allocation.

Question 3: Do you think that the definition of low dependency funding basis provided by draft regulation 6 is appropriate and will it be effective?

Strength of the employer covenant

3.18. At its simplest level, the employer covenant is the employer's obligation to support the scheme. The strength of the employer covenant is the financial ability of the employer to support the scheme now and in the future. The strength of the employer covenant is a relevant factor for trustees' and managers' decisions in determining the appropriate funding and investment risks to take and has over time become a key feature of the scheme funding regime. For this reason, paragraphs 4 and 5 of Schedule 1 to the draft Regulations provide that in determining or revising the funding and investment strategy, the principles the trustees or managers of a scheme must follow relating to the level of investment risk and the level of funding risk that can be taken by a scheme as it moves along its journey plan are that the level of risk is dependent, primarily, on the strength of the employer covenant.

3.19. Draft regulation 7(2)(a) and (b) defines the strength of employer covenant as the financial ability of the employer to support the scheme together with the level of support that can be provided by any contingent assets, to the extent that these contingent assets are legally enforceable by the trustees or managers and sufficient to provide that support at the time it might be needed. Contingent assets include guarantees from a parent company or a third party for example.

3.20. Draft regulation 7(3) requires the strength of the employer covenant to be assessed in relation to the size of any scheme funding deficit (or surplus). For example, even a successful and profitable employer might not provide a strong employer covenant if the pension scheme funding deficit is disproportionally large. Conversely, an employer with limited income might provide a strong covenant if the pension scheme deficit is very small.

3.21. Draft regulation 7(4) requires that in assessing the financial ability of the employer to support the scheme, the matters to be considered are the likelihood of employer insolvency and the cash flow of the employer and other factors which are likely to affect the performance or development of the employer's business, as set out in a Code of Practice issued by the Pensions Regulator. The factors in draft regulation 7(4)(c) seek to capture the employer’s wider business prospects. For example, the employer’s: market position and outlook; strategic importance within any corporate group; range of products, customers, suppliers and regions it operates in; environmental, social and governance issues; and resilience.

3.22. Draft regulation 7(5) provides that the assessment of the deficit (or surplus) is by reference to the actuary's estimate: of the scheme liabilities on a low dependency basis; and the solvency of the scheme. Draft regulation 7(6) provides that these estimates should be as set out in the valuation to which the funding and investment strategy relates. Draft regulation 7(7)(b) provides that the actuary’s estimate of the solvency of the scheme has the meaning given in regulation 7(6) of the Occupational Pensions (Scheme Funding) Regulations 2005 – the cost of purchasing annuities to discharge the liabilities of the scheme.

Question 4:

i) Do you agree with the way that the strength of employer covenant is defined?

ii) Are the matters which trustees or managers must take into account when assessing it, as provided by draft regulation 7, the right ones?

iii) Does draft regulation 7(4)(c) effectively capture the employer’s broader business prospects?

Relevant date

3.23. Section 221A(2)(a) and (b) of the Pensions Act 2004 requires the funding and investment strategy to specify both the funding level the trustees and manager intend the scheme to have achieved and the investments they intend the scheme to hold at the relevant date. Draft regulation 8 sets out how the relevant date is to be determined.

3.24. Draft regulation 8(1) requires scheme trustees or managers to set, review and where necessary revise the relevant date as follows.

3.25. Draft regulations 8(2) and (3) provide that the relevant date must not be later than the end of the scheme year in which the scheme is expected to (or did) reach significant maturity, as set out in the actuarial valuation to which the funding and investment strategy relates. At each valuation the scheme actuary will be required (by amendments to the Scheme Funding Regulations – see below) to estimate the date on which the scheme will reach significant maturity using the methodology and metric set out in these draft Regulations and the revised Defined Benefit Funding Code of Practice.

3.26. Each time the funding and investment strategy is reviewed, draft regulation 8(4) requires trustees or managers to review and, if necessary or appropriate, revise the relevant date. The policy aim is for trustees or managers to consider whether the relevant date remains appropriate, taking into account the actuary's latest estimate of when the scheme is expected to reach significant maturity.

3.27. Draft regulation 8(5)(a) defines the meaning of scheme year. Draft regulation 8(5)(b) sets out the meaning of the phrase "the actuarial valuation to which the funding and investment strategy relates" by reference to the provisions of draft regulation 13 which sets out when the funding and investment strategy must be determined, reviewed and if applicable revised. Draft regulation 8(5)(b)(iv) provides that where the funding and investment strategy is being reviewed or revised in circumstances other than those set out in draft regulation 13, then it means the most recent actuarial valuation.

3.28. We envisage that in complying with these draft Regulations trustees or managers will first determine the date of significant maturity, on actuarial advice, and then choose a relevant date which must be on or before the end of the scheme year in which the scheme will reach significant maturity. The trustees will then determine a low dependency asset allocation they intend the scheme to have achieved by that date and a low dependency funding basis consistent with that asset allocation. That low dependency funding basis will also be used by the actuary to estimate the scheme's funding level, on a low dependency funding basis, as at the effective date of the actuarial valuation (see below).

Question 5: Does it work in practice to set a minimum requirement for the relevant date to be no later than the end of the scheme year that the scheme is estimated to reach significant maturity?

Question 6: Does your scheme already have a long-term date and how is it calculated?

Question 7: Where the funding and investment strategy is being reviewed out of cycle with the actuarial valuation, would it be more helpful to require it to align with the most recent actuarial report?

Actuarial methods and assumptions for purposes of funding level

3.29. Draft regulations 9(1) and 9(2) require trustees of managers, in determining a funding level that they are targeting at the relevant date, to: use an accrued benefits funding method; and calculate the liabilities of the scheme on a low dependency funding basis. Draft regulation 9(3) specifies that it is for the trustees or managers of the scheme to determine which methods and assumptions are used.

Consistency of assumptions

3.30. The requirement of draft regulation 10 means that, whilst different low dependency actuarial assumptions can be used for different occasions on which the funding and investment strategy is being determined or revised, on any occasion it is being determined or revised, the same set of low dependency actuarial assumptions must be used by the trustees or managers for all aspects of that particular determination or revision (for example, determining the funding level they are targeting at the relevant date).

Schedule 1 - matters and principles

3.31. Draft regulation 11 requires the trustees or managers of a scheme take into account the matters, and follow the principles, set out in Schedule 1 to the draft Regulations when determining or revising the scheme's funding and investment strategy. **Matters** – paragraph 1 requires that in determining or revising the scheme's funding and investment strategy, trustees or managers must take into account the actuary's estimate of: the date that the scheme is expected to (or, if applicable, did) reach significant maturity; and the maturity of the scheme at the effective date of the actuarial valuation to which the funding and investment strategy relates. **Principles** – paragraph 2 of the Schedule requires the trustees or managers of a scheme, in determining or revising the scheme's funding and investment strategy, to follow the principles set out in paragraphs 2 to 6.

Minimum requirements on and after the relevant date

3.32. The principles relating to the minimum requirements that a scheme is subject to on and after the relevant date under paragraph 3 of Schedule 1 are:

a) the requirement to have sufficient and appropriate assets to have a funding level of at least 1:1 calculated on a low dependency funding basis; and

b) the requirement for the assets of the scheme to be invested in accordance with a low dependency investment strategy.

Whilst draft Regulations provide for schemes to stay at low dependency on their employer after significant maturity, we would like your views on whether some more risk taking could be permitted, provided this can be supported by high-quality contingent assets provided by another company within the group or a third party and is limited to, for example, five per cent of total liabilities. Contingent assets could include cash in an escrow account.

Question 8: Do you think that these minimum requirements are sensible and will provide additional protection for the accrued pension rights of scheme members?

Question 9:

i. Should such limited additional risk at and after significant maturity be permitted, if supported by contingent assets? If so, to what percentage of total liabilities should this be limited?
ii. What additional risks to members' benefits might be posed as a result, and what safeguards should apply to protect members?

Investment risks on journey plan

3.33. Paragraph 4 of Schedule 1 provides for supportability principles to apply to the level of investment risk that trustees or managers can take as the scheme moves along its journey plan (the period from the current date to the relevant date). Schemes which are maturing will likely draw closer to their relevant date as they progress along the journey plan. Schemes which remain open to new members may also be maturing, but generally more slowly than schemes which are closed to new members or further accrual. Schemes with sufficient new members joining and further accrual may not be maturing at all, in which case the relevant date may be moved further into the future when the funding and investment strategy is revised.

3.34. The principles are that the level of risk taken:

a) is dependent on the strength of the employer covenant. Paragraph 4(2)(a) makes clear that more risk can be taken where the employer covenant is stronger, and less risk can be taken where the employer covenant is weaker.
b) subject to the strength of the employer covenant, is dependent on how near the scheme is to reaching the relevant date. Paragraph 4(2)(b) specifies that subject to the strength of the employer covenant, more risk can be taken where a scheme is a long way from reaching the relevant date, and less risk can be taken where a scheme is near to reaching the relevant date.

3.35. During the passage of the Pension Schemes Act 2021 through Parliament in 2020, Ministers committed to ensuring that secondary legislation does not prevent appropriate open schemes from investing in riskier assets, where there are potentially higher returns as long as the risks being taken can be supported and members' benefits protected. These provisions aim to deliver that commitment.

Question 10: Do you think that the provisions of paragraph 4 of Schedule 1 will allow appropriate open schemes to continue to invest in growth assets as long as that risk is appropriately supported?

Risk in relation to calculation of liabilities on journey plan

3.36. Paragraph 5 of Schedule 1 provides for the same new supportability principles to apply to the level of risk that can be taken by the trustees or managers of a scheme in determining the actuarial assumptions used for the purposes of calculating the liabilities of the scheme as it moves along its journey plan. The principles are that the level of risk taken:

a) is dependent on the strength of the employer covenant. Paragraph 5(2)(a) specifies that more risk can be taken where the employer covenant is stronger, and less risk can be taken where the employer covenant is weaker.

b) subject to the strength of the employer covenant, is dependent on how near the scheme is to reaching the relevant date. Paragraph 5(2)(b) specifies that subject to the strength of the employer covenant, more risk can be taken where a scheme is a long way from reaching the relevant date, and less risk can be taken where a scheme is near to reaching the relevant date.

3.37. The principle that funding and investment risks should be supportable is already good practice and part of the Integrated Risk Model set out in the Pensions Regulator's guidance and followed by most schemes. These provisions bring this good practice into legislation for the first time.

Question 11: Do you think that the principles in paragraphs 4 and 5 of Schedule 1, requiring funding risks and investment risks to be linked primarily to the strength of the employer covenant, are sensible?

Liquidity

3.38. The principle in paragraph 6 of Schedule 1 requires the assets of the scheme to be in investments with sufficient liquidity to enable the scheme to meet expected cash flow requirements and make reasonable allowance for unexpected cash flow requirements, both as the scheme moves along its journey plan and on and after the relevant date.

Question 12: Do you think that the new liquidity principle set out in paragraph 6 of Schedule 1 is a sensible addition to the existing liquidity requirement of regulation 4(3) of the Occupational Pension Schemes (Investment) Regulations 2005?

Question 13: Will the matters and principles set out in Schedule 1 enable the scheme specific funding regime to continue to apply flexibly to the circumstances of different schemes and employers, including those schemes that remain open to new members?

Funding and investment strategy – level of detail

3.39. Draft regulation 12 sets out the level of detail trustees or managers of defined benefit pension schemes must include in their funding and investment strategy. Draft regulation 12(a) requires trustees or managers to set out the way in which pensions and other benefits under the scheme will be provided over the long term. For example, this may be to run-on with low dependency on the employer, buy-out with an insurer by a set time, or enter a consolidation vehicle, where appropriate, within an agreed time-frame. Draft regulation 12(b) requires the funding and investment strategy to set out the expected duration of the scheme's liabilities at the relevant date, where a scheme has not yet reached that date.

3.40. Draft regulation 12(c) provides that the level of detail about the information on scheme investments required to be included in the funding and investment strategy by section 221A(2)(b) of the Pensions Act 2004 is the proportion of assets that the trustees or managers expect to allocate to different categories of investment. By categories of investment, we mean high level asset classes such as equities, corporate bonds and gilts. The funding and investment strategy will not therefore include information on actual scheme investments. Employers are responsible for funding their defined benefit pension schemes and will therefore need to agree the funding and investment strategy. But trustees will continue to be responsible for investing funds on behalf of scheme members and employer agreement is not required for all other investment decisions.

Question 14: Is the level of detail required for the funding and investment strategy by draft regulation 12 reasonable and proportionate?

Question 15: Do you think the requirement for high level information on expected categories of investments will impact trustees' independence in making investment decisions in the interests of scheme members?

Determination, review and revision of funding and investment strategy

3.41. Draft regulation 13 sets out the time allowed for scheme trustees or managers to determine, review and, if necessary, revise, their scheme's funding and investment strategy. In most cases this is aligned with the requirements for regular and additional valuations provided for in section 224 (1)(a) of the Pensions Act 2004 and regulation 7 of the Scheme Funding Regulations.

3.42. Draft regulation 13(1) requires the first funding and investment strategy to be determined not later than 15 months after the effective date of the first actuarial valuation of the scheme after the draft Regulations come into force.

3.43. Draft regulation 13(2) requires the funding and investment strategy to be reviewed and, if necessary, revised as follows:

a) within 15 months after the effective date of each subsequent actuarial valuation under section 224(1)(a) of the Act (actuarial valuations and reports);

b) in the case of an actuarial valuation where the Regulator has given directions under section 231(2)(b)(i) of the Act (powers of the Regulator)—

   i. if the effective date of the valuation is before the date of the directions, within three months after the date of the directions,

   ii. within six months after the effective date of the valuation if that date is the same as or later than the date of the directions;

c) in the case of an actuarial valuation which does not fall within sub-paragraph (a) or (b), within 15 months after the effective date of the valuation;

d) where the Regulator has given directions under section 231(2)(aa) of the Act, and in a case which does not fall within sub-paragraphs (a) to (c), within three months after the date of the direction; and

e) as soon as reasonably practicable after any material change in the circumstances of the pension scheme or of the employer in relation to the scheme.

3.44. Draft regulation 13(3) specifies that the material changes in the circumstances of the pension scheme or the employer in draft regulation 13(2)(e) include, but are not limited to, a material change in the:

- value of the assets of the scheme relative to the value of its liabilities;
- maturity of the scheme; or
- strength of the employer covenant.

Question 16: Are the requirements and timescales for determining, reviewing and revising the funding and investment strategy in draft regulation 13 realistic?

4. Chapter 4 – Statement of strategy

4.1. The Pension Schemes Act 2021 inserts a new section 221B into the Pensions Act 2004 that requires trustees to prepare a written statement of strategy setting out the scheme's funding and investment strategy itself (Part 1) and supplementary matters (Part 2). The policy aim for the statement of strategy is to facilitate better trustee and manager engagement, and better understanding and accountability between trustees and managers of schemes and the Pensions Regulator.

Supplementary matters

4.2. Section 221B(2) of the Pensions Act 2004 sets out the supplementary matters to be included in Part 2 of the written statement of strategy. Trustees or managers are required to provide an assessment of whether the funding and investment strategy is being successfully implemented, or any remedial action they intend to take, to get the strategy back on course. Trustees or managers are also required to set out the key risks and mitigations for implementation and their reflections on any key decisions and lessons learned.

4.3. In addition, draft regulation 14 sets out at paragraphs 2 to 19 of Schedule 2 (statement of strategy – supplementary matters) additional matters to be included in Part 2 of the statement of strategy as follows:

Maturity

4.4. Paragraphs 2 and 3 require the statement to set out the actuary's estimate of the maturity of the scheme as at the effective date of the actuarial valuation and (for a scheme that has not reached its relevant date) how the scheme's maturity is expected to change over time.

Investment risk

4.5. Paragraphs 4 to 6 require trustees or managers to explain the level of risk they intend for the scheme to take in relation to the investment of assets now and (for a scheme that has not reached its relevant date) over the course of the journey plan. Trustees or managers must also include information on compliance with the principles in Schedule 1 which relate to investment risk on the journey plan and low dependency investment allocation on and after the relevant date.

Liquidity

4.6. Paragraph 7 requires detail about the scheme's compliance with the principle relating to liquidity of assets, in paragraph 6 of Schedule 1. This is to allow schemes to detail how they expect to meet cash flow requirements.

Funding level

4.7. Paragraphs 8 to 10 require trustees or managers of schemes to set out the actuary's estimate of funding level of the scheme as set out in the actuarial valuation. For a scheme which has reached the relevant date, they must set out the assumptions used in that estimate. For schemes before the relevant date, trustees should set out the assumptions used in specifying the funding level they intend the scheme to have achieved at the relevant date and explain how these differ from those used in the technical provisions.

Technical provisions

4.8. Paragraphs 11 and 12 also require trustees or managers to include the discount rate(s) and any other assumptions used in calculating the scheme's technical provisions and how they expect the discount rate to change over time.

Risk in relation to calculation of liabilities

4.9. Paragraph 13 requires that trustees or managers detail how risks taken as part of actuarial assumptions are in compliance with the principles on risk in relation to calculation of liabilities on the journey plan (paragraph 5 of Schedule 1).

Employer covenant

4.10. Trustees or managers are required to provide an assessment of the strength of the employer covenant by paragraphs 14 to 16 of Schedule 2.

General

4.11. Trustees and managers are required by paragraphs 17 to 19 to explain how the funding and investment strategy remains appropriate. They must also confirm that the sponsoring employer has been consulted when preparing or revising Part 2 of the statement of strategy and provide any comments which the sponsoring employer has asked to be included too.

Part 2 of the statement of strategy – level of detail

4.12. Draft regulation 15 provides, in relation to the requirement that the trustees or managers articulate the main risks in implementing the funding and investment strategy and any steps they intend to take to mitigate these risks, that Part 2 of the statement includes a section setting out what action they intend to take if the risks materialise (for example, trigger points to manage risks and contingency plans).

4.13. This draft regulation also provides, in relation to the requirement to prepare a written account of the level of risk taken by trustees or managers regarding asset investment now and as the scheme moves along its journey plan, that Part 2 of the statement includes a section setting out details of the proportion of assets allocated to different categories of investment and the level of risk carried.

4.14. Draft regulation 15 also requires the trustees or managers to explain the evidence on which information given in Part 2 of the statement is based.

Review and revision of Part 2 of the statement of strategy

4.15. Further to section 221B(4) of the Pensions Act 2004, draft regulation 16 obliges trustees or managers to review Part 2 of the statement of strategy and make any revisions if needed. This must be done as soon as practicable following a review of the funding and investment strategy. Any review of Part 2 will in turn mean trustees or managers will have to include it with Part 1 to form a complete, revised statement of strategy.

Question 17: Are there any other assessments or explanations that trustees should evidence in Part 2 of the statement of strategy?

Requirements for chair of trustees

4.16. New section 221B (6) and (7) of the Pensions Act 2004 requires a chair of the trustee board to sign-off the statement of strategy and where the board does not have a chair, they must appoint one. The appointment of the trustee board encourages the following of best practice and allows for accountability of the trustee board and the decisions they make in respect of their funding and investment strategy. Draft regulation 17 lists the requirements for the chair. Those schemes that already have a chair can continue with the same chair and only their successors will need to meet the requirements in draft regulation 17. These requirements are consistent with what is currently expected for the appointment of a chair by defined contribution pension schemes (regulation 22 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996).

Question 18: Do you agree that these are the appropriate requirements for the scheme trustee board when appointing a chair? Are there any other conditions that should be applied?

Form of the statement of strategy

4.17. Draft regulation 18 requires that the statement of strategy is submitted in the form that is set out by the Pensions Regulator.

Information to be sent with the actuarial valuation

4.18. New section 224(7A) of the Pensions Act 2004 requires scheme trustees or managers to submit a copy of the actuarial valuation in all cases, whereas previously this was only required from those schemes that were in deficit. Draft regulation 19 requires that the statement of strategy is submitted to the Pensions Regulator along with the scheme's actuarial valuation. This will be via the process as set out in the Regulator's Defined Benefit Funding Code of Practice.

5. Chapter 5 – Amendments to Regulations

5.1. Draft regulation 20 makes amendments to the Occupational Pension Schemes (Scheme Funding) Regulations 2005[2]. Draft regulation 20(2) inserts a definition of Funding and Assessment Investment Strategy Regulations (which means the Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023 - these draft Regulations). It also defines 'relevant date' as having the meaning given in draft regulation 2.

Calculation of technical provisions

5.2. Technical provisions is the amount required on actuarial calculation to make provision for the scheme's liabilities for the purposes of an actuarial valuation or report carried out under section 224 of the Pensions Act 2004. Trustees or managers of a pension scheme determine which methods and assumptions are to be used when calculating the scheme's technical provisions but are required to follow certain principles set out in the Scheme Funding Regulations. Draft regulation 20(3) of these draft Regulations obliges trustees or managers to ensure assumptions made in calculating the scheme's technical provisions on and after the relevant date are consistent with how they intend the pensions and other benefits under the scheme will be provided over the long term, as set out in the scheme's funding and investment strategy.

5.3. Draft regulation 20(3)(b) amends an existing principle in the Scheme Funding Regulations so that changes from the method or assumptions on the last occasion on which technical provisions were calculated can be made with a view to achieving this new principle relating to consistency with the funding and investment strategy.

Actuarial valuations and reports

5.4. Trustees or managers of a pension scheme must obtain actuarial valuations comparing the assets and liabilities of defined benefit occupational pension schemes. An actuarial valuation must include the actuary's certification of the

[2] https://www.legislation.gov.uk/uksi/2005/3377/contents

calculation of technical provisions and the actuary's estimate of the solvency of the scheme.

5.5. Draft regulation 20(4) amends the Scheme Funding Regulations to include a new requirement for the actuarial valuation to include: the actuary's estimate of the level of the scheme's maturity at both the effective valuation date and the relevant date; when the scheme is expected to reach significant maturity; and the actuary's estimate of the funding level, on a low dependency funding basis as at the effective valuation date. This estimate must use the set of low dependency assumptions chosen by the trustees or managers of the scheme, as set out in paragraph 3.30 above. This information, together with the funding level the trustees intend the scheme to have achieved at the relevant date specified in the funding and investment strategy (as required by section 221A (2)(a) of the Pensions Act 2004), will assist trustees with journey planning. Scheme trustees or managers will be able to assess their scheme funding on a low dependency basis at each valuation date compared with their target funding level at the relevant date.

Question 19: We would like to know if you think these requirements will work in practice?

Recovery Plan

Trustees or managers of a pension scheme are required to prepare or revise a recovery plan following an actuarial valuation if the scheme is deemed to be in deficit. Regulation 8(2) of the Occupational Pension Schemes (Scheme Funding) Regulations 2005 prescribes matters which trustees of managers must take account of in preparing or revising a recovery plan. These matters include the scheme's asset and liability structure, risk profile and liquidity requirements as well as the age profile of members. Section 226(3A) of the Pensions Act 2004 allows regulations to define more clearly what is appropriate in the context of a recovery plan. Draft regulation 20(8) of these Regulations amends the Scheme Funding Regulations to require the trustees or managers, when determining whether a recovery plan is appropriate, to follow the principle that funding deficits should be recovered as soon as the sponsoring employer can reasonably afford. We also wish to consider whether this new factor should have primacy over the existing matters and whether these existing factors are still relevant to recovery plans.

Question 20: Do you consider that the matters prescribed by regulation 8(2) of the Occupational Pension Schemes (Scheme Funding) Regulations 2005 remain relevant for trustees or managers to take account of when determining or revising recovery plans? If so, why and how are they relevant to the setting of appropriate recovery plans?

Question 21: Do you consider that the new affordability principle at draft regulation 20(8) should have primacy over the existing matters, if they do remain relevant?

Multi-employer schemes

5.6. Draft regulation 20(9) extends the existing provisions in Schedule 2 to the Scheme Funding Regulations, so that where the legislation treats individual sections of a multi-employer scheme as if they were separate schemes for the purposes of the Scheme Funding Regulations and Part 3 of the Pensions Act 2004, then they will also be treated in that way for the purposes of the Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023. For example, where an actuarial valuation is required for an individual section of a multi-employer scheme, a funding and investment strategy and statement of strategy will also be required for that section.

Question 22: Will the requirements in draft regulation 20(9) work in practice for all multi-employer pension schemes?

5.7. Draft regulation 20(9) also inserts references to the Funding and Investment Strategy Regulations into the paragraphs of Schedule 2 to the Scheme Funding Regulations dealing with schemes covering United Kingdom and foreign employment, schemes with a partial guarantee by a public authority and schemes which are not required to appoint an actuary.

6. Chapter 6 – Business burdens and regulatory impacts

6.1. An impact assessment considering the business impacts of requirements for defined benefit pension scheme trustee boards to appoint a Chair and to regularly prepare, review and submit a statement of strategy to the Pensions Regulator was published as part of the enactment of the measure in the Pension Schemes Act 2021[3]. This assessment is not considered to have changed materially.

6.2. We have however updated the impact of meeting the funding and investment strategy in the impact assessment that accompanies this consultation.

6.3. We will not be able to determine the full impacts and costs that are introduced by these legislative changes until the detail of all components of the regime are known. This includes the Pensions Regulator's revised Defined Benefit Funding Code of Practice which will contain more detailed guidance and specification on how to comply with legislative requirements in setting the funding and investment strategy. A Business Impact Target will be completed by the Pensions Regulator following their consultation to accompany the revised Defined Benefit Funding Code of Practice. Once that is completed, we will update our impact assessment of these legislative changes accordingly.

6.4. At this stage, we give a high-level assessment of possible business and other impacts. The business impacts will mainly be for schemes whose technical provisions are currently weaker than that which would be required for them to achieve low dependency investment allocation and achieve full funding on a low dependency funding basis at significant maturity. We anticipate there to be minor familiarisation and implementation gross cost to business, partially offset by savings for schemes associated with improved clarity of the requirements.

6.5. The impact of any changes to deficit repair contributions as a result of the funding and investment strategy will be included in the Regulator's Business Impact Target assessment. These costs would result from legislative changes however it is the Pensions Regulator's revised Defined Benefit Funding Code of Practice which will determine the scale of these costs.

6.6. We welcome any evidenced comments on the impact assessment.

Question 23: Do you agree with the information presented in the impact assessment for the funding and investment strategy?

[3] https://publications.parliament.uk/pa/bills/lbill/58-01/004/5801004-IA-Annex-E.pdf

Question 24: Do you expect the level of detail required for the funding and investment strategy to increase administrative burdens significantly?

Question 25: Do you agree with information presented in the impact assessment for the statement of strategy, referenced in paragraph 6.1?

Annex A – Consultation questions

Scheme Maturity
Question 1:

Draft regulation 4(1)(b) provides that a scheme reaches significant maturity on the date it reaches the duration of liabilities in years specified by the Pensions Regulator's revised Defined Benefit Funding Code of Practice.

i) Do you think that it would be better for the duration of liabilities at which the scheme reaches significant maturity to be set out in the Regulations rather than the Code of Practice?

ii) If you think that the point of significant maturity should be specified in Regulations, do you agree that a duration of 12 years is an appropriate duration at which schemes reach significant maturity?

Low dependency investment allocation
Question 2: Do you think that the definition of low dependency investment allocation provided by draft regulation 5 is appropriate and will it be effective?

Low dependency funding basis
Question 3: Do you think that the definition of low dependency funding basis provided by draft regulation 6 is appropriate and will it be effective?

Strength of the employer covenant
Question 4:

i) Do you agree with the way that the strength of employer covenant is defined?

ii) Are the matters which trustees or managers must take into account when assessing it, as provided by draft regulation 7, the right ones?

iii) Does draft regulation 7(4)(c) effectively capture the employer's broader business prospects?

Relevant date
Question 5: Does it work in practice to set a minimum requirement for the relevant date to be no later than the end of the scheme year that the scheme is estimated to reach significant maturity?

Question 6: Does your scheme already have a long-term date and how is it calculated?

Question 7: Where the funding and investment strategy is being reviewed out of cycle with the actuarial valuation, would it be more helpful to require it to align with the most recent actuarial report?

Minimum requirements on and after the relevant date

Question 8: Do you think that these minimum requirements are sensible and will provide additional protection for the accrued pension rights of scheme members?

Question 9:

i. Should such limited additional risk at and after significant maturity be permitted, if supported by contingent assets? If so, to what percentage of total liabilities should this be limited?
ii. What additional risks to members' benefits might be posed as a result, and what safeguards should apply to protect members?

Investment risks on journey plan

Question 10: Do you think that the provisions of paragraph 4 of Schedule 1 will allow appropriate open schemes to continue to invest in growth assets as long as that risk is appropriately supported?

Risk in relation to calculation of liabilities on journey plan

Question 11: Do you think that the principles in paragraphs 4 and 5 of Schedule 1, requiring funding risks and investment risks to be linked primarily to the strength of the employer covenant, are sensible?

Liquidity

Question 12: Do you think that the new liquidity principle set out in paragraph 6 of Schedule 1 is a sensible addition to the existing liquidity requirement of regulation 4(3) of the Occupational Pension Schemes (Investment) Regulations 2005?

Question 13: Will the matters and principles set out in Schedule 1 enable the scheme specific funding regime to continue to apply flexibly to the circumstances of different schemes and employers, including those schemes that remain open to new members?

Funding and investment strategy – level of detail

Question 14: Is the level of detail required for the funding and investment strategy by draft regulation 12 reasonable and proportionate?

Question 15: Do you think the requirement for high level information on expected categories of investments will impact trustees' independence in making investment decisions in the interests of scheme members?

Determination, review and revision of funding and investment strategy

Question 16: Are the requirements and timescales for determining, reviewing and revising the funding and investment strategy in draft regulation 13 realistic?

Statement of strategy

Question 17: Are there any other assessments or explanations that trustees should evidence in Part 2 of the statement of strategy?

Requirements for chair of trustees

Question 18: Do you agree that these are the appropriate requirements for the scheme trustee board when appointing a chair? Are there any other conditions that should be applied?

Actuarial valuations and reports

Question 19: We would like to know if you think these requirements will work in practice?

Recovery plan

Question 20: Do you consider that the matters prescribed by regulation 8(2) of the Occupational Pension Schemes (Scheme Funding) Regulations 2005 remain relevant for trustees or managers to take account of when determining or revising recovery plans? If so, why and how are they relevant to the setting of appropriate recovery plans?

Question 21: Do you consider that the new affordability principle at draft regulation 20(8) should have primacy over the existing matters, if they do remain relevant?

Multi-employer schemes

Question 22: Will the requirements in draft regulations 20(9) work in practice for all multi-employer pension schemes?

Business burdens and regulatory impacts

Question 23: Do you agree with the information presented in the impact assessment for the funding and investment strategy?

Question 24: Do you expect the level of detail required for the funding and investment strategy to increase administrative burdens significantly?

Question 25: Do you agree with information presented in the impact assessment for the statement of strategy, referenced in paragraph 6.1?