



Law Society
of Scotland

Consultation Response

Consultation on the draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023

October 2022



Introduction

The Law Society of Scotland is the professional body for over 12,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied, and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders, and our membership.

Our Pensions Law Sub-Committee welcome the opportunity to respond to the Department of Work and Pensions consultation on the draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023¹.

We have the following comments to put forward for consideration:

Consultation questions

Question 1. Draft regulation 4(1)(b) provides that a scheme reaches significant maturity on the date it reaches the duration of liabilities in years specified by the Pensions Regulator's revised Defined Benefit Funding Code of Practice.

i) Do you think that it would be better for the duration of liabilities at which the scheme reaches significant maturity to be set out in the Regulations rather than the Code of Practice?

We consider it would be better for the duration of liabilities to be set out in the code of practice rather than the regulations as it will be easier for this to be revised should that be considered appropriate.

¹ [Consultation document: The draft Occupational Pension Schemes \(Funding and Investment Strategy and Amendment\) Regulations 2023 - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/the-draft-occupational-pension-schemes-funding-and-investment-strategy-and-amendment-regulations-2023)

ii) If you think that the point of significant maturity should be specified in Regulations, do you agree that a duration of 12 years is an appropriate duration at which schemes reach significant maturity?

We believe that 12 years does seem a reasonable target, however it may not be appropriate for some schemes. We have some concerns if no flexibility is envisaged.

We note that there may be schemes which are already significantly mature on the definition proposed but which are not already invested in a low-risk investment allocation or close to being fully funded on a low dependency funding basis. What flexibility will there be for these schemes? Will flexibility be included in the Code? Duration is also dependant on interest rates used, which have varied significantly over 2022 particularly in recent weeks, how will this be factored into the duration calculations?

Question 2: Do you think that the definition of low dependency investment allocation provided by draft regulation 5 is appropriate and will it be effective?

We consider that the definition seems broadly reasonable, however we believe that it needs clearer definitions of, or further guidance on, what is meant by “highly resilient” and “short term adverse changes to market conditions”. Will these be clarified in the Code? We are of the opinion and expect it will be effective, however it is impossible to say with any certainty. We question whether this definition should also include an allowance for future scheme expenses as well as the value of benefit payments?

Question 3: Do you think that the definition of low dependency funding basis provided by draft regulation 6 is appropriate and will it be effective?

We support the definition, which seems appropriate, however our support is subject to the full details of the actuarial assumptions to be used and the detail included in the Code of Practice, which we look forward to reading in due course.

Question 4:

i) Do you agree with the way that the strength of employer covenant is defined?

We support this as it seems reasonable to us.

ii) Are the matters which trustees or managers must take into account when assessing it, as provided by draft regulation 7, the right ones?

We believe they are and note that while the covenant of the wider group might be relevant, we agree that it should only be considered if support is legally enforceable.

iii) Does draft regulation 7(4)(c) effectively capture the employer's broader business prospects?

We consider that Regulation 7(4)(c) is not specific, as it refers to other factors which are to be set out in a Code. We therefore believe it is difficult to say whether they effectively capture the employer's broader business prospects, and this will depend on the content of the Code. We note that it should be acknowledged that it will always be difficult to take a long-term view of employers' business prospects.

Question 5: Does it work in practice to set a minimum requirement for the relevant date to be no later than the end of the scheme year that the scheme is estimated to reach significant maturity?

We believe it will and note however that there will be schemes which have already passed that date by the time the regulations come into force. We believe there should be some flexibility in the Regulations and Code for these schemes.

We further note that maturity will be dependent upon prevailing interest rates and will therefore vary over time. For example, maturity will have reduced considerably in recent weeks and months due to significant interest rate rises. Would this mean all schemes must now achieve full funding in a shorter period of time? What happens if rates fall again, and maturities subsequently increase?

Question 6: Does your scheme already have a long-term date and how is it calculated?

We have no comment to make.

Question 7: Where the funding and investment strategy is being reviewed out of cycle with the actuarial valuation, would it be more helpful to require it to align with the most recent actuarial report?

We agree it would be more helpful to align with the most recent actuarial report or other reliable funding update from the Scheme Actuary (e.g., based on online funding modeller). Trustees would want to refer to the most up to date funding information available.

Question 8: Do you think that these minimum requirements are sensible and will provide additional protection for the accrued pension rights of scheme members?

We consider that generally yes, however we note there is a question of how quickly schemes which are already significantly mature can be expected to reach these minimum requirements.

Question 9:

i. Should such limited additional risk at and after significant maturity be permitted, if supported by contingent assets? If so, to what percentage of total liabilities should this be limited?

We believe that this may over complicate matters. While there would be an advantage for some employers, it seems inconsistent with the rest of the Regulations. We consider that there should be some measure of flexibility introduced in the Code for those schemes that will be unable to comply with the regulations, for example those that won't be fully funded on a low-dependency basis by the time of significant maturity.

ii. What additional risks to members' benefits might be posed as a result, and what safeguards should apply to protect members?

We have no additional safeguards to suggest.

Question 10: Do you think that the provisions of paragraph 4 of Schedule 1 will allow appropriate open schemes to continue to invest in growth assets as long as that risk is appropriately supported?

We consider yes, however we note that there will be some loss of flexibility for strong employers. The approach is consistent with the overarching policy being implemented by these regulations.

Question 11: Do you think that the principles in paragraphs 4 and 5 of Schedule 1, requiring funding risks and investment risks to be linked primarily to the strength of the employer covenant, are sensible?

We think the principles are sensible.

Question 12: Do you think that the new liquidity principle set out in paragraph 6 of Schedule 1 is a sensible addition to the existing liquidity requirement of regulation 4(3) of the Occupational Pension Schemes (Investment) Regulations 2005?

We are neutral on this, as it sets out the requirement in more specific terms. However, while regulation 4(3) of the Occupational Pension Schemes (Investment) Regulations 2005 refers to the liquidity requirement in more high-level terms, it is difficult to see what it could have meant except this.

Question 13: Will the matters and principles set out in Schedule 1 enable the scheme specific funding regime to continue to apply flexibly to the circumstances of different schemes and employers, including those schemes that remain open to new members?

We consider that it will not continue to apply as flexibly. Stronger employers will not have the same flexibility to invest on a higher risk basis and weaker employers will not have the same flexibility around timescales to get to a low-risk basis.

Question 14: Is the level of detail required for the funding and investment strategy by draft regulation 12 reasonable and proportionate?

We consider this looks very vague and open to wide interpretation. Is the intention for more detail to follow in the Code? We are confused by Regulation 12(b) – would it not inevitably be “significantly mature” at the relevant date as that is how relevant date is defined? Alternatively, is this intended to mean the maturity of the scheme at the current date if not already significantly mature?

Question 15: Do you think the requirement for high level information on expected categories of investments will impact trustees’ independence in making investment decisions in the interests of scheme members?

Yes. We believe that as drafted the regulations appear to require trustees to agree the high-level investment strategy with the employer, which goes beyond the current requirement for trustees to simply consult with the employer on the investment strategy. Requiring agreement with the employer would clearly impact the trustees’ independence in this area. We assume this is unintentional and are of the opinion that the wording of the draft regulations should be revised.

Question 16: Are the requirements and timescales for determining, reviewing and revising the funding and investment strategy in draft regulation 13 realistic?

We believe that they appear to be.

Question 17: Are there any other assessments or explanations that trustees should evidence in Part 2 of the statement of strategy?

We believe that it may be appropriate for trustees to evidence the reasons that they have fallen behind their target timeframe to reach low dependency depending on the circumstances of the scheme in question.

Question 18: Do you agree that these are the appropriate requirements for the scheme trustee board when appointing a chair? Are there any other conditions that should be applied?

We believe that the specified requirements are minimal, and we consider that it would be difficult to legislate for further conditions.

Question 19: We would like to know if you think these requirements will work in practice?

Yes, we do.

Question 20: Do you consider that the matters prescribed by regulation 8(2) of the Occupational Pension Schemes (Scheme Funding) Regulations 2005 remain relevant for trustees or managers to take account of when determining or revising recovery plans? If so, why and how are they relevant to the setting of appropriate recovery plans?

We suggest that adding a further requirement that the recovery plan (for TP deficits) should be aligned with and have regard to the long-term funding target.

Question 21: Do you consider that the new affordability principle at draft regulation 20(8) should have primacy over the existing matters, if they do remain relevant?

We do not think so and we consider that the question of what is reasonably affordable is too subjective.

Question 22: Will the requirements in draft regulations 20(9) work in practice for all multi-employer pension schemes?

We have no comment to make.

Question 23: Do you agree with the information presented in the impact assessment for the funding and investment strategy?

We disagree with this, as we believe a number of assumptions about the current LTO's in use are based on one survey.

Question 24: Do you expect the level of detail required for the funding and investment strategy to increase administrative burdens significantly?

We consider that based on the draft regulations, there will be an increased burden, however we expect the additional work should be manageable by most trustee boards and we note this will be subject to the final requirements and detail set out in the Code.

Question 25: Do you agree with information presented in the impact assessment for the statement of strategy, referenced in paragraph 6.1?

We have no comment to make.

For further information, please contact:

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