

PREMIER PENSIONS MANAGEMENT

LEGISLATION UPDATE : 6/05

The New Scheme Funding Regime

This affects any triennial valuation that has an effective date on or after 22 September 2005.

IMPORTANT POINTS TO NOTE ARE:

- 1 The responsibility for achieving a satisfactory conclusion to the valuation process rests with the Trustees and the code indicates the strategies and behaviours The Pensions Regulator (TPR) expects the Trustees to demonstrate in achieving this. In particular, trustees are expected to establish and monitor an action plan covering the whole process and to have procedures in place to manage conflicts of interest that could emerge during the course of the valuation.
- 2 Employers will have to collaborate constructively with the Trustees, for example, providing business plans to enable the Trustees to comply with the Regulators code.
- 3 TPR expects the outcome to be improved security for members. TPR expects the assumptions used to be stronger and the periods for correction of any deficit to be shorter. Where this is unlikely to be achieved the TPR will review the procedures.
- 4 The Trustees have responsibility for ensuring that the valuation process is completed successfully. TPR advises Trustees to draw up an action plan which they should monitor regularly to ensure all statutory obligations are met.
- 5 TPR has the power to take control of the financial management of the Scheme.
- 6 Normally, Trustees will have 15 months from the effective date of the valuation to complete the valuation process.
- 7 The Trustees must have final versions of the Statement of Funding Principles, Schedule of Contributions and recovery plan, and received certificates of the technical provisions and the Schedule of Contributions from their actuary.
- 8 Trustees are explicitly given the responsibility for the funding process operating in line with legislation and TPR guidance, but at all stages they are expected to consult and in most cases reach agreement with the Principal Employer.
- 9 The balance of power in the Trust Deed is important. It is assumed here that agreement of the employer is needed.

If the Trust Deed does not require this then the Trustees only need to consult!
- 10 If the actuary has the power to set the contribution rate then the Trustees must take this into account and cannot agree to a contribution rate lower than the Scheme Actuary has recommended.

- 11 Employers and Trustees will need to ensure that they have the necessary processes in place to facilitate the exchange of information, including issues that could arise due to confidentiality and conflicts of interest.
- 12 The Statutory Funding Objective is that the Scheme must have sufficient assets to meet its technical provisions. How this is achieved is controlled by the Statement of Funding Principles (S of FP).
- 13 The S of FP must include:
 - approach towards methods and assumptions to be used in calculating technical provisions
 - the way any gap between the assets and the technical provisions will be filled.
- 14 In determining the basis for the calculation of the technical provisions, prudent assumptions must be used regardless of the Employer's ability to pay.
- 15 Technical provisions are defined as 'the amount required to make provision for the schemes liabilities'. Broadly these are the assets required so that the Trustees can meet benefits as and when they fall due. The technical provisions must represent a prudent estimate of the provisions needed to meet benefit payments.
- 16 When the value of the schemes assets is less than its technical provisions, the Trustees must produce a recovery plan that sets out how the shortfall will be met. The guiding principle is that ANY SHORTFALL SHOULD BE ELIMINATED AS SOON AS THE EMPLOYER CAN REASONABLY AFFORD.
- 17 There are however, circumstances when it will be permissible for shortfall payments to be deferred:
 - a) If the employer's spending commitments are such that immediate payment could be difficult
 - b) if an alternative is agreed eg contingent security .
- 18 TPR expects Trustees to require strong employers to fund the shortfall as soon as possible. However, trustees with a strong employer are able to justify lower technical provisions than those with a weak employer.
- 19 Recovery plans should be revised from time to time. However, a shortfall that has already been recognised in an earlier plan should not be aggregated with any new shortfall.
- 20 The Schedule of Contributions is maintained. It must cover a period of five years or the term of the recovery plan if longer.
- 21 If the Trustees and employer are unable to agree on the content of any of the documents that make up the valuation, the Trustees are expected to consider MODIFYING THE RATE AT WHICH BENEFITS ACCRUE IN RESPECT OF FUTURE SERVICE. The aim is to arrive at a level of benefits that the employer can agree to finance. Trustees are required to get the employer to agree to any modification.
- 22 Modification of accrual will favour deferred and pensioner members.

- 23 Employers that cannot agree to meet the current technical provisions are unlikely to feel comfortable that the target is steadily increasing. Trustees cannot be expected to be responsible for further accrual of benefits that the employer is unwilling to pay for.
- 24 Under new legislation, consultation of any change like this is required. This process is at least two months and should be built into the valuation plan, if necessary.
- 25 The valuation will contain an estimate of the scheme's solvency. This is calculated assuming the buy-out basis.
- 26 Full valuations are required every three years, actuarial reports must be annual for all schemes with more than 100 members.
- 27 The Scheme Actuary role is critical to the Trustees, however, it is only to advise and the eventual decision must be made by the Trustees.
- 28 There are responsibilities for both partners. The actuary must give comprehensive advice to facilitate the decision making process.
- 29 The Actuary's responsibility is to the Trustees. It is however, also possible to give advice to the Company. The Trustees must be comfortable with this and have a process to manage any conflicts that could arise. The Trustees should agree with the actuary what would happen when a conflict arises.
- 30 Following valuations, the Trustees must send copies of recovery plans and contribution schedules to TPR within 10 working days.
- 31 If the Trustees cannot reach agreement with the employer then they must report this to TPR.
- 32 Trustees must prepare a summary funding statement to send to members following completion of an actuarial valuation or funding report.
- 33 TPR will operate a filter process based upon:

1. Trigger Mechanisms

- The Pensions Regulator ("TPR") will use "trigger mechanisms" to manage its workload, they are NOT funding targets.
- TPR will focus on schemes most likely to pose a risk to the security of member's benefits or entry into the Pension Protection Fund ("PPF").
- TPR triggers remain based on the value placed on the liabilities (technical provisions) and the deficit correction proposals (the "Recovery Plan").
- The primary triggers will now be FRS17/IAS19 and PPF liabilities instead of 70% to 80% of the buy-out cost.

- If a trigger is breached TPR's reaction will depend upon the maturity of the scheme and the strength of the Employer covenant. A mature scheme with a weak Employer will likely trigger an enquiry, for example:
 - a) Recovery Plans will be queried if longer than 10 years. Credit may be taken in the Recovery Plan for performance of assets in excess of the prudent assumptions used to determine the value of the technical provisions.
 - b) TPR will look out for "inappropriate assumptions" underlying the Recovery Plan, especially investment returns.
 - c) FRS17/IAS19 and PPF will not be suitable as funding targets.

2. Monitoring

- TPR's primary focus will be to ensure that technical provisions are being calculated PRUDENTLY regardless of the Employers ability to meet the deficit.
- More flexibility will be allowed in the Recovery Plan.

3. Action

- If a scheme triggers, TPR will request further information e.g. accounts, minute books. One purpose is to ensure the Trustees have followed due process and taken appropriate advice in determining the assumptions to be adopted in calculating the technical provisions.
- Further assessment will be used to identify schemes where Trustees have made imprudent or inappropriate finding decisions, which TPR may then act upon.

The information in this bulletin is generic and is not advice. You should contact your professional advisers for guidance on any issues raised by the change in TPR's approach.

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