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Dear Sirs/Madams

Consultation response: Draft defined benefit (DB) funding code of practice and regulatory approach consultation

We write to you on behalf of Railways Pension Trustee Company Limited (RPTCL) in response to TPR's consultation on its draft defined benefit (DB) funding code of practice (the 'draft Code') and its regulatory approach.

Please find two appendices enclosed within this letter:

- Appendix 1 – sets out RPTCL's detailed responses to TPR's consultation questions in relation to the draft Code
- Appendix 2 – sets out RPTCL's response to TPR's consultation in relation to Fast Track and its regulatory approach

RPTCL has also issued these responses via TPR's online survey.

We hope TPR finds these responses useful, in addition to the extensive engagement we have had with TPR and the DWP over the last couple of years. We would welcome any further opportunities to provide input on these very important issues, as TPR and the DWP continue to develop the new funding regime.

Our detailed response to the DWP's consultation on its draft regulations was issued on 17 October 2022. Given the additional insight provided by the draft Code, we intend to provide a follow-up response to the DWP, recognising that some of the suggestions below are likely to require amendments to the draft regulations.

About us

RPTCL is the corporate trustee of the principal pension schemes in the UK railway industry, including the Railways Pension Scheme (RPS), the British Transport Police Force Superannuation Fund (BTPFSF), the British Railways Superannuation Fund (BRSF), and the BR (1974) Pension Fund. Collectively, the schemes we support provide defined benefit pensions for over 350,000 members from almost 150 companies operating within the railway industry, with combined assets of over £35 billion.

These schemes serve as excellent examples of the variety of schemes that TPR and the DWP need to cater for within a truly flexible, scheme specific, funding regime. For example, the RPS

is a sectionalised multi-employer scheme, having over 100 distinct sections that each carry out their own actuarial valuation under Part 3 of the Pensions Act 2004. Many of these sections operate on a shared cost basis, with contributing members paying 40% of the cost of benefit accrual and deficit contributions, if required, and employers paying the remaining 60% of this cost. Within the RPS and the BTPFSF, there are still over 100,000 active members accruing defined benefits for future service. Around 90,000 of these members belong to over 40 schemes/sections that remain open to new entrants and, in 2021, there were over 6,000 new entrants admitted to defined benefit membership in the RPS and the BTPFSF.

RPTCL is a proud supporter of collective pension schemes and the benefits they can bring to members, employers and society. In contrast to the significant amount of DB provision we still offer, the majority of the UK is now reliant on DC pensions. Although auto-enrolment has gone some way to improving member outcomes over recent years, research from the PPI suggests that over 90%[1] of these DC savers are facing an inadequate retirement. Further, the PLSA's research on Pension Adequacy[2] has found that without reform more than 50% of savers will fail to meet the retirement income targets set by the 2005 Pensions Commission.

This is a major societal problem for the next generation of retirees and beyond. It makes it ever more important that people with access to well-run DB pensions are not forced to follow this path.

As pointed out in the DWP's consultation last year, almost 10 million people across the country remain reliant on DB schemes, with around 65%[3] of these DB savers still in schemes that have some form of benefit accrual, and around 23%[2] in schemes that remain open to new members. To repeat the words of the ex-Minister for Pensions and Financial Inclusion in the Houses of Parliament, it is vital that the new funding regime is able to:

"ensure that the requirement for all schemes to have a funding and investment strategy works appropriately for open schemes and ensures that immature open schemes are not prevented from taking appropriate investment risks where that is supportable."

We recognise that our schemes have characteristics that are not typical in the universe of UK DB schemes. However, our schemes are important, not simply to our members, but also to employers and the wider UK railway industry. It is essential that the funding regime allows members to continue to build up affordable and sustainable pensions, and that the Trustee remains able to pay these benefits over the long-term.

Key points in our response

Most of the draft Code is welcome detail since the draft regulations were published last year. It is helpful that the new regime is starting to take shape, but in our view there are still a number of areas where the draft regulations, and/or the draft Code, may lead to unintended negative consequences for DB schemes and their members.

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[1] Pensions Policy Institute (2021) 'What is an adequate retirement income?'
[2] https://www.plsa.co.uk/Policy-and-Research/Document-library/Five-steps-to-better-pensions-time-for-a-new-consensus
[3] PPF 'The Purple Book 2021'

As set out in the Ministerial foreword to the DWP's consultation, the majority of schemes are well run, plan for the future, and manage their risks effectively, within the existing scheme-specific funding regime. The draft Code is relatively prescriptive in many places, which may encourage unnecessary changes in the way many of these schemes operate, with little to no gain in member security, at the expense of much additional time and money. We believe that it should be left to the Scheme Actuary and other advisers to continue to provide the most appropriate advice for trustees, based on the characteristics of their scheme.

Our main concerns are set out in the following paragraphs.

Impact on viability of open schemes

We appreciate the evolution of the Code which has taken place since TPR published its first consultation in March 2020. The draft Code does a good job of recognising that open schemes are different to closed schemes, and therefore require very different treatment in many areas. We believe stakeholders of open schemes would benefit from a specific section of the Code that brings all of the requirements for open schemes into one place, and makes their unique requirements even clearer.

When responding to the DWP's consultation on the draft regulations we noted that they threatened the viability of open schemes. In particular, we highlighted that if the requirement to reach low dependency by the relevant date was predicated on the assumption that no new entrants would join the scheme after the valuation date, this could substantially increase Technical Provisions. We estimated that it could increase Technical Provisions by around 50% and the cost of accrual by as much as 75% for an immature scheme with a strong employer covenant, depending on the detail of how this is implemented in the revised DB Code.

We are pleased to see the draft Code state that the Scheme Actuary can include some allowance for new entrants and future accrual when projecting the maturity of open schemes. However, we are concerned that limiting this to the period of covenant reliability, even when there is no expectation of any closure to new entrants, is still likely to have a material impact on Technical Provisions for many open schemes when they conduct their first valuation following the implementation of the new Code. For example, we estimate that making allowance for new entrants and future accrual for a period of 6 years for a typical open section of the RPS may only reduce Technical Provisions by up to 5%. The allowance for open schemes therefore may do little to mitigate the increase in costs which potentially threaten the viability of some open schemes, regardless of whether they are balance of cost or shared cost, damaging the retirement outcomes of many current and future pension savers.

Further, it is important to note that while only 23% of the UK's DB members are in schemes that remain open to new entrants, these tend to be some of the largest DB schemes. Many of these schemes are also effectively supported and funded, in full or in part, by the UK taxpayer.

We do not see the rationale for the link between covenant reliability and the period to assume new entrants. In our view this should more naturally be related to covenant longevity. It is very important to note that any employer which still offers membership of a DB scheme to new recruits is likely to have carefully considered the costs and risks to its business of doing so. In the context of many employers across the UK having closed DB schemes over the last 20 years, replacing them with DC arrangements which typically provide far worse outcomes for

members, employers choosing to keep DB schemes open should not be punished through a regulatory framework which increases cost unnecessarily.

As discussed through our early engagement with the DWP and TPR, we believe the same policy intent could have been achieved if a carefully considered contingency planning process were incorporated. However, as set out in our response to the DWP's consultation on its draft regulations, we appreciate that the DWP may find it too difficult to incorporate this alternative approach within the draft regulations without making substantive changes. We therefore suggested the draft regulations were amended to explicitly state that the Scheme Actuary can include a reasonable allowance for new entrants, and future accrual, when projecting a scheme's maturity into the future. We further suggested that amendments should then confirm that schemes which are not expected to mature over time, as may reasonably be the case for some schemes based on this calculation, are exempt from the requirement to set a low dependency target. We continue to encourage the DWP and TPR to adopt this approach.

We would like to see the regulations amended to explicitly state that the Scheme Actuary can include a reasonable allowance for new entrants, and future accrual, when projecting a scheme's maturity into the future.

Finally, we note that last week the Work and Pensions Committee of the UK Parliament issued a Call for Evidence in relation to an inquiry on DB pension schemes. The first question on which the Committee has requested evidence is:

"Is the right regulatory framework in place to enable open DB schemes to thrive?"

We would strongly encourage TPR to await the outcome of that inquiry before finalising its Code of Practice, to allow the Committee's findings on the question above to be carefully considered.

Covenant assessment is narrowly defined

In our response to the DWP's consultation on its draft regulations we expressed concerns with the way in which employer covenant had been defined. In particular, the matters to be taken into account when assessing covenant are too narrowly defined in the draft regulations. These matters should instead take account of the complexity of the covenant assessment process, and be principles based. This would allow covenant assessment to continue to be based on the bespoke circumstances of the employer (and scheme) and take into account, for example, balance sheet and liquidity, other material liabilities, creditor priority and the expected outcome on insolvency.

It is hard to comment comprehensively on the covenant aspects of the draft Code, noting that we await updated guidance from TPR later this year. However, we are pleased to see that TPR has been pragmatic in its interpretation of the draft regulations in a number of areas, and many of the principles TPR sets out are reasonable. We would encourage TPR to retain this principles-based approach to covenant. For example, the approach to assessing an employer's future cashflow will depend upon the specific characteristics of the employer and its market. TPR should therefore not seek to be prescriptive in such an approach and it should be made clear that any appropriate approach is acceptable.

Furthermore, in our response to Question 18, we caution whether the benefits of good covenant assessment can be achieved through distilling information into a small number of

metrics, e.g. “annual affordability” and “reliability period”. It will be important for schemes to understand TPR’s expectations in relation to how this will be evidenced, and it is difficult to comment further on this until we have seen TPR’s detailed covenant guidance in this area. However, if such emphasis is to be placed on one or two isolated numbers, there is a real danger that covenant advisers’ analysis would be undertaken with an abundance of caution, to the costs and detriment of employers and members. Whilst a formulaic assessment of risk may be beneficial for some schemes, it is important that schemes also remain able to adopt a more holistic, tailored covenant approach that informs the appropriate funding and investment strategy for a particular scheme’s circumstances.

Our concerns regarding covenant extend to the determination of appropriate recovery plans. The matters listed in draft paragraph 286 risk being interpreted as an exhaustive list of the factors that can be considered when setting recovery plans. We do not think this is the intention, particularly given the statements in draft paragraph 285 that recovery plans must be appropriate and have regard to the nature and circumstances of the schemes. We therefore suggest that it is reworded to make it clear that other factors may properly be taken into account when considering if a recovery plan is appropriate, having regard to the nature and circumstances of the scheme, including key factors like member affordability in shared cost arrangements. We provide suggested wording for this in response to Question 39.

Maturity assessment

Like TPR, we are very concerned by an approach to measuring maturity which is highly sensitive to market conditions, when used in combination with a fixed point of significant maturity, which is not sensitive to market conditions. This presents a risk that the timeframe in which schemes need to reach a position of low dependency accelerates dramatically over a short space of time (as we would have seen in certain periods last year), when the maturity profile of the underlying benefit cashflows that are expected to be paid has not substantially changed. This is clearly both unattractive and unreflective of the real risks that the new funding regime is attempting to mitigate. It also poses significant challenges for the ongoing governance and monitoring of scheme journey plans.

Assuming that the DWP retains duration as the measure of maturity for all schemes, we support “Option 1” in TPR’s consultation i.e. the measure of maturity and the point of significant maturity are both set independent of market conditions (e.g. using a 0% real yield or a chosen yield which remains fixed over time).

Once the measure of maturity is determined, the appropriate point of significant maturity also needs to be reviewed. We understand that TPR’s proposal to set significant maturity in line with a duration of 12 years is based on analysis and market conditions as at 31 March 2021. Whilst a duration of 12 years may have been broadly appropriate for a typical scheme in March 2021, this will not be appropriate based on a 0% real yield or market conditions as at 31 December 2022, for example. The appropriate duration under TPR’s updated methodology (a 0% real yield for example) should be set so that a typical scheme is expected to reach significant maturity at a consistent date as it would have under March 2021 market conditions (if this is indeed when TPR carried out its initial analysis).

Further detail on our thoughts on maturity is included in our response to Question 17.

Low dependency definition

The draft Code provides some helpful clarifications in its interpretation of DWP's definitions of low dependency. However, we believe too much emphasis is currently placed on assets producing cashflows, which could still be interpreted as TPR expecting a Cashflow Driven Investment (CDI) strategy, either in full, or in part, for all schemes to satisfy the definition of low dependency.

We question whether such an approach is appropriate or even possible for all schemes, particularly smaller schemes accessing matching assets via multi-client pooled funds which may not distribute contractual cashflows.

We believe it would be appropriate to place more emphasis on the assets being sufficiently liquid, and we have provided a suggested alternative definition of the "low dependency investment allocation" in our response to Question 3.

Impact assessment

The consultation does a good job of setting out the key considerations, but we encourage TPR to provide a quantitative estimate of the possible impacts of the draft Code, tackling key questions such as those posed in our response to Question 54. We believe that events last year demonstrated the material impact that DB pension schemes can have on the economy as a whole when extreme events occur. Whilst we acknowledge that any estimate will not accurately reflect what plays out in practice, lessons should be learned from the events of last year. We believe it is important that modelling is undertaken by the GAD to assess the potential worst case systemic impacts of TPR's proposals.

Transitional arrangements

As per our response to the DWP's consultation on its draft regulations, we recommend that the option of a reasonable transition period is factored into the draft regulations and / or the draft Code. This will give schemes a suitable window to understand the requirements of the new funding regime once it is in its final form, and may be an important release valve for schemes which find themselves already at, or near, TPR's chosen measure of significant maturity at potentially very short notice.

Our full response to the consultations is set out within Appendix 1 and Appendix 2. We would welcome the opportunity to meet with you to discuss our response.

Yours faithfully

Christine Kernoghan
Chair – RPTCL

Enc. Appendix 1: responses to DB funding code consultation questions
Appendix 2: responses to Fast Track and regulatory approach consultation questions

Appendix 1: responses to DB funding code consultation questions

Code chapter 2 - An outline of the funding regime

Question 1: Are there any areas of the summary you disagree with or would like more/less detail? If yes, what areas and why?

We broadly agree with the proposed summary but note the following comments:

- We suggest there needs to be a specific sub-section within Chapter 2 to outline how the funding regime is intended to work for open schemes. In our view, draft paragraph 23 does not cover this sufficiently, missing out the key point that trustees of open schemes can make an allowance for new entrants and/or future accrual when projecting scheme maturity and determining an appropriate journey plan to low dependency.
- We believe the use of "should" in draft paragraph 26 should be "must", given draft regulation 20(4)(c) refers to the new requirement for an actuarial valuation to include the actuary's estimate of the maturity of the scheme as at the relevant date.
- We believe the wording in draft paragraph 29 should be revisited or removed. In our view, it does not make sense for the "risks in the assumed investment strategy to be sufficiently prudent". The point this paragraph is trying to make appears to be clearly made by draft paragraph 33, where we agree that the use of "must" is appropriate.
- Draft paragraph 56 provides some welcome clarifications regarding trustees not being required to invest in line with the Funding and Investment Strategy ("FIS") at all times. However, we still believe the requirement to agree the FIS with the employer may risk restricting the current autonomy trustees have in relation to setting investment strategy (please see views expressed in response to Question 46). Trustees will also be restricted by the requirement that the valuation assumptions applicable to the period preceding the relevant date must be calculated in a way that is consistent with the planned investment transition, as set out in the journey plan element of the funding and investment strategy, as per draft paragraph 54.

Code chapter 3 – Low dependency investment allocation

Question 2: Do you agree with the principles for defining a matching asset that i) the income and capital payments are stable and predictable; and ii) they provide either fixed cash flows or cash flows linked to inflationary indices? If not, why not and what do you think is a more appropriate definition?

No – TPR's proposed definition of a matching asset could be interpreted as requiring that these assets distribute their cashflows to pension scheme investors. This is of course not the case for many of the matching assets listed by TPR in its consultation, in the form they are typically accessed by pension schemes. For example, multi-client pooled government bond funds are surely a matching asset, but these do not provide investors with the same contractual cashflows as investing directly in a government bond. More importantly, these are of course very liquid assets that can be used to provide cashflows through regular disinvestment, which we think is a perfectly reasonable approach to take.

We therefore suggest TPR inserts an additional paragraph to clarify that these types of funds meet its definition of a matching asset: "This definition of a matching asset refers to the characteristics of the underlying asset class itself, not the fund through which they may be accessed."

Question 3: Do you agree with our approach for defining broad cash flow matching? If not, why not and what would you prefer?

Similar to our comments in response to Question 2, the proposed definition could imply that TPR is expecting all schemes to hold a full or partial Cash flow Driven Investment portfolio consisting of assets that distribute contractual cash flows that are expected to broadly match those of the scheme's benefit and expense cash flows. We question whether such an approach is appropriate or even possible for all schemes, particularly smaller schemes accessing matching assets via multi-client pooled funds which may not distribute contractual cash flows.

If, as we expect, TPR's proposed definition is intended to also permit approaches whereby disinvestments are used to match benefit cash flow, we suggest the proposed definition makes this clear.

In our view, this point is well made by the second bullet of draft paragraph 58, subject to a minor addition to make it clear that this also permits schemes to invest in some less liquid assets, as long as these are expected to produce predictable cash flows that can support benefit payments: *"The assets [of the scheme are invested in such a way that they] would be sufficiently liquid [and/or produce predictable cash flows] to enable the scheme to meet expected cash flow requirements, and with reasonable allowance for unexpected cash flow requirements."*

We believe the suggested wording above could replace the requirement to broadly cash flow match within the definition of a low dependency investment allocation in the draft regulations, in addition to the requirement to be "highly resilient", and achieve the desired outcome.

Furthermore, we do not think it is appropriate to include an illustrative low dependency investment allocation in the draft Code, as per draft paragraph 72, particularly when this illustration is materially lower risk than the examples set out in TPR's consultation document.

Question 4: Do you think the draft adequately describes the process of assessing cashflow matching? What else would be appropriate to include in the code on this aspect?

The draft Code provides some helpful clarifications. However, please note our comments in Question 2 and Question 3 regarding the emphasis currently placed on assets producing cash flows. As per our suggested alternative definition of the "low dependency investment allocation", we think more emphasis should be placed on the assets being sufficiently liquid.

Question 5: Should the code set out a list of the categories of investments into which assets can be grouped for the purposes of the funding and investment strategy? If so, what would you suggest as being appropriate?

Yes – but these categories should be optional guidance only, noting that the level of detail will need to be proportionate to the circumstances of each scheme and its relative position on the journey to low dependency.

We agree with TPR that less detail is necessary when recording how a scheme's investment strategy is expected to transition over time, particularly where that scheme is a long way from significant maturity. A sensible level of detail here might be limited to how target hedging levels and expected return are expected to progress through time, rather than full details of the intended proportion of assets to be invested in various asset categories.

As set out in our response to the DWP's consultation on its draft regulations, the suggested approach above would appear to contradict the requirements of draft regulation 12(c) to set out "the proportion of the assets of the scheme intended to be allocated to different categories of investments". We therefore continue to encourage the DWP to update the regulations accordingly, noting that this is already a common approach for schemes that have agreed their ultimate objective (be it buy-out, run-off, etc) and would appear consistent with 221A(2)(b) in the Pension Schemes Act 2021, which requires the funding and investment strategy to specify "the investments the trustees or managers intend the scheme to hold on the relevant date or relevant dates".

Question 6: Do you agree that 90% is a reasonable benchmark for the sensitivity of the assets to the interest rate and inflation risk of the liabilities?

Yes – this is a sensible benchmark for a low dependency investment allocation.

Question 7: Should we, and how would we, make this approach to broad cash flow matching more proportionate to different scheme circumstances (eg large vs small)?

Yes – this approach should be proportionate.

For example, as already noted, small schemes may not be able to access contractual cashflows in the same way as larger schemes. However, we believe this is not required and can be resolved by the changes suggested in our responses to Question 2 and Question 3.

Draft paragraph 74 and its reference to proportionality is helpful. However, it may be even more helpful to provide some examples of this proportionality in action. For example, references to curve risk within draft paragraph 68 are important considerations for most schemes, but some smaller schemes will not be able to access LDI investments that appropriately deal with that curve risk due to typical minimum investment sizes in LDI profile funds and LDI bucket funds. Curve risk is also arguably disproportionate for smaller schemes where the reliability of the projected benefit cashflows is highly variable due to the idiosyncratic risks inherent within a smaller membership.

Question 8: Do you agree with our approach that a stress test is the most reasonable way to assess high resilience?

Yes – however, we suggest TPR includes clarification that this stress testing should be proportionate to the circumstances of the scheme in question. For example, VaR may not be possible for some schemes, so simple deterministic scenarios may be needed as an alternative.

We also suggest that draft paragraph 75 is updated to make it clear that the requirement for high resilience relates to the low dependency investment allocation on and after the relevant date, not the investment strategy prior to that.

Question 9: Do you agree that setting the limit of a 4.5% maximum stress based on a one year 1-in-6 approach is reasonable? If not, why not and what would you suggest as an alternative?

Yes – this is sensible.

Question 10: Do you agree that we should not set specifications for the stress test but leave this to trustees to justify their approach? If not, what would you suggest as an alternative?

Yes – we agree that the specifications for the stress test should be left to trustees to justify their approach based on their specific scheme circumstances. We note that TPR intends to prescribe parameters and assumptions for the stress test under Fast Track, so schemes which would like a prescribed approach have that option available to them.

As set out in our response to Question 8, stress testing should be proportionate to the circumstances of the scheme in question. For example, VaR may not be possible for some smaller schemes, so simple deterministic scenarios may be needed as an alternative.

Question 11: Do you agree with our approach for not expecting a detailed assessment of liquidity for the low dependency investment allocation (LDIA) since we have set out detailed expectations in relation to schemes' actual asset portfolios?

Yes – we agree that a consideration of the general characteristics of the proposed asset classes in the low dependency asset allocation is a proportionate approach for schemes which are still several years away from their relevant date. Once a scheme approaches its relevant date, then a more detailed assessment of liquidity would be appropriate.

As noted in our response to Question 3, we believe the definition of the low dependency investment allocation could be improved by replacing the requirement to "broadly cash flow match" with the requirement that "the assets would be sufficiently liquid to enable the scheme to meet expected cash flow requirements, and with reasonable allowance for unexpected cash flow requirements."

Code chapter 4 - Low dependency funding basis

Question 12: Do you agree with our approach for not expecting a stochastic analysis for each assumption to demonstrate that further employer contributions would not be expected to be required for accrued rights, but rather focussing on them being chosen prudently? If not, what would you suggest as an alternative?

Yes – the key factor influencing the expected need for further employer contributions will be the overall level of prudence in the low dependency funding basis.

Assessing the appropriate level of prudence is a well-established process when determining the Technical Provisions basis, with trustees setting the appropriate level after receiving advice from the Scheme Actuary, and pending agreement with the employer (in most cases). TPR's proposed approach therefore appears proportionate, and broadly consistent with current best practice.

Analysis that might support this assessment could include a test of whether the scheme would still be expected to meet its future cash flow requirements following a 1 year 1-in-6 VaR event, through best estimate investment returns alone, for example. This is a far more valuable test than stochastically analysing each individual assumption in the low dependency funding basis. However, fundamentally we believe that it is best left to advisers to determine the advice needed by trustees to consider this risk for their scheme.

Question 13: Do you agree that the two approaches we have set out for the discount rate for the low dependency discount rate (LDFB) are the main ones most schemes will adopt? Should we expand or amend these descriptions, if so, how?

Yes – we agree these are likely to be the two main approaches taken by schemes.

The appropriate margin added to the risk-free rate may of course vary over time, depending on the prudent return estimates of the underlying asset classes in the trustees' low dependency investment allocation. We suggest draft paragraph 103 is updated as follows to make this clear: "The margin added to the risk-free rate should be a prudent estimate of the return on the trustees' low dependency investment allocation[, which may vary through time.]".

Our interpretation of draft paragraph 100 of the draft Code is that TPR is not proposing to limit schemes to these two approaches, if alternative approaches can be justified on a scheme-specific basis – we agree with this approach.

We also agree with TPR's general expectation that yield curves should be used, although noting that this may be disproportionate for some smaller schemes with a significant amount of idiosyncratic risk (as set out in response to Question 7).

Question 14: Should we provide guidance for any other methodologies?

No – although the Code should recognise that other methodologies may be possible, provided they are consistent with the requirements in the regulations to reflect the intended low risk investment strategy and that the overall funding target is such that the employer is not expected to be required to make future deficit contributions in reasonably foreseeable circumstances.

Question 15: Do you agree with the guidance and principles set out in Appendix 3 and 4? Are there any specific assumptions here you would prefer a different approach? If so, which ones, why and how would you prefer we approached it?

We note the following wording in the consultation document: “We don’t believe it is appropriate at the current time for TPR to prescribe all the other assumptions within the code”. We do not believe it would ever be appropriate or proportionate for TPR to prescribe all of the assumptions within a Code of Practice, and we agree with TPR’s decision to provide guidance on some assumptions instead.

We make the following comments regarding the guidance and principles set out in Appendix 3 and 4:

- Salary increases: It should be possible to allow for increases lower than inflation if that is the consensus view of the employer and trustees on likely future progression of salary increases.
- Demographic assumptions: Small schemes should not be required to layer prudence on prudence. Appendix 3 appears to suggest that additional prudence is required in each demographic assumption where the scheme is too small to have reliable experience. As currently, we suggest that the trustee should instead ensure that the overall level of prudence in the technical provisions is appropriate, taking into account factors such as the evidence on which the demographic assumptions were based.

Code chapter 5 – Relevant date and significant maturity

Question 16: Do you agree that a simplified approach to calculating duration for small schemes is appropriate?

Yes – we agree that a simplified approach is an appropriate option for some smaller schemes, and the proposed approach appears sensible. A simplified approach may also be proportionate for other schemes, noting that any definition of significant maturity is somewhat arbitrary, and in reality the maturity profile of a scheme changes gradually over time – there is not a cliff edge.

Question 17: Do you think setting an earlier point for significant maturity within Fast Track as compared to the code (as described in option 3 in this section of the consultation document) would be helpful for managing the volatility risk of using duration? If yes, where would you set it and why?

No – although the proposed approach in option 3 might go some way to managing the potential risk, significant risk would still remain.

Like TPR, we are very concerned by an approach to measuring maturity which is highly sensitive to market conditions, when used in combination with a fixed point of significant maturity, which is not sensitive to market conditions. This presents a risk that the timeframe in which schemes need to reach a position of low dependency accelerates dramatically over a short space of time (as we would have seen in certain periods last year), when the maturity profile of the underlying benefit cash flows that are expected to be paid has not substantially changed. This is clearly both unattractive and unreflective of the real risks that the new funding regime is attempting to mitigate.

The proposed option 3 in the consultation document would mitigate some of this risk, by allowing a slight slippage in the point of significant maturity, but some schemes of average maturity might still move several years closer to this point if we see a big shift in market conditions.

Use of different significant maturities in the Code and Fast Track also risks confusion, particularly noting that any definition of significant maturity is somewhat arbitrary, as the characteristics and risks of a pension scheme do not change materially in the year in which it reaches significant maturity, however it is defined.

We are also unsupportive of the proposed option 2. This smoothed approach risks severely overcomplicating what could be a very simple process, and still risks producing an unattractive outcome if we see a big shift in market conditions during that smoothed period. Furthermore, the outcome of smoothing can also be highly variable – depending on the progression of rates over time, for any given date and market conditions, the required relevant date for a scheme could differ materially. In our view, the relevant date should only move when there is a very good reason for it to move – primarily a material change in the underlying membership profile, such as a bulk transfer.

For closed schemes, it is essential for planning, ongoing scheme governance and monitoring, that the scheme's relevant date, once established, does not vary significantly over time unless the profile of the underlying membership (and hence the expected benefit cash flows) changes significantly.

In order to achieve this desired outcome, we believe one of two solutions is required:

1. The measure of maturity and the point of significant maturity are both set independent of market conditions (e.g. using a 0% real yield or a chosen yield which remains fixed over time); or
2. The measure of maturity and the point of significant maturity both remain sensitive to market conditions over time.

Given the DWP's draft regulations require TPR to specify a "date [the scheme] reaches the duration of liabilities in years", we suggest that the former approach would be the preferred method, to avoid TPR having to re-issue an appropriate duration of liabilities for the point of significant maturity on a regular basis, and the lack of transparency and uncertainty that this could introduce for schemes.

We note that the former approach would be consistent with option 1 proposed by TPR in its consultation document and that TPR notes in its consultation document that this would require a small change to the wording in the current draft regulations.

Once the measure of maturity is determined, the appropriate point of significant maturity also needs to be reviewed. We understand that TPR's proposal to set significant maturity in line with a duration of 12 years is based on analysis and market conditions as at 31 March 2021. Whilst a duration of 12 years may have been broadly appropriate for a typical scheme in March 2021, this will not be appropriate based on a 0% real yield or market conditions as at 31 December 2022, for example. The appropriate duration under TPR's updated methodology (a 0% real yield for example) should be set so that a typical scheme is expected to reach significant maturity at a consistent date as it would have under March 2021 market conditions (if this is indeed when TPR carried out its initial analysis).

Code chapter 6 - Assessing the strength of the employer covenant

It is hard to comment comprehensively on the covenant aspects of the draft Code, noting that we await updated guidance from TPR later this year.

Question 18: Do you agree with the definitions for visibility, reliability, and longevity? If not, what would you suggest as an alternative?

We agree with the overall principle that the future affordability characteristics of employers typically become less certain the further into the future we look. This is not to say the estimate itself necessarily gets worse, but it can become less reliable. We also appreciate that by viewing "visibility" and "reliability" in aggregate, the draft Code rightly recognises that affordability characteristics can be estimated beyond the period typically covered by an employer's detailed cashflow forecasts.

Whilst it might appear helpful to view these affordability estimates in three broad categories, asking a covenant adviser to stipulate the date this "reliability" disappears is a big ask – as noted above, in practice it is likely the degree of reliability will decrease over time, without a definitive end date. As such, we expect that it is likely to result in either a huge increase in covenant advisory costs, or the introduction of unnecessary prudence, both of which could be to the detriment of the employer and member outcomes.

We also caution the use of information / advice on visibility and reliability as a finite number – to be used by trustees as part of an investment and funding "equation" or "sum". Much of the benefits of good covenant assessment and understanding comes from the integrated discussions between covenant, investment and actuarial advisers in arriving at a reasonable and affordable integrated funding strategy. If covenant input is distilled to one or two single numbers e.g. "annual affordability" and "reliability period", most of these benefits will be lost. In addition, if such emphasis is to be placed on one or two isolated numbers, the costs of providing such important numbers could increase hugely – if covenant advisers are willing to risk their Professional Indemnity cover in such a way. There is a real danger that covenant advisers' analysis would be undertaken with an abundance of caution, to the costs and detriment of employers and members.

Whilst a cash flow forecast from an employer is useful, the real information is gleaned from the assumptions that sit behind these forecasts, the reasonableness of those assumptions, and the impact of stressing key assumptions. Detailed forecasts should not be viewed as "truth" – they are just forecast after all. From an affordability characteristic perspective, it is more useful to arrive at a view of expected "annual future maintainable cash flow". This is a well-used and understood concept (e.g. in corporate finance), and does not suffer from the vagaries that affect detailed cash flow forecasts. The approach to arriving at a future maintainable cash flow number is very similar to the approach outlined in the draft Code.

Question 19: Do you agree with the approach we have set out for assessing the sponsor's cash flow? If not, what would you suggest as an alternative?

The approach appears reasonable, as long as it is viewed as a framework/principles based. The appropriate approach to assessing an employer's future cash flow will depend upon the specific characteristics of the employer and its market. The Code should therefore not seek to be prescriptive in such an approach and it should be made clear that any appropriate approach is acceptable.

Allowance should also be given for an appropriate interpretation of non-legal-entity-specific business plans and cash flow forecasts. In many circumstances, where the employer is part of a wider group, business plans, forecasts and management information is prepared on a relevant business unit, not legal entity basis. Trustees should be allowed to demonstrate how such non-legal-entity-specific information has been taken into account and what level of reliance has been placed on it.

Question 20: Do you agree with the approach we have set out for assessing the sponsor's prospects? If not, what would you suggest as an alternative?

The approach appears reasonable, as long as it is viewed as a framework/principles based. The appropriate approach to assessing an employer's long term prospects/longevity will depend upon the specific characteristics of the employer and its market. The Code should therefore not seek to be prescriptive in such an approach and it should be made clear that any appropriate approach is acceptable.

Question 21: Do you agree with the principles we have set out for contingent assets, ie that i) it is legally enforceable and ii) it will be sufficient to provide that level of support? If not, what would you suggest as an alternative?

We agree with the principle that contingent assets should be legally enforceable to be taken into account for covenant assessment purposes.

In our view and experience contingent assets have a significant role to play in improving the security of members' benefits, and it is important that they continue to be appropriately taken into account within the DB funding regime. If the approach is too prudent or unduly reduces the benefit of a contingent asset, then it could reduce the incentive for them to be put in place by employers. Contingent assets, and group guarantees in particular, are an important "life support" mechanism, which encourage wider groups to stand behind and support sponsoring employer subsidiaries in the event of trading challenges. The provision of contingent assets should therefore continue to be encouraged.

The draft Code mentions "look through" guarantees, and describes them as including a formal look through to the guarantor for affordability purposes, which we assume is referring to affordability when assessing deficit repair contributions i.e. on an ongoing rather than insolvency basis. We note that the standard PPF-form guarantees do not include any such provision, and we hope / expect there will be no suggestion that the terms of PPF-form guarantees are insufficient to allow trustees to look to the guarantor for covenant assessment purposes (particularly PPF guarantees that cover the full Section 75 debt obligations). Such standard PPF form guarantees do, however, provide an unfettered ability for trustees to claim against the guarantor in respect of all monies owed to the scheme and cannot be revoked without trustee agreement. Such features are also noted in the draft Code as being features of a "look through" guarantee. Any suggestion that the terms of PPF-form guarantees are insufficient would be counterintuitive to their role in lowering PPF levies, and requiring or encouraging trustees to replace existing guarantees to include "look through" terms could lead to significant advisory fees.

Question 22: Do you agree with the approach we have set out for valuing security arrangements? If not, what would you suggest as an alternative?

Yes – we agree with the broad principles set out. Trustees should be able to demonstrate that any contingent asset is expected to produce the relied on value at a time when it is required. We may want to comment on this further once TPR issues its more detailed guidance later this year.

Question 23: Do you agree with the approach we have set out for valuing guarantees? If not, what would you suggest as an alternative?

Yes – we agree with the broad principles set out. Trustees should be able to demonstrate that any contingent asset is expected to produce the relied on value at a time when it is required. We may want to comment on this further once TPR issues its more detailed guidance later this year.

Question 24: Do you agree with the approach we have set out for multi-employer schemes? If not, what would you suggest as an alternative?

Yes – we agree these might all be relevant factors to consider when assessing the employer covenant of a non-sectionalised multi-employer scheme.

Question 25: Do you agree with the approach we have set out for not-for-profit covenant assessments? If not, what would you suggest as an alternative?

The draft Code appears to assume that most not-for-profit organisations are types of charities. However, there are a number of entities within the railways industry, although not strictly not-for-profit, where the sponsoring employer's ability to support its pension liabilities benefits from specific legislative, contractual, or other structural support from the rail industry or the UK government, usually demonstrated by one or more of: (i) specific legislative provisions (ii) a Crown guarantee (iii) written correspondence from UK central or local government bodies, or devolved government bodies such as the Scottish Parliament or (iv) other specific documented arrangements confirming effective ongoing support by the industry or the RPS to the employer to meet its obligations to the Scheme. In the almost 30 year existence of the RPS, there have been no instances whatsoever of where such a not-for-profit employer in the railways industry has entered a PPF Assessment Period.

Code chapter 7 – Journey planning

Question 26: Do you agree with how we approached how maturity has been factored into the code? If not, what would you suggest as an alternative in particular with reference to the draft regulations?

We agree that, generally, it might be expected that less risk is taken as a scheme matures, and that a scheme should plan to be in a position of low dependency by the time it reaches significant maturity.

However, as per our response to the DWP's consultation on its draft regulations, we also recognise that there could be instances where the maturity of a scheme may not need to be directly linked to its investment strategy. For example, for very small DB schemes where the covenant strength is very strong (annual cash flow is many multiples of the Section 75 debt), a

high percentage downside investment risk could remain supportable until significant maturity – and could be desirable for the trustees and the employer (and the members) as all parties seek to reach full funding on a solvency basis in a cost-efficient and timely way.

We would therefore like to see less prescription from TPR in relation to appropriate journey plan “shapes”, outside of its Fast Track approach. The appropriate journey plan shape should be left to trustees to determine based on integrated funding advice that considers the specific circumstances of each scheme.

We also note, that under the draft Code and the draft regulations, there is an expectation that all schemes, including schemes which are expected to remain open to a material flow of new entrants for the foreseeable future, will eventually reach a point of significant maturity. As set out in our response to Question 37, this could have a material impact on costs for many open schemes, and we believe the same policy intent could have been achieved if a carefully considered contingency planning process was incorporated instead.

Question 27: Do you agree with the way in which we have split the journey plan between the period of covenant reliability and after the period of covenant reliability? If not, what would you suggest as an alternative?

We note that this places a great deal of importance on the assessment of the covenant reliability period, so it will be important for schemes to understand TPR’s expectations in relation to how this will be evidenced. It is difficult to comment further on this until we have seen TPR’s detailed covenant guidance in this area.

As per our response to Question 18, we caution whether the benefits of good covenant assessment can be achieved by distilling information into a small number of metrics. Whilst a formulaic assessment of risk may be beneficial for some schemes, it is important that schemes also remain able to adopt a more holistic, tailored covenant approach that informs the appropriate funding and investment strategy for a particular scheme’s circumstances.

Question 28: Do you agree that trustees should, as a minimum, look at a one-year 1-in-6 stress test and assess this against the sponsor’s ability to support that risk?

Yes – this is a sensible approach, provided the assessment of the sponsor’s ability to support the risk is not just formulaic and can take into account the factors we have highlighted in our responses to Question 18 and Question 27.

As noted in response to Question 8, VaR may not be proportionate for certain smaller schemes on the basis of cost. In these instances, it may be helpful for TPR to have set out some example deterministic scenarios/stresses that would be broadly consistent with a 1-in-6 VaR, to ensure that these schemes can meet minimum expectations in a cost effective way.

Question 29: Do you agree that if trustees are relying on the employer to make future payments to the scheme to mitigate these risks, then the trustees should assess the employer’s available cash after deducting DRCs to the scheme and other DB schemes the employer sponsors?

No – we believe the approach outlined could be improved by factoring the full Technical Provisions deficit into this assessment of risk, and then viewing this relative to the full free

cash flow available to repair this deficit over a reasonable period of time. The current approach outlined would essentially penalise employers when agreeing short recovery plans.

Question 30: Do you agree that this approach is reasonable for assessing the maximum risk that trustees should take during the period of covenant reliability?

Yes – this is a reasonable approach, subject to the point made in our response to Question 29 that existing recovery plan payments should not be deducted when assessing the employer's available cash.

Please note our comments in response to Question 18 and Question 27 regarding the assessment of covenant reliability.

Question 31: Do you agree with the considerations we have set out regarding de-risking after the period of covenant reliability?

Based on TPR's definition of the covenant reliability period, the proposed expectations around de-risking profiles would appear appropriate for the majority of schemes.

As per our responses to Question 18 and Question 27, we note that this places a great deal of importance on the assessment of the covenant reliability period, so it will be important for schemes to understand TPR's expectations in relation to how this will be evidenced. It is difficult to comment further on this until we have seen TPR's detailed covenant guidance in this area, although detail of the evidence which will be expected is a major outstanding area of concern to us.

Question 32: Do you agree with our approach of not being prescriptive regarding the journey plan shape?

Yes – the decision not to prescribe a journey plan shape (where maximum risk is not being taken during the covenant reliability period) is welcomed. We agree that this should be based on the specific circumstances of each scheme.

We note though that the requirement for all possible journey plan shapes to be below the line of "maximum risk" can be unduly constraining. For example, a journey plan which includes constant risk for the majority of the period up to significant maturity (because this is appropriate given the employer covenant, say) should be possible, but would not always be below the maximum risk line as set out in the draft Code.

Furthermore, we also note that paragraph 4(2)(a) of the underlying draft regulations could be interpreted as requiring all schemes to adopt a linear path of investment de-risking as they mature. As per our response to the DWP's consultation on its draft regulations, and as set out in our response to Question 26 above, there could be instances where the maturity of a scheme may not need to be directly linked to its investment strategy. More flexibility may therefore be required in the regulations to ensure these align with TPR's interpretation, for example paragraph 4(2)(a) might be reworded as follows "…more risk [is likely] to be taken where a scheme is a long way from reaching the relevant date and less risk [is likely] to be taken where a scheme is near to reaching the relevant date".

Question 33: Do you agree with our approach that the maximum risk trustees should assume in their journey plan is a linear de-risking approach where they are taking the maximum risk for the period of covenant reliability?

We expect this may be broadly sensible in most instances, but prescribing a linear de-risking approach is overly prescriptive in a bespoke funding regime. The appropriate journey plan shape should be left to trustees to determine based on integrated funding advice that considers the specific circumstances of each scheme. Please also note our comments in Question 31 regarding the importance this places on the assessment of the covenant reliability period, and in Question 32 regarding potential alternative journey plan shapes.

Code chapter 8 - Statement of strategy

Question 34: Do you agree with our explanation of the statement of strategy and are there areas it would be helpful for us to expand on in this section?

Yes – we broadly agree, but please note the following comments:

- As per our response to Question 5, we agree with TPR that the level of detail provided on the low dependency investment allocation should be proportionate to the circumstances of each scheme. For example, where a scheme is a long way away from significant maturity, a sensible level of detail here might be limited to how target hedging levels and expected return are expected to progress through time.
- We note that TPR will be required to receive and process a large amount of information, and that for us, any information will need to be submitted for over 100 separate sections. In order to plan appropriately and to ensure TPR's expectations are workable, we would appreciate early sight of, and engagement with, TPR on the required format of the statement and submission.

Code chapter 9 — Technical provisions

Question 35: Do you agree with how we have described the consistency of the TPs with the funding and investment strategy? If not, why not and what do you suggest as an alternative?

No – draft paragraph 54 states that the valuation assumptions applicable to the period following the relevant date "must" be actuarially consistent with the low dependency funding basis assumptions as determined in the funding and investment strategy. This appears inconsistent with draft regulation 20(3)(c), which sets out that "the assumptions chosen must be consistent with the way in which the trustees or managers intend 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".

Question 36: Do you agree that open schemes could make an allowance for future accrual – thereby funding at a lower level - without undermining the principle that security should be consistent with that of a closed scheme?

Yes – we absolutely believe that open schemes can make an allowance for future accrual and new entrants when projecting maturity. We note that there is no legislative requirement for TPR's proposed principle that the security of past service benefits should have the same level of security as in a comparable closed scheme.

“Security” could be interpreted in a number of ways. The ultimate objective of any DB scheme is to ensure that members’ benefits are paid in full as they fall due, and therefore it would be reasonable to interpret security as the probability of achieving this aim. As long as each scheme meets this aim, comparisons between schemes (whether open or closed, or otherwise) is not relevant and is not consistent with a scheme specific funding regime.

Although Technical Provisions might be lower in an open scheme relative to a comparable closed scheme due to higher expected returns, these higher expected returns could reasonably lead to the same, or even higher, probability of meeting all of the scheme’s past service cash flows.

Nonetheless, as set out in our response to Question 34, we suggest that open schemes should consider contingency planning for the event of scheme closure as a valuable integrated risk management exercise.

We therefore suggest that the wording in draft paragraph 273 should be amended, or the paragraph deleted.

Finally, we note that last week the Work and Pensions Committee of the UK Parliament issued a Call for Evidence in relation to an inquiry on DB pension schemes. The first question on which the Committee has requested evidence is:

“Is the right regulatory framework in place to enable open DB schemes to thrive?”

We would strongly encourage TPR to await the outcome of that inquiry before finalising its Code of Practice, to allow the Committee’s findings on the question above to be carefully considered.

Question 37: Do you agree that this should normally be restricted to the period of covenant reliability? If not, why not and what do you suggest as an alternative?

No.

When responding to the DWP’s consultation on the draft regulations we noted that they threatened the viability of open schemes. In particular, we highlighted that if the requirement to reach low dependency by the relevant date was predicated on the assumption that no new entrants would join the scheme after the valuation date, this could substantially increase Technical Provisions. We estimated that it could increase Technical Provisions by around 50% and the cost of accrual by as much as 75% for an immature scheme with a strong employer covenant, depending on the detail of how this is implemented in the revised DB Code.

We are pleased to see the draft Code state that the Scheme Actuary can include some allowance for new entrants and future accrual when projecting the maturity of open schemes. However, we are concerned that limiting this to the period of covenant reliability, even when there is no expectation of any closure to new entrants, is still likely to have a material impact on Technical Provisions for many open schemes when they conduct their first valuation following the implementation of the new Code. For example, we estimate that making allowance for new entrants and future accrual for a period of 6 years for a typical open section of the RPS may only reduce Technical Provisions by up to 5%. The allowance for open schemes therefore may do little to mitigate the increase in costs which potentially threaten the

viability of some open schemes, regardless of whether they are balance of cost of shared cost, damaging the retirement outcomes of many current and future pension savers

In addition, we do not see the rationale for the link between covenant reliability and the period to assume new entrants. In our view this should more naturally be related to covenant longevity. We also note that asking trustees to “robustly” consider this assumption in line with draft paragraph 277 places undue focus on this assumption relative to other key assumptions. Trustees should robustly consider the appropriateness of all assumptions, so we suggest this emphasis is applied more broadly, or not at all.

As per our response to the DWP’s consultation on its draft regulations, we believe the policy intent could have been achieved if a well thought through contingency planning process was incorporated. We appreciate that this would require changes to the draft regulations, noting that not all schemes would be expected to have a relevant date under this approach.

Question 38: Do you agree with our principle based approach to future service costs? If not, why not and what do you suggest as an alternative?

We agree with TPR’s principled based approach, however we note that draft paragraph 281 could be misinterpreted as implying that trustees of all schemes have the power to stop future service and may therefore need to be reworded accordingly.

Code chapter 10 - Recovery plans

Question 39: Do you agree with our approach to defining Reasonable Alternative Uses? If not, why not and what do you suggest as an alternative?

The suggested factors that might be considered are reasonable.

Question 40: Do you agree with the description in the draft Code of the interaction between the principle that funding deficits must be recovered as soon as the employer can reasonably afford and the matters that must be taken into account in regulation 8(2) of the Occupational Pension Schemes (Scheme Funding) Regulations 2005?

No – as per our response to the DWP’s consultation on its draft regulations, the principle that funding deficits must be recovered as soon as the employer can reasonably afford is problematic for shared-cost arrangements, where the affordability of the active membership is a relevant consideration in determining recovery plan affordability.

We suggest this principle is reworded in the draft regulations and the draft Code to remove explicit reference to the employer i.e. the principle becomes “funding deficits must be recovered as soon as this can reasonably be afforded”. We also note the use of the word “overriding” in draft paragraph 287, which might imply that this principle has primacy over other factors. We are aware that the DWP is consulting on this aspect, and as per our response to the DWP’s consultation on its draft regulations, we believe schemes should retain the flexibility to appropriately tailor recovery plans to both scheme and employer circumstances.

Furthermore, as per our response to the DWP’s consultation on its draft regulations, the relevant factors listed in regulation 8(2) of the Occupational Pension Schemes (Scheme Funding) Regulations 2005 and draft paragraph 286 exclude key factors like employer

affordability and member affordability in shared-cost arrangements. These key factors would likely be taken into account when determining if a recovery plan is appropriate having regard to the nature and circumstances of the scheme. If, as we suspect, this list is not intended to be exhaustive, we suggest that paragraph 286 is reworded to be "As a minimum, Trustees must take account of certain matters, namely:" and paragraph 287 should be updated to "Although these matters must always be considered, trustees may [take account of other factors when considering if a recovery plan is appropriate having regard to the nature and circumstances of the scheme and] apply different weights to the various factors depending on the scheme's circumstances."

Question 41: Do you agree that reliability of employer's available cash should be factored in when determining a scheme's recovery plan length?

Yes – this should be one of many important factors, including member affordability in shared-cost arrangements.

Question 42: Do you agree with the principles we set out when considering alternative uses of cash? If not, which ones do you not agree with and why? What other principles or examples would it be helpful for us to include?

Yes – these are all sensible principles and broadly consistent with TPR's previous messaging in annual funding statements and other relevant communications.

We note that the Technical Provisions funding level of other schemes sponsored by the employer is not listed in draft paragraph 313. We suspect this might be captured by the "funding requirement and investment risk" but in our view it would be helpful to make explicit reference to this.

Question 43: Do you agree with our approach to post valuation experience? If not, why not and what do you suggest as an alternative?

Yes – this is sensible and we expect already aligns with common market practice.

Question 44: Do you agree with our approach to investment outperformance? If not, why not and what do you suggest as an alternative?

Yes – we agree with the approach to restrict outperformance under Fast Track but to permit outperformance outside of Fast Track, subject to this being supported by the employer covenant and / or other contingent support.

Question 45: Should we set out more specifics around what we would expect by way of security to protect against the additional risks?

No – the information set out in draft Paragraph 295 is helpful.

Code chapter 11 – Investment and risk management considerations

Question 46: Do you agree with our approach that, while trustees' discretion over investment matters is not limited by the funding and investment strategy, we expect investment decisions by trustees should generally be consistent with the strategies set out in the funding and investment strategy? If not, why not and what do you suggest as an alternative?

As set out in our response to the DWP's consultation on its draft regulations, we are concerned that the statutory requirement to agree with the employer the funding and investment strategy as set out in Part 1 of the Statement of Strategy could, if it impinges on trustees' discretion when it comes to exercising their investment powers, have a detrimental impact on the effectiveness of trustee decision making in the investment process.

We acknowledge that the requirement to agree the funding and investment strategy as set out in Part 1 sits within the primary legislation. Our suggested approach was therefore for the draft regulations to limit the level of detail on the low dependency investment allocation that is required within Part 1 – for example, hedging levels and expected returns. We are therefore pleased to see comments from TPR in the draft Code acknowledging that this level of detail is appropriate, particularly for schemes which are not close to their relevant date, but note that this requires changes to the draft regulations, which currently require an asset allocation to be specified.

It is helpful to see TPR's comments in the draft Code of instances where it may be advantageous for trustees to deviate from the funding and investment strategy set out. Whilst we agree that, subject to compliance with their trustee duties, it would be reasonable to expect that trustees would wish to generally aim to align their actual investment strategy with the funding and investment strategy set out to ensure transparency for all parties, there are certainly instances where this may not be in the best interests of the beneficiaries.

Question 47: Do you agree with the examples we have given for when trustees' investment strategies may not mirror their FIS? Are there other examples we should consider? Should we set out more specifics around what we would expect by way of security to protect against the additional risks?

Yes – we agree with these examples.

Question 48: Do you agree with the expectations regarding trustees with stressed employers? If not, why not and what do you suggest as an alternative?

Yes – while each case clearly needs to be judged on its own merits, the high level considerations noted are sensible. We welcome the comment in draft paragraph 332 recognising that unsupported investment risk may be appropriate for distressed schemes, as it could have a potential reward for members.

Question 49: Do you agree with the principles we have set out regarding risk management? Are there other aspects it would be helpful for us to include?

Yes – this is a sensible, pragmatic approach. However, it is important to recognise that integrated risk management needs to be tailored to the circumstances of individual schemes and the risks they face.

As set out in our response to Question 34, we suggest that another good example of valuable integrated risk management is contingency planning for the event of scheme closure in open schemes.

Question 50: Do you agree with the principles we have set out regarding liquidity? If not, why not and what do you suggest as an alternative?

Yes – we agree with these principles. As noted in our response to Question 3, liquidity is an important consideration and we believe the definition of the low dependency investment allocation could be improved by replacing the requirement to "broadly cash flow match" with the requirement that "the assets would be sufficiently liquid to enable the scheme to meet expected cash flow requirements, and with reasonable allowance for unexpected cash flow requirements."

TPR may also find the following additional comments helpful:

- In draft paragraph 361, we believe "won" should be "own".
- In draft paragraph 365, alongside the opportunity cost of holding a large bank float, TPR may also wish to note here that trustee bank accounts are only likely to be protected by the Financial Services Compensation Scheme up to a maximum balance of £85,000.

Question 51: Do you agree with how we have approached security, profitability and quality? If not, why not and what do you suggest as an alternative?

Yes – we agree that an appropriate investment strategy should balance security, quality, and profitability, considering the scheme circumstances and objectives and how these are expected to evolve over time.

Question 52: Are there other aspects it would be helpful for us to include?

No

Systemic risk considerations

Question 53: Do you agree with the above considerations? If not, please explain.

The consultation does a good job of setting out the key considerations, but we would encourage TPR to request a quantitative estimate from the GAD on the possible impact of the draft Code. We believe that events last year demonstrated the material impact that DB pension schemes can have on the economy as a whole when extreme events occur. Whilst we acknowledge that any estimate will not accurately reflect what plays out in practice, lessons can be learned from the events of last year. We believe it is important that modelling is undertaken by the GAD to assess the potential worst case systemic impacts of TPR's proposals.

Question 54: Do you think there are any areas of systemic risk that should be considered further in in light of our draft code? If yes, please explain.

Yes – as set out in our response to the draft regulations, we believe there are a number of important areas that should be considered, for example:

- What will be the high level impact on the funding position of open schemes if all schemes are required to set a relevant date?
- What will be the high level impact on the funding position of mature schemes that are already past their relevant date and not yet at low dependency?
- What impact will the above have on employer contributions (and member contributions in the case of shared cost arrangements like the RPS), and what knock-on impact will this have on the employer covenant and overall security of member benefits?

Appendix 2: responses to Fast Track and regulatory approach consultation questions

We agree with TPR's positioning of Fast Track as a "regulatory filter" that does not mirror the minimum level of compliance with the expected legal requirements. We also agree with TPR's decision to omit Fast Track from the Code itself.

As set out in our response to TPR's first consultation on draft Code in March 2020, the funding regime is meant to be scheme-specific, and that is a key factor which must always be borne in mind. Whilst a Fast Track filter may be helpful to both TPR and certain more mature closed schemes, its formulation should not influence the way the scheme-specific regime operates for schemes in general.

A Fast Track system should be viewed as a short-cut. It may be attractive to some schemes, if it enables them to operate with lower advisor costs and less management time. It may also be attractive to TPR, if it enables TPR to streamline its process and focus its resources on other schemes. For this to work, we appreciate that there needs to be a higher level of prudence incorporated in Fast Track, to mitigate the risk caused by the lack of scheme-specific analysis undertaken.

It makes sense for TPR to require a more conservative funding and investment approach under Fast Track, so it can be comfortable that the scheme-specific characteristics would be likely to be addressed, had they been analysed more thoroughly.

However, due to these necessarily prudent margins within the Fast Track approach, it automatically becomes inappropriate to use these Fast Track parameters as a starting point against which to compare other schemes' approaches to scheme-specific funding. Scheme-specific approaches should genuinely be scheme-specific, and should not be measured against the Fast Track approach in any way.

We note TPR states that "Some trustees may find Fast Track a useful tool when negotiating with their sponsoring employers" in its consultation document. This does not align with TPR's general positioning of Fast Track and could lead to schemes adopting overly prudent, inappropriate funding and investment strategies. As noted by TPR elsewhere in its consultation, Fast Track will not be appropriate for all schemes, and we would therefore encourage TPR to remove this statement.