March 2023

TPR Consultation – DB Funding Code and Fast Track/Bespoke framework

Cardano Group response

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23 March 2023

Dear Sir/Madam,

Cardano Group response to TPR's second consultation on the draft DB Funding Code of Practice and TPR's consultation on Fast Track and Bespoke regulatory approach

We would like to thank you for providing the opportunity to feedback on the new Funding Code which, alongside the updated Regulations, will represent a step-change in the way DB pension schemes are expected to approach funding and investment decision making.

This response is provided on behalf of the Cardano Group (i.e. an organisation rather than an individual). Cardano specialises in covenant and investment (both advisory and through fiduciary management) so our response is primarily with respect to those matters, leaving others within the industry to comment in more detail on actuarial and legal matters. Nonetheless, given the integrated nature of DB scheme funding and the considerable interdependency across these disciplines, we have provided comments on all questions where we believe we can provide helpful feedback.

Overall, from a covenant perspective, it is extremely positive to see that the draft Funding Code, like the draft Regulations published by the Department for Work and Pensions ("DWP"), puts covenant at the heart of setting the level of supportable risk in a scheme's journey plan and the period over which that risk can be taken. We also recognise that much of the Funding Code detail regarding covenant is in line with industry best practice. For example, the factors influencing the employer's ability to support the scheme (Visibility, Reliability and Longevity) are similar to the "Journey Planning factors" (Affordability, Visibility and Reliability) that have been used in our covenant assessments over the past few years.

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Similarly, from an investment perspective we are pleased to see that the guidance is consistent with what many well-managed schemes have already been doing; setting long-term targets, de-risking gradually over time and proactively planning how to deal with liquidity and cashflow challenges. We also believe sensible judgements have been made to create sufficient flexibility of investment approach within clear boundaries and we are supportive of the pragmatic approach taken in many areas (such as using the PPF stress figures in Fast Track to avoid the unnecessary creation a parallel risk assessment system).

Nevertheless, there are certain aspects of the proposals which we believe could create issues. This is not surprising with a task as complex as this and we have shared our views based on our experience of the industry. To highlight the main challenges as we see them, we have provided an upfront overview of our “Key Observations” along with suggestions for TPR to consider. The majority of these relate to covenant considerations but we also have concerns around the use of duration as a maturity measure.

Given the immediate and significant impact the Funding Code may have on a large number of schemes, the complexity of the framework and likely difficulties in making material changes once finalised, we believe it is extremely important that TPR and DWP take the time to get this as right as possible first time round, rather than pushing to meet previously committed timelines. We look forward to the upcoming consultations on the covenant guidance and Statement of Strategy, which we hope will reflect some of the comments made within this response.

We hope that our response is helpful and clear and we would be happy to discuss any aspect with you further. We confirm that all parts of our response may be made publicly available.

Yours faithfully,

Kerrin Rosenberg
CEO, Investments Cardano UK

Darren Redmayne
CEO, Cardano Advisory

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Key Observations

Funding Code in the context of the wider regulatory framework

We do not purport to provide legal commentary on the Funding Code but have included some high-level observations on the practical application of the framework as we see it from a covenant and investment perspective.

It is a challenge to respond to consultation questions without having sight of the full regulatory picture (i.e. commenting on the draft Funding Code of Practice without also having sight of the final Regulations or draft covenant guidance, given all three are inherently linked).

Proposal: We suggest allowing respondents an opportunity to provide further comments on the "final draft" Regulations and Funding Code of Practice (and, possibly, further detailed guidance), once both have been updated and published.

It is our view that the Regulations should be used to set out the overarching framework for schemes, as represented by key principles, with the Funding Code providing flesh to the bones in terms of how to satisfy those Regulations. We have concerns over certain issues where the Funding Code strays beyond clarification of principles into a level of detail that could prove unduly restrictive or lack credibility in certain cases (with the maximum supportable risk equation being an example, discussed in more detail later).

Proposal: The Funding Code should focus on key principles and requirements for trustees; additional detail and regulatory preference should be including in guidance or other commentary.

We are aware that the information provided to TPR as part of triennial valuation submissions will be changing; with covenant analysis provided as a matter of course. We are supportive of trustees documenting the basis for strategic decisions but our strong view is that trustees should not commission analysis solely for the purposes of regulatory disclosure.

Proposal: We suggest a further consultation on data TPR is likely to request for its own risk profiling purposes to ensure trustee resources can be focused on adding value for members.

Potential unintended consequences

Recent engagement with trustees, schemes and sponsors on the subject of the Funding Code has highlighted that the current drafting may have significant unintended consequences that would run contrary to TPR's stated aims.

> Covenant complacency: Trustees may lose sight of the underlying covenant risks through "box-ticking" or a false sense of security linked to meeting Fast Track or low dependency parameters. For example, a common question that has arisen since the publication of the consultation is "*do I need to consider covenant if submitting a Fast Track valuation?*", despite references within the Funding Code to the need to "*bear in mind the strength of the employer covenant*".
>
> ***Proposal***: We suggest TPR commentary (around the Funding Code and periodically thereafter) reinforces the need for covenant input, particularly in the context of Fast Track.

Low dependency is not “no dependency”: Both the Regulations and the Funding Code place a significant amount of emphasis on the “low dependency” funding basis and investment allocation, with the key target of “significant maturity” related to full funding on this basis. There is, however, limited reference to the journey past this point. The low dependency investment and funding principles defined by the Code mean it is unlikely that sponsor contributions are called upon, but scheme risks nevertheless remain. TPR notes in its consultation document that “certain types of LDIA portfolios with up to 20 to 30% in growth assets could be appropriate, so long as the risks are well managed”. The recent gilts crisis materially impacted many schemes that supposedly had low risk investment strategies. Employer covenant remains the ultimate underpin for scheme risks and, while a solvent employer is needed to ensure members receive their benefits in full, there will be a degree of covenant reliance.

Proposal: We suggest TPR commentary (around the Funding Code and periodically thereafter) makes it clear that low dependency is not the same as no dependency; management of investment risk and monitoring of covenant remains relevant albeit there should be a shift of focus from affordability of contributions to downside covenant risks, and trustees would benefit from thinking beyond the low dependency basis to their end game and how they will get there.

Inappropriate risk management through premature re-risking or de-risking: By drawing a line in the sand, representing Fast Track parameters, TPR appears to be indirectly approving the re-risking of schemes that currently run a more prudent funding and investment strategy. The acceptance of this implicit position has been made clear by recent public statements, including during the recent TPR webinar (on 23 February 2023). With no covenant parameters considered within Fast Track, it is possible that a move to re-risk by a scheme might not be supported by the covenant (and the lack of regulatory scrutiny for Fast Track would mean this risk increase may not be spotted by TPR).

A further potential unintended consequence is too much focus on near term de-risking driving extended reliance on covenant (and ultimately putting members benefits at risk). As with the re-risking example above, this extended period of covenant reliance might not be picked up by TPR as a risk if the scheme satisfies Fast Track criteria.

Premature re-risking or de-risking do not cancel one another out – both of these situations mean the wrong strategy increases the risk of members suffering a shortfall.

Proposal: We suggest that TPR commentary addresses these two points specifically, stressing the potential impact on members of trustees acting inappropriately. Furthermore, we suggest TPR considers ways in which movements in risk profile could be tracked over time, perhaps as part of the discussion regarding the Statement of Strategy contents, to enable TPR to spot cases involving significant (and inappropriate) re-risking or de-risking.

Interaction between valuations and events: While the Regulations and Funding Code ostensibly deal with the funding and investment framework, including valuations, our experience is that there is inevitably going to be interaction between funding / investment and events (e.g. transactions). There are references in the Funding Code to concepts such as reasonable covenant leakage, which blur the lines between the Funding Code

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and transactions.

TPR has historically advised schemes and sponsors to consider transactions separately from valuations to avoid the risk that transactions that are detrimental to covenant being wrapped into a viable journey plan and valuation without mitigation being provided to the scheme in question. However, this risk is exacerbated within the proposed Fast Track regime, as there will likely be a perception that Fast Track compliance means TPR will not take action in respect of covenant leakage or other transactions that are detrimental to covenant (except in extreme scenarios such as insolvency).

Proposal: We suggest that TPR clearly sets out the interaction between the funding and events frameworks (if any) in the Funding Code.

The covenant "so what"

It is our view that, despite the element of subjectivity and lack of standardisation within the industry, covenant ratings serve a valuable purpose of pulling all relevant factors together and providing a benchmark for tracking changes or evaluating events. In spite of the decision by TPR to stop using the current CG1 to CG4 ratings under the new Funding Code, we would urge TPR to recognise the benefits associated with determining a covenant rating.

Proposal: We would encourage TPR to acknowledge the benefits and the challenges associated with providing a covenant rating, and to then lead trustees towards thinking beyond the rating to the "so what". TPR's proposed approach of disassembling the component parts of a rating appears to be a step backward rather than forward in this regard.

The draft Funding Code splits covenant into its component parts (e.g. cash, contingent assets and prospects; and visibility, reliability, longevity), going into some depth on how to consider each element. The Funding Code does not, however, provide sufficient guidance as to how each element should be used or how to draw it all together to drive strategy – the "so what". This means certain elements (such as period of reliability, a highly subjective concept) are over-emphasised, whilst qualitative factors may be overlooked. As a result, trustees may find themselves confused as to which elements should be driving practical decision-making and in what way.

Proposal: The Funding Code should focus on how key concepts (e.g. visibility, reliability and longevity) impact strategic decision making. The covenant guidance should then be used to help trustees to scope proportionate and appropriately focused covenant work.

We believe it is positive that covenant is placed at the heart of journey planning but accept that this is not easy to implement in practice. The bespoke nature of schemes means that any attempt to over-simplify or be prescriptive risks forcing trustees to take decisions that are not in the best interest of their members. We see the maximum risk equation as a helpful but simplistic illustration (rather than setting out a prescribed approach). It should be included in the covenant (or IRM) guidance rather than in the Code, and used to illustrate the complexities in covenant driven journey planning as well as the importance of considering covenant over the full period of covenant reliance (e.g. until buyout). The risks of a prescriptive one-size-fits-all formulaic approach include poor decision-making, unnecessary costs, trustee / sponsor relationship strain.

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Proposal: There needs to be some flexibility to mitigate the risks of a prescriptive one-size-fits-all formulaic approach. This can most easily be achieved by the Funding Code setting out a principles-based approach (with more specific examples provided in the covenant guidance). Alternatively, the Funding Code could more explicitly acknowledge that the maximum risk equation is not a legal requirement but is instead an example of best practice in the simple scenario illustrated.

Use of duration as a measure of scheme maturity

Over 2022, our client base saw its duration fall by c. 3.5 years on average as a consequence of rising gilt yields. Given the draft Code proposes using a fixed duration of 12 years as the definition of Significant Maturity, and given duration generally falls by around 0.5 years per annum (all else equal), the rises in gilt yields over 2022 have effectively shortened scheme journey plan timeframes by around 7 years. That is a material change which, in our view, demonstrates the significant shortcoming of using a static duration figure as the definition of Significant Maturity.

In addition, it is important to recognise that the original selection of 12 years duration to identify Significant Maturity had a degree of arbitrariness to it – alternative figures could reasonably have been justified. At the time, 12 years duration was reasonably far off for most schemes and it gave reasonable time to address underfunding. The world has moved on and 12 years duration no longer provides sufficient time to reach low dependency for many schemes.

If a change is not made, many schemes may be forced into non-compliance or they may have to fundamentally change their approach (with corresponding consequences on the sponsor and/or to their risk profile). Our understanding is that is not the intent of the Code.

Proposal: It would be preferable to adopt a maturity metric that is not subject to market movements. Various choices could be made, with one example being % of liability value comprised of pensioners. As well as not being subject to market movements (it changes slowly over time, subject to changes to the actual membership), it is also: straightforward to calculate; calculated as standard in the majority of actuarial reports; and transparent and easy to understand. If the DWP and TPR changed to this approach (or something similar), we believe many of the current problems could be greatly alleviated.

Responses to Funding Code consultation questions

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

   Please see our Key Observations section

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

   Yes, we believe the principles are sensible and appropriate, noting that there is scope for TPR to provide additional clarifications in future if required.

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

   Yes, we believe the approach is sensible and appropriate, noting that there is scope for TPR to provide additional clarifications in future if required.

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

   Yes, we believe the description is sensible and appropriate, noting that there is scope for TPR to provide additional clarifications in future if required.

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

   No, we do not believe this is required and consider the qualitative definitions as sufficient.

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

   Yes, it means the majority of the risks will always be hedged whilst providing flexibility to allow the hedging levels to fall moderately due to market movements or active trustee decisions.

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

   We do not believe there is a need to change the approach, as there is sufficient flexibility for small schemes to operate within this framework.

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

Yes, we believe a stress test is a reasonable approach

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

   Yes, as explained in the consultation document, 4.5% is consistent with a reasonable upper risk limit for a low dependency portfolio

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

    We suggest that all schemes report the stress test according to the PPF assumptions (as per the Fast Track approach), so that every scheme can be compared on a like-for-like basis. Then, some schemes may choose also to report a second stress test result based on their own model

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

    Yes, we agree that a detailed assessment of liquidity for the low dependency investment allocation is not required. Firstly due to the detailed expectations in relation to schemes' actual asset portfolios, as noted above. Secondly as liquidity issues are less likely to arise in a low dependency position, given the broad cashflow matching, lower levels of leverage and stronger funding position.

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

    Yes, we agree this is a proportionate approach.

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

    Yes, the two approaches set out are the ones we would expect to be used in the majority of cases but we defer to the actuarial community for a more detailed response.

14. Should we provide guidance for any other methodologies?

    We do not have a strong view on this and we defer to the actuarial community for a more detailed response.

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

We do not have a strong view on this and we defer to the actuarial community for a more detailed response.

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

    We do not have a strong view on this and we defer to the actuarial community for a more detailed response.

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

    We believe this is a key point for TPR to re-consider. Over 2022, our client base saw its duration fall by c. 3.5 years on average. As duration generally falls by around 0.5 years per annum (all else equal), this shortens scheme journey plan timeframes by around 7 years over the space of 1 year. That is a material change which, in our view, demonstrates the significant shortcoming of using a static duration figure as a maturity metric.

    In addition, it is important to recognise that the original selection of 12 years duration to identify Significant Maturity had a degree of arbitrariness to it – alternative figures could reasonably have been justified. At the time, 12 years duration was reasonably far out for most schemes and it gave reasonable time to address underfunding. The world has moved on and 12 years duration no longer provides sufficient time to reach low dependency for many schemes. If a change is not made, many schemes may be forced into non-compliance or they may have to fundamentally change their approach (with corresponding consequences on the sponsor and/or to their risk profile). Our understanding is that is not the intent of the Code.

    It would be preferable to adopt a maturity metric that is not subject to market movements. Various choices could be made, with one example being % of liability value comprised of pensioners. As well as not being subject to market movements (it changes slowly over time, subject to changes to the actual membership), it is also: straightforward to calculate; calculated as standard in the majority of actuarial reports; and transparent and easy to understand. If the DWP and TPR changed to this approach (or something similar), we believe many of the current problems could be greatly alleviated.

    If TPR is not willing or able to change the measure of maturity, then the third option mentioned would increase the flexibility of schemes and allow them to take a more patient approach if needed. The key here, as noted in the consultation document, is that this extra timeframe could be justified only if the covenant is available to support the risk. For that reason, it would be appropriate to allow this in the code but not in Fast Track Valuations (given these do not include a covenant assessment) as suggested.

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

It is positive that TPR is evolving how it expects the market to consider covenant, particularly in the context of journey planning; and we agree that covenant analysis needs to consider distinct elements across each section of the longer-term journey. This is an approach that we have been utilising for some time now – see below for more detail.

While further detail might be provided in the upcoming covenant guidance, we do have some concerns with the current definitions and uses of visibility, reliability and longevity:

- Visibility does not appear to impact journey planning decision making in any way, and therefore we question its inclusion in its current form;
- Reliability appears to be the only element that drives journey planning setting – driving both maximum risk and the period over which risk can be taken;
- The period of reliability represents a very subjective measurement, which will likely result in a range of approaches being used by the industry;
- Longevity does not appear to distinguish between the period up to low dependency or beyond that to an end game (or if focused on the period up to the relevant date, there is no consideration of covenant beyond this point);
- More generally, these all appear to be measurements of time which, in isolation, cannot adequately inform a tailored journey plan. These should, however, be factors that consider both quantitative elements (time and quantum, including £ amounts) and qualitative elements (including the type, likelihood and materiality of "risks" occurring).

Furthermore, our interpretation of the period of covenant reliability is that TPR is not asking trustees (or their covenant advisers) to opine on the specific and precise period over which the sponsor will or will not be able to support the scheme. Rather, TPR is asking for an indication of covenant reliability in the context of setting a scheme funding and investment strategy.

As a more general point, because the Funding Code does not provide sufficient guidance as to how these elements should be used or how to draw it all together, certain elements (such as period of reliability, a concept which is highly subjective) are over-emphasised, whilst other more qualitative factors may be overlooked. As a result, trustees may find themselves confused as to which elements should be driving practical decision-making and in what way.

In that context, it would be worthwhile focussing on key concepts (e.g. visibility, reliability and longevity), how TPR expects these to be assessed and their impact on strategic decision making within the Funding Code. The covenant guidance should then be used to help trustees to scope focused covenant work and understand what is proportionate in the context of the new regime.

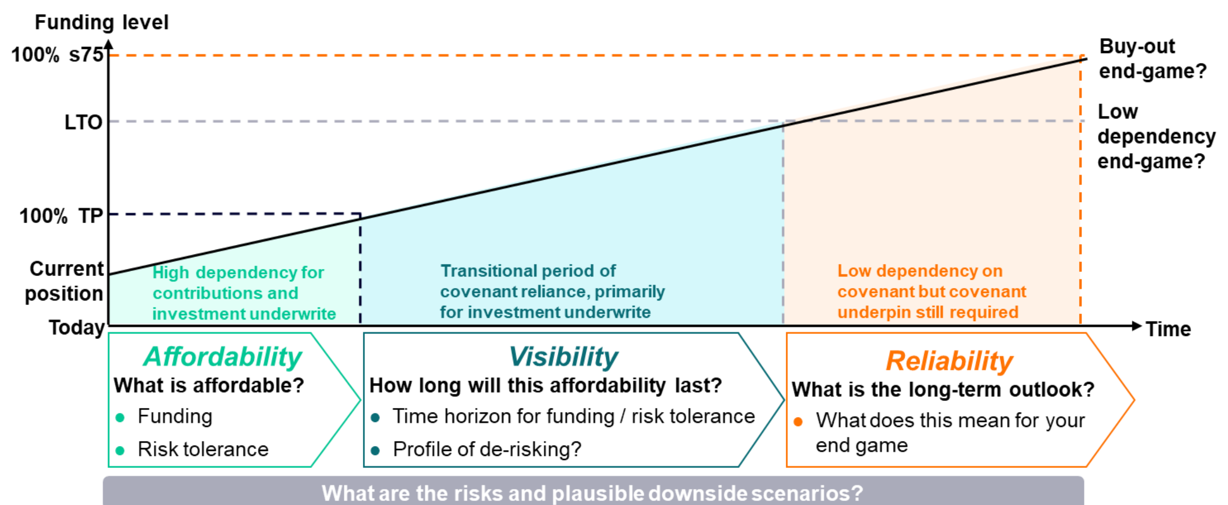
We seek to guide trustees through our own covenant assessments by considering the following elements, which are similar in nomenclature to those in the draft Code but each feeding into the creation of a journey plan that is structured specifically for the scheme's circumstances and the risks that it faces:

Affordability: the ability of the employer to meet the funding needs of the scheme and to support its risks, with this measure likely focusing on the nearer future, to full funding on a Technical Provisions basis (driven in part by information availability and clarity, on both liquidity and risks);

Visibility: the extent to which the affordability position is expected to persist (or otherwise) over the period to the scheme's existing long-term funding target, including an assessment of the risks that might arise over that timeframe (with relevant mitigants). This is a relative assessment across employers, noting that all covenants will experience greater uncertainty further into the future and taking into account the needs of the scheme; and

Reliability: the extent to which the sponsor is expected to be able to provide longer-term support for ongoing but well-funded schemes both for the residual funding, investment, legal and regulatory risks on the journey to buy out (if that is the target) and/or to remain solvent to avoid the issues that would arise from an insolvent sponsor even for a well-funded scheme. Given the timeframe under consideration may be upwards of 30 years, this factor will need to focus on a sponsors' industry/industries and its position within them.

This is set out in the following graphic:



This is an approach that we have used successfully with our clients over the last 3-4 years to help factor covenant into journey plans on a holistic basis. It is particularly valuable where trustees need to balance the near-term level of risk in a scheme with the period over which it is reliant on covenant. These two aspects tend to be in tension with each other when setting a strategy and need to be carefully balanced.

19. Do you agree with the approach we have set out for assessing the sponsors cash flow? If not, what would you suggest as an alternative?

We agree that an assessment of sponsor cash flow should form part of the assessment of an employer's financial ability to support the scheme. We also agree that the starting point for assessing sponsor cash flow should be free cash flow, after taking account of

operational costs and non-discretionary items, and that this will need to consider the employer's position within a group and the appropriateness of assumptions used.

As drafted, the Code is pointing trustees towards calculating one free cash flow number, as demonstrated by the suggestion to "consider using an average free cash flow" if the "employer's cash flow is cyclical or subject to variance". This appears to be for the purpose of the maximum risk equation.

However, based on our experience, not only is the calculation of free cash flow highly subjective; particularly if guidance suggests adjusting based on an assessment of management assumptions, for example; but also this approach could lead to significant changes in trustee journey planning decisions based on relatively small movements in the free cash flow number, via the maximum risk equation.

This approach has the (potentially unintended) consequence of minimising the valuable analysis of risks and uncertainties in forecasts, which can often drive cyclical or varying cash flow forecasts, and which should be reflected in journey planning. For example, as drafted, the impact of a significant and foreseeable one-off hit to free cash flow that, in reality, might materially impact the ability of the sponsor to support the scheme would be minimised – which is arguably the opposite approach that trustees should be taking. If this is not the intention, further guidance should be provided on how to adjust for these risks and uncertainties (that are currently lost in a single metric approach), either in the Code or in subsequent covenant guidance.

As part of the "Assessing cash flow" section, it would not be unhelpful to set out up front the context within which cash flow is being assessed; specifically:

- what cash could reasonably be paid into the Scheme under the recovery plan – which we would term "reasonable affordability"; and
- what additional cash could be paid into the Scheme if required, for example in a scheme downside scenario, and should be considered as part of journey planning – or "absolute affordability"

This section currently sets out the absolute affordability position, which should be the starting point as the most prudent view of available cashflow. Reasonable affordability must take into account reasonable alternative uses of cash and therefore the Code should signpost to chapter 10 on recovery plans, where this is considered in more detail (at the moment there is no reference to this further detail).

Structuring it in this way aligns with our view that the Code should be setting out the principles of what trustees should be doing to comply with the Regulations – in this case, "consider a sponsor's reasonable affordability to understand what could be paid as contributions under a recovery plan" and " consider a sponsor's absolute affordability to understand what risk can be underwritten". Further specific detail on how to consider reasonable and absolute affordability should then be set out in the covenant guidance.

As the above suggests, we would advocate the changing of the term "cash flow" to "affordability" within the Regulations, the Code and the covenant guidance (once published). This re-naming would better reflect the reality that it is not cash flow

generation in isolation that trustees need to consider, but cash flow, balance sheet items (e.g. cash/liquid investments) and general financial flexibility with reference to the Scheme's risk and requirements.

20. Do you agree with the approach we have set out for assessing the sponsors prospects? If not, what would you suggest as an alternative?

    In an effort to ensure that the Regulations and the Code are as joined up as possible, it would be useful to confirm within the Code what represents the "other factors…as set out in a Code". We have assumed those "other factors" are largely represented by the assessment of sponsor prospects.

    Paragraph 144 sets out a large number of factors to be considered as part of trustees' assessment of an employer's prospects. The factors referenced generally appear to be sensible, with many considered as a matter of course as part of comprehensive covenant assessments. However, we would recommend further guidance on proportionality be provided, particularly for smaller schemes where not all factors need to be considered.

    Paragraph 146 states that this assessment of prospects will inform the trustees' view on the employer's covenant longevity which does not appear to influence trustees' decision making. While some of this analysis should feed into the assessment of reliability; which, under the proposed drafting, would inform the period of covenant reliability set out within the maximum risk equation; for much of the qualitative analysis it is unclear what actions this should drive.

    We would also recommend removing the "risk of an employer insolvency event" from the list of drivers for performance and including as a separate item for consideration. This would align with the Regulations, which includes "the likelihood of an insolvency event" as its own matter to be considered.

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

    We agree with the principles set out for contingent assets, which will be more straightforward to apply for certain structures (e.g. PPF compliant guarantees). We would recommend providing further guidance on contingent assets, including those that are less standard in nature, to avoid the scenario whereby sponsors are unwilling to provide contingent assets for fear of not getting credit from a covenant perspective.

    The approach of assigning a numerical value to a contingent asset for factoring into the maximum risk equation potentially undermines the ability of trustees to give credit for contingent assets offering more nuanced value. Many contingent assets have less easily quantifiable benefits that are still covenant enhancing (e.g. creating a legally binding incentive for a stronger guarantor to provide ongoing support to a weaker sponsor) – it would be a shame to not recognise such enhancements to covenant, with the associated impact being that it may be harder for trustees to negotiate these in the future.

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

    The approach set out regarding valuing security arrangements makes sense but we would suggest TPR sets out further detail on how to give covenant credit for security arrangements based on the circumstances in which that security provides value. For example, many security arrangements provide protection against a downside or worst-case scenario rather than the specific means to make good a funding shortfall.

    It would also appear that the draft regulations and Code give considerable credit for security in the assessment of covenant strength, but limited credit for balance sheet strength without security. This may make it harder to argue that transactions that weaken the balance sheet (where there is not security) are detrimental to covenant.

    We would extend the point made by TPR within the Code that some security arrangements may not have a "certain value" to specify that, for some security arrangements, it will be very difficult to attribute a specific value at all. We note that ABCs are not mentioned in the draft Code. There is also no mention of contingent funding arrangements and how these relate to ongoing funding strategies. These are an important part of many schemes' covenants and should be included.

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

    We agree with the approach to valuing non-look through guarantees as an example. However, in practice, such guarantees are unusual. One reason may be the potential difficulty for sponsor directors in signing up to recovery plans that are unaffordable to the sponsor but affordable for the guarantor, on the basis that it would be in contradiction with their directors' duties.

    We would suggest including (in the Code or Guidance) further detail on proportionality, for example for those instances where a full s75 guarantee is provided to a small scheme by a guarantor of material size.

    As noted in question 21, too much focus on a numerical valuation may impact the ability and willingness of trustees to negotiate covenant enhancing guarantees that are not easily valued.

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

    We agree that it is important to consider the factors set out in paragraph 162 as part of assessments of multi-employer schemes. However, we would add the following (noting that the list does not consider sponsor specific factors):

    - The size of employers by financial performance, position and prospects; and
    - The structural and strategic importance of each material group entity (including employers), including interconnected nature of entities

While useful to include these factors, there is currently limited guidance included on how each should influence the approach taken. We would suggest adding this in the upcoming covenant guidance.

Many multi-employer schemes have complex structures and differing levels of reliance on different sponsors in different circumstances (e.g. last man standing schemes). The maximum supportable risk equation requires some highly subjective assumptions for multi-employer schemes.

Non-associated multi-employer schemes tend to be complex and we would expect to see further commentary on these in the covenant guidance.

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

Not-for-profit covenant assessments provide a helpful example of the issues raised in the answer to question 19. Most notably, covenant assessments of not-for-profit entities typically require the consideration of more qualitative factors, given the dynamics associated with diverting cash away from the sponsor's purpose to fund the scheme. Focussing on a specific cash flow number would ignore these important specific dynamics.

Linked to this, the maximum supportable risk equation (question 30) may penalise not-for-profit organisations that do not generate surplus cash flows or those that have balance sheet strength but no security

We believe a proportionate approach is important in all cases but particularly so for charitable organisations. Unfortunately, these are also examples of cases where the proposed prescriptive approach to covenant assessment and factoring covenant into journey planning set out in the draft Code is likely to be hardest to translate, risking wasted effort in complying with requirements that do not helpfully inform scheme strategy

As an aside, we would also expect to see commentary in the covenant guidance on employee-owned sponsors. These are not necessary the same as not-for-profit but are a further example of a slightly different type of business that the Funding Code needs to fit

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

In a framework which puts scheme maturity as a primary determinant of a journey plan, the approach to maturity is sensible. This is because, all else equal, a more mature scheme should ideally be taking less risk, as the consequences of funding losses are felt more severely due to the greater "cashflow drag" that mature schemes face.

However, we believe that covenant should be the primary determinant of a journey plan (as per the Draft Regulations). This is because covenant is a more significant factor than maturity on journey plans: covenant dictates the DRCs, contingent assets and so on,

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which have a major effect on the journey plan; whereas, maturity causes cashflow drag which only in some situations has a material impact on a journey plan.

We believe this could be emphasised more in the Funding Code by reference to the covenant longevity (subject to how that is ultimately defined - see question 18). This will also become more important if the maturity definition / parameters are flexed to allow schemes more time to reach low dependency.

As noted in our Key Observations, it would be preferable to adopt a maturity metric that is not subject to market movements. Our proposal would be % of liability value comprised of pensioners on the basis that this is straightforward to calculate; is calculated as standard in the majority of actuarial reports; is transparent and easy to understand; and it is not subject to market movements (it changes slowly over time, subject to changes to the actual membership).

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

We agree with the concept that trustees' journey planning should be driven by covenant and, as a result, once there is uncertainty around covenant (including as a result of a lack of visibility), plans should be made to adjust the level of risk being taken accordingly.

It is entirely possible, and potentially highly likely that for many schemes the period of reliability will roll forward three years at each valuation, pushing out the point at which de-risking would take place. It would be helpful to make it clear that this would not represent a "failure" for the trustees.

It should also be clear that there is no cliff edge between the period of covenant reliability and the following period – covenant does not suddenly stop. This supports the idea of rolling forward the period of reliability but we also consider ie t important to look at the journey plan as a whole.

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

We agree that trustees should be considering the ability of the employer covenant to support the level of investment risk being taken by a scheme.

However, we have some concerns that the 1-in-6 year stress test is a much less prudent measure of investment risk than the value at risk measures often currently used, which typically consider 1-in-20 year stresses. These concerns are more significant in the context of the prescriptive maximum risk equation; the combination of subjective assessments of affordability and contingent asset values compared against lower investment risk calculations could lead to unnecessary and unsupportable funding and investment risk being taken.

A comparison of a stress metric to a covenant metric is very helpful and provides a useful benchmark. This analysis should not be at the expense of more thoughtful downside scenario planning in the context of integrated risk management

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

When considering the employer's ability to support downside risk, there should be fewer deductions from the free cash flow position – as per our answer to question 19, this should be considering the sponsor's "absolute affordability", on the basis that this affordability would be needed in a downside scenario, therefore at the expense of some of the business' discretionary spending needs. This should be considered after deducting DRCs from cash flow, if considering purely the additional funding need; or before DRCs if considering the overall greater deficit (including the deficit being addressed by the recovery plan).

An obvious example of a potential unintended consequence linked to focusing only on post-DRC cash flows is set out in our response to question 30: in a situation where a sponsor that pays all it can afford to its scheme, that scheme is unable to take any risk (according to the maximum supportable risk equation); if that same sponsor held back some cash flows and paid lower DRCs, that scheme could take some risk

In terms of taking into account other DB schemes, this may require a scheme or sponsor-specific approach. Clearly, it is not, however, the responsibility of the trustees of sponsor scheme A to protect the members of sponsor scheme B at the potential detriment of their own members.

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

As set out above, it is our view that the "maximum risk equation" should not form part of the Funding Code. We see the equation as a helpful but simplistic illustration (rather than setting out a prescribed approach) that is not necessarily applicable to all situations. It should be included in the covenant (or IRM) guidance rather than in the Code, and used to illustrate the complexities in covenant driven journey planning as well as the importance of considering covenant over the full period of covenant reliance (e.g. until buyout). If retained within the Funding Code, it could be more explicitly acknowledged that the maximum risk equation is not a legal requirement but is instead an example of best practice in the simple scenario illustrated.

The approach sets out a prescriptive one-size-fits-all formulaic approach that will largely result in a small number of specific journey plan shapes (e.g. linear de-risking after the period covenant reliability or "lower for longer"), which may not be the most appropriate for a scheme – it does not consider longer term reliance on covenant (when supported by the covenant or contingent assets) or alternative journey plan shapes (beyond saying lower

risk is acceptable). This might results in poor decision-making, unnecessary costs and trustee / sponsor relationship strain.

The specific requirements within the Regulations do not prescribe a one-size-fits-all formulaic approach to factoring covenant into a journey plan, with this part of TPR's approach to regulation. By including this within the Fast Track / Bespoke commentary, this would allow some flexibility in the application of the equation to ensure trustees are making decisions appropriate to their scheme specific circumstances and, therefore, in the best interest of members.

Our specific concerns regarding the maximum risk equation are as follows:

Subjectivity of the equation: This calculation, which is calculating one specific number to drive a whole funding and investment strategy, is based on a number of subjective elements including:

- Covenant reliability, which drives both maximum supportable risk and the period over which that risk can be taken. However, unless the covenant has a clear cut off (e.g. sponsor reliance on a key contract), the period of covenant reliance is likely to be highly subjective;
- The maximum affordable contribution, which requires judgements on discretionary and non-discretionary cash items and may be based on inaccurate or illustrative forecast information (e.g. if forecasts are not prepared by the employer); and
- The stochastic 1-in-6 downside calculation is based on subjective assumptions

Contingent assets: Contingent assets are included within the equation but it's not entirely clear how they should be factored in for. While maximum affordable contributions appear to be measured annually, contingent asset support might be a lump sum (and therefore not appropriate to multiply by the period of covenant reliance), and the scenario for claiming on a contingent asset may not be a 1-in-6 downside event (but insolvency, for example, which does not help mitigate increased funding gaps)

Liquid assets: The extent to which liquid assets can be included should be clarified. While they are included as part of the assessment of available cash (paragraphs 298 and 299), it is unclear whether they are included in the equation (and if so, how they should be included)

Specific practical application issues: We can think of a number of specific instances where the practical application of the equation encounters some difficulty. For example:

- Quantifying the maximum affordable contribution and period of reliance for multi-employer schemes further amplifies the subjectivity (e.g. how different employer metrics are combined in a last man standing scheme vs joint and several)
- Scheme with sponsors with negative cash flows cannot take any risk based on the equation
- Sponsors that use all their spare cash flow to contribute to the scheme have nothing left to support investment risk so have to take zero investment risk. By contrast a sponsor that hold back some cash flow could take more investment risk despite the scheme being funded more slowly

The implications of the concerns raised above could include:

Increased costs and loss of focus: Asking advisors to quantify each element will potentially lead to increased advisory costs and may ultimately distract from holistic and more scheme-specific journey planning

Subjectivity creating a point of contention: In cases where there is not a clear margin (which might be few and far between if advisors are using prudent versions of all inputs), the subjectivity could result in unnecessary and protracted discussions between sponsors and trustees on each element

Cliff-edge for challenged schemes: Schemes on the borderline between stressed and not stressed will face a cliff-edge given flexibilities proposed for stressed schemes

Opinion-shopping: There is a risk of "opinion-shopping" to ensure compliance given the subjective nature of the inputs

Mixed messages re Fast Track/Bespoke: Inconsistent application of the maximum risk equation (e.g. if it is not required for those schemes meeting Fast Track requirements) undermines the message that all schemes need to comply with the Funding Code, and Fast Track is just a regulatory filter

Extended reliance on covenant: As set out in our Key Observations, the maximum risk equation focuses on near term risk capacity. However, de-risking in the near term could extend reliance on covenant, reducing the security of members' benefits over the life of the scheme

In light of these concerns, it is worth reiterating (as set out in question 18) our strong view that it would be worthwhile focussing on key principles and concepts in the Funding Code, how TPR expects these to be assessed and their impact on strategic decision making within the Funding Code. In this way, the maximum risk equation can be utilised to demonstrate the key principles that TPR wishes schemes to follow (in a scheme-specific way) without making it a prescriptive approach.

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

Yes, we believe the considerations are sensible and appropriate. They provide clarity on the reasonable maximum risk level, with some flexibility around that.

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

Yes, there is no single approach that would be best for all schemes, so the approach of allowing flexibility within certain limits is sensible.

It is for this reason that we believe the maximum risk equation should not form part of the Funding Code; certainly not in a prescriptive way.

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

Yes, we believe this approach is sensible and appropriate.

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

    Yes, we believe the current explanation is sensible and appropriate.

    We understand that TPR is consulting on the Statement of Strategy in due course and we look forward to sharing our feedback at that point.

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

    Yes, we believe the approach is sensible and reasonable.

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

    Yes, we believe the approach is sensible and reasonable.

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

    The concept that trustees should not plan for accrual beyond the period over which they have confidence the sponsor will be in a position to continue to meet such additional obligations appears reasonable, noting that the period of covenant reliability will likely extend with each valuation – notwithstanding our comments regarding the period of covenant reliability.

38. Do you agree with our principled based approach to future service costs? If not, why not and what you suggest as an alternative?

    We do not have a strong view on this and we defer to the actuarial community for a more detailed response.

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

    We understand that the term 'reasonable alternative uses' of cash aims to reflect discretionary cash outflows that trustees may consider constrain sponsor affordability; in particular, affordability for contributions for the purposes of setting a recovery plan that eliminates the scheme's deficit 'as soon as the employer can reasonably afford' (i.e. "reasonable affordability").

    The three alternatives identified appear reasonable and would be expected to catch many alternative uses of cash. It is, however, clearly not exhaustive and would benefit from a

catch all note to highlight that there may be other, non-standard uses of cash that should be considered using the same basis/methodology set out. Furthermore, TPR should be mindful that considerations of “reasonable” alternative uses of employer resources may result in tension between trustees and employers.

It is worth noting that considerable judgement will be required to come to a quantitative answer on “reasonable affordability”, with scheme and sponsor specific considerations to take into account. Not only will this, therefore, represent a subjective assessment, but also a single number will obscure all the nuances of the underlying cash flows and risks to the sponsor that can only be highlighted through qualitative commentary.

As we have noted within our Key Observations, our experience tells us that there is inevitably going to be interaction between funding / investment and events (e.g. transactions) and the references in this section to the concept of “reasonable covenant leakage” blur the lines between the Funding Code and transactions.

As set out currently, the Funding Code runs the risk that events that are detrimental to covenant (e.g. sale of division with proceeds distributed through a dividend) will be wrapped into a viable journey plan and valuation without mitigation being provided to the scheme in question; for example on the basis that the event isn’t seen to impact the level of “reasonable affordability” required for the valuation outcome or extend the recovery plan past the point of covenant reliability.

This risk is exacerbated within the proposed Fast Track regime, as there will likely be a perception that Fast Track compliance means TPR will not take action in respect of covenant leakage or other transactions that are detrimental to covenant (except in extreme scenarios such as insolvency).

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

We will defer to the legal community for a viewpoint on the interaction between the Funding Code and the Regulations. However, it is our view that “reasonable affordability” should be considered *alongside* the other matters set out in regulation 8(2) of the Occupational Pension Schemes (Scheme Funding) Regulations 2005, rather than being the primary overriding principle/driver above all other matters. This would reflect the scheme specific circumstances, rather than considering sponsor-only factors.

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

Both reasonable affordability and covenant reliability (which factors in extent to which affordability levels persist) should be among the factors considered regarding a scheme’s recovery plan length.

We note that the drafting of this question, which refers to a qualitative (and subjective) consideration regarding quantum and persistence of cash flow levels, highlights the flaw in

the current definition of covenant reliability, which only refers to a time period. Please see our response to question 18 for our views on how to improve this definition.

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

With regards to the principles set out in the Code from paragraphs 305 to 320, we would agree with:

- The concept that the lower the funding ratio, the less reasonable it will be to use available cash for discretionary payments or to effect covenant leakage, as set out in paragraph 307.
- The concept set out in paragraphs 314 to 317 that trustees need to assess/understand risks and benefits of investment, how it might impact covenant going forward and therefore the cost/benefit of forgoing earlier contributions

Further clarification would be useful on the following points:

- While we agree that, in general, the more mature a scheme, the greater need for available cash to be paid to the scheme in the near term, as set out in paragraphs 308 and 309, it should be noted that this is subject to funding level of scheme
- We tend to agree with the concept in paragraph 310 that cash shouldn't be used for discretionary payments if it means DRCs will be paid after the period where cash is reliable. However, it is worth TPR being clear that all principles (including this concept) need to be considered together, rather than in isolation. For example, it may be the case that investment in sustainable growth may push a recovery plan out past the period of covenant reliability and that may be acceptable based on the trustees assessment of that investment, as set out in paragraph 314 to 317.
- Within paragraphs 312 and 313, it is not clear whether this relates to "levelling up" or "levelling down"; and we would not expect TPR to be encouraging trustees to level down to the position of a competing DB scheme creditor
- Similarly within paraphs 312 and 313, it should be acknowledged that "fair treatment" will inevitably be seen differently by various stakeholders and "fair treatment" will be dependent on scheme specific circumstances (including covenant, legal protections etc). It would be useful to have more detail in the guidance regarding how the regulator considers "fair treatment" across schemes within the same group but with different covenant structures, funding needs and legal powers.

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

Yes, that appears sensible

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

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Yes, we believe that it is appropriate for journey plans to be based on an asset return assumption that is higher than the prudent asset return assumption used in the TP basis.

The Funding Code encourages trustees to focus first on the journey plan, and then on the TP valuation. A scheme's journey plan should be based on an appropriate assumption regarding asset performance, and Technical Provisions will be calculated by reference to specific requirements (including with respect to prudence).

We would question whether a term such as "outperformance" fit in the new regime where the journey plan leads the valuation and not the other way around.

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

No, we appreciate the principles-based approach as it stands

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

Yes, we agree with this approach.

47. Do you agree with the examples we have given for when trustees investment strategies may not mirror their FIS? Are there other examples we should consider?

Yes, we agree with the two examples given. In particular, we note the importance of the second example to allow schemes to move, where desired, from low dependency funding to Buy Out funding without placing all the burden of funding improvements on the sponsor.

Other situations to consider include crisis management (such as the Q4 2022 gilt crisis) where investment decisions may be required to manage immediate tail-risks rather than proceed towards the long-term funding targets.

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

We agree with the approach described by TPR in the Code, which seems pragmatic. However, we would prefer that the regulations are changed to make it clearer that this is allowed in law.

The Funding Code notes trustees should not give credit in technical provisions calculations for investment returns that are associated with unsupported investment risk. It would be helpful to have clarification as to the extent to which this is applicable for wider decisions for trustees of stressed schemes. For example, trustees need to be able to justify their decisions in the context of members' best interests (whilst not taking the PPF into account) – what can they assume for investment returns here?

We also note there appears to be a cliff edge between employers that are deemed stressed and allowed the flexibility set out in the Funding Code, and those that are on the borderline (i.e. not deemed stressed but failing the maximum supportable risk test). We would expect the covenant guidance to include commentary as to how a stressed scheme is defined and how borderline schemes are treated in the Funding Code (to ensure they do not become stressed schemes).

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

    Yes, we agree that the principles are sensible and appropriate.

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

    Yes, we agree that the principles are sensible and appropriate.

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

    Yes, we agree that the approach is sensible and appropriate.

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

    N/A

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

    Yes, we agree with the above considerations

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

    We believe the major “herding risk” is in relation to gilts and LDI, which is sensibly and appropriately discussed in the Code.

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Responses to Fast Track consultation questions

We have only included those questions where we have answers and/or strong views. For those questions that are more legal or actuarial in nature, we defer to the legal and actuarial communities for their views:

1. Do you agree with how we have positioned Fast Track relative to the code of practice?

   The Draft Regulations and Code put covenant at the heart of journey planning but Fast Track does not have any covenant parameters. Whilst we understand TPR's rationale for a simplified set of parameters for filtering schemes, they will need to be mindful of mixed messaging.

   We would appreciate further guidance on the impact on potential enforcement of having the Fast Track and Bespoke detail outside the Code, if any.

2. Are there any aspects of this you think it would be useful for us to clarify further?

   Guidance, in as clear as possible terms, that a decision to go down the Fast Track or Bespoke track should not be a main driver in taking covenant advice would be welcome. This would help to avoid the risk, for example, that covenant advice is not taken when submitting a Fast Track valuation, regardless of the risk profile of the scheme and sponsor.

3. Do you agree that Fast Track should come with a lower level of burden in terms of the explanations required as part of the trustees' valuation submission?

   Not from a covenant perspective (we do support a proportionate approach to covenant assessment and documentation but this should be by reference to covenant strength in the context of scheme needs, not Fast Track)

6. Are there other considerations not discussed in the consultation document we should be considering?

   Not beyond the points raised in our responses to questions 1 and 2.

7. Do you believe it would be useful to include an additional set of parameters for schemes where the employer has a high insolvency risk? If yes, how should schemes in this category be defined and where should the Fast Track parameters be set?

   Fast Track is unlikely to be appropriate for schemes where the employer has a high insolvency risk. Rather than changing the Fast Track parameters, we would suggest emphasising the principles already set out by TPR: just because a scheme can meet the Fast Track parameters, that doesn't mean that approach is the right one for the scheme.

   This question contradicts that principle by suggesting that Fast Track is fine right up to a high risk of insolvency (and even then an amended version might be appropriate). Also, in

practice, there are other covenant scenarios where Fast Track is also not appropriate (e.g. where there are material doubts over the medium to longer term future of the sponsor).

10. Do you agree that for a Fast Track low dependency funding basis measure, the minimum strength of the discount rate basis should be gilts + 0.5% with no inflation risk premium?

    Yes, we agree this is sensible and appropriate.

13. Do you agree that the maximum recovery length after significant maturity should be set to three years rather than six? If no, explain why and what you would suggest as an alternative.

    Typically recovery plan length / period would be linked to covenant but it would create confusion to have covenant partly referenced in Fast Track. Instead, we would suggest this is called out as an example as to how Fast Track only covers scheme risks and covenant needs to be considered separately.

16. Do you agree that annual increases to deficit repair contributions should not be more than CPI? If no, what would you suggest as an alternative?

    As a broad principle, it makes sense not to have a back end loaded recovery plan in Fast Track; particularly if the back end loading were linked to covenant considerations.

17. Do you agree with our approach for the stress test? If no, explain why and what would you suggest as an alternative?

    Yes, we agree this is sensible and appropriate.

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