# Funding regime jigsaw

**It is a relief to finally have the new funding regime pinned down and to see that the Pensions Regulator has responded to genuine concerns raised during the initial consultation process, says Mark Alexander**

Shortly before Christmas, an early present arrived in the form of the final scheme funding regulations and associated code of practice were published. This put the final pieces of the jigsaw into place – so at long last we know the details of the new funding regime.

However, we still await final confirmation of the way in which the Pensions Regulator will oversee the new regime. Chairman David Norgrove's earlier proposals regarding funding triggers, as set out in the October consultation document, were interpreted by many as introducing a new minimum funding requirement via the back door. And, as that document was certainly far more prescriptive about issues such as funding targets and recovery periods, it may well assume greater importance than the code of practice and the regulations themselves.

The draft funding regulations and code of practice had first been issued in March, followed by a seven-week consultation window. In total some 400 pages of feedback were received from the pensions industry, and the weight of the responses caused the final publication date to be moved back from August to September and finally December.

Of particular interest are the changes made to the original draft – as these highlight how policy has changed once the impact of the original paperwork has been considered. None of the changes have been fundamental – as the regime is designed to comply with European legislation – but the government and regulator have taken on board many points raised on the detailed wording.

Trustees' actions will be judged against the code of practice, and several relaxations have been made compared with the draft. This could potentially ease the burden on trustees, although only by making an already difficult job slightly less onerous.

The draft code would have required trustees to negotiate "robustly and independently" when entering into discussions with the sponsor. The final version uses the much more practical suggestion that "if negotiation proves necessary, trustees should be well prepared and be willing to work with the employer to reach a common agreement". This should remove the need for an unnecessary paper trail when both parties are happy with the proposed funding plan.

## Trustee obligations

Trustees are reminded they should set aside their other duties and interests – particularly any responsibilities to the sponsor – when making decisions, and should consider in advance how they will recognise and deal with any conflicts which do arise. Such conflicts should be taken seriously, and are described as "a wider issue which concerns matters other than funding, and goes to the heart of the nature of the role of the trustee".

The code acknowledges that the strength of the employer's covenant is at the centre of scheme funding decisions and refers for the first time to employers' obligations to provide the trustees with the information needed to assess sponsor creditworthiness.

Funding targets should also be prudent, which had led to concerns that trustees would be compelled to use unreasonably strong funding targets.

Despite calls for much needed clarity, the regulator has chosen not to define prudence, but has gone some way towards clarifying its meaning. It is understood that trustees are not required to target buy-out funding, and assumptions which include an equity risk premium "will not necessarily be imprudent".

The new code also clarifies how prudence should be measured – against the basis as a whole, rather than insisting that each key assumption should be prudent. The change from the draft code, which appeared to require "prudence on prudence", should come as a relief to both trustees and their sponsoring employers.

Instead of simply requiring deficits against the funding target to be "made good as soon as practicable", the regulator has made certain practical concessions. Norgrove suggests trustees should make allowance for the impact of deficit payments on corporate plans – allowing for one-off company expenditure, such as when a loan falls due for repayment. This reinforces the need for trustees to understand, and perhaps obtain objective verification of, the company's financing structure.

The regulator states trustees should also question their ability to recover any wind-up debts when considering the length of the recovery plan. Noting that companies domiciled outside the UK may be harder to pursue, the regulator suggests overseas employers or parents should be asked for more money up front. For multi-national groups, the precise way in which the subsidiary companies are structured and registered could therefore have a significant cash flow impact on the business.

All in all it is a relief to finally have the new funding regime pinned down and to see that the regulator has responded to genuine concerns raised during the initial consultation process. Under the new regime, companies are bound to have to accelerate their deficit funding and it remains to be seen how many more will follow Rentokil's lead and look to close their defined benefit schemes for future service.

***Mark Alexander is a consultant at Lane Clark & Peacock***