A quick guide to

Code of Practice 3: Funding defined benefits

Information for employers

Our updated code of practice on funding defined benefits came into force for valuations with effective dates from 29 July 2014 onwards.

The code balances trustees' objectives to comply with their duties and ensure they pay benefits when due, with employers' objectives to grow their business while ensuring that pension promises are kept. This quick guide will help you understand the key messages in the code and how they apply to you.

Your role

Employers offer vital support for a pension scheme to pay promised benefits to its members. Our code emphasises that the best support for a well governed scheme is to have a strong ongoing employer, together with an appropriate funding plan.

We recognise that defined benefit (DB) schemes can represent significant liabilities for their employers, so you'll want to understand how the risks to the scheme are managed and how to work with the trustees to reach the most suitable funding arrangements.

Working together

Trustees and employers should engage in an open, collaborative and transparent manner.

Our code encourages trustees and employers to work together in an open and transparent way to reach feasible funding solutions. Working together will enable trustees to understand your circumstances and set appropriate investment and funding strategies. Ongoing engagement from an early point with the trustees will give you greater insight and engagement into the management of the scheme, as well as the potential risks from and benefits of the funding strategy. You will need to provide trustees and their advisers with the information they need to carry out their duties so they can make informed decisions about the running of the scheme.

Trustees should understand the potentially sensitive nature of the information you provide and any constraints on disclosure. It is important that both parties work together to find solutions to overcome any concerns, for example through confidentiality agreements or the use of sub-committees.

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Managing risks

Trustees are expected to assess the ability of the employer to address a range of likely adverse outcomes over an appropriate period.

Trustees are expected to manage the risks associated with scheme funding, scheme investments and employer covenant in an integrated way.

The code recognises it is not necessary to eliminate all risks; some risk-taking can be beneficial to both the scheme and employer. For example, by accepting an appropriate level of risk in the investment strategy, trustees may be able to improve the scheme's funding position and minimise any adverse impact on your sustainable growth plans. It is important that these risks are actively managed.

You should discuss the long-term plans for the scheme with the trustees and decide on your appetite to risk. This will inform trustees' thinking when they set investment and funding strategies that reflect your risk appetite and covenant (the extent of your legal obligation and financial ability to support the scheme now and in the future).

Trustees should have a view on the range of likely adverse outcomes which could lead to additional contributions being required, for example poor investment performance, changes in interest rates, inflation or mortality rates. They should discuss potential solutions with you so they are able to take prompt action to address these outcomes when they arise.

A balanced approach to reaching funding targets

Trustees should seek an appropriate funding outcome that reflects a reasonable balance between the need to pay promised benefits and minimising any adverse impact on your sustainable growth.

Trustees can use the flexibilities available in the funding regime to set funding strategies that are appropriately tailored to the scheme's and employer's circumstances.

The code recognises how important it is for employers to invest in their business to enable them to grow and fulfil their obligations. In turn, this should enable trustees to fulfil their key funding objective and protect members' benefits. Trustees and employers should work together to reach an appropriate funding strategy which balances the needs of both parties.

In most cases trustees can use the flexibilities in the funding regime to tailor an appropriate funding strategy which will enable you to support the scheme and invest in your business.

Where you plan to prioritise investment in your business over funding the pension scheme, trustees will need to understand the nature of your plans, and how this investment will benefit the employer covenant and in turn help you fund the required contributions to the scheme in the future.

We are not expecting trustees to be involved in your business decisions but it is important that the trustees understand your circumstances so they can best use the flexibilities in the funding regime. The degree of trustee scrutiny should be proportionate to the level and complexity of risk.

Trustees should ensure that the scheme is treated fairly alongside your other priorities and creditors. For example, trustees should explore the extent to which shareholders can share in providing support to your sustainable growth plans, when required.

The full DB code can be viewed at **www.tpr.gov.uk/code3**. You may also wish to read our essential guide to the DB code at **www.tpr.gov.uk/essential-db**.

Key messages for trustees and employers undertaking valuations in 2015

Many schemes with valuations in 2015 are likely to face higher than expected deficits due to challenging market conditions, in particular arising from a significant fall in gilt yields.

Our annual funding statement provides our views on current market conditions and guidance to trustees and employers on how they can reach a balanced outcome in their valuation in light of these prevailing conditions.

For further information you can find the full version of the annual funding statement and accompanying analysis at **www.tpr.gov.uk/statement2015**.

How to contact us

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