

EXPLANATORY MEMORANDUM TO
THE OCCUPATIONAL PENSION SCHEMES (MINIMUM FUNDING
REQUIREMENT AND ACTUARIAL VALUATIONS) AMENDMENT
REGULATIONS

2004 No.3031

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 These Regulations amend the definition of "transitional period" for the purposes of regulations 11 and 12 of the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 (S.I. 1996/1536) (the MFR Regulations). This extension will have the effect of preventing the additional requirements on pension schemes in connection with MFR valuations, set out in regulations 11 and 12 of the MFR Regulations, coming into effect when the current MFR transitional period expires on 31 December 2004.

2.2 These regulations also clarify the requirements for the statement which scheme actuaries must complete when carrying out MFR valuations.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Background

4.1 Provisions in the Pensions Bill, currently before Parliament, will replace the MFR with new scheme funding arrangements. The amendments proposed will have effect for the period leading up to the replacement of the MFR. They further extend the MFR transitional period in order to prevent the additional requirements of regulations 11 and 12 of the MFR regulations taking effect at the end of the current period. (A transitional period was built into the MFR framework at the outset to allow schemes a period of time to adjust to its new requirements.)

4.2 The amendments proposed also clarify the requirements for the statement which scheme actuaries must complete when carrying out the MFR valuations.

5. Extent

5.1 These Regulations apply to Great Britain.

6. European Convention on Human Rights

6.1 Not applicable.

7. Policy background

Requirements of regulations 11 and 12 of the MFR Regulations

7.1 Regulations 11 and 12 of the MFR Regulations would impose new requirements on trustees to obtain additional actuarial valuations in specified circumstances. Since the operation of these requirements is suspended until the end of the MFR transitional period, they have never taken effect.

7.2 The original transitional period (running to 5 April 2002) was extended to 31 December 2004 by the Occupational Pension Schemes (Minimum Funding Requirement and Miscellaneous Amendments) Regulations 2002 (SI 2002/380) as part of the interim amendments to the MFR Regulations which came into force on 19 March 2002. Since the MFR will be replaced by new scheme funding requirements in the Pensions Bill, it is considered inappropriate to allow these additional requirements in connection with MFR valuations to come into effect in the meantime. Since the MFR will still be in force at 31 December 2004 a further extension of the transitional period is, therefore, now necessary.

7.3 If in force:

- a. Regulation 11 would require trustees or managers to obtain an additional MFR valuation if, having consulted the scheme actuary, it appeared that there was a serious risk that the current schedule of contributions would no longer be sufficient to satisfy the MFR provisions; and
- b. Regulation 12 would require trustees or managers to obtain an additional MFR valuation if the actuary, when preparing an annual re-certification of a scheme's schedule of contributions, is of the opinion that the scheme may now be in serious shortfall (less than 90% funded on the basis of the MFR).

7.4 These requirements would involve additional cost and complexity in the administration of pension schemes. Discussions with the actuarial profession have also indicated that regulations 11 and 12, as worded, would be very difficult to operate in practice, because significant additional actuarial input is likely to be required in order to enable the actuary to advise the trustees on these matters.

Completion of the actuary's statement

7.5 The MFR regulations specify that each MFR valuation must contain a statement from the scheme actuary which satisfies prescribed requirements. The actuary must indicate in the statement the extent to which the assets of the scheme would be sufficient to provide, on the MFR basis, the benefits of each category of scheme member if the scheme were to start winding up at the effective date of the valuation, with funding at the level shown in the valuation report. The policy intention is that, in doing so, the actuary should reflect the order of precedence of liabilities to be followed if the scheme is wound up, known as the 'priority order', that would apply on the effective date of the valuation. This will be the priority order set out in section 73 of the 1995 Pensions Act, as modified by the Occupational Pension Schemes (Winding Up) Regulations 1996 (SI 1996/3126) (the Winding Up Regulations), and further modified from 10 May 2004 by the Occupational Pension

Schemes (Winding up) (Amendment) Regulations 2004 (SI 2004/1140) (the Winding Up Amendment Regulations).

7.6 Responses to the consultation on the Winding Up Amendment Regulations (which ran to 22 July 2003) indicated that the requirements for the completion of the statement are causing some uncertainty. It appears that in completing the statement, some scheme actuaries may have been using the priority order which would apply in the absence of the modifications made by the Winding Up Regulations (in effect, the "post-2007" priority order). A number of responses to that consultation proposed an amendment to make the position clear, and these amendment regulations provide a suitable opportunity.

Consultation

7.7 The Department for Work and Pensions published draft regulations for consultation on 3 September 2004. Seventeen organisations responded, of which eight were voluntary or representative organisations in the pensions and insurance industry, seven were companies within the pensions industry and two were governmental or quasi-governmental organisations.

7.8 All of the respondents who addressed the issue were in favour of preventing the additional requirements of regulations 11 and 12 from taking effect. One suggested that an alternative way of achieving the policy intention would be to revoke regulations 11 and 12. This suggestion was considered, but was not adopted because of concerns that section 57 of the Pensions Act 1995 may require mandatory provision.

7.9 All those respondents who commented on the issue welcomed the clarification of the requirements for completing the actuary's statement. Some queried whether the regulations would affect statements completed before the coming into force of the new provisions, but this will not be the case. They will only affect statements completed after the commencement of these regulations.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

8.2 Most public sector schemes are exempt from the minimum funding requirement, which applies primarily to private sector defined benefit occupational pension schemes.

9. Contact

Michael Axton at the Department for Work and Pensions can answer any queries regarding the instrument. He can be contacted by telephone (020 2272 2537) or e-mail (michael.axton@dwp.gsi.gov.uk).