



# The role of the scheme actuary in scheme funding – with a case study where the actuary is in the hot seat!

**Robert West**

Partner

**Mark Solomon**

Senior Associate

**9 September 2015**

# Setting the scene

- The legislative background
- The significance of scheme rules
  - in the context of the legislation
  - as stand-alone provisions

# The policy intention behind scheme specific funding

- Introduced under Pensions Act 2004
  - replaced the Minimum Funding Requirement
- DWP's stated intention in 2005:
  - to “allow schemes the flexibility to take account of circumstances specific to their scheme... when determining their detailed funding strategy”
  - for the “trustees, having taken actuarial advice, to agree a prudent funding strategy with the sponsoring employer”
- However, it was recognised that not all scheme contribution rules were the same
  - some prescribe differing roles for the trustees, sponsoring employer and actuary
  - some prescribe a funding basis or standard

# Recognition of the different roles of the trustees, employer and actuary under scheme rules

- In general: the trustees make determinations under scheme specific funding, subject to sponsoring employer consent
- However, Baroness Hollis (junior Minister at the DWP) in the House of Lords recognised the variations:
  - “We are aware that a requirement to seek the agreement of the sponsoring employer raises particular issues for schemes in which the rules of the scheme give the trustees or scheme actuary the responsibility for determining the level of contributions payable to the scheme”
  - “We therefore propose to modify the new provision... to provide that when rules of the scheme provide for the trustees or scheme actuary to set the contribution rate, that arrangement may continue.”

# Overview of the statutory process

- Pensions Act 2004 (Sections 221 to 232)
  - The Occupational Pension Schemes (Scheme Funding) Regulations 2005 (SI 2005/3377)
- The overriding requirement in order to meet the Statutory Funding Objective: “sufficient and appropriate assets to cover its technical provisions” (s.222)
- Trustees must
  - prepare Statement of Funding Principles (s.223)
  - obtain periodic actuarial valuations (s.224)
  - prepare Recovery Plan where appropriate (s.226)
  - prepare Schedule of Contributions (s.227)

# The Regulator's powers to intervene in valuations

- Powers to impose penalties on trustees who have not taken all reasonable steps to comply with scheme specific requirements and timescales (s. 227 (8))
- Encouragement to reach consensus
  - skilled person's report
  - alternative dispute resolution
- Imposing a scheme specific valuation (s. 231)
  - standard procedure for non-urgent cases
  - requires determination by Determinations Panel

# The role of the employer

- Agreement of the employer is generally required to
  - methods and assumptions used in calculating “technical provisions” (s.222(4))
  - Statement of Funding Principles (s.223)
  - Recovery Plan (s.226)
  - Schedule of Contributions (s.227)
- But the employer’s agreement is not required where scheme rules provide that
  - employer’s contribution rate is determined by the trustees without the employer’s agreement and
  - employer cannot reduce or suspend contributions (paragraph 9, Schedule 2)
- In which case, the employer need only be “consulted”
- However, as will be seen below, if the actuary determines the rate under the scheme rules, the legislation imports a requirement for employer agreement

# The role of the actuary in scheme specific valuations

- Trustees must obtain the actuary's advice (s.230) on
  - Technical Provisions
  - Statement of Funding Principles
  - Recovery Plan
  - Schedule of Contributions
- Actuarial certification (s.225 and 227) that
  - calculation of the “technical provisions” complies with s.222
  - calculation uses method and assumptions determined by the trustees and set out in the Statement of Funding Principles
  - Schedule of Contributions is appropriate to the Statutory Funding Objective
  - Schedule of Contributions is consistent with Statement of Funding Principles



# The role of the actuary in specific circumstances

- But: what happens when scheme rules provide a more specific role for the actuary?
  - Where trustees are required to determine contributions “by or in accordance with the advice” of the actuary?
    - trustees must “take account of the recommendations” of the actuary (Regulation 5(3)(b))
  - Where the rate is determined by the actuary with no apparent input from the trustees or the employer under the rules?
    - trustees determine the rate but subject to consent of employer and additional actuarial certification

## Additional certification where the scheme's rules provide for the employer's contribution rate to be determined by the actuary

"In the case of a scheme under which the rates of contributions payable by the employer are determined by the actuary without the agreement of the employer, Section 227(6) of the 2004 Act shall apply as if it required that, in addition to the matters specified there, the **actuary's certificate** must state that the rates shown in the schedule of contributions are **not lower than the rates he would have provided for if he, rather than the trustees or managers of the scheme, had the responsibility of preparing or revising the schedule, the statement of funding principles and any recovery plan.**" (Schedule 2, paragraph 9(5), Scheme Funding Regulations)

## Paragraph 9(6) specifies the wording to be added to the certificate:

“I also certify that the rates of contributions shown in this schedule are not lower than I would have provided for had I had the responsibility for preparing or revising the schedule, the statement of funding principles and any recovery plan”

## The Regulator's comments on the responsibilities of the actuary where the rules give the actuary power of determination

- The Regulator's Code of Practice Number 3 (Funding Defined Benefits) does not comment on this issue
  - the code makes the assumption that the actuary is playing an advisory role and that the trustees make all determinations
- However, the Regulator's Scheme Funding FAQs comment:
  - “the actuary must put himself or herself in the shoes of the trustees” in assuming “the rates he would have provided for”
  - a sensible approach is to “treat the process as tripartite from the outset and be involved with and agree all the Part 3 decisions as they are made”
  - the actuary needs to be comfortable about the information on the employer's covenant
  - any external report on covenant should be addressed to both the trustees and the actuary
  - if the information is inadequate, the actuary should commission a report and bill the trustees
- The Institute comments that the actuary is not, by training or qualification, in a position to make an expert judgement on the employer's covenant

# The basic legal duties of the actuary

- contractual duty to the trustees
- contractual duty to the employer (sometimes)
- duty to take reasonable care under law of negligence (including possibly owing that duty to members and the employers)
- potential fiduciary duty to the members
- professional duties

# The potential significance if the actuary's role were found to be fiduciary

- If the role were fully fiduciary, the actuary would be required to exercise his powers as if he were a trustee himself
- If the role were less than fiduciary in the fullest sense, but includes elements which are “fiduciary” in nature, the actuary must exercise powers in good faith and take into account the interests of affected parties
- The actuary may also owe a duty of care to the trustees, the employer and members in applying his professional skills under the law of negligence, whether or not his role is fiduciary

# The roles of the trustees and the actuary – and how they are affected by Paragraph 9(5)

- Until the very last stage, it is the trustees (and the employer) who are responsible for all steps in the statutory valuation process
- Until that point, the actuary's role is simply that of an adviser (and provider of certificate under Section 225)
- Paragraph 9(5) does not substitute the role of the actuary for that of the trustees
  - “rates shown... are not lower than the rates he would have provided for if he, rather than the trustees or managers of the scheme, had the responsibility of preparing or revising the schedule, the statement of funding principles and any recovery plan” (Paragraph 9(5))
  - no policy intention to impose on scheme actuaries the full fiduciary responsibilities to members
  - does not specify that he must fulfil that responsibility as if he were a trustee
- But can the actuary discharge this duty without assessing the position which the trustees themselves were likely to have reached if discharging the same obligation?

# Issues relating to the employer's covenant and affordability

- Edge v Pensions Ombudsman
  - due process is observed by exercising "the power for the purpose for which it was given, giving proper consideration to the matters which are relevant and excluding from consideration matters which are irrelevant"
- Reflects the focus placed by the Pensions Regulator upon the employer's covenant and affordability
- The actuary, when making a certification under Paragraph 9(5), must understand the strength of the employer's covenant



# Practical steps for the actuary to consider in assessing the employer's covenant

- reasonableness of relying on third party advice
- evidence from the trustees if advice not taken by them
- assurances from the trustees regarding:
  - knowledge of employer and information available to them
  - evaluation of that information
  - expertise of the trustee body
- assessing third party security
- actuary may need to commission independent advice
- reporting to the Pensions Regulator

# Potential significance of a funding standard contained in the employer contribution rule

- Does the employer contribution rule
  - help determine the rate under scheme specific funding?
  - exist independently of the statutory regime? (See the British Vita and Pilots cases, considered later)
- Regulation 6(1) of the Funding Regulations
  - requires that the Statement of Funding Principles must include "any funding objectives provided for in the rules of the scheme, or which the trustees or managers have adopted, in addition to the statutory funding objective"
  - requires any funding objective specified in the scheme rules to be incorporated into the funding process as part of the Statement of Funding Principles, from which the Schedule of Contributions and any Recovery Plan flow

# Some examples of contribution rules

- Some formulations of the scheme's employer contribution rule
  - actuary to determine the employer contribution
  - actuary to determine the employer contribution rate by reference to a specified standard (such as solvency)
  - actuary to determine the employer contribution rate by reference to the funding standard that the actuary believes appropriate
- But are they capable of operating alongside and in addition to the statutory regime

# British Vita Unlimited v British Vita Pension Scheme Trustees Limited (2007)

- Rules provided for contributions to be “determined by the Trustees acting on the advice of the Actuary”, as “required to enable the benefits to be maintained”
- Following acquisition by a private equity firm, the trustees demanded lump sum payments based on more conservative assumptions
- Occurred in 2006, before first scheme specific valuation
- Warren J decided that as there was no scheme specific schedule of contributions in place there could be no conflict and the rules were not overridden (s.306)
- Contribution rule continues as contractual obligation alongside statutory regime
  - this may apply to both the funding standard and the framework for assessment
  - the actuary could therefore still be put in hot seat where he has unilateral power to determine contributions

# The Pilots Case (2010)

- Pilots' National Pension Fund
  - industry-wide scheme for UK marine pilots
  - 53 participating bodies
- The trustee broadened the employer contribution rule beyond statutory regime to
  - encompass former employers which were not statutory employers
  - permit assessment of contributions on alternative bases to scheme specific funding
- Warren J held contribution rule capable of operating independently of statutory regime even where a scheme specific schedule of contributions was in place

## Case Study

- Actuary power to determine contributions
- Scheme Funding Regime
- Failure to agree
- Regulatory involvement
- Scheme specific provisions
- Actuary as fiduciary or independent expert
- Grounds for challenging expert's determination

# Power to determine contributions/Scheme Funding Regime

- Actuary only power to determine contributions under scheme provision
- Scheme Funding Regime
  - Trustees determine the rate
  - Subject to consent of statutory employer
  - Additional actuarial certification

## Failure to agree

- Trustees and statutory employer failure to agree under scheme funding regime
- Regulatory involvement
  - “encouragement” to reach agreement (a visit to Brighton)
  - formal Section 231 process
- Position where scheme funding regime requires agreement but scheme provisions do not
- British Vita/Pilots – scheme contribution rule capable of operating independently
- Section 231 process only required where scheme contribution rule does not meet scheme funding obligation



# Actuary as fiduciary or independent expert (1)

- Actuary as a fiduciary
  - act in good faith
  - act in best interests of members and employers
  - possible duty of care
- Actuary as expert
  - determine contributions in accordance with strict provisions of rules
  - achieve greatest practicable degree of fairness between parties
  - no power to choose to favour one side or the other

## Actuary as fiduciary or independent expert (2)

- Scheme specific provisions generally silent on nature of role
- Courts highly likely to apply case law relating to expert determinations
  - *Re George Newnes* (determination of dissolution benefits)
  - *Re Imperial Foods* (determination of portion of fund to be segregated on cessation of participating employer)
  - *Cornwell v Newhaven Port* (determination of portion of deficiency to be attributed to employer ceasing to participate)

## Challenging decision of actuary (1)

- Grounds for challenging an expert determination are very narrow
  - if determination is not what relevant provision required (valued the wrong thing)
  - if expert guilty of fraud or collusion or actual bias
- Not sufficient that expert has given the wrong answer to the right question
- A perverse or unreasonable decision cannot be challenged as is treated as a type of wrong answer

## Challenging decision of actuary (2)

- The less prescriptive the provision is, the less scope for challenge
- Scope for investigating what the actuary has done is extremely limited
- Courts extremely resistant to attempts to:
  - obtain information about what an expert has done
  - challenge expert determinations on the basis of inferences

---

Any Questions?





# The role of the scheme actuary in scheme funding

– with a case study where the actuary is  
in the hot seat!

**Robert West**

Partner

**Mark Solomon**

Senior Associate

**9 September 2015**