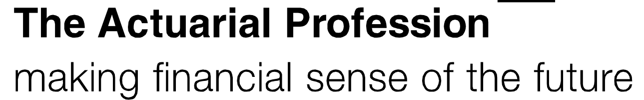

**To All Scheme Actuaries**

September 2002

Dear Scheme Actuary

**Professional Responsibilities in Volatile Markets**

Scheme Actuaries will be aware that there has been much press comment of late about the falls in world equity markets and the effect on pension schemes. Whilst the statutory certification system in place at the current time is sufficiently robust to cope with the stresses placed on it by these market conditions, the Pensions Board would like to remind Scheme Actuaries of some important technical and professional issues.

Most Scheme Actuaries will have experienced the challenges presented by volatile market conditions and such experience is invaluable in today's testing economic environment. Some Scheme Actuaries will, however, not have worked in the pre-Pensions Act regulatory regime and for them there may well be issues they are experiencing for the first time, resulting in a steeper learning curve both technically and professionally.

This letter is intended to remind Scheme Actuaries of some of the issues that need particular vigilance to ensure that the validity of the relevant actuarial certificates are considered and to assist trustees to consider the implications of events which could adversely affect the security of members' benefits. In considering the various issues, actuaries must bear in mind paragraph 3.1 of the Professional Conduct Standards (PCS):

> "In formulating advice, a member must pay proper regard to any relevant professional guidance or other guidance and, subject to that guidance, is expected to exercise best judgement".

**Regulation 30 of the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 (SI 1536)**

GN9 (Retirement Benefit Schemes – Actuarial Reports) is a Practice Standard Guidance Note. Failure to adhere to GN9 would therefore constitute a material breach of the PCS.


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Paragraph 4.7 of GN9 states:

> "Regulation 30 refers to the issue of a revised Statement during the inter-valuation period. This is not designed to require the actuary to monitor the situation continuously; however, if he or she is made aware or becomes aware of developments which materially affect the continuing validity of the latest Statement, then a revised Statement should be prepared and issued under Regulation 30."

We are aware that some actuaries may have interpreted "developments" as relating only to matters specific to that scheme e.g. a material change in the membership or significant benefit improvements. However we believe that, from a public interest perspective and a complete reading of Section 4 of GN9, such an interpretation is too narrow. For example, Regulation 30 and paragraph 4.3 of GN9 do not require the actuary to **anticipate** very significant falls in equity markets before signing the Statement. However when such falls have happened (and bond yields have also fallen) we believe that paragraph 4.7 of GN9 requires the actuary to review the situation. Our conclusion is reinforced by paragraph 3.1 of the PCS quoted above, which makes clear that guidance sets minimum standards, and above and beyond that, an actuary is expected to exercise best judgement.

The review need not necessarily cause the Statement to be revised. Some schemes, e.g. those which are particularly well funded or those which are quite immature, may well be able to continue under the existing Statement.

However others may not be able to do so. The Pensions Board regards this as very much a scheme specific issue but is clear that it is incumbent on the Scheme Actuary to consider the position for all the schemes to which he or she is appointed and to act where necessary. I do not believe that it is for the Pensions Board to prescribe how such a revision should be made. Clearly, what is appropriate is a matter for professional judgement in the circumstances of the individual scheme. The legislation allows for a qualified or a negative opinion to be given, with supporting reasons on the face of the Statement. Thus, the appropriate form of words is very much for the Scheme Actuary, taking into account the purpose of the Statement and that it is a document that is disclosable to members of the scheme.

The comments above refer to current requirements. Scheme Actuaries should, of course, be aware of their current obligations and in many cases will feel it appropriate to discuss matters with trustees. This is no doubt an area that the Government is including in their consideration of what legislation to introduce following the expected abolition of the MFR. We may well see a strengthening of the monitoring duties placed upon the profession with the move to a more scheme specific regulatory regime. Scheme Actuaries will be aware that the Board is also reviewing GN9 and is, in particular, focusing on areas that need to be strengthened in the light of the changed political and financial environment that now prevails.

**Recertification of a Schedule of Contributions**

Scheme Actuaries will be aware of the requirement to take into account prevailing market levels when they recertify Schedules of Contributions.

The Occupational Pension Schemes (Minimum Funding Requirement and Miscellaneous Amendments) Regulations 2002 (SI 380) came into effect on 19 March 2002. These amending regulations dispensed with the previous requirement for a Schedule of Contributions to be recertified on an annual basis if the scheme was not below 100% funded on the MFR basis both at the effective date of the most recent MFR valuation and at the effective date of certification of the Schedule of Contributions.

For such schemes, the falls in equity markets may have resulted in the expectation that the contribution rate detailed in the current Schedule of Contributions will not now be adequate to maintain the MFR funding level above 100% over the period of the Schedule of Contributions. This will be particularly relevant for schemes where the assets and MFR liabilities are not closely matched.

Although in these circumstances a certificate of inadequacy (which would otherwise trigger the requirement for an emergency MFR valuation or a revision to the Schedule of Contributions) is not now required, Scheme Actuaries should consider if the desirability of revisions to the Schedule of Contributions should be drawn to the attention of the trustees. The Pensions Board recognises that where a number of Scheme Actuary appointments are held, the Scheme Actuary will need to plan this work and prioritise between different cases. The Guidance Note does not set out a definitive timescale for completing a revision of an actuarial certificate. However, we would expect Scheme Actuaries to adopt a plan of review that is sensible and timely bearing in mind these important professional requirements.

Scheme Actuaries will also be aware that Regulation 12 of The Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 (SI 1536) (which requires an emergency MFR valuation in certain circumstances of new serious underfunding) is not effective until 31 December 2004 (the end of the transitional period). Scheme Actuaries should, however, consider if an early MFR valuation should be recommended to trustees.

**Certificate T**

Some issues relating to Certificate T have recently been drawn to the Board's attention. We are reviewing this as a matter of urgency and will write again on this subject as soon as possible.

**Transfer Values**

Both my two predecessors as Board Chairman have reminded Scheme Actuaries (in April 1999 and again in February this year) that Section 3 of GN11 requires the actuary to set an appropriate basis for cash equivalents which is then underpinned by MFR as a minimum.
We have again discussed this matter at the Board. We are of the view that it is increasingly difficult for an actuary of any scheme to continue to certify that cash equivalents equal to the MFR minimum satisfy the mandatory requirements of GN11. The position has, we believe, become close to untenable, largely as a result of recent market developments over the summer.

Of course, where actuaries believe that the MFR position has fallen below 100% they should consider whether it is appropriate to recommend to trustees that cash equivalents (as per GN11, as above) be scaled back in payment to more closely reflect the scheme's MFR funding

level. (We recognise that legislation is unduly inflexible in this area as it will not allow full reduction to MFR funding and we have drawn this to the attention of the Department for Work and Pensions.) It may be that a new certificate under Regulation 14 is required in order that any reduction can be made to cash equivalents. If so a new MFR valuation and Schedule of Contributions would also be required.

**Discretionary Benefits**

Where scheme's funding levels are such that certain categories of priority benefits are not funded, the actuary should consider advice to the trustees in respect of discretionary benefits such as early retirement, particularly where these give rise to additional costs and/or acceleration through the priority order.

**Money Purchase Schemes**

I would remind Scheme Actuaries who deal with money purchase schemes that such schemes are also affected by falling markets. Many professional considerations of a similar nature to those above are therefore equally applicable. Actuaries advising such schemes should consider what communication with trustees or members is appropriate. This may be particularly relevant to those money purchase schemes which target a defined level of benefit.

Pensions are much in the news at the moment. In consequence, the work of Scheme Actuaries is under scrutiny as never before. In these circumstances, it is incumbent on Scheme Actuaries to achieve the highest possible professional standards. I very much hope you will see this letter as helpful in that context.

Yours sincerely

**Ronald S Bowie**
**Chairman, Pensions Board**