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Current Issues in Pensions

Scheme Funding

Agenda


- The Scheme Funding Requirements
 - Timing and transition
- Funding and the Pension Protection Fund
- Funding, debt and statutory priority order
- Funding and closed schemes



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The Scheme Funding Requirements

- Statutory funding objective
- Statement of funding principles
- Certification of technical provisions
- Recovery Plan
- Schedule of contributions
- Consultation and agreement with employer
- Requirement to consult actuary
- Powers of regulator

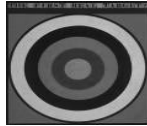


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The Scheme Funding Requirements

The Statutory Funding Objective

- What is the SFO?
 - A funding target shaped by government policy on security and the need to satisfy a European Directive
- What is the funding target?
 - Technical provisions
 - Member's accrued rights
 - Regulator's Code of Practice



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The Scheme Funding Requirements

The Statement of Funding Principles

- What is the SFP?
 - Trustees' policy to ensure the statutory funding objective is met ...
 - ... and other matters prescribed in regulation
- The SFP must record decisions made by the trustees on
 - How the technical provisions are calculated
 - How any deficit will be met

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The Scheme Funding Requirements

Actuarial valuations

- Valuations required every year ...
 - ... or every three years if 'actuarial reports' are prepared annually.
- Actuarial valuation:
 - report on value of assets and technical provisions
- Actuarial report:
 - report on matters that have affected technical provisions since previous valuation

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The Scheme Funding Requirements

Certification of technical provisions

- What is the certificate?
 - It is a requirement of the European Directive
- What is involved?
 - The actuary must certify the calculation of the scheme's technical provisions
- What about the trustees' statement of funding principles?

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The Scheme Funding Requirements

Recovery Plan

- What is the Recovery Plan?
 - It is needed if the Statutory Funding Objective is not met.
 - It sets out what will be done to meet the SFO
- What is involved?
 - Recovery plan must be 'appropriate to the nature and circumstances of the scheme' ...
 - ... but take into account prescribed matters.
 - Copy must be sent to Regulator



The Scheme Funding Requirements

Schedule of Contributions

- What is the Schedule of Contributions?
 - Sets out contributions paid to the scheme by or on behalf of active members
 - Likely to be managed in similar way for MFR Schedule of Contributions
 - Actuary must certify that
 - Schedule consistent with statement of funding principles
 - Rates adequate to ensure SFO met by end of recovery plan period

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The Scheme Funding Requirements

Agreement with employer

- Trustees must get agreement from employer on:
 - Methods and assumptions for calculating technical provisions
 - Anything in Statement of Funding Principles
 - The recovery plan
 - Anything in the schedule of contributions
- Exceptions
 - Intention is not to reduce existing Trustee powers
 - e.g. power to set contribution

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The Scheme Funding Requirements

Advice of actuary

- Trustees must get advice from actuary on:
 - Methods and assumptions for calculating technical provisions
 - The Statement of Funding Principles
 - The recovery plan
 - The schedule of contributions
 - Modifying scheme for future accruals
- Actuary will have to take account of professional guidance
 - Guidance being drafted
 - Likely to cover matters that will also be subject to Regulator's Codes of Practice

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The Scheme Funding Requirements

Role of Regulator

- Regulator can
 - Modify future benefit accruals
 - Direct how technical provisions are calculated
 - Direct the content of the recovery plan
 - Impose a schedule of contributions
- Will only act 'proportionately'



The Scheme Funding Requirements

Timing and transition (1)

- Valuations on or after 23 September 2005
- Effective dates no more than 3 years apart
- 15 months from effective date for completion
 - Statement of funding principles
 - Valuation report
 - Schedule of contributions
 - Recovery plan

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The Scheme Funding Requirements

Timing and transition (2)

- Valuation date before 23 September 2005
- Existing legislation will apply until first valuation post 23/9/05
- MFR failure triggers valuation under new regime
- Valuation dates after 1 April 2005?

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The Scheme Funding Requirements

Action Plan

- Code of practice recommendation
- 3 months before effective date
 - Consider timetable to completion
- By 5 months after effective date
 - Aim to calculate technical provisions
 - Trustees monitor progress and prompt for action
- Within 15 months of effective date
 - Complete process

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Funding and the PPF

Does the SFO provide security?

- Security for whom?
 - Regulator responsible for good scheme management and for Pension Protection Fund
- Most employees' benefits are secured to a considerable extent by PPF
- Employees achieve extra retirement security for each additional year their scheme remains open ...
 - ... but each additional year of accrual could eventually impose extra costs on the PPF

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Funding and the PPF

The functional view:

- Valuations will have to be carried out to determine levy
- Funding to the PPF basis will minimise the levy

The dis-functional view:

- Why fund at all if there's a PPF?

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Funding and the PPF

The functional view

- The PPF will require regular valuations
- Basis yet to be prescribed
 - Buy out?
 - Corporate bonds?
 - Accrued liabilities?
 - PPF liabilities?
- Funding to this standard should minimise levy

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Funding and the PPF

The functional view

- Funds with insolvent employers will be assessed by PPF for eligibility
- Criteria yet to be prescribed
- If rejected, but cannot then buy out PPF benefits, can reapply
 - ⇒ Buy out basis

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Funding and the PPF

The dis-functional view



- Employer game plan
 - Persistently under-fund scheme with generous benefits
 - Live with levy; flirt with insolvency
- Employee outcome
 - Just so long as employer survives, get good benefits;
 - Once employer gone, get scaled down but still reasonable, benefits
- Success criterion
 - Depends on how cost of levy compares to buy-out cost of scheme benefits

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Funding, debt and priority orders

June 11, 2003

- Employer liability clarified:
 - Full buy out cost applied to all accrued liabilities
 - Statutory priority orders principally matter to schemes with insolvent employers

April 6, 2005

- Government priority clarified
 - Protection of PPF is key

Summer 2005

- Partial debt to be clarified

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Funding, debt and priority orders

Purpose of funding is to meet liabilities:

- Ultimate target now full buy out of leaver benefits
- Uncertainties are:
 - Pace of funding
 - Controlled by basis and/or spreading
 - Content of SFP
 - Riskiness of assets
 - Content of SIP

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Funding and closed schemes

Solvent employer

- Timing of debt payment closer
- Employer no longer gaining economic benefit from scheme:
 - More scope for conflict of interest
 - Trustees need to apply more pressure
- Trustee dilemma:
 - Run whole scheme on?
 - Buy out part of the benefits?

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Funding and closed schemes

Insolvent employer

- Apply to PPF post 6 April 2005
- During assessment period
 - No transfers paid
 - Benefits may be reduced
 - Stop wind up process
- Scheme rescue possible?

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Conclusion

Regulation -

- European Directive
- Pensions Act 2004 and regulations
- Regulator's code of practice and guidance
- Professional guidance

Timing

- Effective from 23 September 2005
 - After - use new regime
 - Before - use MFR, might have choice
- Transitional arrangements

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Conclusion

Some high level principles

- Trustees to determine SFO on basis of
 - Actuarial advice
 - Relevant codes of practice
 - Agreement with employer
- Actuary's role is advisory
- New regime clarifies responsibilities

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Discussion

▪ Group 1

What factors should an actuary guide the trustees to consider in deciding on the actuarial methods and assumptions to be included within the Statement of Funding Principles that will determine the technical provisions?

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Discussion

- Group 1

How would you determine the value of an employer covenant and build it into financial modelling? How could this be used to inform discussion at Table 1

Discussion

- Group 2

How frequently do you think references to the Regulator will arise and can you identify such circumstances?

Hint: assume the Regulator will view its role here as one of last resort with trustees and employers having previously exhausted extensive discussions/negotiations on options.

Discussion

- Group 2

How should the PPF set its risk based levy? In particular, how should it be adapted in different employer covenant and investment risk situations?

Discussion

- Group 3 & 4

What factors should be taken into account in advising trustees and employers on the length of a recovery period?

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Discussion

- Group 3 & 4

What would you expect to see included in a statement of funding principles?

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