ECPA
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Date: 16 September 2020

Dear Ms. Harvey

Consultation document: Defined benefit funding code of practice

I write to you on behalf of the Employer Covenant Practitioners Association ("ECPA") in response to your consultation document on TPR's proposed defined benefit funding code of practice. It is helpful to have an opportunity to provide input on this important issue.

Background to ECPA

The ECPA's member firms are can be found on the Association's website at https://ecpa.org.uk/members/ . Collectively the ECPA provides a forum where specialist employer covenant professionals:

- Discuss technical, legal and regulatory issues relevant to providing financial advice to clients – trustees or sponsoring employers – on matters connected with the employer covenant.
- Participate in discussion around relevant matters such as the Pensions Regulator and Pension Protection Fund and, where appropriate, to promote the views of the ECPA with those bodies.
- Act as a vehicle for raising the standards of, and promoting, the employer covenant financial advisory industry generally amongst the pensions community, including trade bodies, professional groups and potential clients - scheme Trustees or sponsoring employers.

At the heart of our work is the preservation of value for scheme members, supporting the ongoing viability of sponsors and schemes, and ensuring their ability to deliver members benefits in full through appropriate funding arrangements and adherence to good quality, effective, coherent regulation.

The ECPA's responses to the Consultation questions

There is always the risk that a response from a professional body can be seen as partisan or self-interested. Our response seeks to be objective and is built off the very considerable experience of our members in advising on employer covenant-related matters with massively variable features and dimensions. In our response, we have sought to illustrate certain of our comments with examples to "bring alive" how variable – and non-formulaic – the dimensions of employer covenant can be.

Our responses to the questions are set out in the online response form. There are a three key messages that we wish to emphasise in particular:

1. Until a Scheme is bought out or transferred to a commercial consolidator, its members are dependent on the covenant to underwrite the risks in the scheme, and therefore this fundamental feature should be factored into both the Fast Track and Bespoke compliance regimes.
2. Protecting members' benefits is not just about funding assumptions and investment strategy, it is also about management of a concentrated, dynamic credit risk – the ability of the sponsor to support the scheme now and in the future, reflecting a full range of covenant indicators rather than set metrics. If a formulaic approach is promoted in regulation, it may lead to confusion amongst trustees and a systemic weakening in credit risk management practice, to the detriment of members..
3. The current environment of COVID-19 and BREXIT underlines that Employer Covenant is dynamic and should, therefore, be integral to trustees' journey to buy-out. Making broad assumptions about covenant and/or ignoring it may have unintended consequences, even if the assumptions are prudent.

It is therefore the view of the ECPA that TPR should be explicit that trustees' duties do not stop at complying with regulation but extend to considering and managing the specific characteristics of scheme and employer.

The proposed Fast Track process appears to be an efficient way for the Pensions Regulator to allocate its limited resources across the DB pensions landscape. However, Fast Track should be seen simply as one route to regulatory compliance rather than an ideal route applicable to all schemes. The principles of a scheme-specific approach are embodied in the Bespoke approach which should not be measured against standardised parameters.

In addition, the Funding Code makes the assumption that, *because covenant visibility decreases over time, there is an erosion of covenant strength*. This is incorrect. As banks and other long-term lenders and investors (such as pension funds) will attest, Employers with competitive positions in attractive sectors have enduring credit characteristics. Regular covenant monitoring and in-depth review at the triennial valuation stages improves covenant visibility and, in many cases, will show the enduring nature of many covenants.

Indeed, all other things being equal, as liabilities amortise over time as benefits are paid, the strength of covenant may actually increase as the relative scale of the scheme, to the sponsor's financial capacity, diminishes.

There are real cash flow consequences of making an uninformed reduction in assumed covenant strength. In this case, deficits will appear larger and increase cash demands on sponsors, unnecessarily reducing their ability to invest in their own sustainable growth, or reducing their ability to cope with unforeseen risk.

While regulatory focus is on the majority of Schemes which are closed to future accrual and to new members, there are very significant numbers of members still in open schemes. The enduring nature of the covenant is much more relevant here than the concept of scheme maturity which is stressed in the draft Funding Code.

The TPR policy team has, in a number of discussions subsequent to the commencement of the consultation process, described the benefits of the Fast Track approach in the context of the 2,200 or so small schemes with less than 100 lives each. Such schemes may in some (but not all) circumstances, have limited advisory budgets and limited access to best practise governance processes to enable an efficient allocation of scheme resources. However, the consultation itself does not make such a distinction between size of schemes. We have therefore provided our response in relation to schemes of all sizes.

In closing, we would very much value the opportunity to be closely engaged with you as your thinking around DB funding develops. The uncertainties which have arisen around Covid-19, and also Brexit, have served to illustrate well how flexibility and creativity are vital ingredients in the toolkit of those responsible for DB scheme funding – whether Trustees, sponsors, advisers or Regulators. At present, our member firms are working with schemes to address clear and present challenges in ways which seek to balance the needs of schemes with the long-term success of the sponsors which support them. This goes to serve how vital it is to maintain a scheme specific funding approach which allows for flexible decision-making to suit a variability of circumstances as they unfold. The ECPA very much look forward to being part of the debate which enriches this approach.

The ECPA would welcome further engagement with TPR on this matter.

Yours sincerely

Paul Burnett
Chair
Employer Covenant Practitioners Association