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THE 100 GROUP
Pensions Committee

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1 September 2020

Dear Ms Harvey

Consultation on the defined benefit funding code of practice

I am writing on behalf of the Pensions Committee of the 100 Group of Finance Directors with regard to the above-named consultation.

About the 100 Group

The 100 Group represents the finance directors of the FTSE 100, several large UK private companies and some UK operations of multinational groups. Our member companies represent the vast majority of the market capitalisation of the FTSE 100, collectively employing 6% of the UK workforce, and in 2019 paid, or generated, taxes equivalent to 12% of total UK government receipts. Our overall aim is to promote the competitiveness of the UK for UK businesses, particularly in the areas of tax, reporting, pensions, regulation, capital markets and corporate governance.

The 100 Group represents companies sponsoring defined benefit (DB) pension schemes with assets of approximately £590bn and membership of 3.5m (around a third of the overall DB universe).

Whilst this letter expresses the views of the 100 Group of Finance Directors as a whole, these views are not necessarily those of our individual members or their respective employers.

We are happy for the 100 Group to be included on the list of respondents.

Key principles for a new funding regime

In our view, the key principles that should underpin the new funding regime are:

1. The regime should be supportive of established close working relationships between trustees and employers. Schemes work best where there is a strong collaborative approach between trustees and employers. An overly formulaic approach to scheme funding could undermine that by imposing an approach on schemes that is at odds with plans that have already been carefully negotiated and agreed between trustees and employers.

2. The Bespoke track should be entirely bespoke. It should be regulated with a principles-based approach which allows for different solutions that involve more sophisticated risk management, supported by professional advice. We are concerned that under the proposed twin-track approach, the Fast Track will become a benchmark for Bespoke valuations and a baseline for TPR.

3. Covenant needs to be recognised as a key pillar of scheme funding. We acknowledge that there may be difficulties in assessing covenant beyond 5 years but that does not mean that the covenant has ceased to exist altogether. There needs to be an allowance for sophisticated covenant assessment, especially for larger and more complex corporate structures.

In our response to the consultation questions, we have focused on the questions of most significance to the 100 Group, and have left some of the more technical questions to other organisations, who are better placed to respond.

We look forward to discussing our response with David Fairs at our meeting on 18 September.

Yours sincerely,

Alan Stewart
Chairman
The 100 Group Pensions Committee

100 Group Pensions Committee – Responses to Selected Questions

1. Twin-track compliance

Do you think twin-track compliance is a good way of introducing objectivity into a scheme-specific regime? What are your views on the proposals set out above? If you disagree, what do you propose instead?

Yes, subject to the twin track regime being underpinned by appropriate principles and being implemented proportionately in practice.

In our view, the key principles that should underpin the new funding regime are:

1. The regime should be supportive of established close working relationships between trustees and employers. Schemes work best where there is a strong collaborative approach between trustees and employers. An overly formulaic approach to scheme funding could undermine that by imposing an approach on schemes that is at odds with plans that have already been carefully negotiated and agreed between trustees and employers.

2. The Bespoke track should be entirely bespoke. It should be regulated with a principles-based approach which allows for different solutions that involve more sophisticated risk management, supported by professional advice. We are concerned that under the proposed twin-track approach, the Fast Track will become a benchmark for Bespoke valuations and a baseline for TPR.

3. Covenant needs to be recognised as a key pillar of scheme funding. We acknowledge that there may be difficulties in assessing covenant beyond 5 years but that does not mean that the covenant has ceased to exist altogether. There needs to be an allowance for sophisticated covenant assessment, especially for larger and more complex corporate structures.

We agree with TPR's aim of raising standards in poorly managed schemes and to that end acknowledge that the Fast Track approach needs to be simple and provide an appropriately high hurdle. Our concern is with the model being proposed for the Bespoke approach, rather than with the general principle of twin-track compliance.

We would also observe that:

- To enable schemes to continue to operate a flexible and scheme-specific approach, the regulation of Bespoke cases needs to reflect the individual characteristics of each situation (as per para 72 bullet 4 of the consultation, but not referenced elsewhere in the consultation).
- This can allow for the recognition of important differences between schemes such as:
    - different aims / expected returns, e.g.:
        - whether schemes are targeting run-off or buyout – noting that gilts+0.5% pa is overly prudent compared to returns available on run-off portfolios
        - different levels of fees by scheme size;
    - the benefits of protections such as dividend-sharing mechanisms / negative pledges;
    - alternative risk reduction allowing a higher discount rate, e.g. longevity swaps; and
    - ability to adapt to changing market conditions over time.
- An overly formulaic approach might result in worse outcomes for members as a result of schemes adopting a less sophisticated approach to risk management than at present.

2. Insolvency risk and reliance on covenant

Do you think the risk of member benefit reductions on insolvency is an acceptable part of the existing regime and that trustees should be able to place some reliance (whether implicit or explicit) on the employer covenant? To what extent do you think this should be the case? Do you think this risk is well understood by scheme members?

Yes. As referred to in our key principles set out in response to question 1, placing reliance on employer covenant is a necessary and crucial part of scheme funding.

The alternative would be to fund on a risk-free basis. This would fundamentally change the nature and cost of benefits that were promised to members. It would also be an incredibly inefficient way to fund the benefits and would drive significant unintended consequences. For example, it would be unaffordable for many companies which could ultimately lead to a reduction in benefits, it would completely end all open DB schemes, there would be a big shift to low risk assets which would have wider implications on the economy and it would further widen the intergenerational gap, directing money away from investing in growth and jobs.

The key is that trustees understand the level of reliance they are placing on employer covenant, together with the level of investment risk and prudence in the funding assumptions to ensure a balanced and holistic approach.

In our experience, members do generally understand that the security of their pension depends on the level of assets in the scheme and the support of the sponsor, reinforced through annual summary funding statements. Trustees certainly do.

Covenant is a key part of the benefit promise – DB benefits were never intended to be guaranteed in all circumstances and eliminating any reliance on covenant changes the nature of the benefit promise. This is not consistent with principles of intergenerational fairness.

3. Integrating covenant into funding

a. Do you think it is better to keep the Fast Track route simpler by only factoring covenant into Bespoke (TPs and/or RP)?

No. As a necessary and crucial element in the funding of UK pension schemes, covenant should be incorporated into the Fast Track approach, but using a simplified and straightforward approach that is practical for schemes to adopt.

Whilst a formulaic approach may be needed to factor covenant into the Fast Track route, that does not mean that the trustees of a scheme following Fast Track should only take a simplistic approach to covenant. Trustees should be encouraged to devote appropriate resources to covenant and get advice in relation to it.

b. If you think covenant should only feature in Bespoke, how do you think it should be done?

We do not think covenant should only feature in Bespoke. As we said in our response to question 1, covenant should be a key principle underpinning any scheme funding regime, whether Fast Track or Bespoke.

Therefore, even if it is not allowed for in Fast Track, we would expect the Bespoke approach to allow for tailored and sophisticated approaches to factoring covenant into funding. Strength and quality of covenant could be allowed for in a range of different ways including

(but not limited to) the level of TPs prudence, assumptions for future investment returns above the prudent discount rate, and recovery plans (length, shape and nature).

For many large organisations, assessing the strength and quality of the sponsor covenant is complex and multi-layered as evidenced by the breadth and depth of external assessments by credit rating agencies and other capital market stakeholders. As such, a formulaic approach based on four grades of covenant is over-simplified and not appropriate.

The Bespoke approach should reflect the specific circumstances of the scheme and sponsor covenant, taking account of, for example:

- the extent and quality of more detailed and comprehensive assessments available on the quality and nature of the sponsor's financial strength and covenant;
- other forms of sponsor support and contingent assets that may exist; and
- the support and resources available to the scheme to manage covenant risk.

c. If we were to integrate covenant into Fast Track guidelines, do you prefer option 1, 2 or 3 or some other approach for reflecting the employer in scheme valuations, and why? If another approach is appropriate, what do you think this should be?

Option 1 (integrating covenant into Fast Track technical provisions via the discount rate) would seem to be the most practical and preferred approach and more consistent with existing practice. As stated in previous questions, we would expect a more sophisticated approach tailored to the specific circumstances of the scheme and sponsor covenant to be allowed within Bespoke.

4. Covenant assessment

a. Should a holistic approach to assessing employer covenant be retained (but with further guidance to assist trustees), or should we seek to define a more prescribed, formulaic approach

A holistic approach to assessing employer covenant should be retained, reflecting the diverse and complex nature of different employer organisations. A formulaic approach may help to inform this assessment, but this should not be at the expense of a more holistic approach for the overall assessment of covenant.

We would also expect a holistic approach to look at covenant capacity to support downside risk over time separately from assessing what the employer can currently reasonable afford.

b. If the former (holistic approach), what amendments/clarifications to our existing guidance on covenant do you consider may be necessary? Do you agree with the ones suggested above? Is the structure and content of our existing employer covenant guidance helpful and accessible to trustees? If not, what would make it better?

Care needs to be taken in updating existing guidance to avoid unnecessarily constraining trustees in how they approach covenant assessment given the complexities of this task and the diverse and complex nature of different sponsors, particularly given that the current regime is deemed to be broadly working.

On the specific amendments / clarifications suggested:

- Cash affordability – in assessing affordability, it is important to recognise the duties and responsibilities that sponsors have to a wide range of other stakeholders as well as a defined benefit pension scheme;
- Reliance on indirect covenant – in assessing sponsor covenant, we strongly believe it remains appropriate to take account of wider group strength beyond just 1 or 2 years,

consistent with the approach adopted by other external stakeholders (e.g. rating agencies and capital market participants). It does not make sense that the existence of a stronger indirect covenant should lead to a more onerous funding approach (e.g. increased DRCs and shorter RP as set out in paragraph 133); and

- Covenant visibility – many well-established UK businesses and sponsors have very long-term business models supported by long-term debt and equity investors. Lack of visibility beyond the medium term should not automatically mean no reliance on covenant beyond 3-5 years.

c. If the latter (formulaic approach), what do you think of the proposed RACF approach? How would you propose that covenant could be explicitly defined in a clear, consistent and measurable manner? What other metric(s) may be appropriate?

Not applicable.

d. Alternatively, would it be appropriate to require employer covenant to be assessed in a prescribed (formulaic) way for Fast Track purposes, and only allow for a more holistic approach under the Bespoke framework?

Given the complex nature of covenant assessment, we believe a holistic approach is the most appropriate for UK pension scheme funding for all schemes.

Whilst a formulaic approach may be needed to factor covenant into the Fast Track route, that does not mean that the trustees of a scheme following Fast Track should only take a simplistic approach to covenant assessment.

5. Reliance on indirect covenant

Do you think that the strength of the wider commercial group should be factored into the sponsoring employer's assessment? If so, how, and to what degree?

Yes, trustees should understand the wider business in which sponsoring employers sit. This is directly relevant to their covenant strength. We do not agree that reliance on the strength of indirect group covenant should be limited to one to two years where sophisticated covenant analysis suggests that a longer period might be appropriate. In addition, we do not consider that there is any need for the wider covenant to have a clear and tangible benefit for the scheme – if that were the case, they would not be relying on indirect covenant.

Whilst reliance on wider covenant may mean that the direct sponsor is less financially strong than the wider commercial group, it can protect the pension fund from negative events elsewhere (e.g. politically motivated claims or liabilities against another group company). Indeed, some credit rating agencies derive individual company ratings off those of the wider corporate group, recognising the importance of certain entities to the wider group.

15. Covenant visibility

a. Do you think it is prudent for reliance on employer covenant to be reduced beyond the period over which there is reasonable visibility? If not, why not?

Not if covenant visibility is set at an arbitrary period of 3-5 years. A fixed period for covenant visibility is only appropriate where limited analysis has been done in relation to covenant strength.

Like any projection, covenant visibility inevitably reduces further into the future but "reasonable visibility" is something which should be judged by the trustees. This

assessment should be considered and informed, irrespective of whether the trustees are using Fast Track or Bespoke. Note that whilst covenant visibility is expected to reduce over time, so is the monetary reliance on the sponsor as benefits are paid out over time, creating a natural risk mitigation.

In the context of Fast Track, covenant visibility will be factored into the discount rate. Without being aware of what the assumptions proposed in relation to this are, we cannot at this stage comment in more detail.

In relation to the Bespoke approach, as we said in the principles in response to question 1, bespoke must mean truly bespoke and appropriate to the individual scheme.

b. How much visibility do you think most trustees can have over the employer covenant? In the absence of evidence to the contrary, do you think it is reasonable for most schemes to assume there is reduced visibility beyond 3-5 years?

No – we do not think assuming reduced visibility beyond 3-5 years is reasonable.

Any entity that sponsors a pension is likely to rely on some form of credit assessment by third parties (e.g. investors, lenders, lessors, landlords, trade creditors) - in many instances, this will include an independent assessment by credit rating agencies or similar.

It is too simplistic to reduce such an assessment down to a formulaic approach as a means of overcoming a difficult analysis. Being fundamental to the interests of the sponsor, it is in its own interest to share assessments and material to support the analysis - engagement is natural. Indeed, a lack of cooperation from the sponsor should understandably lead to a more cautious assessment.

In essence, covenant assessment requires the support of advisers, input from the sponsor and judgement by the trustees. 3-5 years is an arbitrary time horizon that has the danger of becoming a benchmark that is only relevant by coincidence. For some schemes, 3-5 years may even be too long a covenant horizon. It can also become an easy option for avoiding this most important analysis that is critical to both the scale of investment risk in the fund and the sponsor's financial well-being.

16. Use of additional support

Should additional support, such as contingent assets and guarantees, be allowed in scheme's funding arrangements provided they are sufficient for the risk being supported, appropriately valued, legally enforceable and realisable at their necessary valued [sic] when required?

Yes. Additional support, such as contingent assets and guarantees, can be an important means by which pension schemes can mitigate funding risks.

17. Appropriateness of RPs and affordability as key factor

a. Should employer affordability be the key factor to determine the appropriateness of a RP? If not, what should it be?

No. It is not the key factor but only one of a number of factors, including covenant, which should be taken into account.

As the consultation document itself concedes, it is not possible to use affordability alone as a factor for assessing the appropriateness of a recovery plan. It is also necessary to take into account an employer's sustainable growth plans, and how practical it is for the employer to pay off any deficit within a particular timeframe. For example, the consultation

document notes that TPR would not necessarily expect deficits to be recovered immediately (for example via a single lump-sum payment) even if this is affordable. This suggests that TPR accepts that a simplistic focus on affordability in isolation is not correct – recovery plans should be considered within the wider context of a forward-looking assessment of a business's overall structure, development plans and efficient capital resource management. If TPR is to retain the term "affordability", it should adopt a much more nuanced view of what it means by this.

In the case of the Bespoke route in particular, trustees should be able to take advice from their advisers about their employer's short to medium-term business plans and opportunities and make informed decisions based on this advice about the time period over which it is practical and reasonable to recover any deficit, rather than being constrained by any narrow definition of "affordability". There is a risk that a narrow definition of affordability could lead to trustees feeling forced to demand money from employers, undermining relationships between trustees and employers.

In addition, businesses have a whole host of stakeholders they need to take into account. Any assessment of affordability should acknowledge this and not be crude and simplistic.

b. Is it reasonable to require schemes with a stronger employer covenant (and a resulting reduction in prudence in the assumed TPs and size of deficits) to have a commensurately shorter RP?

No, this seems to be penalising stronger employers simply for the fact that they are stronger.

As indicated in our answer to Q17(a), the determination of the length of the recovery plan should be a scheme-specific decision by the trustees based on advice from their covenant (and other) advisers. In some cases, this may involve stronger employers paying off their deficits sooner, but this should be a decision taken on a clear and deep understanding of the employer's financial position rather than on a prescription from TPR.

43. Equitability

What are your views on the concept of 'equitability' in respect of how a scheme is treated compared with other stakeholders? Should any requirements be qualitative (in line with the commentary above) or should trustees also be expected to consider a specific metric? If so, what might be an appropriate measure of equitability (for example, comparing the ratio of DRCs to dividends, or the size of scheme deficit to the 'stake' of other stakeholders) and how could this reflect a scheme's superior creditor status over shareholders?

In our view, equitability is an important concept and ensuring equitable treatment is part of the fundamental role of trustees. However it cannot be approached in a simplistic or formulaic way. It depends very much on the specific circumstances of the sponsor, the scheme and the other stakeholders.

Sponsors need to balance the need of all stakeholders and different circumstances may require different priorities to be given to each. As every company and situation is different depending on multiple factors, we favour a principles-based approach to considering equitability. It is not possible to codify an approach that is suitable in all circumstances.

We also note that, for cases where a scheme is meeting the Fast-Track approach and the Recovery Plan length is less than the minimum length for all covenant groups, no test or restriction should be needed on dividends or equitable treatment in general, as the scheme is already receiving funding to a high level, with any deficit being made up over a short time period.

49. Criteria for assessing Bespoke arrangements

What are your views on the criteria we propose to use to assess Bespoke arrangements? If you disagree, what would you change and why? What else should we consider?

We do not agree with them. Taking each of the proposed assessment criteria in turn:

1) How the Bespoke arrangement complies with legal and DB Code principles

Whilst this is acceptable in principle, care needs to be taken when determining which legal requirements are at issue here. The consultation document suggests that potentially the requirement could extend widely.

The valuation process is not an appropriate point at which to require trustees to confirm that they comply with any governance requirements in excess of those which directly relate to the valuation. Using the Fast Track will not ensure compliance with wider governance requirements and there should be no additional burdens on schemes using Bespoke arrangements.

Trustees should only have to confirm that they are following legal requirements in relation to the valuation process. The Code should set out exactly which legal requirements trustees may need to demonstrate compliance with.

Similarly, this criterion refers to the need to satisfy the principles of Chapter 5 of the consultation paper. There should be clarity around what the relevant principles are and they should be limited to those which are directly relevant.

2) Assess the Bespoke arrangement using Fast Track as a reference point

No – this is inappropriate. The Bespoke approach cannot operate in this way. In particular, we would observe that the current scheme-specific approach operates well for many schemes and the flexibility allowed in this regime should not be lost.

There are several reasons for this:

First, we're fundamentally concerned that benchmarking Bespoke arrangements against the Fast Track approach undermines the more sophisticated and nuanced approach taken under Bespoke which reflects the specific features of the scheme including the complexity of assessing the nature and the quality of the sponsor covenant.

Secondly, if the trustees of a scheme, on professional advice, determine that particular assumptions for their scheme are appropriate, it creates an unnecessary regulatory burden to require them to demonstrate that they are "more appropriate" than other assumptions.

We acknowledge that trustees using the Bespoke approach should be able to explain why particular assumptions are appropriate for their scheme. However, they should not be required to assume the burden, or indeed the cost, of providing evidence that they are more appropriate than the Fast Track assumptions.

Benchmarking to the Fast Track may make for regulatory simplicity but it will not ensure better governance or better outcomes for scheme members.

3) Assess how additional risk (if any) is being managed

We believe that the level of mitigation that the consultation paper suggests may be required here is unnecessary and inappropriate. The reason for the additional risk

mitigation suggested appears to be for regulatory compliance rather than ensuring a better outcome for the scheme.

The consultation paper says that any additional risk must be managed or mitigated. There is no reference here to the employer covenant – it suggests the only way to manage or mitigate risk is to put additional security in place (instead of, for example, relying on an appropriately scrutinised employer covenant).

If the scheme benefits from a strong employer covenant and the trustees and employer agree to incorporate additional risk in the investment strategy, will additional mitigation/support be required?

Alternatively, if on professional advice, the trustees decide that it is appropriate to use assumptions which are less prudent than those set out in the Fast Track, and again the scheme is supported by a strong covenant, why should additional mitigation/support be necessary?

In addition, it may not always be apparent that trustees are taking "additional risks" to those set out in the Fast Track as the nature of the risks taken may be different.

Additional risk mitigation should only be required where the valuation approach proposed in Bespoke assumptions would be reasonably likely to affect the security of member benefits.

4) The quality of the supporting evidence provided by the trustees

We consider it impractical to ask for "robust evidence" in relation to all funding assumptions chosen by trustees. The nature of actuarial assumptions is that they are future predictions and that different actuaries will make different predictions.

A more practical approach would be to ask trustees to show that they have taken appropriate advice and the actuary has taken into account the circumstances of their scheme. We don't see what additional evidence in relation to any actuarial approach could be provided.

In this light, it would be better to require trustees to state what evidence they have taken into account and how they have arrived at the approach they have adopted.

This would also be a proportionate approach to regulation, putting sensible and targeted criteria in place.

50. Bespoke examples

a. *Do you have any comments on the assessments we have made in the examples above?*

We would start by reiterating the general principles that we set out in relation to question 1:

1. The regime should be supportive of established close working relationships between trustees and employers. Schemes work best where there is a strong collaborative approach between trustees and employers. An overly formulaic approach to scheme funding could undermine that by imposing an approach on schemes that is at odds with plans that have already been carefully negotiated and agreed between trustees and employers.

2. The Bespoke track should be entirely bespoke. It should be regulated with a principles-based approach which allows for different solutions that involve more

sophisticated risk management, supported by professional advice. We are concerned that under the proposed twin-track approach, the Fast Track will become a benchmark for Bespoke valuations and a baseline for TPR.

3. Covenant needs to be recognised as a key pillar of scheme funding. We acknowledge that there may be difficulties in assessing covenant beyond 5 years but that does not mean that the covenant has ceased to exist altogether. There needs to be an allowance for sophisticated covenant assessment, especially for larger and more complex corporate structures.

In all of the examples, there is an explicit benchmarking to a Fast Track equivalent approach which, as highlighted above, we reject as we believe a more principles-based approach is required. As noted in the consultation document, the examples are simplified in many areas and not exhaustive. It is not possible to fully capture the diverse range and complex nature of the different schemes and their sponsors. Nor can they adequately allow for the full range of contingent assets and other forms of security and protections that each sponsor is able to provide reflecting their specific circumstances and how they can be taken into account for the purposes of pension scheme funding. If anything, the examples highlight why the Bespoke approach needs to be principles-based, underpinned by strong governance and professional advice rather than benchmarked to the formulaic approach under Fast Track.

- Example 1: It's entirely appropriate for schemes to use demographic assumptions based on their own experience and scheme specific features. In line with TPR's assessment, there should be no additional risk in reflecting the actual past and expected future experience of a scheme, even if it results in a lower LTO than the Fast Track approach. This can also be appropriate for other assumptions (including financial assumptions) reflecting either experience and / or scheme specific features.

- Example 2: It's generally accepted that a CDI approach is an appropriate strategy to provide a stable, long-term and low risk solution for a maturing scheme and the DB funding regime shouldn't deter trustees and sponsors from following such strategies. The example contains a fairly basic range of very high quality UK bonds and we would expect a CDI approach that incorporates a broader range of credit and similar assets also to be acceptable to the extent that it is a well-diversified and balanced portfolio, robustly tested for liquidity events and adverse credit market scenarios. While the mark-to-market value of such assets can be volatile over a period of time, they provide a relatively high certainty of returns if held to maturity, which pension schemes can do.

- Example 3: We agree that it's reasonable to use a higher TPs discount rate where covenant is strong and where there is clear visibility of covenant over the medium term. This may be appropriate where there is evidence of profitability and free cash flow (as in the example) or for larger, established employers that are systemically important to the economy in a way that business streams are unlikely to be disrupted in the medium term. Such employers are likely to be heavily regulated and we think it's reasonable for trustees to assume a stronger and more sustainable covenant for such employers. We note that such circumstances may also support a longer recovery period.

- Example 4: It's important to ensure that non-cash support is taken into account when assessing Bespoke arrangements as such arrangements provide an important way of providing additional security for pension liabilities while supporting the sustainable growth of sponsoring employers. We agree that trustees should assess the quality and nature of the support and the degree to which it is realisable in a stress event.

- Example 5: It's important to the sustainable growth of employers that the funding regime affords trustees and sponsors flexibility when structuring recovery plans. If a back-end loaded recovery plan is appropriate and reasonable it should be a permitted feature of the Bespoke regime if there's a genuine need. It's reasonable for the pension scheme to be treated consistently with other creditors when the trustees are making an assessment of the reasonableness of such an approach. However, we note that this is a nuanced judgement and there will be circumstances where dividends may still be paid potentially at a reduced level (rather than not paid at all as in this example) during a period of increased corporate investment.

- Example 6: It's important to the sustainable growth of employers that the funding regime affords trustees and sponsors flexibility when structuring recovery plans and the regime shouldn't preclude longer recovery plans than those expected under the Fast Track approach. It's important to ensure that non-cash support is taken into account when assessing Bespoke arrangements as such arrangements provide an important way of providing additional security for pension liabilities while supporting the sustainable growth of sponsoring employers. We agree that trustees should assess the quality and nature of the support and the degree to which it is realisable in a stress event.

- Example 7: It's reasonable for trustees to agree a longer recovery plan where the TPs are stronger than might otherwise be.

- Example 8: The Bespoke regime should provide flexibility for the trustees to agree TPs and recovery plans that reflect a stronger covenant if arrangements are made to bolster covenant of the statutory employer through an intra-company guarantee. In the example given, there are a number of features of the parent company guarantee which may not always be available (e.g. not being time limited, or the level of guarantee). This should not mean the guarantee has no value to the scheme and highlights why it is important for trustees, under the Bespoke approach, to have flexibility around how a guarantee (or other contingent asset) is taken into account in determining TPs and any recovery plan.

- Example 9: It's important to ensure that non-cash support is taken into account when assessing Bespoke arrangements as such arrangements provide an important way of providing additional security for pension liabilities while supporting the sustainable growth of sponsoring employers. These arrangements should support the agreement of higher levels of investment risk and lower TPs where appropriate. This example includes some specific features of the contingent asset being "realisable when needed (for example cash, or property not occupied by the employer)". Again, this may not always be available but the contingent asset can still provide value to the Scheme and it is important for trustees to have the flexibility to reflect this in determining TPs and any recovery plan under the Bespoke approach.

- Example 10: We don't agree that adopting a single discount rate in itself suggests that TPs are inconsistent with an LTO. This is particularly the case where the discount rate is prudent and/or there is strong covenant support. Further, we don't agree that having no explicit link between TPs and LTO means that the TPs aren't prudent. We do agree that the trustees should be able to demonstrate how their approach to TPs links to an LTO. But this link shouldn't need to be formulaic. For example, a secondary funding target embedded within the trustees' integrated risk management framework and against which funding, investment and covenant decisions are taken should be sufficient.

- Example 11: Taking rewarded investment risk is an important way of securing pension liabilities in the long run. We agree that a higher risk investment strategy should be compliant with the principles under the Bespoke regime provided it's supported by the

employer covenant and/or contingent assets and the trustees have a contingency plan in place if the investments underperform over a reasonable time horizon – note this may be longer than the 3-year inter-valuation period depending on the quality and level of contingency provided.

- Example 12: Taking rewarded investment risk is an important way of securing pension liabilities in the long run. We agree that a high risk investment strategy should be compliant under the Bespoke regime provided it's supported by the employer covenant and/or contingent funding as part of a contingency plan if the investments underperform.

- Example 13: We agree that the trustees should be able to agree weak TPs assumptions to the extent that the position is supported by covenant and/or contingent funding. We don't agree that it's the place of trustees to seek commitments from the employer to keep a scheme open to accrual and that maturity shouldn't be the only consideration when assessing the appropriateness of TP assumptions.

b. Could you provide other examples (relevant to your own scheme experience or that of schemes you advise) of arrangements which you think will follow the Bespoke route? Why do you think these arrangements would be compliant?

We have not set out any examples as this would suggest that there is a limited number of answers to this question. In our view, any type of scheme might choose to follow the Bespoke route for a myriad of different reasons. It is therefore impossible to highlight only a small number of arrangements which would be compliant. A scheme-specific funding regime allows for the possibility of as many possible compliant solutions as there are schemes. This is why it is our strong preference that principles should underpin regulation of the Bespoke approach and not specific metrics.

c. In example 2 (LTO–CDI strategy), could it be appropriate, in your view, to be able to use a higher discount rate/lower value of TPs (low dependency basis) than in FastTrack? If so, in what circumstances and by how much?

We would reiterate our general principle that the Bespoke framework should have the flexibility to be truly bespoke. This should extent to all aspects of a Bespoke approach, including the LTO.

A fundamental principle of the Bespoke framework is that it should be flexible to accommodate the circumstances of the scheme and the position relative to Fast Track shouldn't be a constraint. Investment-grade corporate bonds provide a relatively high certainty of higher returns than gilts if held to maturity and also help trustees meet their objective of paying benefits when they fall due, particularly in mature schemes. Accordingly, the expected investment outperformance should be available to support a higher discount rate / lower value LTO than gilts +0.5% to gilts +0.25%. We accept that there may need to be limits on allowance for investment outperformance where a scheme holds a high proportion of private debt and high yield/emerging market bonds.

52. Trustees' assessment of additional support in Bespoke arrangements

Do you have any views on the framework we set out for trustees to assess the appropriateness of additional support in Bespoke arrangements? If you disagree, what do you suggest?

We would reiterate our general principle that the Bespoke framework should have the flexibility to be truly bespoke. Any framework should be principles based.

We agree with the high-level four-step approach set out in the consultation document, i.e. assessing any risks arising from the additional support, determining when those risks will crystallise and how much support will be needed, and assessing the quality of the additional support. However, it is important that these steps are applied in a principles-based way, taking account of the specific circumstances of the pension scheme, the employer and the additional support under consideration. Any rules-based approach to additional support would undermine the whole idea of a Bespoke route.

53. Accessing additional support

When do you think trustees should be able to access the additional support? Does it depend on the Bespoke arrangement and the type of risk that it supports?

We agree with the statement in the consultation document that "[e]very scheme and employer's circumstances are different, and the Bespoke arrangements will also be unique as they will be tailored to fit those conditions. We cannot therefore define exactly the situations where a particular risk will be crystallised and the support should be accessible." Trustees should take advice from experienced and knowledgeable advisers and give careful consideration to the timing of access to any support.

In addition, multi-stakeholder environments mean that sponsors must be able to give proper consideration to what will work across their stakeholders, including giving appropriate consideration to the scheme. Trustees should be aware of completing pressures for sponsor money and not feel compelled to demand more than might be appropriate in particular circumstances. This is consistent with TPR's own statutory objective of minimising "any adverse impact on the sustainable growth of an employer" in the context of using its powers under the statutory funding regime.

54. Assessing the value of additional support

Should trustees be required to assess the stressed value of any contingent asset? What other guidance do you think we should set out on the recoverable value of contingent asset support?

Whilst we agree that it is reasonable for trustees to assess the stressed value of any contingent asset, it should be for the trustees of a scheme, having taken advice, to assess that value in a way that is appropriate to their scheme and the contingent asset. We do not think that TPR should prescribe a particular approach. It is for experts to determine the appropriate means for valuing a particular asset. Our preference would therefore be for "broad guidance" on the process for valuing contingent assets drafted on a proportionate and principles-based basis rather than more "detailed requirements".

55. Independent valuation

Should trustees always be expected to seek an independent valuation of continent [sic] assets, or should it depend on asset value and/or type? If this should be based on value thresholds, how should these be defined? How frequently should we expect trustees to seek an independent valuation? Should trustees be expected to regularly monitor contingent asset value in the intervening period?

TPR should take a principles-based approach to the valuation and monitoring of contingent assets. For example, where the value of a contingent security reduces in line with the deficit, there may come a time when the costs of a full valuation and extensive or frequent monitoring come to seem disproportionate in the context of the size of the contingent asset.

Trustees should seek a valuation as often as they need to. There should be no specific rules. The frequency of valuations and the level of monitoring required should be proportionate to the circumstances and the level of additional security provided to the scheme by the contingent asset.

56. Guarantees

a. Should we treat guarantee support differently to asset backed support?

Yes.

We would start by observing that there cannot be a formulaic approach to the assessment of security. Different types of security may well have different pros and cons for different schemes and we would challenge the assumption that asset-backed security is always better. There may be many cases where trustees would prefer to have an on-demand guarantee than the support of assets they may find difficult to collect in and liquidate.

We acknowledge that there are obviously differences between guarantee support and asset-backed support that should be taken into account in the trustees' assessment of the overall benefits of entering into such an arrangement. However, for the same reasons that we challenge the short-time horizon for covenant visibility for large listed companies (see our response to Q15), we would also object to the view expressed in the consultation document that "we would be concerned if a guarantee is being used as justification for a longer RP given there will typically be reduced visibility about a guarantor's financial strength in the longer term". Where the guarantor is a large listed company, it is likely that there will be significant information available about the medium and longer term prospects of the company, which could enable a guarantee to be used to underpin a recovery plan beyond 3-5 years.

b. Should trustees rely on guarantee support to change the covenant grade assessment or do you think in these circumstances the supporting entity should become a statutory employer instead?

No, it is not necessary for the supporting entity to become a statutory employer.

It will depend on the type and nature of the guarantee, but in principle we think there is no reason why guarantee support should not be used to change the covenant grade assessment, so long as the covenant provided by the guarantor has been properly assessed. Whilst it may be appropriate for some schemes and corporate structures, it would seem unnecessary (and potentially impractical) to require a supporting entity to become a statutory employer in all cases, and might lead to the promise of additional support being withdrawn.

58. Reporting information on additional support

Is there any reason why it would be unreasonable to expect trustees to undertake the analysis and provide the information outlined above? Is there additional information that should also be provided to us?

Yes, there are reasons why and circumstances in which this would be unreasonable.

We agree that in principle trustees should share assessments they have already made with TPR. However, exactly what is required should be proportionate and determined by how much reliance the trustees are placing on the additional security. Trustees should not have to produce additional documents that they and their advisers do not consider necessary simply to provide them to TPR.

Any requirements should set out the areas that TPR would expect trustees to consider as part of agreeing additional support rather than list the information to be provided to TPR via the Statement of Strategy. Trustees should obtain professional advice, and then take informed decisions, taking account of that advice and TPR's expectations.

We would also be concerned if TPR were to make unnecessary requests for further information on additional support that could make trustees think twice about accepting an additional support mechanism if the compliance burden seemed too great to make it worthwhile.