Spotlight

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DB Funding Code – a year of developments

A recap and what we learnt since the Code was laid just over a year ago

On 29 July 2024 the Pensions Regulator confirmed that the draft new Defined Benefit (DB) Funding Code had been laid before Parliament. The Code came into force on 12 November 2024 and applies to actuarial valuations with effective dates on or after 22 September 2024.

Our actuarial and investment teams of experts have already helped clients navigate the new Code and are ready to help any trustees who need support and assistance in this complex area.

The Code places substantial new requirements on DB scheme trustees, many of which will require them to take additional advice. In this Spotlight we will focus on some key aspects of the Code, summarise recent guidance from the Pensions Regulator, and describe some of our early experiences advising trustees and sponsors.

Key aspects of the Code

Alongside their first valuation under the Code, trustees now need to set a long-term objective for the funding and investment of their scheme. Trustees need to determine how they intend to provide benefits over the long term, whether that will be by running their scheme on, or ultimately buying out benefits with an insurer, or using a commercial consolidator (such as a superfund as is being legislated for in the Pension Schemes Bill).

In particular, trustees need to set a funding and investment strategy which aims to put their scheme into the position of low dependency on the employer covenant by the time it is significantly mature. Low dependency means that the assets of the scheme are sufficiently large compared with the scheme liabilities, and their investment basis is sufficiently resilient to short-term adverse conditions, that future employer contributions are not expected to be needed. Under the Code, scheme maturity is measured using duration – a technical measure of the time until the average future benefit payment is made. The Scheme Actuary needs to calculate this measure and estimate when the scheme will become significantly mature.

For schemes that have yet to reach low dependency, trustees also need to set out a journey plan which describes how the scheme's funding and investment strategy will develop from its current position to low dependency. Some of the new requirements are summarised below.

1. Fast Track or Bespoke?

The Pensions Regulator has set out a twin-track approach to compliance with the Code with DB scheme trustees choosing which route to take – either Fast Track or Bespoke.

Under Fast Track, the Pensions Regulator has published a set of tests of the various aspects of a scheme's funding and investment strategy which the scheme has to satisfy to use Fast Track. These include:

- the low dependency funding basis
- the technical provisions
- the investment strategy, and
- any recovery plan needed.

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If trustees wish to pursue this approach, the Scheme Actuary will need to provide confirmation that the Fast Track tests are passed. The advantage of Fast Track is that trustees should expect to have to provide less in the way of evidence that their approach is suitable and so should expect fewer questions and less challenge from the Pensions Regulator.

The alternative is the Bespoke route where trustees have more flexibility in setting their funding and investment strategy. However, they should expect to have to provide more evidence that their approach is suitable for complying with the Code and with statutory objectives. This means that trustees should expect more questions and more challenge from the Pensions Regulator, which may require additional professional advice and support.

2. Covenant assessment

There are 13 pages in the Code for trustees to consider in assessing the sponsoring employer(s) covenant as well as substantial additional guidance on the practical aspects of assessing employer covenant.

Trustees are required to carry out an employer covenant assessment to understand the extent to which the employer can support the scheme now and in the future. In general, trustees will need to focus on the employer's cashflow and ability of the employer to make contributions to the scheme to eliminate any funding deficit and address downside risk. This must be done at each valuation and at other times if proportionate to the situation. The Code is clear that even schemes that are fully funded on a low dependency funding basis remain exposed to covenant risk if their funding levels deteriorate or if there were to be an unexpected employer insolvency event. Consequently, trustees should continue to monitor the covenant once low dependency has been reached, both before and after the date of significant maturity.

3. Risk taking, low dependency and the journey plan

What is acceptable during the journey plan is now to be determined using a principles-based approach focussing on risks around employer covenant, employer cash flows and scheme investments. The approach leans towards integrated risk management.

In particular, during the journey plan, funding and investment risks being run by a scheme must be consistent with the scheme's maturity and supportable by the employer covenant (the so-called 'Supportability Principle'). More risk can be allowed for if the scheme has access to sufficient employer cash flows and contingent assets to support such a risk. Trustees will need to decide how to go about evidencing that the Supportability Principle is met for their scheme.

Once a scheme reaches significant maturity, a scheme needs to have a low dependence on the employer covenant, such that no further employer contributions are expected to be needed. Trustees will need to decide how to go about evidencing that this test is met i.e. the so-called 'Low Dependency Test'.

4. Statement of Strategy

Once a scheme has completed its valuation, the trustees need to send the results and accompanying information to the Pensions Regulator. Much of this information will be contained in a document called the 'Statement of Strategy'. The Pensions Regulator has provided a template Statement for trustees to complete and submit online. Completing the Statement can be a substantial undertaking in itself as a great deal of the technical detail underlying the valuation and a scheme's funding and investment strategy need to be included. Although provision of this document is the responsibility of the chair of trustees, we expect trustees will obtain assistance from their professional advisors (including their actuary, investment consultant and covenant assessor) to complete their Statement.

Our experience

A number of the schemes we advise have begun actuarial valuations under the Code, some have made significant progress and at least one is complete. Some of the themes emerging from this early experience of trustees and sponsors operating under Code are as follows:

- There is a lot to take on board. Early preparation and training are key.
- Some schemes are very well funded and running low risk investment strategies. They have more flexibility and can take a more proportionate approach to the new requirements.
- Some of the new requirements mean that trustees will want advice from actuarial, investment and covenant advisors. It is important that these advisors work well together.

- Trustees and employers need to discuss long-term objectives. This helps to clarify and properly align their expectations.

Action points

With the Code now in force we think that trustees should be discussing this issue with their Scheme Actuary and investment consultant, even if their first valuation under the Code is some time away. They will need to be considering:

- When this new legislation and Code will start to apply to them (given the date of their next valuation).
- Do they have adequate knowledge of the Code – and is training required?
- What their long-term objective is.
- Finding out when their scheme reaches significant maturity.
- What a low dependency funding basis could be and what this may mean in practice, including consideration of the 'Low Dependency Test'.
- What arrangements they have for a proper covenant assessment.
- How the current investment policy operates in the light of their long-term objectives.
- What an appropriate journey plan may be.
- Whether potential risks are supported by covenant and contingent assets (the 'Supportability Principle') and whether their risk management processes are sufficient (particularly if the situation is stressed).
- Is there a risk that excessive funding may result in a trapped surplus and how should this be managed?
- Is there a scope for greater use of contingent assets?
- Where they have ongoing accrual or have an open scheme, what the Code will mean for them.

Further materials from the Pensions Regulator

The Pensions Regulator has also published a number of other items that sit alongside the Code, as follows:

- The Statement of Strategy spreadsheet – discussed above
- The Fast Track Submission Tests and Conditions sets out the tests a scheme must satisfy to meet the Fast Track parameters for schemes submitting a valuation with an effective date on and after 22 September 2024
- The updated detailed guidance on assessing covenants was published in December 2024 – this provided guidance on the maximum affordable contributions, covenant reliability and longevity and affordability for recovery plan purposes
- The Regulator's Annual Funding Statement, covering actuarial valuations with effective dates between 22 September 2024 and 21 September 2025, was published in April 2025. In it, the Regulator estimated that around 80% of these schemes can use the Fast Track approach. It also set out some further information to support trustees and sponsors in carrying out their first valuation under the Code.

The Code and these additional documents complete the regulatory guidance for trustees and sponsors carrying out actuarial valuations under the new funding regime.

Conclusion

Please speak to your usual Capita contact if you would like assistance or further information.