

GN9 : Funding Defined Benefits - Actuarial Reports

Classification

Practice standard

MEMBERS ARE REMINDED THAT THEY MUST ALWAYS COMPLY WITH THE PROFESSIONAL CONDUCT STANDARDS (PCS) AND THAT GUIDANCE NOTES IMPOSE ADDITIONAL REQUIREMENTS UNDER SPECIFIC CIRCUMSTANCES

Application

Any Actuary responsible for preparing an actuarial report that includes advice relating to funding defined benefits where the advice is:

- a) based on actuarial methods and assumptions chosen by the actuary or agreed with the client rather than methods and assumptions set by legislative requirements, and
- b) where the report has been prepared
 - in order to satisfy legal requirements, including those imposed by the scheme's governing documents,
 - because a formal actuarial valuation report on the funding of the scheme is requested by the client, or
 - to give funding advice when a scheme is initially established.

The Guidance Note applies to, but is not limited to, reports on valuations that are required under Section 41(2)(c) of the Pensions Act 1995. Section 3 applies to Actuarial Statements required under Regulation 30(7) and Schedule 6 to the Valuation Regulations.

Paragraph 1.4 of this Guidance Note also applies to any funding recommendation that is not made in a formal actuarial valuation report. Paragraph 2.1.2 of this Guidance Note also applies to preliminary reports.

This Guidance Note does not generally apply to defined contribution schemes. However, it should be applied to such schemes (including defined contribution small self-administered schemes) if the advice given is on the contributions required to meet a particular level of benefit (other than lump sum death benefits). The principles of GN9 must be applied if the benefit levels in a scheme with fixed contribution rates are set periodically by the actuary rather than being based on individual account values.

This Guidance Note does not apply to the calculation of Inland Revenue maximum contributions to defined contribution schemes.

This Guidance Note does not apply to calculations of pension expense or directors' remuneration disclosures for employers' accounts.

Version 6.0 can be followed for valuations with effective dates before 20 March 2004. If version 6.0 is used, this should be indicated in the report.

Legislation or Authority

Pensions Act 1995, section 41(1) and (2)(c).

The Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996. SI 1996/1536. ('the Valuation Regulations')

The Occupational Pension Schemes (Disclosure of Information) Regulations 1996. SI 1996/1655. ('the Disclosure Regulations')

Northern Ireland has its own body of law relating to pensions and to family law. In relation to Northern Ireland, references to the Great Britain legislation contained in this Guidance Note should be read as including references to the corresponding Northern Ireland legislation. The Northern Ireland Regulations corresponding to the Great Britain Regulations are included in Appendix 1.

Author

Pensions Board.

Status

Approved under Due Process.

<i>Version</i>	<i>Effective from</i>
1.0	01.04.84
2.0	01.04.87
3.0	01.04.88
3.1	01.09.90
4.0	29.09.92
5.0	01.03.93
5.1	01.06.94
6.0	01.08.97
7.0	20.03.04

1 Introduction

- 1.1 The main purpose of the Guidance Note is to ensure that reports contain sufficient information to enable the expected future course of a scheme's contribution rates to be understood and also to enable the current solvency level of a scheme to be understood. The guidance is therefore intended to ensure that the methods and assumptions used are properly explained and that variations between the assumptions chosen and actual experience are analysed in the report.
- 1.2 The Guidance Note is not intended to restrict the actuary's freedom of judgement in choosing the method of valuation and the underlying assumptions employed in deriving the contributions referred to in section 2.4.9 (or commenting on their adequacy) where these are not restricted by legislative requirements.

- 1.3 In this Guidance Note references to the previous or preceding valuation or report mean the previous or preceding valuation or report of a similar nature, whether carried out by the actuary or another actuary.
- 1.4 The actuary may need to update the funding advice between formal actuarial valuations to allow for benefit augmentations or other benefit changes, or to take account of recent experience that differs from the actuarial assumptions. It is not necessary for such advice to comply with GN9, provided that the actuary confirms that the advice is consistent with the advice given in the previous formal actuarial valuation report and explains any change in valuation assumptions necessary to maintain consistency.
- 1.5 The Guidance Note continues to apply while a scheme is run as a closed fund. Where an event occurs which under a scheme's Trust Deed and Rules triggers winding-up, the actuary must consider whether it would be appropriate to advise the trustees that an actuarial valuation should be carried out. The Guidance Note continues to apply where a scheme has commenced winding-up, although in such circumstances some parts of the Guidance Note might not be applicable (see 1.6 below).
- 1.6 The actuary must confirm whether the valuation report has been prepared in accordance with GN9 current at the date the valuation report is signed. The actuary need not comply with any part of GN9 that is clearly inappropriate, but a complete explanation of all such departures must be given.
- 1.7 Although any report will be addressed to the actuary's client (normally the trustees) the actuary needs to bear in mind that the client may wish to make the report available to third parties. Any limitations on the extent to which third parties can rely on the advice must be set out in the report.

2 The Report

2.1 Introduction

- 2.1.1 The items in 2.2 to 2.6 below, except where otherwise indicated, are essential components of a report. Suitable explanations of other features may also be very important and therefore additional information may often be desirable.
- 2.1.2 Should a preliminary report be issued not including all the components listed below, in the expectation that a further and full report will be made, it must be made clear in the preliminary report that it does not conform to GN9 but that the further report will do so.
- 2.1.3 A report on a scheme subject to the Minimum Funding Requirement may incorporate the actuary's statement (prepared in accordance with Valuation Regulation 14) on that Requirement if the prescribed calculations have been made by the appointed Scheme Actuary and the report is addressed to the

trustees. Care must, however, be taken that the results of calculations with different objectives are clearly identified.

2.2 Basic Information

2.2.1 The report must make it clear to whom it is addressed, by specifying the client. The report must state the purpose for which the valuation is made and the dates as at which the current valuation and, if applicable, the immediately preceding valuation were conducted. The report must also name the actuary who carried out the previous valuation.

2.2.2 It is desirable that the report should also refer to the appropriate sections of the legal documentation of a scheme and any legislative provisions under which the valuation is being made.

2.2.3 The report must include a statement of the benefits which have been valued. This may be a summary of the terms of the scheme or a reference to appropriate documents. Reference must be made to the extent to which allowance has been made for discretionary increases in benefit (and the recent practice in granting such increases) or discretionary benefits. If the actuary has excluded from the report assets and corresponding liabilities in respect of certain benefits, such as AVCs and pensions secured by annuities, the report must note these exclusions.

2.2.4 Where there is any doubt about the benefit basis, the actuary must make clear the assumption made.

2.2.5 The report must include a summary of the membership and financial data on which the investigation is based, including a description of the assets. If audited accounts as at the date of valuation are not available, this fact must be stated. The report must state that the actuary has relied on the accuracy of the information provided by the Trustees. The actuary must take reasonable steps to satisfy himself or herself that the data provided is of adequate quality for the purpose of the valuation. If the actuary has any reason to doubt that the data is sufficiently reliable, the report must be qualified appropriately.

2.2.6 Reference must also be made to any insurance arrangements in place for the benefit of the scheme. This includes group life assurance held by the trustees.

2.2.7 In the case of a scheme in discontinuance, there must be a statement of when benefits ceased to accrue. In the case of a scheme where winding-up has commenced, the effective date of the start of the wind-up and the crystallisation date (where known) (see Regulation 4 of the Occupational Pension Schemes (Winding Up) Regulations 1996) must be stated.

2.3 Inter-valuation Period

2.3.1 The report must include a statement of the rates or amounts of contribution paid during the inter-valuation period; and also those recommended in the previous report and, where the amounts involved are material, in any

subsequent advice. The report must also include a commentary on any material developments affecting the scheme during that period, and on any significant variations in experience from the assumptions made at the previous valuation.

2.4 **Funding**

- 2.4.1 The report must state the funding objectives on which the advice referred to in section 2.4.9 has been based and must also state who set these objectives. The report must note any changes in the funding objectives since the previous report.
- 2.4.2 The implications of the funding objectives for the stability of contribution rates must be explained.
- 2.4.3 Where the scheme has more than one funding objective, in particular if the scheme is subject to the Minimum Funding Requirement, comment must be made on the difference between the objectives.
- 2.4.4 The report must contain a summary of both the demographic assumptions and economic assumptions made, explicitly or implicitly, in valuing both the liabilities or target benefits, and the assets. The summary must include assumptions such as the exercise of material options by the members. A statement must be made as to the extent to which there have been changes to the assumptions used since the previous report.
- 2.4.5 The report must explain the method employed in developing the advice referred to in paragraphs 2.4.9 and 2.4.11 below and whether and in what way future entrants have been taken into account in the valuation. A note must be made of any changes to the method set out in the previous report.
- 2.4.6 The report must draw attention to those assumptions to which the valuation results are particularly sensitive. The actuary must describe or illustrate how the results of this section (2.4) will differ if these assumptions are not borne out so that the reader may understand the sensitivity of the results to the assumptions chosen. Various different approaches to illustrating sensitivity are possible, depending on the circumstances of the scheme. In some circumstances, it will be appropriate to identify events that may give rise to significant additional funding.
- 2.4.7 The report must confirm the compatibility of the basis of valuing the assets with that of valuing the liabilities or target benefits. The actuary must comment on the sensitivity of the funding of the scheme to future investment market changes. Such comments must have particular regard to the relationship between the assets held and the form and incidence of the liabilities. Attention must also be drawn to specific risks that the actuary considers relevant, in particular currency mismatching, concentration of assets, and self-investment. If the assets include derivatives, the actuary must consider the requirements of GN25. The actuary is not required to give investment advice.

- 2.4.8 Where the funding objectives set out in 2.4.1 include a target funding level, the report must state the position of the scheme relative to that target funding level and include a reconciliation of the actuarial surplus or funding level on the basis being used for the current valuation with the position disclosed by the previous valuation. The description must be sufficient to identify the relative significance of the material items of actuarial gain or loss including changes in the valuation method and the valuation assumptions. The report should normally include some quantification of these items.
- 2.4.9 The report must recommend contributions consistent with the funding objectives for the period until the next formal actuarial valuation. The actuary may recommend different contribution rates for different groups of members, or different contribution rates payable for different intervals in the period to such a valuation. Alternatively, if contributions are determined elsewhere, e.g. in governing documentation, so that a recommendation by the actuary is inappropriate, the report must include comment on the adequacy of the rate.
- 2.4.10 The level of detail in the report must be sufficient, in the normal course of events, to determine unambiguously the contributions that should be paid without further reference to the actuary. In particular the following must be considered:
- whether AVCs are excluded from the member contribution rate,
 - whether premiums for death benefit insurance are payable in addition to a fixed contribution rate,
 - whether expense payments are payable in addition to the fixed contribution rate,
 - the definition of pensionable payroll,
 - the timing and frequency of contributions, and
 - the effective dates of any changes to the contribution rate including changes effective from the valuation date.
- 2.4.11 The report must set out the future contributions that on the stated assumptions will be required to meet the stated funding objective over the longer term.
- 2.4.12 References to contributions and contribution rates above or elsewhere in this Guidance Note are not intended to constrain the way future contributions are described.

2.5 **Minimum Funding Requirement**

- 2.5.1 In the case of a scheme subject to the Minimum Funding Requirement, the Minimum Funding Requirement funding level at the current valuation or as given in the most recent statement must be stated with appropriate explanation.

If a schedule of contributions is to be prepared, the report must make clear that the contribution payable is subject to validation when the scheme actuary certifies the schedule of contributions, and that this will depend on market conditions.

2.6 Solvency

2.6.1 The report must provide an estimate of the proportion of the accrued rights and entitlements that would have been covered by the assets of the scheme at the valuation date on the basis set out in this section (2.6). Where this is less than 100%, the actuary must quantify approximately (on this basis) the impact of the applicable priority order on different categories of benefit, had the scheme been wound up on the valuation date. Where the previous valuation complied with this requirement, the actuary must include the figures from the previous valuation in the report.

2.6.2 For this purpose, the assets of the scheme must be taken at not more than market value, and the accrued rights and entitlements valued as described in 2.6.3, 2.6.4 and 2.6.5 below.

2.6.3 If the cost of buying out the benefits at the valuation date with a suitable insurance company is available, the actuary may use the buy-out cost as the value of the accrued rights and entitlements.

2.6.4 Where buy-out cost is not used, the actuary must use those principles likely to be adopted by insurance companies for determining such a cost. These principles must be used irrespective of whether there is adequate market capacity available at the valuation date. The cost may be estimated using parameters provided by an insurance company as a proxy for the buy-out cost to the extent that the actuary considers this appropriate to the circumstances of the scheme. Alternatively, the actuary may use the following principles:

2.6.4.1 Benefit payments must be projected using a prudent allowance for mortality improvement.

2.6.4.2 The actuary must take account of the market terms of financial instruments of high credit quality (overall risk no higher than UK AAA rated debt or comparable credit quality level for benefits denominated in currencies other than sterling) that insurance companies would invest in to obtain as close a match as possible to the accrued rights and entitlements.

2.6.4.3 The actuary must include in the valuation of accrued rights and entitlements prudent reserves for the risk that the benefits will not be met by the investments and must also reserve for the risks arising from the extent to which it will not be possible for the accrued rights and entitlements to be matched precisely. The actuary must explain the reserves made. In all cases, the additional reserves must be positive.

2.6.4.4 The actuary must disclose those risks for which he or she has reserved.

- 2.6.4.5 Where the actuary considers that detailed analysis of the risk reserves (as described in 2.6.4.3 above) is not appropriate, it would be acceptable to determine the discount rate as the long-term gilt yield less at least 0.5% per annum. Where this approach is used, the report must note that this estimate is a guide, that market changes both in interest rates and demand and supply for this type of business means that no one estimate can be relied on, and that ultimately, the actual true position can only be established by completing a buy-out.
- 2.6.5 The actuary must include a realistic allowance for expenses.
- 2.6.6 The actuary must note whether the contributions referred to in 2.4.9 are expected to maintain (or increase) the overall proportion of accrued rights and entitlements covered by the assets (as referred to in 2.6.1). The actuary must state the assumptions used in making this assessment.

3 The Actuarial Statement

- 3.1 This section relates only to the Actuarial Statement required under regulation 30(7) and Schedule 6 to the Valuation Regulations.
- 3.2 A Statement will normally accompany a formal valuation to which the earlier parts of this Guidance Note apply. A revised statement can, however, be issued at any time.
- 3.3 The contributions shown in the Statement must include the longer term contributions referred to in section 2.4.11. The level of detail in the Statement must be sufficient, in the normal course of events, to determine unambiguously the minimum contributions due without further reference to the actuary (see 2.4.10). For some types of contribution, it is sufficient to say they are payable in addition to the contribution rate specified, provided that the amount of these contributions does not affect the validity of the statement.
- 3.4 Section 1 of the Statement requires an opinion from the actuary on the adequacy of the resources of a scheme 'in the normal course of events'. In interpreting this expression, the actuary must take a prudent view of the future without taking into account every conceivable unfavourable development. The actuary should regard this as excluding the possibilities of events - including those external to a scheme - which cannot reasonably be expected to have been allowed for in a conservative approach to the matter.
- 3.5 The actuary will not generally need to give a negative opinion provided that the contributions specified reflect those recommended in 2.4.9 and 2.4.11 above. The opinion may be 'qualified' by identifying conditions under which it would become invalid. The actuary may give a qualified opinion if, in his or her view, this opinion provides greater clarity to scheme members about the financial condition of the scheme. If a positive opinion has not been given, the actuary must ensure that the Statement contains sufficient further information to explain why it has not been given.

- 3.6 The opinion provided in Section 1 of a Statement accompanying a formal valuation must be based on the position at the valuation date. Any revised Statement must be based on the position at the date the Statement is signed.
- 3.7 For the purpose of Section 2 of the Statement, use may be made of the names of commonly used valuation methods as defined in GN26. It is sufficient to describe the key funding assumptions; these are not necessarily limited to the financial assumptions. Readers must be referred to the latest valuation report for fuller details.
- 3.8 If the Statement has been based on information that the actuary considers may be unreliable and the actuary considers this could be material, mention must be made of the actuary's reservations. Particular reference must be made if the Statement is not based on audited accounts.
- 3.9 Regulation 30 refers to the issue of a revised Statement during the inter-valuation period. An unqualified Statement must be revised whenever the actuary is made aware or becomes aware of developments that in his or her opinion are likely to mean that, if a new valuation were to be carried out, the contributions shown in Section 1 of the accompanying Statement would be materially higher than those in the current Statement. If the Statement is qualified to identify any conditions under which the opinion in the Statement will become invalid, the actuary need not revise the Statement if those conditions subsequently arise.

Appendix 1:

Northern Ireland Legislation

GB Provision

Pensions Act 1995 (c.26)

Section 41(1) and (2)(c)

Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 SI 1996/1536

Occupational Pension Schemes (Disclosure of Information) Regulations 1996 SI 1996/1655

NI Provision

Pensions (Northern Ireland) Order 1995 (SI 1995/3213 (NI 22))

Article 41(1) and (2)(c)

Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations (Northern Ireland) 1996 (SR 1996 No 570)

Occupational Pension Schemes (Disclosure of Information) Regulations (Northern Ireland) 1997 (SR 1997 No 98)