Statement of strategy

Response to TPR consultation

April 2024

Hymans Robertson LLP

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Executive summary

We're glad to see TPR publish such detailed guidance for the statement of strategy, but we're concerned about the amount of detail schemes need to provide.

Using templates is helpful in principle. However, we feel the information required would be onerous for schemes and disproportionate to what TPR needs to regulate valuations – especially in an environment where many DB schemes are well funded. It would be helpful to better understand what TPR is going to do with all the information that schemes will submit. As a submission for the regulator's eyes only, it has little value for schemes themselves, beyond compliance.

The format of the template is important. We'd suggest pre-populated sections or some form of automation to make it easier to complete. Lots of free text risks creating onerous work to complete a compliance tool, and could lead to results that aren't easily comparable.

TPR also needs to think more about the submission process and how trustees will prepare the data. For example, a scheme would produce cash flow information as part of every actuarial valuation, but will need processes to extract, collate and report the data in a standard way.

The current proposals would add a lot of work to the valuation process. We estimate a typical scheme's valuation could increase by at least 20% as a result of the extra time and advice that trustees would need to complete the statement of strategy.

Our biggest concern is that TPR is asking schemes for too much detail. For example, the requirements for 100 years of forward rates and cash flows are excessive. The concessions for small schemes and those following Fast Track don't go far enough. Asking for so much information misses the point of Fast Track, and removes the putative usefulness of the regulatory 'filter' for schemes and for TPR.

The templates may not suit Bespoke schemes that are close to meeting Fast Track. We'd suggest that these schemes should fill in a Fast Track submission with extra information linked to the nature and materiality of the additional risks they're taking. This approach would avoid the extremes of a very light-touch Fast Track and onerous Bespoke with nothing in the middle.

Overall, we feel like the statement of strategy asks for too much information, and will create a lot of extra work. We'd be happy to work with TPR to explore the points raised in this response to develop a more proportionate approach that would ultimately help the regulator and DB schemes.

Laura McLaren
Partner & Head of DB Scheme Actuary Services
For and on behalf of Hymans Robertson LLP

Our details

This response represents the view of Hymans Robertson LLP. We're happy for our response to be quoted in a future response the government issues.

Your name
Laura McLaren

Organisation
Hymans Robertson LLP

Type of organisation
Adviser (actuarial and investment)

Job title
Partner & Head of DB Scheme Actuary Services

Postal address
20 Waterloo Street, Glasgow G2 6DB

Telephone
0141 566 7914

Email
Laura.McLaren@hymans.co.uk

Our approach to the statement of strategy

1. To what extent do you agree that our proposal to adjust the information required of smaller schemes as outlined in the document is pragmatic and proportionate?

We agree that smaller schemes should be able to provide less information. The extra burden and costs of providing information would be disproportionate. However, as drafted, we feel that the Regulator hasn't gone far enough to satisfy the proportionality principle.

2. To what extent do you agree with the two definitions proposed for smaller schemes depending on whether we are requesting actuarial or investment information?

We think it might be helpful to have consistent definitions of a 'smaller' scheme for both actuarial and investment information to avoid confusion. Aligning the definition with the size of the section 179 liabilities feels sensible, since schemes already use this measure to assess how much detail to give the Regulator for other purposes.

3. To what extent do you agree with our proposal to have pre-defined templates for the statement of strategy to help trustees provide information that is proportionate, relevant and specific to the circumstances of their schemes?

We agree with the premise of designing a proportionate compliance submission.

Leaving aside the detail, the approach to entering and submitting data will be as important as the template itself, given the amount of information requested. The template should be easy to fill in; data is likely to be collated in parts and would need to be checked. It should have pre-populated options where possible. Schemes should be able to upload spreadsheets with data for yield curves and cash flows.

As a compliance tool, this sort of template has little value for schemes themselves. It may have more value if it could be easily turned into a document that could be shared with scheme members, for example alongside a summary funding statement.

4. To what extent do you agree with the benefits we expect to see by providing a pre-determined statement of strategy?

We agree that a pre-determined statement would set out requirements clearly and help to ensure consistency. To deliver these benefits, an efficient submission process with pre-populated options and automated responses where possible is important. Such a process will also reduce the costs and work to complete the statement. A pre-determined statement will also reduce the risk of schemes producing a document that doesn't comply.

5. To what extent do you agree with the key differences in the information we ask for between the four proposed templates?

We agree with the differences between the templates. However, we'd like more difference between the Fast Track and the Bespoke submissions. Fast Track is meant to offer a streamlined, lower-cost route to compliance, so schemes should be required to submit less information. We're also concerned that the information requested for Bespoke valuations may be excessive for valuations that only just miss Fast Track, if there's a step change in the template requirements. We suggest that the extra information increase in line with the nature and materiality of the additional risks the scheme is taking.

6. Are there any scenarios that the proposed four templates are not suitable for?

The amount of detail required feels particularly disproportionate for some schemes – for example, well funded schemes looking to insure. We're also concerned about treating open schemes the same as schemes closed to accrual, by asking for the same information.

The templates may not suit schemes that only just fall outside Fast Track. If a scheme is close to complying with Fast Track, it will need to complete a Bespoke submission. Doing so means it might give more information than its circumstances merit. We'd suggest that such a scheme fill in extra information only linked to areas that don't meet the Fast Track requirements.

7. To what extent is the example Bespoke template a clear tool that supports trustees' long-term planning and risk management and facilitates engagement between trustees, their employer and TPR?
The example Bespoke template appears to be largely a tool to collect data for TPR, rather than the chair's statement that was initially envisaged. It's therefore likely to have a limited role as a document to support long-term planning and risk management.

8. Do you have any further comments on our general approach to the statement of strategy template?
We have an overriding concern about the amount of information needed. A lot of it seems to be excessive for what TPR needs to filter and regulate valuations. It would be helpful to know how TPR will analyse all this information and what it will do with it. For example, it's not clear why TPR needs 100 years' worth of cash flows, or how it might analyse and use this data.

The current proposals would add a lot of work to the valuation process. Trustees would need expert actuarial, investment and covenant advice to submit the information. We estimate the extra time and advice could increase the cost of a valuation by around 20% for a typical scheme.

Part 1: Funding and investment strategy

1. To what extent do you agree that the long-term objective options (buy-out, run-off, move to a superfund or alternative consolidator) capture most long-term objectives for a scheme?
We agree that these options capture most long-term objectives for a scheme, but we're unsure why the statement of strategy asks for this information. The Regulator will assess whether the low-dependency target is appropriate, regardless of the scheme's long-term objective. Moreover, this objective can change over time. A scheme running on may pivot towards insurance if it becomes attractive or circumstances change. It may be helpful to have an explicit run-on option for open schemes.

2. To what extent do you agree that the three broad categories of growth, matching and hybrid assets gives sufficient breakdown of the low dependency investment allocation?
We agree that these categories are pragmatic. However, such a simplified approach will struggle to capture more complex asset and hedging strategies. We'd expect the Regulator to give more detail or examples of what it expects to see in each category, to avoid assets being mis-categorised. In particular, we need a better description of what would fit in the 'hybrid' category.

3. To what extent do you agree that it is sensible to include all three funding bases (low dependency funding, technical provisions and buy-out)?
Schemes would need to prepare these figures, so we have no material concerns.

4. To what extent do you agree that the standard wording in the proposed statement of strategy template is adequate to outline the funding journey plan?
We think the focus should be on when and how the scheme expects to meet low-dependency funding, with the plan for getting to full funding on a technical provisions basis positioned as an interim step. In practice the two will converge.

The suggested wording explains that the recovery plan will clear a technical provisions deficit, and then investment returns will bridge the gap between technical provisions and low-dependency funding without further contributions being required. As an example, this seems reasonable.

5. To what extent do you agree that the discount rate approach options (horizon method, different rates pre-retirement and post-retirement, constant addition) include the majority of options available?
We agree these options cover the most common approaches. It might be helpful to have a dynamic discount rate option. A scheme might use this when an addition to the nominal gilts curve varies over time and is explicitly linked to returns on actual assets.

6. To what extent do you agree that the selections of gilts, swaps, inflation or other cover the main underlying yield curves used when setting technical provisions and low dependency funding basis?

The inclusion of ‘other’ suggests that all circumstances are covered.

7. In respect of the underlying yield curves, indicate the extent to which you agree with the approach proposed of providing the forward discount rate curve, or for small schemes the appropriate single rate?

It’s unclear why this data is needed and what TPR will use it for. The requirement to provide 100 years of forward rates seems excessive. It’s unclear how useful RPI or CPI curves will be, as benefit increases are likely to be more complex than simply RPI or CPI. We’d favour collecting only the derivation detail, and the single equivalent rates if needed (in line with the current approach).

8. In respect of the addition/premium to the yield curve, indicate the extent to which you agree with the approach proposed to provide the forward discount rates?

It’s not clear that TPR needs this data in this format. This approach assumes the same underlying curve (for example, gilts) for both technical provisions and low-dependency funding – sometimes the curves might be different.

9. In respect to the addition/premium to the yield curve for schemes that use a pre- and post-retirement discount rate methodology, indicate the extent to which you agree with the approach proposed of providing the appropriate single rate?

Single equivalent rates and detail on how they’ve been derived should be enough for all financials.

10. To what extent do you agree with the proposed approach to capture information on inflation and pay increase data?

The requirement to provide 100 years of forward rates is excessive. It’s unclear how useful RPI or CPI curves will be. Benefit increases are likely to be more complex than simply RPI or CPI, and these curves won’t give the Regulator any information about how caps and floors are modelled.

Pay increase assumptions could only be part of the story; promotional pay scales might also apply. For schemes closed to new members, the active population and term to retirement will be reducing the materiality of this assumption. Detail on derivation (in line with the current approach) seems more proportionate than full curves.

11. To what extent do you agree that it would be useful to provide further information on the mortality tables adopted for the mortality assumptions?

The example statement appears to ask only for life expectancies, which is straightforward but at odds with the detail requested on inflation and pay assumptions. The approach is relatively simplistic, and many schemes will adopt assumptions that vary between members.

12. On allowances for commutation, to what extent do you agree that the options provided capture the majority of approaches used?

The only nuance might be for schemes where cash is accrued as a right. These might more usefully express the assumption as a percentage of the additional lump sum available.

The valuation doesn’t necessarily require a value of the change in liabilities if no allowance is made for commutation. To supply this value, many schemes would need to value liabilities again, with an associated cost – which should be weighed against the benefit of doing so.

13. To what extent do you agree with the proposed approach of asking about how the key assumptions differ between the technical provisions and low dependency liabilities?

We agree with this approach.

[illegible] Do you have any further views or considerations on the information required for Part 1 of the statement of strategy, including any views on alternative approaches or missing data to support Part 1?
It's not clear that using the Fast Track approach results in reporting efficiencies for Part 1.

Part 2: Actuarial information

1. To what extent do you agree that it is reasonably straightforward to provide the cashflows information listed?
This data is available and produced as part of every actuarial valuation. However, cash flows aren't necessarily shared between parties. Processes will be needed to extract, collate and report the data in a standard way. Even where hedging strategies are in place, the cash flow information shared would usually be in a different format from what the statement of strategy asks for.

More generally, we question why schemes need to provide this information, especially schemes complying with Fast Track. We expect the scheme actuary's calculation of scheme duration and date of significant maturity to be sufficient for the intended purpose.

2. Is it easier to provide benefit cashflows on a low dependency basis or on a technical provisions basis?
We expect one would be as easy as the other.

3. To what extent do you agree that you would expect these cashflows to be materially different?
We expect cash flows to be similar on the low-dependency and technical provisions bases most of the time, but there are reasons they could differ materially.

Inflation assumptions may differ between the two bases – for example, because of allowances for inflation risk premiums or different approaches to allowing for pension increase caps and floors. Differences could also arise from the allowance for member options and discretionary benefits. Schemes targeting buy-out may align the low-dependency basis with buy-out funding, meaning the cash flow assumptions could differ from technical provisions.

TPR should clarify treatment of additional liabilities often applied as a 'cash flow loading' (for example, expenses, GMP equalisation, risk reserves). These liabilities can differ between the low-dependency and technical provisions bases.

4. To what extent do you agree that splitting the cashflows into the five categories listed is a reasonable approach?
This is a reasonable and typical split of cash flows, but we question why it's needed and whether it's proportionate. We suggest a split only into past and future accrual (for schemes with active members). Schemes may also have cash flows from expenses underlying an expense reserve.

5. Please provide any further considerations that you have on the actuarial data to be included in Part 2 of the statement of strategy.
We have no further comments.

6. To what extent do you agree with the removal of the requirement to provide accounting valuation and s179 valuation data from a valuation submission perspective? Details of the s179 valuation will still need to be provided via the scheme return.
We agree with this proposal and see little benefit from collecting this data.

Part 2: Recovery plan

1. To provide details about post valuation experience, we expect providing an updated estimated deficit would be best. To what extent do you agree that providing an estimated deficit is the appropriate approach?

We agree that a funding update should be available, using the same methodology as the formal valuation but updated for market conditions and known experience. However, the update is likely to be at a slightly earlier date than when the valuation is finally formally signed off.

Approximate 'roll forward' figures should be acceptable. Asset values are unlikely to be based on an audited position.

2. If providing an updated deficit, to what extent do you agree it would be straightforward to also provide the updated estimates for assets and liabilities, if we require that detail?

This would be straightforward to provide if needed.

3. Share your views on our proposed approach to collecting information on investment outperformance and post-valuation experience, including any alternative questions that should be considered.

The proposed approach seems reasonable. It should be straightforward to set out in monetary terms how the deficit (at the valuation or a later date) will be recovered from that point.

Part 2: Investment information

1. We do not envisage schemes will incur significantly more costs in providing journey plan investment risk data. To what extent do you agree with this assessment?

In isolation we broadly agree. Many schemes already calculate a value-at-risk metric based on the current strategic asset allocation, although not one based on the low-dependency investment allocation. However, as long as trustees can be pragmatic in how they calculate this metric, it should only modestly add to costs.

If a scheme has not yet set its low-dependency investment strategy or the de-risking journey to get there, it's likely to incur more cost.

The statement asks trustees to specify the strategic allocation to fixed and inflation-linked bonds of different maturities. Few trustees have considered allocations in this detail. Trustees typically set a strategic allocation to LDI but delegate the detailed decisions to the investment manager.

We don't think it is reasonable to ask trustees to set strategic allocations in so much detail. It's helpful for LDI managers to have discretion to ensure efficient hedges. Something akin to the Tier 1 asset split for PPF purposes may work better.

Part 2: Covenant information

1. To what extent do you agree that the proposed approach to submitting covenant information will work in practice for different types of multi-employer schemes?

In practice, it can be difficult to get covenant information for some types of multi-employer scheme – for example, non-segregated schemes with many employers that operate on a 'last man standing' basis. We recommend that TPR take a proportionate approach here, and we broadly agree with the suggested approach.

2. To what extent do you agree with the proposal that aggregated covenant information should cover employers that account for at least 80% of scheme liabilities?

The information should cover employers that account for a higher proportion of the scheme liabilities. We appreciate the balance of being proportionate. However, multi-employer schemes have many complexities.

For schemes with a 'last man standing' structure, we recommend aggregated covenant information for employers that account for at least 80% of non-orphaned liabilities. However, orphaned liabilities could be significant and still need to be reflected in analysing the covenant to some extent.

For schemes that don't operate on a 'last man standing' basis, there may be merit at looking at the covenant analysis on a standalone basis.

3. We expect employers to work with trustees and provide the appropriate information. To what extent do you agree that information required will be obtainable to understand the level of risk supportable by the covenant?

It's difficult to answer this question fully without the final code.

Some scheme sponsors may be unwilling or unable to readily provide enough details of their future expected cash flows. They may not have forecasts beyond the short term, and certainly not beyond five years. Forecasts rely on assumptions, and may include market-sensitive information such as the forecast free cash flow, expected shareholder returns and investment in sustainable growth.

We question whether every scheme needs a detailed calculation of the maximum level of risk the covenant can support, especially a scheme that isn't relying on the covenant to support risk anywhere near this level.

4. To what extent do you agree that the covenant information we propose to request for Bespoke and Fast Track valuation submissions is reasonable and proportionate?

We agree with the principle that Fast Track schemes should provide less covenant information than Bespoke schemes. Bespoke and Fast Track submissions alike should include details of covenant reliability periods and longevity. But we don't think the disclosure of maximum affordable contributions is necessary for a Fast Track submission.

For Bespoke schemes, TPR could consider what extra information it needs, depending on the nature and materiality of how the scheme deviates from Fast Track.

A scheme shouldn't have to give detailed covenant information once it's reached its relevant date if its assets exceed the liabilities on the low-dependency basis.