PPF Response to TPR DB funding code consultation

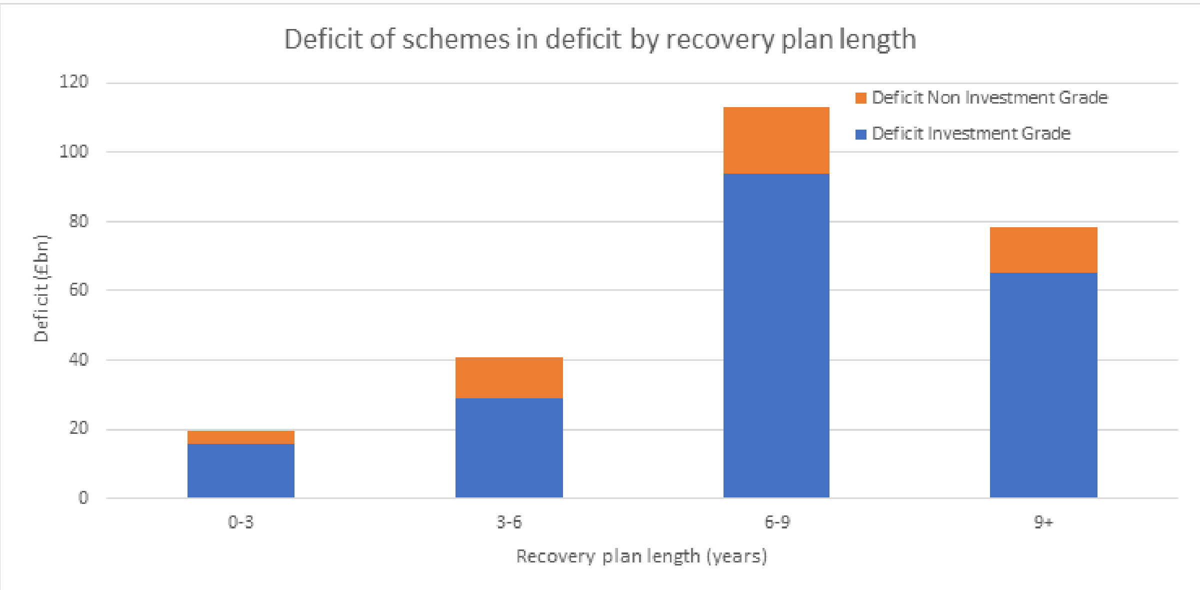
Overall comments and executive summary

Issues in the current system

We believe that change to the current system is necessary to ensure members of pension schemes are properly protected. We support the Government's action to require all schemes to have a long-term funding objective (LTO) and welcome TPR's consultation on a new funding code to fit with this.

The current framework has made it difficult to ensure sustained progress in tackling scheme deficits – and average recovery plan lengths have altered relatively little over the life of the regime. In part this reflects the impact of a low yield environment – making funding more challenging. However it also reflects the limited levers available that have been available to TPR and absence of clear benchmarks on what sponsors needed to do to comply with their funding obligations.

Schemes with strong employers, which account for over 75% of the PPF's exposure, have significant deficits and in some cases very long recovery plans (see graph below). Many recovery plan lengths remain higher than TPRs current proposed maximum length of six years for Fast Track – and schemes with investment grade sponsors constitute most of that - indeed there appears to be no correlation between covenant and recovery plan length. Our experience of insolvency events is that covenant can deteriorate rapidly and is visible for at most five years, so that current strength is limited comfort and it should be a priority for the new regime. This is particularly the case for schemes with very large deficits that could be considered to pose a risk to the protection system (like systemically important financial institutions for their sectors).



Scheme reliance on future payments from sponsors through long recovery plan lengths, combined with significant back ending of DRC payments, presents a significant risk to members and the PPF and the challenging immediate environment due to COVID-19 should not be allowed to de-rail fundamentally sound proposals – not least as the code will not start to affect contributions for some time.

Proposed approach to the regulation of scheme funding

We believe the overall structure TPR are proposing is well thought through and helpful. Critically, the structure includes clear, objective standards against which schemes can be assessed (e.g. the low dependency funding basis for scheme LTOs, limits on acceptable investment risk during the journey to the LTO, and constraints on recovery plan length). This will provide the platform for robust regulation which will be essential in order to ensure schemes and employers are doing all they reasonably can to protect their members (and by extension PPF members and levy payers). Accordingly, we also support the concept of the twin-track approach, allowing regulatory effort to focus on schemes that are below benchmarks.

The key issue is how the various standards are defined and there is a debate to be had about trade-offs between member security and cost to employers. In this context, we recognise that the immediate environment is difficult for many scheme sponsors. However, these proposals should be seen as a long-term change to address fundamental issues with the current system. In considering proposals it is, therefore, important to look beyond the immediate economic challenges. We would also note that for any sponsors where the code does require a step up in contributions, that these are unlikely to occur until 2022.

What should the long term objective be?

In the long term we think schemes and employers should be planning to reach, and maintain, a funding level that protects their members in the event of employer insolvency. The low-dependency funding basis should be set with that principle in mind.

This is critical to protect scheme members the majority of whom, at the point of scheme maturity, are likely to be retired and have a considerable dependency on their income from the scheme. However, it is also important to protect the PPF, reducing the risk of significant claims at the point where the amount the PPF can collect through the levy is expected to have diminished substantially (due to reductions in the levy paying universe and scheme de-risking).

This does not mean the low dependency funding basis should always be equivalent to a buy-out basis. Rather we think it should be set to ensure any losses to members are constrained to acceptable levels - providing the scheme with options where the sponsor is unable to support it further, or if it becomes insolvent (e.g. buy-out or transfer to a non-insured solution such as a TPR approved consolidator[1]) and ensuring– for the typical scheme – there would be no claim on the PPF. The consultation proposes a range of gilts +0.25% to 0.5%, we think a basis towards the lower end of this range would be appropriate.

In terms of the timing of the LTO we consider this could be somewhat sooner than proposed in the consultation e.g. at 15 years maturity. Even by this point, if the scheme is operating on a low-dependency basis, a funding issue will be hard to address, for example longevity risk.

Path to LTO

In considering the 'journey plan' to the LTO we believe that any allowance for employer covenant should be constrained. Our experience is that covenant strength can rapidly disappear and that therefore funding plans should avoid significant reliance on the continued strength of an employer.

In particular scheme *technical provisions* (TPs), effectively a scheme's interim funding objective, should not incorporate *any* allowance for the employer covenant. This protects the scheme from the effects of weakening covenant leading to a back end loaded recovery plan that may then become unaffordable. Otherwise if a sponsor can make low payments in the early years as TPs have been reduced to allow for covenant, if the covenant weakens then the TPs rise revealing the "real" deficit just when they can't afford it. Excluding covenant from TPs also allows for absolute transparency in a scheme's funding position – and comparability between schemes – to support oversight.

Recovery plans (RPs) should be structured to pay off any deficits (the gap between the scheme's funding position and TPs) as fast as reasonably affordable and no longer than 5/6 years to be fast track compliant (given the inability to foresee employer covenant beyond a 5 year period). This could be supported by a requirement on trustees – in order to 'pass' fast track – to confirm that in their view the RP is as fast as reasonably possible. This would help ensure that 5/6 years is a maximum not the benchmark.

We believe schemes supported by stronger employers should be able to take more investment risk (effectively allowing scheme investment returns to reduce the proportion of the deficit that has to be met directly by the employer). However, if investment outperformance means the scheme is ahead of schedule in its journey to full funding, the base expectation should be that it simply gets there earlier – if it is to remain on fast track (rather than seeing a reduction in contributions by the employer).

[1] We would only support transfer to a consolidator where the provider was authorised by TPR following legislation on superfunds or in the interim met TPR expectations as set out in their interim regime – to ensure that there was a low ongoing risk to members.

Equally, there should be an expectation where a recovery plan has gone off course following a new valuation that contributions should rise, all else being equal (and in particular subject to affordability), rather than that the recovery plan is simply extended. If an extension is required due to affordability constraints, our view is that it would be reasonable to expect contributions under to new plan to be as least as high as those currently being paid.

Where recovery plans are extended beyond fast track parameters due to affordability constraints (and there are no offsetting mitigations e.g. through contingent assets) there needs be transparency about the weaker protection these members have – e.g. through labelling arrangements as "at risk". This would then provide an effective hook for further regulatory action and support.

Finally, we agree with the suggestion that open schemes should offer the same degree of security in relation to accrued benefits as other schemes. We would question whether it is appropriate for schemes to continue to generate new liabilities where the sponsor cannot afford a recovery plan in line with fast track parameters. It is a concern that many open schemes have comparatively weak levels of funding. Even if these schemes are maturing more slowly than closed schemes, most are likely to face the challenges of increased maturity, such as cash-flow negativity, in due course.

Detailed responses to consultation questions

Chapter 3: Proposed regulatory approach - Twin-track compliance

1. 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?

We are supportive of the twin-track compliance proposal and the greater scrutiny afforded by focusing on schemes that pose the greatest risk.

We consider that strong employers should be required to pay down their deficits within a reasonable timeframe and that limiting this to 6 years in-line with 1 to 2 valuation cycles is reasonable. The proposition reflects our analysis that covenant strength beyond five years cannot be relied on (qu.15). If anything this would suggest that recovery plan periods should be shorter than 6 years.

We welcome the clarity as to the acceptable duration for recovery plans and recovery plan end dates are not continually pushed back, that funding gains are locked in as schemes mature and the principle that by the time schemes are significantly mature, they are expected to have a low level of dependency on the employer and be invested with high resilience to risk.

We note that schemes unable to comply with the Fast Track approach, for instance those with very long Recovery Plans due to employers facing significant affordability constraints, will be placed on the Bespoke. The current proposal indicates that these schemes would be considered compliant in this circumstance.

We consider that compliance shouldn't necessarily be based on a scheme doing as much as they can. In this instance we suggest that these schemes should be considered as "unable to comply fully" or some such, in recognition that these schemes are a considerable risk and therefore should not be categorised in the same way as a scheme choosing the Bespoke option for instance due to a complex investment strategy that is sound, but requires additional scrutiny. Where schemes are placed on the Bespoke due to being unable to comply fully, we would appreciate if these schemes can be easily identified to manage risk and protect stakeholders.

Chapter 4: Employer covenant - Insolvency risk and reliance on covenant

2. 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?

We consider it reasonable in the short term, but that there should be a diminishing appetite for risk of member benefit reductions as schemes move toward maturity. At the point of an LTO fixed by relation to substantial maturity, when most members are pensioners (unable to deal with risk to income) this should allow for the securing of member benefits in full with limited risk (e.g. through a TPR approved consolidator or close to full benefits on buyout).

The inclusion of covenant within TPs does not allow for a clear view of funding gaps, as covenant strength within TPs masks the true picture of scheme funding by altering the level of funding that is needed. Setting TPs which include covenant strength would not reflect what a scheme needs and TPs would be based on the present covenant strength, which is not visible in the longer term. The TPs would therefore not give a clear picture of the standing of the scheme and would be based on the assumption of covenant strength, which could change in future. We consider that TPs therefore ought to be set to reflect what the scheme needs to be self-sufficient – and so should not account for employer covenant. Covenant though could come in for the period it can be relied on to allow more risk getting there through. If there is a deficit compared to TPs there needs to be a clear view of this deficit and a recovery plan to close it. Our analysis suggests that covenant strength beyond five years cannot be relied on.

We do not consider that the risk is well understood and schemes members may be unaware that benefits may be reduced when under TPs the scheme is fully funded.

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)?-

As set out above we agree with the proposal to allow trustees to imbed some reliance on the employer covenant in RPs for both routes. However, we do not favour approaches which allow TPs to be weaker because a sponsor is strong - as this conceals funding shortfalls. Covenant strength should therefore not factor in TPs.

We consider it reasonable to factor covenant strength into the Fast Track route where covenant strength can be assessed easily and mechanically – such as where the sponsor has a public credit rating, where intragroup support from a publicly rated entity in the group is judged to be highly likely (e.g. as evidenced by past experience). Where assessing the strength of the covenant requires a more holistic approach, the Bespoke route is more suitable. A mechanical assessment of covenant strength aligns with the aim to maintain Fast Track as straightforward and objective as possible.

There is a case that the recovery plan needs to be re-evaluated should certain deterioration in credit rating occur. This would mimic what happens with some corporate debt where lenders can ask for instance for step-ups, when certain conditions are breached (e.g. financial ratios or credit ratings).

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

We believe it prudent to recognise only the present value of cash flows where this is a high degree of visibility and certainty.

Recognising the present value of deficits reduction contributions, agreed in the recovery plan, seems prudent subject to the employer having a sufficiently strong credit quality.

Where an employer is non-investment grade the present value of the cash flows is less certain. We would therefore envision recognition of cash flow to be limited to investment grade employers.

Absent a public credit rating, one could look to the covenant strength. However, this would require visibility of the insolvency experience for each covenant strength and the mapping of such insolvency experience to investment grade / non-investment grade.

We would take additional comfort from a Letter of Credit type bank guarantee, given additional certainty the cash flows will be received. Where a bank is considered investment grade, this could allow deficit reduction contributions from a non-investment grade sponsors to be recognised.

Discounting the cash flow we recommend a through the cycle approach when selecting the most appropriate discount rate. This provides for greater stability with the discount rate only changing when there is a perceived change in credit quality.

During times of economic stress we would expect credit quality to be assessed more frequently, in particular when assessed as being just above non-investment grade.

Limiting the recognition of cash flow to investment grade sponsors provides an additional layer of comfort in a stressed environment, as insolvencies are typically concentrated among non-investment grade entities.

Regarding the use of market value using listed securities – we note that there is no certainty that the cash flows the market value is to capture will be coming to the scheme. Market valuations can also be volatile with volatility not necessarily driven by a perceived change in credit quality.

Pension Protection Fund

Regarding the use of net asset value – again there is no certainty that the net asset value reported on a going concern basis will flow to the scheme. Reported net asset value in the accounts is not a substitute for expected cash flows and there is uncertainty if the scheme will be able to access all of the cash.

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?

We consider option 1 to be inappropriate.

Option 1 allows TPs to be reduced to take account of covenant. This has the impact of reducing the apparent value of the scheme's liabilities to members. We consider this inappropriate, because the members have the same entitlement regardless of the covenant.

We consider that either option 2 is most appropriate.

Option 2 allows for covenant in supporting investment risk. We consider it would be essential to explicitly quantify the value of the outperformance that is expected, and the timing of that out performance; so that the success of the planned outperformance is measured. We also note that the planned investment outperformance would need to be consistent with the investment strategy and the capacity to accept the additional risk.

For option 3, which reflects the value of the sponsoring employer as a resource based on unencumbered asset base, discounted present values of cash flows, or another measurable of employer value. We note that this is at an earlier stage of development and could work in a variety of ways. If a version of this approach is adopted, we would see it as critical that:

- The additional support is of limited term and amount. This is because strong employers may see deterioration in their strength over time.
- It is measurable and fully transparent.

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?

We consider that the holistic approach with further guidance to assist trustees, is better suited to the bespoke regime, where greater scrutiny of trustee's assessment can be made. This would allow for covenant to be assessed where a formulaic approach would be unsuitable and could be tested against evidence provided by schemes through the bespoke regime.

We agree with your analysis that whilst the approach allows trustees to consider all factors of covenant strength, it is open to inaccurate or inconsistent assessments and agree with your assessment of the areas of shortcomings. Therefore we do not consider that this approach is suitable for arrangements with more limited oversight, should the holistic approach be maintained. (see qu.4d)

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?

We agree with your suggested amendments/clarifications. In particular your assessment that indirect covenant support can be overstated (see qu.5).

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?

We caution for "affordability" by default being assessed post servicing of all debt ranking pari-passu with any pension deficit in case of employer insolvency. Such approach could create a waterfall which in a going concern situation would put pension debt effectively by default at the end of the line, transferring an element of equity risk to the pension scheme by making pension contributions dependent on the residual cash flow prior to dividend payments but post servicing of all other stakeholders.

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?

We consider that the holistic approach is better suited to the Bespoke framework, as this would allow greater scrutiny where covenant assessment requires subjective judgements to be made. A formulaic assessment for Fast Track would simplify the assessment and reduce the risk of inaccurate, or inconsistent assessments. We consider that a formulaic assessment should form the baseline metric and where trustees diverge form this approach, an explanation should be provided.

The PPF allows scheme Trustees to assess covenant strength for Guarantors to certify an amount of realisable recovery, should the guarantee be called upon. We provide guidance to Trustees to assist them with their analysis, whilst allowing them to take a holistic view. This approach requires trustees to provide a report to the PPF which demonstrates how the realisable recovery amount certified could be met and the PPF assesses whether the analysis in the report appears reasonable. We consider that a similar approach could be taken by TPR where trustees diverge from a formulaic approach.

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?

Whilst we agree that wider group support in absence of legally binding guarantees can be a factor in determining covenant strength, which is consistent with ratings agencies, our experience is that support is not guaranteed on insolvency.

Given the difficulties in assessing indirect covenant, we think it should not be allowed for in a fast-track model, and caution should be exercised in considering it at all. Members will be better protected by Trustees taking a cautious approach to non-binding expressions of support and sponsor groups have the option to offer legal guarantees if they wish to see support recognised in funding plans for the scheme. Factors to consider in assessing indirect covenant would include historic support, the materiality of the sponsor to the wider group etc.

Our approach to assessing insolvency risk is by a PPF-specific model. This is a statistical model which uses company accounts data to assess insolvency risk, developed using observed insolvencies amongst employers and guarantors of defined benefit pension schemes. The PPF takes a pragmatic approach where ultimate ownership is sufficient criteria to assume group support. The level of group support is in turn derived looking at the statistical evidence collected from past insolvencies of group members. As one would expect the historic data confirms that the strength of the group a company is part is indeed very relevant to the risk of insolvency. However, the historic data also demonstrates that it is not the only factor. Group companies can and do enter insolvency despite being part of a stronger group. So our model has a component for group strength in its assessment of an employer's insolvency risk. But this does not bring the employer's insolvency risk up to the level of the strongest member of the group – the evidence of past insolvencies does not support such a change. We consider this is a reasonable approach for an organisation assessing risks of 6000 schemes, but would fit less well with trustee consideration of a single scheme.

We also note that the notion of group support is a two way street. Group companies can be judged to be weaker when part of a weaker group, than judged on a standalone basis. This can be driven by the likelihood of support for weaker entities in the group, but also by certain core corporate functions being performed centrally. When core corporate functions are performed centrally it is challenging to envision a situation where an insolvency of the group does not impact the functioning of a financially stronger employer.

6. Covenant grades

a. Should we use a greater range of covenant grades to set guidelines in the code and assess schemes and, if so, what would be an appropriate number of grades?

We believe this discussion would benefit from understanding the historic insolvency experience for each of the covenant grades and if such insolvency experience is statistically significant on a 95% confidence interval.

The discussion would also benefit from understanding the distribution across each of the covenant grades and the level of transitioning across covenant grades over a certain time period.

As a general principle we would expect at least one band for "high risk cases" (i.e. insolvency risk >5% or >10%) and the proportion in any band not to exceed 5x proportion in any other band.

b. Would there be sufficiently different characteristics between a greater number of grades, such that a set of trustees could reasonably and reliably assess covenant strength without requiring professional advice?

(See qu.6a)

Chapter 5: General principles

7. Low dependency LTO

Should all DB schemes have a low level of dependency on the employer by the time they are significantly mature? If not, what do you think would be an appropriate expectation to ensure trustees manage the run-off phase for their scheme effectively and efficiently?

We agree that by the time schemes are sufficiently mature "typical schemes", they should have a low, ideally no dependency on the employer. As covenant visibility is unknown post five years we question that schemes should be on low dependency, rather than not relying on employer support at all. Should some dependency be on the employer at the LTO and this were to be unavailable, members would be unable to meet the shortfall due to the maturity of the scheme.

8. Timing of the LTO

What factors should influence the timing of reaching the LTO? Do you think that the timing should be linked to maturity?

As schemes mature scheme members will be less likely to meet shortfalls. Therefore we agree that timing of the LTO should be linked to maturity and that TPs remain within a defined funnel of investment risk that narrows as the LTO comes closer i.e. as the scheme matures.

9. High resilience to risk at the LTO

Do you think that the investment portfolio should be highly resilient to risk when schemes reach their LTO? If not, what do you suggest?

We agree that the investment portfolio should be highly resistant to risk when schemes reach their LTO as there is less time for employer to make good any shortfall that arises as a scheme matures.

10. Risk-taking for immature schemes

Is it reasonable for less mature schemes, which would have more time to reach low dependency funding, to assume and take relatively more investment risk than a mature scheme?

We agree that it is reasonable and appropriate for investment strategies of less mature schemes to take relatively more investment risk than a mature scheme, where they both have the same sponsoring employer strength.

11. Journey planning

What are your views of the rationale above for the journey plan? Do you think there is there a better way for trustees to evidence that their TPs have been set consistently with the LTO?

We agree with the proposals for the journey plan. We think it is appropriate that trustees use their TPs to measure progress towards the LTO, as it allows for adjustment along the journey as needed.

12. Relevance of investments for funding

Do you agree that the actual investments and investment strategy are a relevant factor for scheme funding?

We agree that actual investments and investment strategy are relevant for scheme funding and that where investment risk is increased, mitigation should be built into the plan.

13. Broad consistency between investment and funding strategy

a. Should the investment strategy be broadly consistent with the level of current and future investment risk assumed in the funding strategy? If not, why not?

We'd expect it to be required to be consistent for fast-track, in-line with the aims of this route. Schemes using a bespoke route may choose to diverge and explain, which can then be assessed by TPR.

b. If it is not broadly consistent, for instance where trustees want to take additional investment risk (than that assumed in the TPs), should trustees have to demonstrate that the investment risk taken can be managed appropriately? If not, why not and what would you suggest?

Trustees should be able to demonstrate that the investment risk can be managed appropriately and that any investment losses that emerge can be funded by the sponsoring employer.

14. Liquidity and quality at maturity

Do you think that security, quality, and liquidity become more important as a scheme becomes significantly mature? In particular, do you think that the scheme's asset allocation at significant maturity should have a high level of liquidity and a high average credit quality?

We agree that security, quality and liquidity become more important as a scheme becomes significantly mature, and we'd expect them to increase. The liquidity should be appropriate to the potential needs of the scheme. They should take account of both scheduled pension payments and potential other payments such as lump sum payments and transfers out.

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?

We agree that it is prudent for reliance on employer covenant to be reduced beyond the period where it is reasonably visible, as schemes should not rely on support where this support cannot be assured.

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?

We agree that 3 to 5 years is a reasonable period for visibility over the employer covenant.

We observe that the Credit Derivative Swaps market, even for investment grade entities', tends to only be liquid up to 5 years, with much less liquidity at 10 years. This implies that the investment market consider visibility to be limited to 5 years.

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 when required?

We believe that additional support, such as contingent asset guarantees should be allowed in scheme's funding arrangements where they can reasonably be relied upon on insolvency and are legally enforceable. However, as with sponsor covenant there are likely to be limitations on the period over which such support could be relied upon: guarantees should generally not be relied upon beyond the period for which the covenant is visible; security over assets should also be time-limited where there may be doubts about the longer term value of an asset. Alternatively Asset Backed Contributions may provide greater security depending on their nature.

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?

We recognise that affordability will mean some schemes have to have a longer recovery plan and clearly the regime cannot prevent this (scheme funding rules should not be a driver of insolvency). However, setting a clearly defined boundary on acceptability should drive behaviour. This could be accompanied by a requirement for trustees to certify that they have considered recovery plan period and confirmed it is the fastest reasonably achievable, rather than simply that it is within a standard number of years. In that way the requirement for them to be within 6 years could be seen as a minimum, not a benchmark and we advocate that RPs should be as fast as affordable, but over no longer as covenant can support the scheme, subject to a maximum of 6 years.

We are aware that in some circumstances contributions are back-end loaded and we are of the view that there is too great a reliance placed on covenant strength making future payments, which leads to RP end dates being extended. Back-loading of contributions increases the risk of member benefit reduction on insolvency and the PPF. Our view is that payments should be back-ended by exception, only where there is a strong justification on the grounds of affordability and that RPs should be kept to five years.

It is worth noting that by "affordability" we mean a "reasonably affordable level of payments" i.e. allowing for investment in the business (not the absolute maximum an employer could technically afford to pay).

We also caution for "affordability" by default being assessed post servicing of all debt ranking pari-passu with any pension deficit in case of employer insolvency. Such approach could create a waterfall which in a going concern situation would put pension debt effectively at the end of the line, transferring an element of equity risk to the pension scheme by making pension contributions dependent on the residual cash flow prior to dividend payments, but post servicing of all other stakeholders.

In addition, extending the time to pay the "original debt" should be tightly controlled, requiring strong justification on the grounds of affordability and perhaps specific controls on the payments of dividends (given the debt can be seen as the employer borrowing from the pension scheme). We recognise there may be concerns about creating a trapped surplus, but consider close monitoring of the scheme's funding position (for example) is a more appropriate response than extending recovery plan length.

Where debt increases there *may* also be a case for stronger controls e.g. the default assumption being the same end date will be maintained, with the onus on schemes to demonstrate an "extension" is necessary on the grounds of affordability and perhaps specific controls on the payments of dividends (given the debt can be seen as the employer borrowing from the pension scheme).

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?

We consider that strong employers should be required to pay down their deficits within a reasonable timeframe. Under the current regime schemes with strong employers have significant deficits and very long recovery plans. Most of the PPF's exposure (75%) is with strong employers, which poses a significant risk to the PPF and scheme members.

Where schemes benefit from a strong employer covenant, we consider that the regime should expect these schemes to remove their deficit as quickly as reasonably possible, as attested by trustees, and within the period where covenant strength is visible i.e. up to five years.

18 Open schemes, past service

Should past service have the same level of security, irrespective of whether the scheme is open or closed?

We agree with the suggestion that open schemes should offer the same degree of security in relation to accrued benefits as other schemes. As for example, if there were two identical schemes, one closed and one open, with the same employer, we see no reason for the member security of benefits to be different.

In this context it is a concern that many open schemes have comparatively weak levels of funding. Even if these schemes are maturing more slowly than closed schemes, most are likely to face the challenges of increased maturity, such as cash-flow negativity, in due course.

19. Open schemes, future accruals

Do you think it would be good practice for trustees to ensure that the provision of future accruals does not compromise the security of accrued benefits?

We consider it is very important for trustees to ensure that the provision of future accruals does not compromise the security of accrued benefits. We recognise the value of strong defined benefit pensions, but on balance our view is that where schemes are unable to securely meet future accruals, that past service and the promises made to those members, and additional risk to the PPF, should not be compromised. (We would question whether it is appropriate for schemes to continue to generate new liabilities where the sponsor cannot afford a recovery plan in line with fast track parameters.)

Chapter 6: Other issues

20. Other issues

Do you agree with our assessment of the issues above and do you have any further comments?

(See summary)

Chapter 8: Setting the long-term objective (LTO)

21. Fast Track low dependency discount rate

What are your views on our proposal that the appropriate low dependency funding basis for Fast Track should be with a discount rate somewhere in the range of Gilts +0.5% to Gilts +0.25%? Where in the range do you think it should be and why? If you disagree, what do you think would be a more appropriate basis and why (please provide evidence)?

Schemes should be heading for the reasonable expectation that at the LTO member benefits are met in full. We agree that something in the range of Gilts +0.5% to Gilts +0.25% would be appropriate in supporting this aim. Setting discount rates at this level has the potential protection of allowing for schemes to enter a TPR approved consolidator or buyout without material reduction in benefits.

A rate of Gilts +0.25% would provide a better to protection for scheme members, and would provide a better to protection to the PPF. We would expect the bases to converge on the lower end of the range by the LTO.

PPF currently uses a discount rate of Gilts + 0.3% for pensioners in retirement (level pensions), which reflects the buyout market pricing. We consider that something of around this level would currently be appropriate for a low dependency basis. Although it will be important to keep that level under review over time.

22. Options for defining other assumptions for Fast Track low dependency funding basis. Which of these options should be used to set assumptions for low dependency funding under Fast Track? Are there any other options we should consider? Are there any other pros and cons we should consider?

In respect of base mortality, there can be significant differences between schemes. To set a single set of assumptions would therefore result in liabilities which are too high for some schemes and too low for others. We therefore consider it is not appropriate to set an overall assumption. We would expect that justification for assumptions should be something that TPR could form a view on.

For other assumptions, we think it is unnecessary for TPR to set assumptions, as either

- Assumptions are market assumptions, such as inflation, so expect to be within a small range, or
- Assumptions are based on scheme data – e.g. married proportion, where there can be differences between schemes. These assumptions have a far lower impact than the scheme mortality basis, and thus it seems unnecessary for them to be specified.

23. Defining assumptions for Fast Track low dependency funding basis

c. If we determined mortality assumptions, how could we balance the scheme specific nature of mortality with the desire to ensure a level of consistency in the assumptions used by different schemes?

(See qu.22)

24. Low dependency basis – verification that other assumptions meet the best estimate principle

b. If we decided to require schemes to provide additional information about their assumptions, what information should we require schemes to provide compared to the current requirements?

Sensitivity analysis on the assumptions would be very useful to assess the assumptions made.

25. Other assumptions for Fast track low dependency basis – prudence

a. If we specified certain assumptions, should we aim for those to be best estimate or to be chosen prudently?

We consider that assumptions should be chosen as best estimate, with explicit allowance for prudence in setting the overall objective (rather in the way the PPF uses best estimate and aims to have a 10% reserve at self-sufficiency). As this offers better protection from risks.

b. Given the uncertainty around assumptions such as future improvements in mortality should we: i) define these assumptions in Fast Track and ii) set the assumptions prudently?

(See qu.25a)

26. Low dependency liabilities – reserve for future ongoing expenses

a. Should the low dependency liabilities carry an expenses reserve? If so, should this only be a requirement for schemes that self-fund their expenses?

We agree that an expense reserve is required to manage costs for schemes where the trust deed does not set out that they will be reimbursed by the employer. We consider the TPs and an LTO that closes deficits quickly provides adequate protection for the PPF.

b. To what extent should we define the reserve for future expenses under Fast Track? Should we just provide guidance on how to calculate an appropriate reserve? As part of that, what level of ongoing expenses is it reasonable to allow the employer to pay directly without any reserve?

We consider that at low dependency returns to portfolio must cover all costs, including the PPF Levy and that employer support should not be assumed, as it would be unknown by this point whether the employer could provide this support.

c. If we defined guidelines on expenses for Fast Track, how should we reflect the proportionally different level of expenses incurred by schemes of different sizes? Could we adopt a sliding scale of percentages of liabilities based on the size of the scheme or a fixed element and proportionate element of expenses?

Our experience from setting expenses for section 143 purposes is that actually expenses can vary significantly on wind-up from scheme to scheme, depending on the complexity of the scheme. Also, costs as a percentage of liabilities often need a cap and a floor for very large and small schemes. Further, under such an approach schemes with different benefit structures will have different expenses, which may be difficult to justify. Expressing costs as a per member charge has many of the same advantages as a liability based expense assumption, but does address the issue around different benefit structures.

An expense allowance with some allowance for scheme specific factors will give a more realistic view of likely costs, hence a range may be a more appropriate way to specify for fast-track approval

27. Definitions of maturity

a. Should maturity be defined as duration for the purpose of prescribing significant maturity under Fast Track? If not, which measure would you favour and why? Note that whatever measure we use, it needs to be applicable not only to the time at which we would expect a scheme to reach significant maturity but also at all earlier times in the scheme's life.

Yes we agree that maturity should be defined, and that it should be defined by duration of liabilities.

b. Whichever method is used to determine maturity, we need to use actuarial assumptions to make the calculation. Should we require that the Fast Track low dependency assumptions are used for this purpose? What other assumptions could be used?

We agree that Fast Track low dependency assumptions should be used for schemes in Fast Track. Where TPR are comfortable with the TP basis a scheme uses for Bespoke following involvement, we support the use of these assumptions as it gives the best view of the scheme and would not require calculations to be completed on a different basis

28. Defining the timing point for significant maturity

What are your views on our proposal to set significant maturity (used to define the timeframe for reaching the LTO) for Fast Track to be in the range of a scheme duration of 14 to 12 years (or equivalent on a different maturity measure)? If you disagree, what would be a more appropriate timeframe and why? Please provide evidence.

We agree with much of the approach to this as it would manage the risk for a wide variety of schemes in a wide variety of circumstances.

We agree that further modelling can usefully inform this decision, and suggest that a more prudent duration such as 15 years, may be appropriate.

29. Points or ranges for low dependency funding basis and timing point

Do you think our proposal to set a particular level for the low dependency funding basis and/or a range for the significant maturity timing associated with the LTO would be helpful to schemes to manage volatility and allow some smoothing? If not, what would you suggest?

Pension Protection Fund

Our view is that setting the timing point as a range (e.g. duration of 14 to 12 years) would in practice result in 12 years being the target.

Our view is that it would be preferable to set a clear target. We would expect the trustees to require that the journey plan would take account of the potential for volatility, and thus many schemes would reach the target slightly early.

Chapter 9: Technical Provisions (TPs)

30. Journey plan shape for Fast Track TPs

a. Which shape of journey plan is most appropriate to define for calculating the Fast Track TPs and why? Does this vary depending on the circumstances of the scheme?

We think the linear approach is most appropriate for Fast Track as this approach is more straightforward and requires less oversight, the stepped journey would also be appropriate, as we would expect strategy to be reviewed periodically. Horizon can be included in Bespoke where TPR can assess whether this is appropriate for the individual schemes.

c. What unintended consequences might arise from adopting the linear de-risking or horizon method journey plans for Fast Track?

Those already with a low risk approach may be ok with a horizon approach.

31. Key factors for Fast Track TPs

Should other scheme-specific factors other than covenant and maturity be considered to define the journey plan and TPs in Fast Track?

We consider that they should reflect the investment strategy as detailed above.

32. Extent of reliance on covenant in Fast Track TPs

a. Should we define a maximum period of acceptable full covenant reliance for FastTrack TPs? For example, a general guideline of five years? Or should covenant reliance be assumed to decline in the much shorter term (or immediately)?

We consider that covenant reliance should be for a maximum of five years. Whilst it may be appropriate for covenant reliance to be for a shorter period for some schemes, we consider that doing so is likely to restrict the number of schemes choosing fast track. We therefore believe that setting a guideline of five years is most appropriate.

b. What level of covenant support should subsequently be assumed? Should there be an assumption of a single covenant grade reduction (eg CG1 to CG2), a reduction to assumed returns in line with a weak covenant, or something else?

Our experience of insolvency is that within a five year period covenant strength can significantly reduce. Recent high profile scheme sponsors have reduced from the PPF equivalent of CG1 to insolvent within this period and therefore a single covenant grade reduction would not capture the risk. We do not consider that covenant support should be relied upon beyond five years for this reason and RPs should be limited to this period for typical schemes, with relatively strong sponsors. (see qu.15b)

c. Over what period should any reduction in reliance take place? Should this be immediate (eg a reduction to a lower covenant reliance in the sixth year) or more gradual (eg over the subsequent five years)?

Covenant should not be factored into TPs to allow a clear comparison of scheme positions. While we do agree that there is a place for recognising employer covenant, over the period that there can be confidence in it, we do not consider that that this should be by altering the level of funding that is needed, but by reflecting that more investment risk can be supported in achieving the target.

Transparency is important when asking is my pension scheme funded or not. Robust TPs also protects the regime (and members of the scheme) from the effects of weakening covenant leading to a back end loaded recovery plans that then may become unaffordable. Otherwise if a sponsor can make low payments in the early years as TPs have been reduced to allow for covenant, if the covenant weakens, then the TPs rise revealing the “real” deficit just when they can’t afford it.

Chapter 10: Investments

35. Which reference point from which to measure investment risk in Fast Track

a. Would a measure of the liabilities be an appropriate position to measure investment risk from? If not, why not?

We agree that liabilities are an appropriate reference point.

b. Do you prefer a liability measure on the low dependency basis (Gilts +0.5% to+0.25%) or a Gilts flat basis? Why? Are there any other liability measures that would be suitable?

We consider that low dependency liabilities are an appropriate basis.

We consider that the gilts flat basis is too far removed from other calculations within the overall framework, and that this would be unhelpful.

We consider that the Fast Track TPs is inappropriate, because it is consistent with the long-term funding basis, and this means that the measure of risk would be inconsistent.

35. Which reference point from which to measure investment risk in Fast Track

c. Would a liability reference portfolio approach (as a proxy for liabilities) for smaller schemes be more proportionate and practical? If so, how should a small scheme be defined for this purpose (number of members, assets or liabilities)? What would be an appropriate threshold?

We agree that this is appropriate for small schemes.

d. Would a reference portfolio consisting of gilts and inflation-linked gilts with a duration similar to the liabilities be appropriate as a proxy for the liabilities for smaller schemes? If not, how would you go about constructing a reference portfolio as a reference point from which to measure risk for smaller schemes?

We agree that this is proportionate and appropriate for small schemes.

36. Methodology to measure investment risk in Fast Track

a. Would a simple stress test to measure investment risk in Fast Track be the most preferable option? If not, why not? Are there other measures of investment risk that are more suitable, taking account of the desire for a relatively simple and objective measure?

We consider a simple approach is the most preferable option for Fast Track. This could involve more than one stress testing to avoid "gaming" the outcome. It could be helpful for TPR to see assumed returns and volatilities on different asset classes. These would however need to be quite granular, as values can vary a lot across different assets in the same class.

b. Do you agree with the proposed principles for an appropriate pensions stress test, namely a fall in growth assets and a fall in interest rates? If not, what do you suggest?

We agree with the proposed principles. Additionally, the stress test should cover growth assets, long-term interest rates, long-term inflation, investment grade and non-investment grade credit spreads, and currency exchange rates as key risks. TPR should also consider longevity risk to give benefit to those that have hedged it and similarly those who have annuity policies that provide a match for the scheme's liabilities.

c. What are your views on which stress test we should use? Do you think the PPF stress test (Bespoke and simple approach) would be a good starting point?

We agree that there are considerable advantages for schemes in using the PPF stress test, both simple and bespoke as a starting point which could potentially include additional measures. We consider this is a good opportunity for TPR and PPF to work together to avoid unnecessary burdens on schemes.

d. Which of the ways to measure the impact of the stress would you prefer and why? Is there an alternative method not listed that would work better? If so, please describe it.

We think that either Options 1 or 3 could be appropriate.

Option 1, has the benefit of being linked to a standardised measure of liabilities. This means that the Fast Track limits will be consistent between schemes, which is important. It is not preventing schemes from taking additional risk – it is requiring schemes that take more risk to use the Bespoke approach.

The drawback of Option 1, is that it isn't immediately informative to Trustees in respect of the impact on scheme on the Scheme TPs. Whilst extra work could be done to draw this out, some schemes might choose not to do this.

Option 3 may be more easily convey the approximate impact for example to Scheme TPs and scheme funding. This might make help ensure that investment risk is widely considered.

As the consultation document notes, the drawback of Option 3 is that the Fast Track limits then mean that a scheme with a lower funding position triggers the limits ahead of one that is better funded. However, this might be an acceptable compromise.

37. Approach to defining maximum levels of investment risk for schemes of different maturities in Fast Track

d. What are your views on the considerations we have set out to determine investment limits for immature schemes (journey plan shape, downside risk and covenant)? In particular, should the maximum level of investment risk for immature schemes vary by covenant under Fast Track

For Fast Track, we agree that the investment limits for immature schemes should include consideration of journey plan shape and downside risk.

We do not think it is appropriate for Covenant to feature in this. It is proposed to use the Covenant strength to take additional investment risk for a limited period (bearing in mind that visibility of covenant is limited), then we'd expect this to go through the Bespoke route to ensure that this meets the standards that are set in an alternative way.

38. Defining guidelines for liquidity and quality of the investment portfolio in Fast Track

a. Do you think we should define some guidelines around liquidity and quality in Fast Track?

We consider that there should be guidelines around liquidity at the point of maturity. Prior to that there are a number of considerations and it is difficult to draw out something that is useful without being unduly complex. Therefore we'd suggest it is important to have principles, but not detailed guidelines.

Chapter 11: Recovery plan (RP)

39. Fast Track guidelines on RP length

a. What are your views on the principles set out above in relation to RP length under Fast Track? In particular, do you have views on what may be appropriate RP length thresholds for different covenant strengths? Is it helpful to frame these in terms of the typical multiple of valuation cycles (ie three years)?

We consider that the length of RPs under Fast Track should be restricted to five years as a maximum, regardless of covenant strength. We appreciate that that there is a presentational attraction to tying RP lengths to two valuation cycles (6 years) to set RP lengths. However, it might be more desirable to set it at the limit of covenant visibility (maximum 5 years) with the last year's payments conditional on where the scheme has got to. In reality, many schemes will be well placed to assess then if there is a need to "complete the job", without waiting for the next valuation.

The new regime should encourage schemes to recover deficits as quickly as possible, as opposed to doing enough to meet minimum standards. We consider that to qualify for fast track trustees should have considered recovery plan period and for example confirmed it is the fastest reasonably achievable, rather than simply that it is within a standard number of years (in that way the requirement for them to be within 6 years could be seen as a minimum not a benchmark).

Any scheme with RP lengths above the maximum period, would not fit within Fast Track, and would be required to use the Bespoke route. We would expect greater scrutiny of these schemes and that longer RPs should only be allowed due to affordability constraints. Where schemes set longer RPs due to affordability constraints, these schemes should be identified to mitigate risk and we consider that they should not be considered fully compliant.

b. Do you consider it would be more appropriate to have a single maximum guidance RP length and to expect trustees (under the Bespoke framework) to justify any plans that are longer than this?

We consider that it would be more appropriate to have a single maximum RP length of five years for Fast Track and that where RP lengths are greater than this length there is sufficient justification on the grounds of affordability alone under the Bespoke framework, to allow for greater scrutiny of the reasons why the expectation cannot be met.

Pension Protection Fund

c. Do you think Fast Track RP lengths should be shorter for schemes nearing and/or at significant maturity? If so, to what extent?

We see there are some arguments for this. We also consider there could be some reasons not to do this, particularly since this is a new code and there would not be much time to take action. On balance we consider that this would represent undue and unnecessary complexity. If a hard limit of five or six years is taken, the benefits of marginally adjusting that downwards for more mature schemes is limited, but that the case becomes stronger the longer the maximum acceptable length.

40. Fast Track guidelines on RP structure

Should the extent of back-end loading be limited to increases which are in line with inflation (in the absence of appropriate additional support such as a contingent asset being provided)? Or should there be more flexibility subject to a significant proportion of DRCs being committed in the early years of the plan? If inflation-linked increases are acceptable, what measure of inflation do you consider would be an appropriate benchmark?

As highlighted in the above we are concerned with the level of back-ended contributions of DRC's and consider that back end loading should not be permitted in Fast Track. It could be permitted under Bespoke, by exception, and only where there is a strong justification on the grounds of affordability.

We would see increases in line with inflation as fitting within FastTrack.

41. Fast Track guidelines on investment outperformance

Should investment outperformance not be allowed in Fast Track RPs? What do you think the impacts may be?

We consider that allowance is acceptable as long as assumptions are reasonable and that progress is monitored. Should performance not go as expected contributions should be increased to compensate, rather than plans being extended. Our expectation is that schemes will only take investment risk if employer can cover the cost of it not going according to plan.

42. Fast Track guidelines on future RPs

In what circumstances should/could outstanding RP payments be re-spread at subsequent valuations? In particular:

a. If a scheme's funding deficit has reduced (at least) in line with the expectations at the previous valuation, would it be appropriate to maintain the same end date? Or would it be pragmatic to re-spread the remaining deficit over a renewed period?

There is considerable volatility in the funding level of DB schemes, threatening gains from employer contributions. We consider that funding gains should be locked in as schemes mature. We are concerned that re-spreading the remaining deficit over a longer period can lead to RPs being unable to be supported within the period and extend RP lengths.

Where the deficit has been reduced above expectations, we would expect that contributions should continue as agreed to improve the probability of success and potentially allow schemes to complete their RP early.

b. If a scheme's funding deficit is higher than expected, what guidelines should apply for the appropriate length of the new RP?

In our view, it should finish at the same date, and be constrained to avoid back-end loading. We caution that should deficits be higher than expected this should be questioned by TPR, given that schemes are supposed to manage their risks and excess investment risk is supposed to have been supported by the sponsor. Where the deficit has significantly increased from the time the RP was established unavoidably, schemes should ensure that the original RP payments are paid back within the timeframes of the original RP. Any 'additional' deficit would then be subject to a further recovery plan agreement based on the same principles i.e. as fast as possible and nothing more than five or six years, with the loss of fast track status.

c. Would the idea of 're-spreading' be more acceptable where a scheme has a long period before it becomes significantly mature?

We consider that the justification for re-spreading must be that it is essential for reasons of affordability. A greater period to maturity offers more scope to recover, but should not be a sufficient justification if there is not an affordability constraint.

Chapter 12: Open schemes

45. Fast Track LTO for open schemes

Should the LTO (low dependency at significant maturity) for an open scheme be the same for a closed scheme? If not, how should they differ?

We agree that the LTO should be the same for a closed and an open scheme, in both cases measured with respect to accrued liabilities. We see this as an important protection for members' accrued pensions.

46. Fast Track TPs for open schemes

What option do you favour and why? Are there other options we should consider?

We agree that TPs should be set in the same way for open as for closed schemes. We see this as an important protection for members' accrued pension.

47. Fast Track guidelines for calculating future service costs

a. Which options do you favour and why? Are there any other options for calculating future service costs which should be considered, for example pre-and postretirement discount rates?

We prefer option B as below. We consider this is appropriate to ensure that the security of members' past service is not eroded.

48. Funding future service using past service surplus

Do you think that this approach to funding future service using past service surplus is reasonable? If not, why not? What else would you suggest?

We support the proposed approach.

50. Bespoke examples

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 Fast Track? If so, in what circumstances and by how much?

We agree that this scheme is able to meet its liabilities on cash flow basis. We think it is not necessary – and not helpful – to change the discount rate in order to demonstrate that the pension payments can be met.

51. Stressed schemes

a. Assuming that affordability is genuinely constrained, are very long RPs 'appropriate' and therefore compliant with the Act?

Where the employer cannot support a recovery plan that meets these criteria, the aim should be to remove the deficit at the fastest pace the employer can afford. However, that should not lead to the scheme being marked as "green" or compliant – instead it should be clear the scheme is stressed or at risk.

Where a scheme is in a position of "stress" we think more can be done to adequately balance risks to members, employers and PPF levy payers.

We think there are primarily 2 types of "stress":

A. Weak employers struggling to meet scheme funding obligations

B. Poorly funded schemes, where liabilities are out of proportion to employer size (here the employer may be able to run on for some time, but if the deficit is out of proportion to the employer's turnover it may be impossible to close the funding gap).

Both types should be clearly identified through a failure to establish a funding plan that is considered "acceptable" under the standards set by the new regime (e.g. investment risk within defined boundaries, and recovery plan will close the deficit within 5 years – see qu. 39). This can therefore act as a prompt for further action.

Where schemes are "stressed" there is a risk that employers become insolvent in the short to medium term and that – in the meantime - continuing to run the scheme will only: extract value from the employer and damage future viability; and increase the size of the PPF deficit due to the level of investment risk and PPF drift.

Against those downside risks, there is potential upside for scheme members. Employers could remain solvent and the longer a scheme runs on the more members qualify for the uncapped level of PPF compensation. On the latter, however, trustees should not be taking decisions on the future of their scheme they would not take in the absence of the PPF. In some instances early action (e.g. through restructuring) could enable the scheme to reach a level of funding it will subsequently be unable to reach.

Assessing these difficult issues and trade-offs requires scheme specific analysis – there is no "one size fits all" solution. However, we think it critical that schemes don't just default to running on. Instead stressed schemes should conduct a detailed review of their position to assess the likelihood of meeting future benefit payments in full, and reviewing options to identify the most appropriate way forward. Alternative strategies we have seen include:

Separating the scheme from the employer via existing insolvency mechanisms (with scheme entering the PPF). Restructuring scheme benefits (by establishing a new scheme that members could choose to transfer into) that has lower funding requirements and reaches a position of sustainability.

b. Alternatively, should we make an exception to the principles and allow the trustees of stressed schemes to take unsupported investment risk, or more risk investment risk than other CG4 schemes (schemes with weak employers)? What checks and balances should we put in place in addition to those mentioned above (equitable treatment, risk management)?

We do not consider that additional investment risk should be allowed to be taken by trustees of stressed schemes, as the burden of the additional risk would fall to the PPF and our levy payers. Increasing investment risk could lead to schemes taking more risk than they can legitimately support. This seems likely to mean that in the event of insolvency some schemes would be worse funded than would otherwise be the case where greater investment risk which hasn't paid off – damaging member outcomes and leading to an increased claim on the PPF and so strain on levy payers.

c. For schemes with unviable RPs, should an exception be made for them in terms of the level of acceptable investment risk?

We consider that schemes with unviable RPs should be identified and not be considered compliant, with additional support provided. We do not consider that increasing investment risk is appropriate in these circumstances, as this approach could lead to deficits becoming even greater, risking member benefits and a larger call on the PPF.

Chapter 14: Additional support

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 consider that trustees should be able to access additional support when they are required to use the Bespoke due to being unable to comply with the Fast Track e.g. where affordability constraints require long RPs.

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?

We consider that trustees should be required to assess the stressed value of contingent assets and importantly the value on insolvency.

55. Independent valuation

Should trustees always be expected to seek an independent valuation of contingent 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?

Trustees should recognise their skills and limitations. They should always seek appropriate professional advice. The level to which it is required will depend on the complexity of the asset/guarantee provided. It is critical that trustees understand the nature of any contingent asset in the same way as they understand their employers covenant strength. They will need to assess the risk they face and plan reviews accordingly.

56. Guarantees

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

Yes. Guarantee support should be seen as providing additional covenant whereas asset backed support could be considered contingent scheme funding. For all forms of support, trustees should consider the period over which that support may be relied upon. Guarantees should be limited by reference to the period over which there is covenant visibility, whereas asset backed support should be limited by reference to the period over which assets can be relied upon to retain their value.

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?

Although it might be attractive for a guarantor to become a statutory employer, this might not be reasonable or practical, especially if provided by a party outside the jurisdiction. It does not appear unreasonable for a guarantee to support a covenant change provided it is done in a robust manner similar to approach adopted by the PPF on the use of contingent asset guarantees for levy purposes.

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?

We consider that the information requirements are reasonable. However, particularly for smaller schemes with limited resources who are unable to comply with Fast Track, are likely to require additional assistance. We consider that the regime should seek to support these schemes in most need as they are less likely to be able to undertake the required analysis and information requirements.