Tim Illston

Legal Issues on Funding

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Topics

- Who has the power?
- Are scheme rules relevant anymore?
- What is the role of the of actuary?
- What is the right process?
- TPR's role?

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Who has the power?

- Trustees in the driving seat
- The building blocks
  - technical provisions*
  - sufficient and appropriate assets
  - statement of funding principles*
  - valuations (including estimate of solvency)
  - recovery plan*
  - schedule of contributions*
- Agreement of employer needed*
- Some exceptions

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What does the actuary have to do?

- Trustees have to obtain the advice of the actuary on
  - methods and assumptions
  - SFP
  - recovery plan
  - schedule of contributions
- "Comprehensible advice"
- Compliance review
- The actuary has to certify the calculations of the TPs and the schedule of contributions

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Actuary's certificates

- Certificate that TPs comply with regulations and method and assumptions in the SFP
- Certificate that contributions (a) such that SFO will be met at end of recovery period and (b) consistent with SFP
- What if significant changes in assets values/TPs?
- Don't forget whistle-blowing duties
- Ongoing role to alert trustees to changes?

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How is this working in practice (TPs)?

- What is prudent?
- Actuaries standing back to allow trustees to decide
- In-depth consideration of mortality (including group characteristics) and discount rates
- Future changes must be justified by change of circumstances
- What does the Regulator say or the PPF do?
- What's your recommendation?
- Two stages : TPs and then recovery plan

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How is this working in practice (recovery plans)?

- What is appropriate (having report to nature and circumstances of the scheme)?
- Risk/liquidity/age profile/asset:liability structure
- Average remaining working lives vs 10 years
- What can the employer reasonably afford?
- Request for covenant information/willingness to support
- Contingent assets

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Employer push-back

- Nothing wrong with current funding basis
- Confidence in equity out-performance
- Strength of covenant
- Cashflow requirements/investment in the business (back-end loading)
- "Trapped surplus"
- Contingent assets
- Positive dialogue?

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Who has the power?

- Position changes depending on scheme rules
  - actuary determines contribution rates
  - trustees determine contribution rates in accordance with actuary's advice
  - trustees determine contribution rates

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Actuary determines contribution rates

- Trustees still drive process with employer agreement
- Actuary has to certify contributions not less than rates he would have provided if he had responsibility for the schedule, the SFP and any recovery plan

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Trustees on advice of actuary

- If rules say contributions determined by trustees in accordance with actuary's advice, they must take account of recommendations of actuary on TPs and recovery plan

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Trustees determine contribution rates

- Duty to consult with employer rather than get agreement

But

- Does not apply if employer can reduce or suspend contributions
- May only apply in circumstances where prescribed conditions exist

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Regulator

- Recovery plan, schedule of contributions and valuation summary sent to TPR within a reasonable period
- Failure to agree
- Powers
  - modify future accrual
  - give directions on manner of calculation of TPs and recovery period
  - impose schedule of contributions

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Practical points

- Disregard transfers until transfer payment made
- Exclude section 75 debts if unlikely to be recovered without disproportionate cost or within a reasonable time
- Schedule must include all contributions payable to the scheme except voluntary contributions
- Schedule also includes payment dates and separate deficit and future service contributions
- Expenses met direct by employers

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Practical points

- Schedule must be signed by the trustees and the employer
- GN49 is incorporated into the regulations
- Employer covenant analysis may need external advisers

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Practical points

- Sectionalised schemes
- Multi-employer schemes : who is the employer nominated to act as representative?
- Frozen or paid-up schemes

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Are scheme rules relevant anymore?

- Allocation of powers under regulations
- Funding objectives in scheme rules or adopted by trustees are included in SFP eg. “secure the benefits”, “maintain solvency of the scheme”
- Is Part 3 of the PA04 a complete code <u>or</u> is it, like MFR, supplementary to scheme rules?
- Baroness Hollis : no intention to override existing rules if that would dilute trustees’ powers

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British Vita case

- Trustees determine contributions to maintain benefits
- Gilts-matching led to £50m demand
- Court held
  - no conflict between Part 3 and scheme rules, so no statutory override
  - trustees free to make demand above statutory level

  <u>But</u>
  - going to appeal
  - limited to case where a statutory schedule of contributions not yet in place

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The process

- Resolving conflicts
  - Regulator's approach
  - how trustees are dealing with this in practice
- QC advice
  - abstention, resignation etc
  - confidential company information
- Actuary's potential conflict of duty

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Headlines

- Trustees rising to the challenge/managing conflicts
- Employers fighting TPs and then recovery period
- Actuaries' role still being worked through
- Watch out for
  - relevance of scheme rules
  - British Vita
  - mechanical pitfalls
- Can the rules be changed?

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