Debrief

Pensions funding and governance with the Pensions Regulator and Regulator of Social Housing

The new Defined Benefit pensions funding code is the biggest shake up in Trust based funding since the creation of The Pensions Regulator over 15 years ago.

This debrief note follows on from Isio's webinar with the NHF and the two Regulators held in December 2020. We summarise the key themes from that discussion, consider what the new funding code might mean for the housing sector and what movement this might lead to in Trust-based funding and governance.

Note that this code will not apply directly to the LGPS, although organisations with LGPS exposure will be interested in the themes discussed here.

This debrief note covers:

- What is the new DB funding code?
- NHF response to TPR's first consultation
- How will this affect housing associations and contribution rates?
- Key messages from the Regulator discussion
- Finding the right solution
- Actions for a housing association
- How Isio can help

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What is the new DB funding code?

The Pensions Regulator's new Defined Benefit (DB) funding code will require all Trust based schemes to consider:

- Level of investment risk
- Reliance on employer
- Long term objective
- Prudence in assumptions
- Length of recovery plans

It aims to put in place a benchmark for funding risk and will require all schemes not meeting this "Fast track" method to provide evidence of why a "Bespoke" route is appropriate for the scheme and sponsoring employer(s). The first consultation period is now closed and the pensions bill is moving through Parliament. A second consultation on the detail of implementation is due in 2021. The code is due to come into force for valuations from Spring 2022.

The Pensions Regulator (TPR) believes that the typical employer covenant visibility is 3-5 years, meaning there may be a significant impact on stronger employers who can afford to pay contributions but would prefer to take the risk over the longer term. TPR's "rule of thumb" for recovery plans is a maximum of 6 years, with a longer period justifiable if the employer is weaker and can't afford.

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NHF response to TPR's first consultation

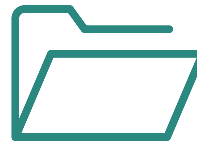
The NHF engaged with TPR during the first consultation in 2020 and responded on behalf of the housing sector. The consultation response publicly available **here.**

There are four main points posed to TPR on behalf of the housing sector:

- The housing sector has significant covenant visibility and is not a typical "not for profit"
- Higher pensions demands may frustrate housing management, development and building
- Could regulatory efficiency come from creating a "Fast lane within Bespoke" for housing?
- Could housing associations utilise the current 30 year business plan projections to evidence strong covenants?

TPR has had discussions with RSH to understand the sector further and look at whether perhaps schemes and employers could utilise the testing already done by RSH, which already enables RSH to have confidence over governance and future sustainability of each housing organisation.

These issues were explored further in the webinar discussion.



How will this affect Housing Associations and contribution rates?

This code applies to all trust based schemes across the housing sector as well as, for example, the FTSE100. This is around 6,000 schemes in total for TPR to regulate. For a housing association, it will apply directly if you are in SHPS, your own trust or a section in TPT.

It does not apply to the LGPS, which is regulated by MHCLG rather than TPR, although it is possible that these principles may start to be used by the LGPS in future. Housing associations in the LGPS should be aware of the trends and consider what the impact would be if their LGPS Fund starts to think in this way.

Isio analysis shows that the implementation of a **Fast Track approach could increase contributions by 1 to 4 times**, depending on the current approach to risk already in the scheme.

Taking a bespoke approach route could limit the impact on contributions significantly, but will require more work from the scheme and employer in order to first develop the funding strategy and then to evidence the rationale to TPR.

Scenario	Funding level	Annual deficit contributions
Current funding agreement	75%	Status quo – 12 year recovery plan
Impact of Fast-track– less reliance on future investment returns	70%	x 1.5
Impact of Fast-track – less reliance on future investment returns and a 6 year recovery plan	70%	x 3

Fast-track: x 1 to x 4

Bespoke route: x 0.5 to x 1

Notes: Isio analysis based on example scheme (numbers rounded to show order of magnitude)

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Key messages from the discussion

TPR
Fiona Frobisher

"TPR's focus is risk, greater accountability and transparency and efficient regulation. A bespoke route is available but we will require evidence of why a scheme and its employer(s) not using Fast Track parameters"

Some of the key themes from Fiona:

- The code will come in and will lead to a "hard edge" of required funding measures
- Funding plans are best made individually with schemes, employer and trustees working together
- TPR is not against risk being taken, but it should be supported by employer covenant and a long term plan
- For housing, TPR realises that there are competing demands on cash – scheme, housing, investment
- TPR wants to avoid unintended consequences of this code, for example where an employer is strong and a bespoke risk profile is supported
- TPR is supportive of using employer assets to support a pension scheme – it is already a common method in lots of schemes for achieving overall security for members benefits being paid
- There are options for how to treat housing sponsored schemes, perhaps using a sector approach as for other regulated industries

RSH
Will Perry

"Pensions is one debt on the debt pile. We expect each provider to make an informed choice based on risk, in line with the objectives of the organisation, and ensure proper controls and advice are in place before decision made."

Some of the key themes from Will:

- Providers are facing a wider range of strategic choices and pressures on resources and capacity than we have seen for a long time
- There is increasing pressure on providers to look at their existing housing assets and to work out how best to get "bang for your buck"
- Providers should be projecting costs over time, flexing around this and understanding how pressures in the business could develop. This includes pensions
- Providers have choice and discretion over how they choose to service their pension deficit
- Using social housing assets in a pensions support arrangement will not be right for every provider. You would not need RSH consent but RSH would look to understand why this is the right answer for your organisation

Key takeaways

A **bespoke** approach is likely to be the right answer for housing sector DB pension schemes

Applying the bespoke route requires a scheme and employer(s) to **evidence** why their chosen level of risk is supported by employer covenant or asset backing

A scheme and its employer(s) needs to consider the **employer strength, long term objectives**, how you want to manage **risk** and how liabilities are best funded

There may be the possibility of developing a "fast lane through bespoke" for the housing sector to reduce the level of **administration** complexity

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Finding the right solution

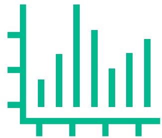
" There is a range of risks in the sector already – a proactive and informed employer is able to get right outcome for its organisation"

Housing associations have long covenant visibility and are generally very strong – illustrated by the fact that the sector provides much more asset support for its combined pensions deficit than the FTSE100 does, for example. It has significantly more resources available to support its pension schemes if things should not happen as expected. It also does not "leak" dividends.

This discussion highlights the relevance of covenant and what is an **appropriate level of risk** for the scheme and employer in combination. In simple terms, if a return-seeking investment strategy is taken within the scheme, this higher risk approach might expected to lead to lower cash contributions if the returns come through. But the question then is, what covenant is needed to support the potential downside? The answer is bespoke to each scheme and employer(s).

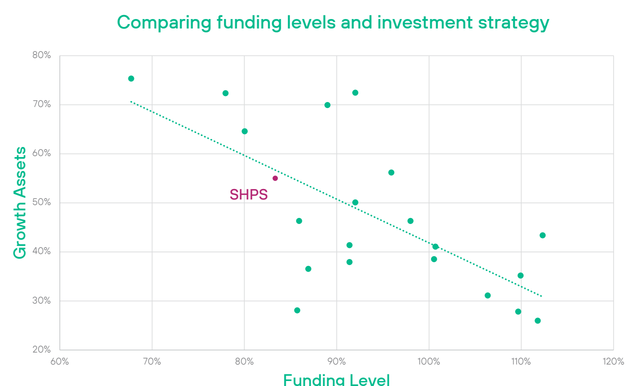
With an appropriate investment strategy and structuring of assets there might be a way of giving the scheme (and TPR) the security required whilst offering employer the continued use of assets and a longer, more stable contribution profile. We expect to see more **use of employer assets** and also other **liability management exercises**, which are all part of a **long term funding plan**.

Employers and trustees have a **shared goal to ensure members benefits are paid in full**. Whatever scheme a housing association is in, it will need to monitor its risk, understand its options and consider the value of each route against its own business objectives.



A strong employer covenant can support a longer term funding strategy with lower cash contributions

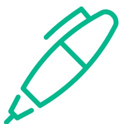
Pensions risk profile in the sector



Notes:

Isio analysis based on 31 March 2020 financial statements for housing associations with SHPS, SHAPS, own trusts or sections of TPT

This graph illustrates the range of approaches currently in the sector. It does not show the level of hedging in a scheme, which will also influence the overall level of risk taken



Actions for a housing association:

1. **Business projections** – incorporate expected contributions in business plan
2. **Stress testing** – flex scenarios to understand risk profile of your pensions "debt"
3. **Strategic review (Finance, People, Governance)** - weigh up or revisit full range of strategic options
4. **Risk register** – embed pensions risks into wider risk management
5. **Liability management** - consider feasibility of member options
6. **Funding strategy** - review long term target and use employer influence where possible
7. **Asset structuring** - consider use of employer assets to support effective funding plan
8. **Consider timing** – e.g. next valuation cycle

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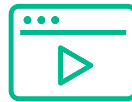
How Isio can help

We can help you and your organisation:

- Set your cash contribution levels
- Find the right balance between cash and investment
- Use your covenant and assets effectively
- Review the governance of your pension trust arrangements

These are specific to the issues raised here. We can also help with any other pensions challenges you are facing at the moment.

Please contact us for more information or just for a chat through any of the issues here in the context of your organisation.



You can watch the 90 minute video of the full discussion here

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