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Gearing up for your first valuation under the new DB Funding Code

The Pensions Regulator's (TPR's) new funding code of practice applies to valuations after 22 September 2024, so any valuation in 2025 will have to comply with the new regulatory requirements.

Improved funding levels over recent years, mean the impact of the new regime for many schemes will be less than anticipated when the code was first drafted. Although, required valuation changes may be more transformational for some. However, all trustees and sponsors are likely to have work to do to write up and evidence plans in the format required.

Getting to grips with the detail and changes shouldn't be underestimated. But good advice will manage compliance proportionately and keep focus on the big picture strategic issues.

We would encourage trustees and sponsors to start preparing now. **Read on for our quick guide to getting started.**

Key requirements under the new funding code:

1. Set long-term plans
The Regulations have now made it a legal requirement to put in place a long-term strategy. Trustees must set a low-dependency objective for 'significant maturity'[1] and consider how the scheme intends to provide benefits long-term. The objective must be prudent enough so that if fully funded on a low-dependency basis and invested in accordance with a corresponding 'highly resilient' and 'sufficiently liquid' low-dependency investment allocation, then there should be minimal reliance on the sponsor (ie no more contributions expected under reasonable circumstances). Then trustees must set a journey plan for how to manage risk to meet the objective that reflects covenant strength and scheme maturity.

2. Align valuations
Integrate long-term objectives and journey plans into funding solutions. The technical provisions target and investment strategy should converge to low-dependency as the scheme matures. Covenant analysis is more important than ever before, and any deficits must be repaired "as soon as the employer can reasonably afford".

3. Document plans in a 'statement of strategy'
New reporting to TPR of a scheme's funding and investment strategy and various other supplementary matters, with 'Fast Track' or 'Bespoke' routes to compliance. Fast Track will act as a filter with less expected scrutiny if the strategy meets key parameters. In a nutshell, these require a plan to be fully funded on a gilts + 0.5% basis (or stronger) by significant maturity, technical provisions that are a minimum proportion of these liabilities, a recovery plan of six years or less (no back-loading), and limited investment risk. These tests strengthen over time as a scheme matures towards significant maturity and its low-dependency position.

[1] *Significant maturity is defined as when a scheme reaches an actuarial duration of 10 years.*

So what should trustees and sponsors be doing to prepare for upcoming valuations?

A high-level impact assessment should help you prioritise and plan.

- **Book in training that covers the new requirements.** Understand implications of new regime ahead of your next valuation.
- **Determine how you'll approach your covenant assessment.** Consider whether you need to engage a covenant adviser for the first time or expand your current assessment to include new requirements. Trustees will need to identify key covenant features such as the sponsor's free cash flow, maximum affordable contributions, and its covenant "reliability" and "longevity" periods. In most cases more information from your sponsor will be needed.
- **Review any contingent support.** Do you place reliance on any other entities or rely on contingent assets? These must be legally enforceable and appropriately valued. TPR has tightened up expectations, so it's worth checking how current arrangements stack up and what amendments may be needed.
- **Get the right governance in place.** Trustees must appoint a chair and should also have processes in place which effectively identify and manage (potential) conflicts. A conflicted trustee should consider if and when they might withdraw from any negotiations.
- **Consider when and how you intend to engage with your sponsor.** You will need to jointly agree aspects of the long-term strategy including your ultimate end-game aspirations for the scheme – these may not have been discussed previously. Worth opening dialogue early and proactively. Look to head off any potential pressure to 'level down' plans if appropriate.
- **Check your rules for whether an expense reserve is needed.** Schemes should include an expense reserve in their low dependency target unless the sponsor has a legal obligation to meet expenses (though a reserve is still encouraged). Trustees should consult their rules to understand the position and consider an appropriate reserve aligned with their long-term strategy (eg run-on, buy-out). Likely to be a new requirement for many.
- **Understand your scheme's duration and timescales.** How far is your scheme from being significantly mature? It will be important to understand how long a timescale you have to reach low dependency. Where schemes are open, consider what a reasonable allowance for future accrual and new members is.
- **Review endgame goals and consider how any established long-term target might map across.** Trustees will need to set down how they intend benefits to be provided over the long term. Is there a view on end game (eg buy-out, run-on, superfund) that parties will be happy to document and use to drive plans? Consider how any established secondary funding target (or target implicit within your technical provisions discount rates) aligns with up-to-date views. At a time when the range of endgame options is expanding, schemes should take the opportunity to review intentions and consider if objectives need reassessed.
- **Test whether current funding plans are likely to meet Fast Track.** In the first instance, it's worth understanding whether your current plans would meet the Fast Track tests or, if not, how material any changes would be to make this option available. Greater flexibility is possible going Bespoke but schemes that are closer to the Fast Track requirements can expect lighter touch scrutiny, so it's a useful reference point.
- **Form a view over what's 'proportionate' to feed into scoping and planning.** The greater the complexity or risk within your plans, the greater the level of detail and explanation TPR will expect to see. Bespoke valuations will need more evidence for how scheme risks are supported. Think about what a 'proportionate' assessment of factors such as covenant looks like.

An updated valuation roadmap

The new funding code is going to require additional work by both trustees and sponsors, particularly for the first valuation that is carried out. It's worth starting early and planning this additional activity (and time) into your valuation timetable.

6 months before

- Training on new requirements.
- High-level impact assessment on how current plans stack up.
- Discuss valuation approach, principles, long-term objectives and low dependency targets. Engage with sponsor early.
- Scope and commission review of sponsor covenant to include new assessment of 'reliability' and 'longevity'.

Valuation date

- Scheme actuary presents advice on valuation assumptions, considering scheme maturity, Code principles and Fast Track.
- Initial valuation results, covenant assessment, and stress/sensitivity testing. Explore recovery plans if required.
- Trustee/sponsor discuss and refine proposals.
- Agree Fast Track or Bespoke compliance route and draft statement of strategy using TPR templates.
- Complete documentation, including schedule of contributions and agreed statement of strategy. Scheme actuary certifies Fast Track (if relevant).
- Submit to TPR, who verifies whether valuation meets Fast Track, or next steps for engagement on Bespoke.

Deadline 15 months after valuation date

Want to find out more?

If there's anything you'd like to discuss further, please get in touch with your usual consultant, or one of our funding code experts.

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To find out more about the requirements of the new funding code, and for some additional resources, visit our dedicated **funding code hub.**

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