Scheme Funding

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This presentation

- Not a comprehensive overview of the legislation or the code of practice
- Aspects of particular interest to actuaries
- The forthcoming Regulator's "Statement"

The new regime

Part 3 of the Pensions Act 2004

The scheme funding regulations (SI 2005/3377)

The Regulator's code of practice

Other Regulator guidance

The Regulator's approach

Special cases

- Shared cost schemes
- Multi-employer schemes
- Cross-border schemes
- Regulatory own funds schemes
- Schemes having fewer than 100 members
- Schemes in wind-up
- Schemes where trustees or actuary set the contributions rate

Trustees set the contribution rate

- Consult the employer (except for modifications, where agreement still needed)
- May be subject to conditions, in which case agreement needed where conditions not satisfied

Contribution rate set by or in accordance with the advice of another person

- Applies to anyone other than trustees and employer (eg, the actuary)
- Trustees (and Regulator) must take account of that other person's recommendation when deciding on method, assumptions and recovery plan
- If it's the actuary, he/she can only certify SoC if contributions are no lower than if he/she had the responsibility under Part 3 for SFP, RP and SoC.

Schemes in wind-up

- Part 3 won't apply if wind-up was already in progress on 30 December 2005
- Where wind up begins on or after 30 December 2005, the trustees must obtain a solvency valuation every scheme year following the one in which wind up began

The Code of Practice

Code only – no supplementary guidance, but

We have provided some examples of the funding documents including:

- Statement of funding principles
- Recovery plan
- Schedule of contributions
- Summary funding statement

We've also provided a flow chart to help with the transition from MFR to Part 3

Key issues for actuaries

- The solvency calculation
- Advice around the actuarial method
- Advice around the assumptions for technical provisions
- Advice around recovery plans
- Certification of the schedule of contributions
- The "actuarial report"
- Input to the SFS
- Revisions to a SoC

Solvency

- Estimate of buy out, or
- Where actuary considers it is not practicable to make such an estimate, “in such manner as the actuary considers appropriate in the circumstances of the case”

Actuarial method

- Accrued benefits funding method
- For a company, it seems largely one of philosophy; which generation of shareholders should be paying for the pension consequences of the employer’s pay awards?

Assumptions

- Starting point
- How to provide illustrations of risk so that trustees can make appropriately prudent choices
- What to say about mortality
- The code accepts that the emphasis for trustees should be on the overall level of prudence of the technical provisions

Recovery plans

- Recovery plans have to be “appropriate”
- Assumptions as to asset return during a recovery period might differ from those underlying the technical provisions themselves (but must be included in the SFP)

Certifying the SoC

- Unlike MFR, no requirement for estimate of funding position at date of certification
- Five different forms of certificate are provided for

The actuarial report

- Developments affecting the technical provisions
- Assessment of changes in the value of assets
- Trustees will usually expect some quantification but it’s not mandatory

Input to summary funding statement

- An explanation of changes in the funding position must be included. Actuaries should consider preparing their valuation reports and actuarial reports with this requirement in mind

Revisions to a SoC

- The actuary should explain the implications of the two basic forms of certificate as applicable to a revised schedule and whether some supporting calculations at the certification date are required

Consultation document

Purpose of statement:

Transparency: explains how we will regulate funding of defined benefits

Human rights: explains when we may intervene and how we will use our powers

Furthers our aims of protecting members' benefits and reducing calls on the PPF

Consultation document

Underlying principles:

- protecting members
- scheme specific
- risk based
- proportionate
- preventative
- practicable
- referee not player

What people said - principles

- Need to encourage continued pension provision
- Questioned whether regulator can avoid becoming a "player"

Triggers: technical provisions

- Range from 70% to 80% of full buy-out (based on evidence of where section 179 and FRS17 lie for typical schemes)
- Section 179 valuation of PPF benefits for the actual scheme
- FRS17 valuation for the actual scheme

Triggers: recovery plans

Proposal to consider intervention if:

Recovery period > 10 years

Strong employer

Significant back end loading

Triggers

- Help us to make an initial decision on whether closer investigation may be necessary
- Are only one way in which schemes may come to our attention
- Will not necessarily result in intervention
- Are not a replacement for trustees calculating an appropriate funding level based on prudent actuarial assumptions

What people said – trigger approach

- Need for filters was widely accepted
- Triggers may become targets
- Lack of clarity around the triggers
- Suggestion for triggers to be more directly related to prudent assumptions

What people said – trigger approach

- Triggers should reflect scheme specific matters, particularly:
  - scheme maturity
  - sponsor strength
  - and allow for equity exposure
- Triggers are there to manage workload; it's the judgments that count

What people said – technical provisions triggers

- Benchmarks received mixed reception
- Some advocated having a single trigger of the section 179 valuation of PPF benefits
- Others criticised s179 as valuing the wrong benefits and being purely gilt based
- Some criticised FRS17 as being purely bond based and an employer accounting measure
- Many criticised buy-out as an unreliable standard on which to base triggers
- Some considered the 70% buy-out to be too high for immature schemes with strong employers
- Some expressed concern over creating surplus which is difficult to recover

What people said – recovery plan triggers

- Many thought 10 year trigger too short
- Some considered it was reasonable as long as it is only a trigger
- Views differed over whether strong employers should have shorter or longer time to pay off a deficit

Other issues raised in consultation responses

- Inappropriate investment policy should be recognised as major risk
- Welcomed recognition that contingent security may have a part to play
- Called for more detail on the regulatory response – especially after agreement has been reached

Statement

- Expected late April or early May
- One message we can give in advance:

  Any triggers we do adopt are not to be seen as trustee targets

Any questions?

Break out tasks

1) You decide it is not practicable to estimate annuity costs for the solvency estimate. What principles would you apply when making your alternative estimate in the case of:
   - a scheme which you believe to be too large for the available market?
   - a scheme not covered by the description above but your firm has no recent first hand knowledge of the available market and no rules of thumb are available?

Breakout tasks continued

2. The trustees have asked you for guidance on prudent assumptions for a) mortality and b) asset return in calculating technical provisions. What advice would you give and how would you illustrate risk? Note any differences between large and small schemes and strong and weak employers.