The new funding regime and surplus sharing

Thoughts from a practitioner

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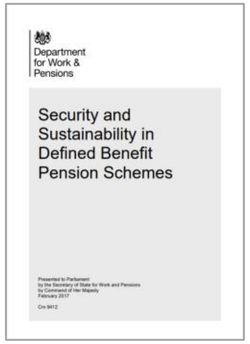
Background to the new regime and key aims for TPR/DWP

High-profile cases

- British Home Stores
- British Steel
- Carillion

Plus public scrutiny of TPR by the Work & Pensions Committee

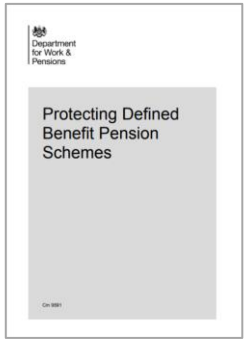
DWP Green Paper


Department for Work & Pensions

Security and Sustainability in Defined Benefit Pension Schemes

2017

Consultation on protecting DB schemes


Department for Work & Pensions

Protecting Defined Benefit Pension Schemes

2018

"For all schemes and businesses we are clarifying the rules and expectations, for example through a clearer, enforceable Defined Benefit Funding Code, but otherwise not making fundamental changes to the existing system"

Pension Schemes Act 2021

+

Funding and Investment Strategy Regulations

+

New Code of Practice

- Focus on reducing risk/reliance on sponsor as schemes mature
- Align funding and investment with long-term aims
- 'Formalise' covenant assessment
- Make it easier for TPR to pursue schemes making 'irresponsible decisions'

High-level outline of the new requirements

Agree how benefits will ultimately be delivered

This could be an eventual aim to run-on, buyout or transfer to a consolidator (e.g. a superfund). The **Funding and Investment Strategy** needs to address how benefits will ultimately be delivered so that a plan to achieve this can be constructed.

Establish what low dependency looks like

You must choose a **relevant date** by when you aim to have reached **low dependency** with a **low dependency investment allocation** and targeted funding level on a **low dependency funding basis**.

Consider your journey plan towards low dependency

Reaching **low dependency** will usually involve improving the funding position and/or transitioning the investment allocation – a funding journey plan and an investment journey plan. Covenant strength affects the level of risk that can be supported through the journey plan.

Ensure your Technical Provisions support this journey plan

All previous requirements about technical provisions remain. In addition, you will need to ensure there is consistency between your journey plan and the technical provisions – i.e. that they support the journey towards reaching **low dependency**.

Produce a Statement of Strategy

All previous funding documentation requirements continue (i.e. Statement of Funding Principles, Actuarial Valuation Report, Recovery Plan and Schedule of Contributions). In addition, a **Statement of Strategy** must be prepared that articulates much of the above.

Key (new) terminology

Significant maturity

A scheme's maturity is a measure of its expected time horizon. A scheme reaches 'significant maturity' when the scheme actuary calculates it will have a duration of 10 years.

Relevant date

This is a date that will need to be chosen to be no later than when the scheme is expected to reach significant maturity.

Low dependency

A state of not expecting to need further sponsor contributions. The trustee must aim to reach this position by the relevant date.

Low Dependency Investment Allocation (LDIA)

A notional investment allocation that is highly resilient to adverse short-term changes in investment market conditions.

Low Dependency Funding Basis (LDFB)

Actuarial assumptions to achieve low dependency (and consistent with the LDIA). The trustee must aim for the scheme to be at least 100% funded on the LDFB by the relevant date.

Funding and Investment Strategy

A strategy for ensuring that pensions and other benefits under the scheme can be provided over the long term.

Statement of Strategy

A written two-part document, signed by the Chair and submitted to TPR, that sets out the agreed Funding and Investment Strategy (Part 1) and certain other matters (Part 2).

How does the valuation process now look?

Preparation/training

- ✓ Cover new requirements
- ✓ Agree process/timeline
- ✓ Set objectives

Effective date of valuation

In principle decisions

- ✓ How will benefits be provided over the long term?
- ✓ Working assumptions for:
  - Low Dependency Investment Allocation
  - Low Dependency Funding Basis
  - Relevant Date
  - Solvency position (for covenant assessment)

Undertake covenant assessment + consider LDIA

Agree basis to be used for initial results

- ✓ Consider advice on LDIA and TP and LDFB assumptions, taking into account covenant assessment.
- ✓ Agree basis for initial results

Consider initial results

- ✓ Including:
  - Technical Provisions and Low dependency funding basis
  - Consistency between proposed Technical Provisions and the funding and investment strategy
  - Effect of varying funding level target on LDFB
  - Scenario analysis / stress testing
  - Journey plan options
- ✓ Revisit working assumptions for Relevant Date and inputs to covenant assessment
- ✓ Consider whether to pursue Fast Track route

Negotiate/consult with sponsor

- ✓ May need to revisit earlier decisions if agreement can't be reached
- ✓ Ensure covenant assessment remains valid

Provisional agreement

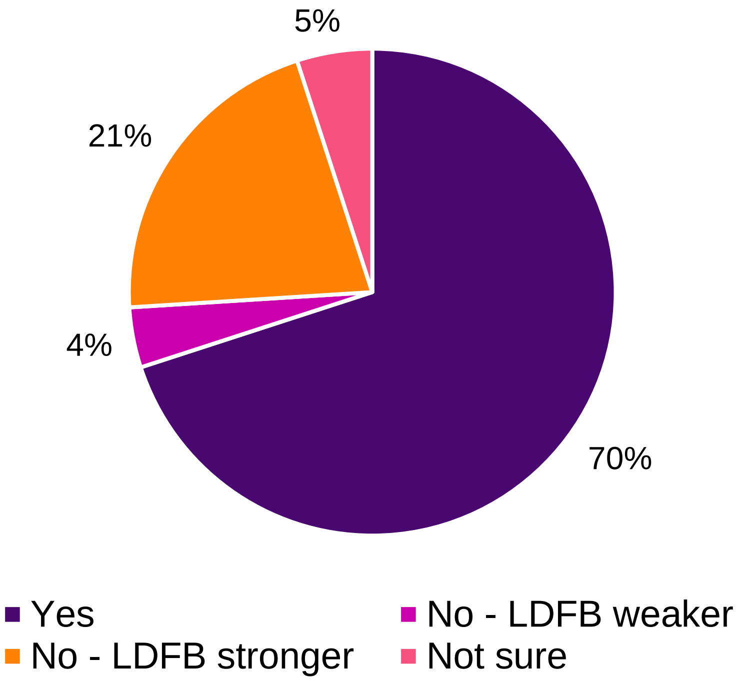
Complete valuation documentation

- ✓ Statement of Strategy
- ✓ Statement of funding principles
- ✓ Valuation report
- ✓ Schedule of contributions
- ✓ Recovery plan (if required)

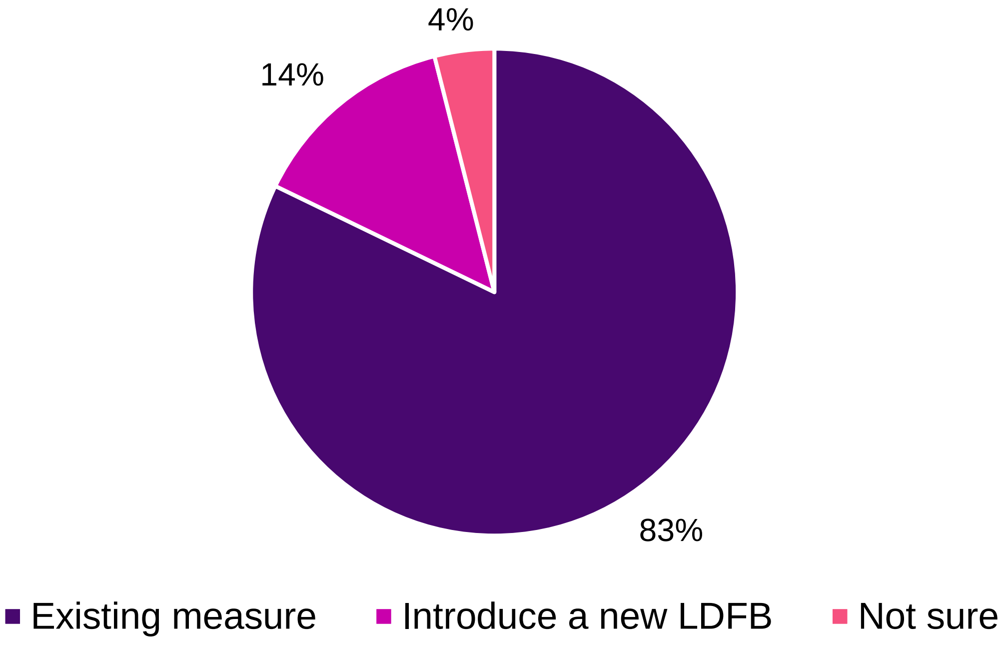
Statement of strategy submitted to TPR

Low dependency basis – survey results

Do you anticipate that your LDFB will be set in line with your current 'ultimate' technical provisions basis?

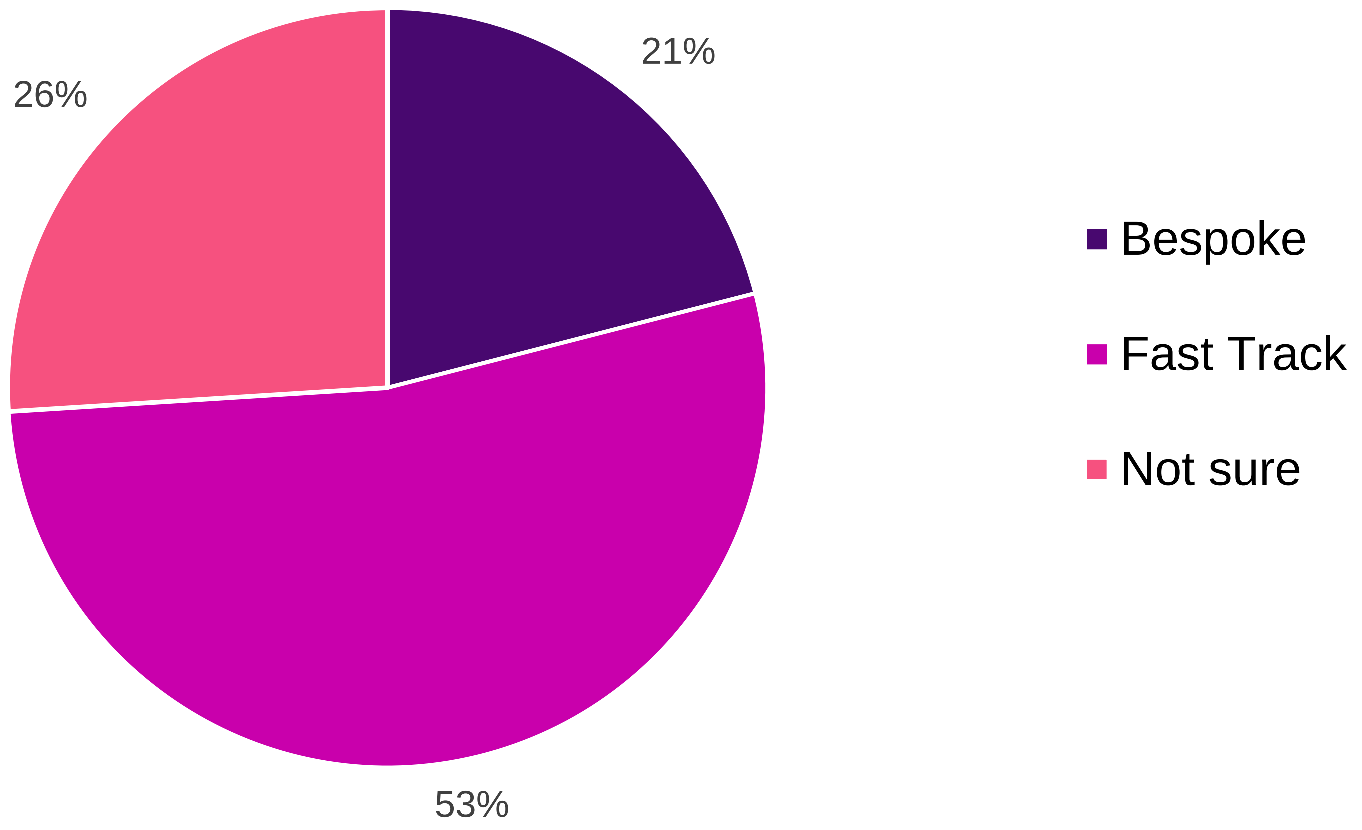


Do you expect to use one of your existing measures (possibly with some amendments) as the LDFB?



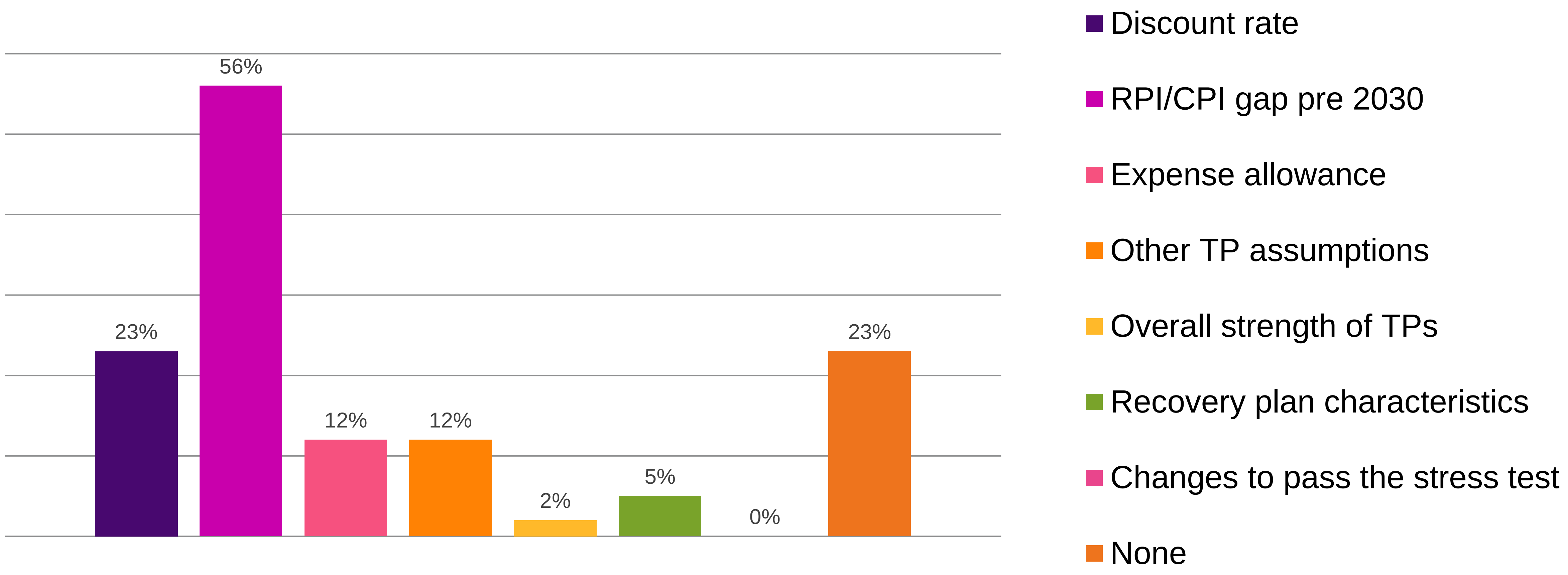
Survey results from a survey of WTW consultants carried out in April and May 2025

Fast Track or Bespoke?



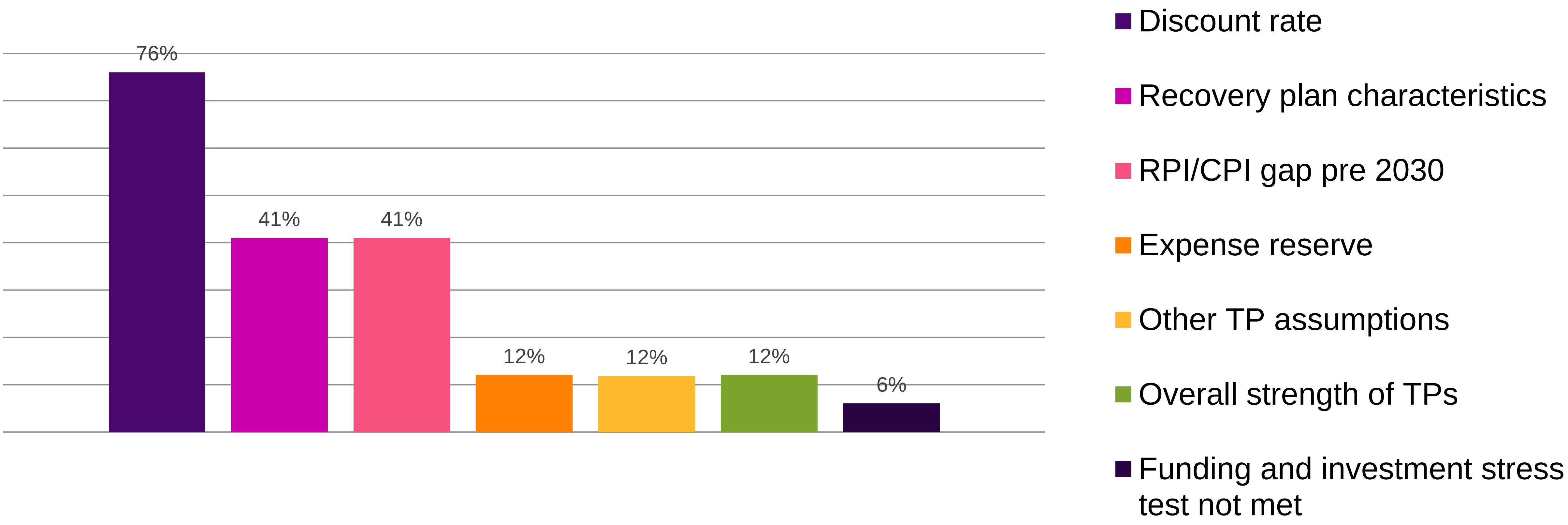
Survey results from a survey of WTW consultants carried out in April and May 2025

For schemes expecting to use Fast Track what changes do you expect to make to meet Fast Track parameters?



Survey results from a survey of WTW consultants carried out in April and May 2025

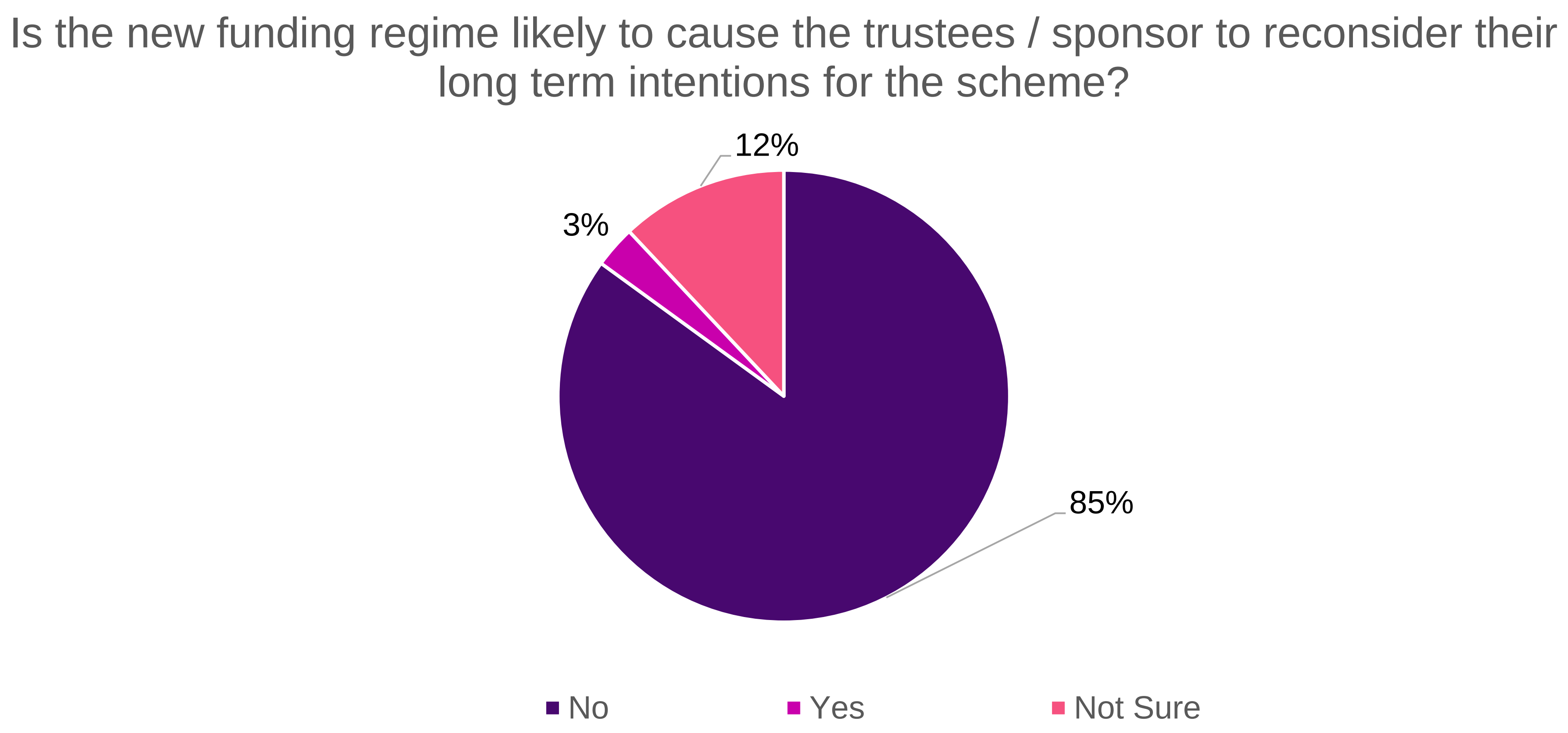
For schemes expecting to use Bespoke which aspects are not expected to meet Fast Track parameters?



Survey results from a survey of WTW consultants carried out in April and May 2025

How to provide benefits over the long term?

Survey results from a survey of WTW consultants carried out in April and May 2025



Statement of Strategy – Covenant Disclosures

	Bespoke (Pre/Post Relevant Date)	Fast Track (Pre/Post Relevant Date)	Low Risk
Confirmation that **independent covenant advice** taken or sufficient Trustee experience	✓		
Is the strength of the employer covenant **adequate** by reference to the actuarial valuation to which the funding and investments strategy relates?	✓	✓	✓
Period of **reliability** (PoR)	✓	✓	
Period of **longevity**	✓	✓	
Maximum affordable contributions over period of reliability £	✓	✓	
Free Cash Flows **Calculation** of maximum affordable contributions	✓		
Does **Recovery Plan** exceed PoR/6 years (3 years post relevant date)	✓		
Alternative uses of cash and liquid assets (if exceeds RP/6 years/3 years)	✓		

How is “Low Risk” defined?

Schemes that follow a Fast Track approach and would be in surplus on a low dependency funding basis after applying an immediate Fast Track stress test

Schemes that follow a Fast Track approach and where full benefits for all members have been secured with an insurer

Schemes that follow a Bespoke approach which have reached their relevant date and would be in surplus on a low dependency funding basis after the application of an immediate stress test

Key questions for how the new regime will affect schemes

The LDIA is described in the Code as a ‘notional strategy’, but could the requirement to agree this constrain trustees’ investment decisions in practice?

How will technical provisions be affected and what does being ‘consistent’ with the scheme’s Funding and Investment Strategy mean in practice?

Will the new regime result in pressure to ‘level down’ or ‘level up’, or other changes in negotiating positions?

What are the implications of stating how you intend to provide benefits in the longer term?

How attractive is FastTrack as an option?

Will the new Recovery Plan requirements make much difference in practice?

How much flexibility is there in ‘low dependency’ and a scheme’s ‘journey plan’?

And finally, surplus sharing…

…determining the LDFB is now even more important!

The response

"We are minded to amend the threshold at which trustees are entitled to share surplus with the sponsoring employer from the current buyout threshold to a threshold set at full funding on the low dependency funding basis. Further detail will be set out in draft regulations, on which we will consult."

The question

Question 8: Under what combination of these criteria should surplus extraction be permitted? If you feel alternative criteria should apply, what are they?

Eligibility criteria for surplus extraction under consideration included:

- *Funding above the low dependency funding basis plus a fixed margin, for example, above 105% of the low dependency basis.*
- *Funding above the low dependency funding basis plus a variable margin based on investment risk, for example, above 100% + y% of the low dependency basis, where y is determined by the level of investment risk in the scheme.*
- *A covenant requirement, for example only allowing access to surplus where funding is above the low dependency funding basis plus a fixed margin, and the strength of the employer covenant is considered sufficient to offset any additional risk posed to members.*
- *Maintain a buyout funding level threshold.*

Source: Government response to the Options for Defined Benefit schemes consultation that the Department for Work and Pensions launched on 23 February 2024

Thank you

Questions?