The Pensions Regulator

Scheme Funding

Fraser Low

9 November 2005

Scheme Funding

Part 3 of PA 2004

Secondary legislation in the form of Regulations

Regulator guidance in the form of a code of practice and sample documents

Regulator's use of powers

The Pensions Regulator

Key Elements

- Statutory funding objective
  - technical provisions
- Statement of Funding Principles
- Regular actuarial valuations
  - actuarial reports in between
- Recovery plan if there's a shortfall
- Schedule of Contributions (SoC)
- Modify future accrual

The Pensions Regulator

Actuarial Certification

- Calculation of technical provisions
  - not covering prudence
  - in accordance with Regulations under S222
- Adequacy of SoC
  - but not requiring calculations as at certification date

Regulator's powers

- Modify future accrual
- Direct how technical provisions are calculated
- Direct how shortfall is eliminated
- Impose a SoC

Schemes included

- All occupational pension schemes except
  - purely money purchase schemes
  - prescribed exemptions
- May be exemptions from any provisions of Part 3

HEALTH WARNING

The Regulations and the Code have not yet been finalised. Whilst this presentation is based on the position as currently known it may be subject to change.

Main special cases

- Shared cost schemes
- Multi-employer schemes
- Cross-border schemes
- Schemes where trustees or actuary has power to set contributions rate
- Schemes having fewer than 100 members
- Schemes in wind-up

Shared cost schemes

When there is a shortfall at the valuation

- trustees are given the power to modify the scheme such that the shortfall is eliminated through either:
  - additional member and employer contributions in the usual proportions, or
  - if the employer agrees, additional member and employer contributions but with the employer paying more than his usual share

Multi-employer schemes

- Segregated sections are to be treated as separate schemes
- In an unsegregated scheme, agreement must be reached with all employers unless rules or employers nominate a representative
- In the absence of a nomination, an employer may waive his right to agree except for the modification of future accrual

The Pensions Regulator

Cross-border schemes

- Annual actuarial valuations
- 12 month time limit (rather than 15)
- No recovery plans
- Shortfalls made up within 2 years of ED
- (And impact of host country social & labour laws and relevant assumptions)

The Pensions Regulator

Trustees set the contribution rate

- Consult the employer (except for modifications)
- May be within a limit, in which case agreement needed to exceed limit

The Pensions Regulator

Actuary sets the contribution rate

- Applies to anyone other than trustees and employer (usually the actuary)
- Trustees and Regulator must take account of that other person's recommendation when deciding on method, assumptions or recovery plan
- Actuary can only certify SoC if rate is at least his/her recommendation

Fewer than 100 members

- At all times throughout the period
- Do triennial valuations without the need for intervening reports and hence may issue summary funding statements after valuation only

Schemes in wind-up

- Part 3 won't apply if wind-up already in progress when it comes into force
- Limited application of Part 3 to wind-ups beginning on or after its commencement
  - Annual solvency valuations if membership exceeds 99 at previous year end

The consultation this spring

- Covered Regulations, Code of Practice and Guidance
- Ended in early May but followed by consultation events in Glasgow, Leeds, Bristol and London
- Over 50 written submissions

The Pensions Regulator

The main issues raised

The Regulations

- Liabilities matched by annuity policies
- Content of actuarial reports
- Certification of the schedule
- Actuary setting contribution rate
- Solvency

The Pensions Regulator

The code, guidance and sample documents

- Overall approach
- Prudence and technical provisions
- The employer's covenant and reaching agreement
- Recovery plans
- Reporting to the Regulator/ members

The Pensions Regulator

Overall approach

Summary of responses:

- Generally well written
- Too long, some repetition
- Stick to principles in code
- High level of trustee knowledge assumed
- Trying to educate

Overall approach

What we have done:

- Cut out “educational” material
- Had difficulty with principles because of need to provide “practical guidance”
- Code only – no supplementary guidance
- Specimen documents on website
- Improved focus and signposting
- Clarified some messages

Prudence and technical provisions

Summary of responses:

- Some wanted prudence defining
- Some thought message too risk averse implying little short of solvency
- Could employer covenant be a factor?
- Concentration should be on overall prudence of basis

Prudence and technical provisions

What we've done:

- Accepted much of the criticism
- Technical provisions don't have to be full buy-out
- An allowance for equity out performance may be prudent if employer can stand shocks

The Pensions Regulator

Prudence and technical provisions (continued)

- A margin is not required on top of prudence
- Overall prudence of technical provisions at an appropriate confidence level should be aim
- Select individual assumptions appropriately
- Mortality is different

The Pensions Regulator

Employer's covenant and reaching agreement

Summary of responses:

- Trustees should be able to require employer to provide information
- Too much reliance on accountants
- Concern over confidentiality agreements
- Role for trade unions?
- More needed on conflicts of duty/ interest

The Pensions Regulator

Employer's covenant and reaching agreement

What we've done:

- Accepted that Administration Regulations place obligation on employer to provide information
- Range of sources of advice and information about employer's financial strength
- Not proper for trades unions to be involved in Part 3 negotiations
- Code addresses conflict issues

The Pensions Regulator

Recovery Plan

Summary of responses:

- Guidance generally helpful though some thought too prescriptive
- Some thought employer's business plans should be a factor
- May thought the messages over speed of recovery plan were ambiguous
- Many argued that contingent security could justify a longer period

The Pensions Regulator

Recovery Plans

What we've done:

- Shortfalls should be eliminated as quickly as employer can reasonably afford
- Trustees should take account of business plans and contingent security provided

The Pensions Regulator

Reporting

Summary of responses:

- Five working days can be too tight, particularly for report to members

What we've done:

- Moved to ten working days for reports to Regulator
- And one month for reports to members
- Emphasised that urgent reports can be flagged by telephone and sent as soon as reasonably practicable

The Pensions Regulator

Miscellaneous

Summary of responses:

- Guidance on actuarial advice to the employer not helpful
- Little experience of mediation but unlikely to be of significant value
- Discussions about peer review of actuary's advice not welcomed by all

The Pensions Regulator

Miscellaneous

What we've done:

- Trustees should discuss in advance the provision of advice to employers
- Accepted some criticisms around mediation and tweaked messages
- Retained peer review section but are stressing appropriateness to schemes and that discussion might take place on appointment

The Pensions Regulator

Implementation

- ED of first Part 3 valuation no more than 3 years after that of last MFV
- Newly established schemes, ED within one year
- Scheme not previously subject to MFR, ED no later than 29/12/06

The Pensions Regulator

Timings

- Regulations expected to be in force by 30 December but effectively back-dated to 22 September
- Code to be laid before Parliament about same time
- Regulator consultation document on how it intends to regulate Part 3 expected end of October

The Pensions Regulator

The Pensions Regulator

Any questions?