LCP's response to The Pensions Regulator (TPR) consultation on statement of strategy

16 April 2024

This document sets out LCP's response to TPR's consultation on the statement of strategy published on 5 March 2024 (the "Consultation").

Who we are

LCP is a firm of financial, actuarial, and business consultants, specialising in pensions, investment, insurance, energy, health and business analytics. We have over 1,100 people in the UK, including 160 partners and over 300 qualified actuaries.

The provision of actuarial, investment, covenant, governance, pensions administration and benefits advice, and directly related services, is our core business. About 80% of our work is advising trustees and employers on all aspects of their pension arrangements, including investment strategy. The remaining 20% relates to insurance consulting, energy, health and business analytics. LCP is authorised and regulated by the Financial Conduct Authority and is licensed by the Institute and Faculty of Actuaries in respect of a range of investment business activities.

Format and scope of our response

Rather than answering all individual questions, we have set out an executive summary of our views, including some high-level points as well as some more detailed points in certain areas. We would be happy to discuss any of these points further with TPR if helpful.

We are happy for LCP to be named as a respondent to the consultation and happy for our response to be in the public domain. We are happy for you to reference our comments in any response.

Executive summary of our views

We recognise TPR's ambition to become more data driven and the potential benefits this could have for pension schemes and their members.

We also agree with the use of standard templates as TPR proposes.

However, in our view the scope and scale of what is being proposed risks being overly onerous for many schemes. In particular, we believe the information requested is not proportionate for the current circumstances of the many schemes that are well-funded and moving towards buy-out.

We therefore ask that TPR only seek information that it expects to use in the performance of its functions, and that it only seek detailed information such as that set out in the draft statement of strategy in cases where it has material concerns.

As such, any steps to reduce the potential burden for schemes would be welcome – we include some examples in our more detailed comments below. One option which we recommend would be a substantially abbreviated template for schemes which are very well funded (eg above estimated buyout funding levels and already at a Fast Track compliant investment strategy).

Regardless of the specific information requested, we urge TPR to do the following:

- **Ensure the system used for schemes to provide this information is as easy to use and to update as possible.** Given the nature of what is being requested, in particular the tabular information such as 100-year cashflows, it will be important that this can be provided simply, for example by uploading a standard template spreadsheet, rather than requiring 100 separate items to be input manually into a database. Further, different advisers will likely need to input before trustees sign off the information. We therefore propose that it should be possible to print and check all submitted information before it is finally signed off. Ensuring it is easy to make updates, noting that the statement may need to be updated more frequently than every valuation, would also be important in limiting costs and burden.
- **Provide clear guidance on where schemes can be proportionate or pragmatic in providing the information.** We note in some situations, eg in

relation to affordability data, it would not be proportionate to analyse in detail the precise figures requested, where a simple answer of "more than X" would be sufficient. TPR should provide guidance here to help schemes understand where scope of work and costs could be limited on proportionality grounds.

To inform our response to this consultation it would have been helpful to have had sight of the new DB Funding Code and updated covenant guidance. We trust that both will be aligned to the requirements of the statement of strategy and will support trustees in completion of the requested information.

We comment below on some more specific points in relation to the actuarial, investment and covenant information requested.

As a final point covering the breadth of the statement of strategy, our preference is for a single definition of "small schemes" to improve clarity and avoid confusion. There should also be clarity on exactly which assets, or indeed members if a membership threshold is used, should be included or excluded when testing against the threshold. For example, pure DC assets or pure DC members should be excluded.

Specific comments in relation to actuarial areas

Most of the actuarial information requested should be available from calculations that will be required for the new regime, and therefore possible to provide in isolation. However, there is a significant increase in the amount of information requested versus current valuations, and hence there will be an increase in costs for schemes. In our view, TPR should only seek information that it expects to use in the performance of its functions.

One particular simplification that could be made, if TPR concludes the information is necessary at all, is in relation to the cashflows requested. Unless there is a particular regulatory need, an aggregate set of cash flows (rather than split by category, insured status etc) would be simpler to produce.

Further guidance in some areas would also be welcome, for example where TPR requests "*The proportion of the liabilities on a low dependency basis which are linked to inflation*" – this could be interpreted or calculated in several different ways.

Specific comments in relation to investment areas

Like the actuarial areas, we believe most of the investment information requested should be readily available.

We recommend TPR reviews some of the questions that are being asked to ensure it receives the information it wants. In the table below we have set out specific questions TPR may want to consider revising.

Question	Comment
Current strategic asset allocation (rows 85 – 112)	TPR has opted to use the same asset breakdown categories as those used in the scheme return, which we support. However, a tier three scheme can replace its government bond allocation with a corresponding cash allocation and interest rate and inflation rate sensitivities. As a result, in the statement of strategy such schemes will appear to have a high cash allocation (eg 50%+) that is not representative of their actual asset allocation or the level of risk these schemes are running.
Target liability hedge ratios (row 116)	We recommend clarifying in the definition whether the liability hedging figures only allow for hedging from developed markets, investment grade bonds, or whether it is permissible to also allow for proxy hedges (eg property with high grade tenants that delivers a stream of highly predictable cashflows).
The liquidity of the asset allocation (rows 121 & 122)	We recommend a third category is added for medium liquidity assets or that the illiquid

Question	Comment
	category is amended to be clear that this is anything that can't be described as highly liquid. For example, we believe it currently isn't clear which category a weekly or monthly dealt listed credit fund should be allocated.
Difficulty in meeting liquidity demands (row 124)	We believe the answer options for this question are quite broad and it may be reasonable for a large number of schemes to tick all the options (therefore reducing the value of this information to TPR).

Specific comments in relation to covenant areas

We recognise the challenges in compiling a standard template for covenant information given the wide variety of covenant structures supporting the DB schemes that TPR regulates. Clear guidance to support trustees in completing the requested information will be important and we assume that the upcoming covenant guidance will be aligned with the requirements. As an example, trustees of pension schemes sponsored by not-for-profit employers will need clear guidance about how to establish free cash flow figures.

Our main feedback on the volume of covenant data being required for the statement is that we do not see the level of covenant information being requested as reasonable or proportionate for many schemes. In particular, where a scheme is fully funded on a buy-out basis, there should be a significantly reduced data requirement to reflect the reduced level of reliance on the covenant. We do not see TPR's current proposals as risk based and we question what use will be made of the covenant information where a scheme has reached full funding on a buy-out basis.

We see some challenges in providing information for multi-employer schemes where consolidated financial information is not available or not suitably reflective of the employer covenant. Whilst in some circumstances aggregated financial information will represent a fairly accurate picture of combined employer resources, this will not always be the case and aggregating financial information may overstate cash flows and other financial metrics because it does not take account of inter-company trading and financing relationships.

In relation to quantifying employer reliability and longevity periods we welcome the option to respond on the basis of 'at least X years'. However, in our view the focus of these questions should be on identifying and seeking to mitigate risks to reliability or longevity over the period for which the scheme is required to rely on the covenant, rather than on predicting the time horizon of potential future employer distress.

There will be many situations where the reliability period is 'at least six years' and it may not be practical for many schemes to provide a figure for maximum affordable contributions over an entire reliability period. In particular, the employer is unlikely to produce forecasts beyond three years in most cases (and noting that in many cases employers will only routinely prepare one year budgets / forecasts). Further, if a scheme is not reliant on further contributions from its employer (i.e. because contributions would not foreseeably be required even after a reasonable stress event), then we would question the usefulness of providing this information to TPR. It does not appear to be a reasonable or proportionate request for well-funded schemes.

We hope these comments are helpful as you work through the responses to this consultation. Please let us know if it would help to discuss our thinking.

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About Lane Clark & Peacock LLP