

Sarah Harvey
Regulatory Policy, Advice and Analysis Directorate
The Pensions Regulator
Napier House
Trafalgar Place
Brighton BN1 4DW

Our ref CS/IM
Contact Iain McLellan
0141 739 9120
07768 658368
iain.mclellan@isio.com

2 September 2020

Dear Sarah

Defined benefit funding code of practice consultation

I am writing on behalf of Isio Group Limited in response to the defined benefit funding code of practice consultation that was published in March 2020.

I set out in this letter Isio Group Limited's overarching views on the proposed new regime, including our key points on the overall framework and the Fast Track and Bespoke compliance routes. The appendix to this letter includes our responses to the individual questions raised as part of the consultation.

Overall framework

We are broadly supportive of the proposed twin-track compliance regime. We also support the flexibility to move between the Fast Track and Bespoke frameworks at subsequent valuations.

We believe that the regime should be designed to allow Fast Track to be a robust and simple "off-the-shelf" approach with minimal compliance costs. Bespoke should aim to live up to its name and require the demonstration that a scheme specific IRM approach, including external covenant and investment advice, has been followed in order to reach the valuation outcome.

While you may want to use Fast Track as a "yardstick" as part of your regulatory approach (which makes sense as all Bespoke schemes should understand where they sit relative to it) it should not be the starting point for schemes when they approach their own valuation and it should be reasonable that a Bespoke approach may give a materially different outcome compared to Fast Track.

Fast Track regime

We support a Fast Track framework that is predicated on achieving a low dependency position by the time a scheme reaches significant maturity.

We believe that the Fast Track framework should be as simple to follow as possible. We are supportive of the Pensions Regulator setting all assumptions that are not scheme specific (i.e. financial vs demographic) to avoid gaming the system. Our view is that to keep the Fast Track framework as simple as possible it may be sensible to make it covenant agnostic, i.e. external covenant advice would not be required. This would be consistent with a maximum fixed single recovery plan length for schemes adopting Fast Track, avoiding potential cliff-edges between covenant bands.

We envisage a possible "Fast Track Lite" option should be included, where a scheme follows the Fast Track principles but where the sponsor is unable to afford the required contributions. In this case, external covenant advice (limited to reviewing sponsor affordability and equitability) would be required with the ability to submit a longer Recovery Plan at an affordable level. We believe this would help both the Regulator, with only an additional check of the covenant advice compared to standard Fast Track cases, and the sponsor/trustees, by avoiding the cost of a full Bespoke compliance where the answer is likely to come back to the same point of maximum affordability.

We do not believe that the funding regime should significantly constrain a scheme's investment strategy. In particular, while liquidity is a risk that needs to be managed by trustees, we don't believe placing specific limits on credit quality and illiquidity would be helpful. Trustees have fiduciary responsibilities in respect of investment risk and overall risk management and this, along with a simple stress test (as discussed in the consultation document), should be considered sufficient for the purposes of Fast Track.

We note that there is no reference to allowing for post-valuation experience in the consultation document. Under Fast Track, we believe that it would be appropriate to give trustees the ability to allow for post-valuation experience if the scheme actuary certifies the position at the month end prior to submission. This should provide additional flexibility, without introducing material additional risk.

Bespoke regime

We do not believe that Fast Track is a fair reference point for assessing a Bespoke arrangement, and our view is that the Bespoke framework should give trustees the ability to adopt a significantly different funding approach to Fast Track.

The suitability of a Bespoke arrangement should be based on a full IRM assessment, including professional independent covenant advice. This would incorporate a full assessment of all covenant, investment and funding risks to ensure that the risks being taken can be mitigated or appropriately managed.

For this reason, whilst maturity should be one factor to consider under Bespoke, it should not override covenant. For example, we don't think a mature scheme should be constrained to targeting only very low levels of return (i.e. marginally above gilts). We advise many mature schemes that operate a cashflow-driven-investment (CDI) approach that are exposed to very low levels of investment risk but which still target modest returns.

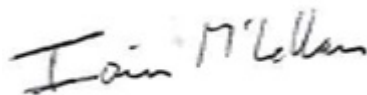
Assessing sponsor covenant strength now and many years into the future will vary significantly from sponsor to sponsor. Just because covenant may be less visible beyond a few years, does not, in our view, mean it should be assumed to be nil.

While any "additional support" would ideally be legally binding and enforceable, it will be important that trustees are not pushed to dismiss any contingent support that doesn't meet this ideal standard. Something has to be better than nothing, e.g. being part of a wider group is relevant to the assessment of covenant even if not legally binding or a contingent asset that is time bound. It should be for the trustees, taking appropriate advice, to assess the reliance that they can place on any "additional support" as part of their wider IRM approach.

In terms of reporting information under the Bespoke approach to the Pensions Regulator, the information required should be proportionate and pragmatic (particularly for smaller schemes).

We will be happy to discuss our response further with you should you have any queries on our comments,

Yours sincerely



Iain McLellan