RP05/95-96

UK Pensions Act -
Minimum Funding Requirement

Research and Library Services Division
Legislative Council Secretariat
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Background

In June 1992, a Pension Law Review Committee (PLRC) was set up by the UK Secretary of State for Social Security following the Maxwell affair. The Committee, chaired by Professor Roy Goode, was asked to review the existing law relating to occupational pension schemes in the United Kingdom. The report of the Committee (often referred to as the Goode Report), forms the basis for the White Paper published in June 1994 and the Pensions Bill introduced to the UK Parliament in late 1994.

2. The Goode Report and the Pensions Bill cover a wide range of topics related to occupational pension schemes. This paper studies only the part on the minimum funding requirement, which is most relevant to Members' discussions on the funding problems of superannuation schemes of institutions financed by the University Grants Committee in Hong Kong.

Minimum Funding Requirement Proposed in Goode Report

3. The Goode Report made the following major recommendations regarding the funding requirement of defined benefit schemes:

- A minimum solvency requirement needs to be introduced to protect pension rights of scheme members

- The assets of a scheme should be sufficient to meet its liabilities

- Schemes within a solvency band between 100 per cent to 90 per cent should have their solvency level restored to 100 per cent within **three years**

- Schemes with solvency below 90 per cent should have their levels restored to 90 per cent within **three months** and to 100 per cent within **three years**

Response of UK Government

4. The above recommendations were accepted by the UK Government and included in its White Paper "Security, Equality, Choice: The Future for Pensions". In response to comments received after the release of the White Paper, the Secretary of State for Social Security revised the details about the time limits to restore the funding level and the valuation method of asset and liability in late 1994. His proposals are quoted below:

- "the time limits for restoring schemes' funding levels to at least 90 per cent and 100 per cent of the statutory minimum solvency requirement should be extended to **one year** and **five years** respectively"

- "the statutory minimum solvency requirement calculation should be **smoothed** over a period of months rather than being based on market values on a particular day"

These have been included in the Pensions Bill published in December 1994 after its first reading in the House of Lords.

The Pensions Act

5. The Pensions Bill received the Royal Assent on 17 July 1995. The sections on the minimum funding requirement (MFR) are at Appendix I. It will be noted that under Section 56, defined benefit schemes are required to have sufficient assets to cover their liabilities.

6. The UK Department of Social Security advises that the detailed working of the MFR will be set out partly in regulations and partly in the form of an actuarial guidance note. The regulations aim to explain the general principle for the valuation of scheme assets and liabilities whilst the latter will set out the methodology for the calculations. Consultation on the content of the regulations with major representatives in the pensions industry is being conducted. Based on the outcome, draft regulations will be prepared for further consultation. The regulations should be in place by April 1996.

7. According to the consultation documents, the principle regarding the time limit for underfunded schemes to restore to MFR and the valuation of scheme assets and liabilities are as follows:

- Schemes that are less than 90 per cent of the MFR must have their funding level restored to 90 per cent within **one year** and to 100 per cent within **five years**

- The calculation of asset and liability values is to be **averaged over a period of seven months**, which may be on either side of the valuation date.

Conclusion

8. The introduction of a minimum funding requirement was recommended by the Pension Law Review Committee to ensure security of pension rights of scheme members. This requirement is now provided for under the new Pensions Act. The detailed working of the minimum funding requirement will be set out in the forms of regulations and actuarial guidance note which will be finalized by April 1996. The current thinking of the UK Government is that underfunded schemes are given one year to restore their funding to 90 per cent and five years to 100 per cent of the minimum funding requirement. To smooth out market fluctuations, the UK Government has at this stage suggested the calculation of scheme assets and liabilities be averaged over seven months (which may be on either side of the valuation day), instead of be based on one particular valuation day.

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References

Press release "Peter Lilley details changes to future Pensions Bill" issued by UK Department of Social Security dated 8 December 1994

Security, Equality, Choice: The Future for Pensions, UK Department of Social Security

Specifications for regulations on the minimum funding requirement, UK Department of Social Security

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Minimum funding requirement

56. - (1) Every occupational pension scheme to which this section applies is subject to a requirement (referred to in this Part as "the minimum funding requirement") that the value of the assets of the scheme is not less than the amount of the liabilities of the scheme.

Minimum funding requirement

(2) This section applies to an occupational pension scheme other than -

(a) a money purchase scheme, or
(b) a scheme falling within a prescribed class or description.

(3) For the purposes of this section and sections 57 to 61, the liabilities and assets to be taken into account, and their amount or value, shall be determined, calculated and verified by a prescribed person and in the prescribed manner.

(4) In calculating the value of any liabilities for those purposes, a provision of the scheme which limits the amount of its liabilities by reference to the amount of its assets is to be disregarded.

(5) In sections 57 to 61, in relation to any occupational pension scheme to which this section applies -

(a) the amount of the liabilities referred to in subsection (1) is referred to as "the amount of the scheme liabilities",

(b) the value of the assets referred to in that subsection is referred to as "the value of the scheme assets",

(c) an "actuarial valuation" means a written valuation prepared and signed by the actuary of the scheme of the assets and liabilities referred to in subsection (1), and

(d) the "effective date" of an actuarial valuation is the date by reference to which the assets and liabilities are valued.

Valuation and Certification of assets and liabilities.

57. - (1) The trustees or managers of an occupational pension scheme to which section 56 applies must -

(a) obtain, within a prescribed period, an actuarial valuation and afterwards obtain such a valuation before the end of prescribed intervals, and

(b) on prescribed occasions or within prescribed periods, obtain a certificate prepared by the actuary of the scheme -

(i) stating whether or not in his opinion the contributions payable towards the scheme are adequate for the purpose of securing that the minimum funding requirement will continue to be met throughout the prescribed period or, if it appears to him that it is not met, will be met by the end of that period, and

(ii) indicating any relevant changes that have occurred since that last actuarial valuation was prepared.

(2) Subject to subsection (3), the trustees or managers must -

(a) if the actuary states in such a certificate that in his opinion the contributions payable towards the scheme are not adequate for the purpose of securing that the minimum funding requirement will continue to be met throughout the prescribed period or, if it appears to him that it is not met, will be met by the end of that period, or

(b) in prescribed circumstances,

obtain an actuarial valuation within the period required by subsection (4).

(3) In a case within subsection (2) (a), the trustees or managers are not required to obtain an actuarial valuation if -

(a) in the opinion of the actuary of the scheme, the value of the scheme assets is not less than 90 per cent. of the amount of the scheme liabilities, and

(b) since the date on which the actuary signed the certificate referred to in that subsection, the schedule of contributions for the scheme has been revised under section 58(3)(b).

(4) If the trustees or managers obtain a valuation under subsection (2) they must do so-

(a) in the case of a valuation required by paragraph (a), within the period of six months beginning with the date on which the certificate was signed, and

(b) in any other case, within a prescribed period.

(5) A valuation or certificate obtained under subsection (1) or (2) must be prepared in such manner, give such information and contain such statements as may be prescribed.

(6) The trustees or managers must secure that any valuation or certificate obtained under this section is made available to the employer within seven days of their receiving it.

(7) Where, in the case of an occupational pension scheme to which section 56 applies, subsection (1), (2) or (6) is not complied with -

(a) section 3 applies to any trustee who has failed to take all such steps as are reasonable to secure compliance, and

(b) section 10 applies to any trustee or manager who are failed to take all such steps.

58. - (1) The trustees or managers of an occupational pension scheme to which section 56 applies must secure that there is prepared, maintained and from time to time revised a scheduled (referred to in sections 57 to 59 as a "schedule of contributions") showing - Schedules of contributions.

(a) the rates of contributions payable towards the scheme by or on behalf of the employer and the active members of the scheme, and

(b) the dates on or before which such contributions are to be paid.

(2) The schedule of contributions for a scheme must satisfy prescribed requirements.

(3) The schedule of contributions for a scheme -

(a) must be prepared before the end of a prescribed period beginning with the signing of the first actuarial valuation for the scheme,

(b) may be revised from time to time where the revisions are previously agreed by the trustees or managers and the employer and any revision in the rates of contributions is certified by the actuary of the scheme, and

(c) must be revised before the end of a prescribed period beginning with the signing of each subsequent actuarial valuation

(4) The matters shown in the schedule of contributions for a scheme -

(a) must be matters previously agreed by the trustees or managers and the employer, or

(b) if no such agreement has been made as to all the matters shown in the schedule, must be -

(i) rates of contributions determined by the trustees or managers, being such rates as in their opinion are adequate for the purpose of securing that the minimum funding requirement will continue to be met throughout the prescribed period or, if it appears to them that it is not met, will be met by the end of that period, and

(ii) other matter determined by the trustees or managers; and the rates of contributions shown in the schedule must be certified by the actuary of the scheme

(5) An agreement for the purposes of subsection (4)(a) is one which is made by the trustees or mangers and the employer during the prescribed period beginning with the signing of the last preceding actuarial valuation for the scheme.

(6) The actuary may not certify the rates of contributions shown in the schedule of contributions-

(a) in a case where on the date he signs the certificate it appears to him that the minimum funding requirement is met, unless he is of the opinion that the rates are adequate for the purpose of securing that the requirement will continue to be met throughout the prescribed period, and

(b) in any other case, unless he is of the opinion that the rates are adequate for the purpose of securing that the requirement will be met by the end of that period.

(7) The Authority may in prescribed circumstances extend (or further extend) the period referred to in subsection (6).

(8) Where, in the case of any occupational pension scheme to which section 56 applies, this section is not complied with -

(a) section 3 applies to any trustee who has failed to take all such steps as are reasonable to secure compliance, and

(b) section 10 applies to any trustee or manager who has failed to take all such steps.

Determination of contributions: supplementary

59. - (1) Except in prescribed circumstances, the trustees or managers of an occupational pension scheme to which section 56 applies must, where any amounts payable by or on behalf of the employer or the active members of the scheme in accordance with the schedule of contributions have not been paid on or before the due date, give notice of that fact, within the prescribed period, to the Authority and to the members of the scheme.

(2) Any such amounts which for the time being remain unpaid after that date (whether payable by the employer or not) shall, if not a debt due from the employer to the trustees or managers apart from this subsection, be treated as such a debt.

(3) If , in the case of an occupational pension scheme to which section 56 applies, it appears to the trustees or managers, at the end of any prescribed period that the minimum funding requirement is not met, they must prepare a report giving the prescribed information about the failure to meet that requirement.

(4) If in the case of any such scheme, subsection (1) or (3) is not complied with -

(a) section 3 applies to any trustee who has failed to take all such steps as are reasonable to secure compliance, and

(b) section 10 applies to any trustee or manager who has failed to take all such steps.

Serious underprovision.

60.- (1) Subsection (2) applies where, in the case of an occupational pension scheme to which section 56 applies, an actuarial valuation shows that, on the effective date of the valuation, the value of the scheme assets is less than 90 per cent. of the amount of the scheme liabilities (the difference shown in the valuation being referred to in this section as "the shortfall").

(2) The employer must -

(a) be making an appropriate payment to the trustees or managers, or

(b) by a prescribed method,

secure an increase in the value of the scheme assets which, taken with any contributions paid, is not less than the shortfall.

(3) The required increase in that value must be secured -

(a) before the end of a prescribed period beginning with the signing of the valuation, or

(b) if the actuarial valuation was obtained by reason of such a statement in a certificate as is referred to in section 57(2), before the end of a prescribed period beginning with the signing of the certificate.

(4) Except in prescribed circumstances, if the employer fails to secure the required increase in value before the end of the period applicable under subsection (3), the trustees or managers must, within the period of fourteen days (or such longer period as is prescribed) beginning with the end of that period, give written notice of that fact to the Authority and to the members of the scheme.

(5) If the employer fails to secure the required increase in value before the end of the period applicable under subsection (3), then so much of the shortfall as, at any subsequent time, has not been met by an increase in value under subsection (2) made -

(a) by making an appropriate payment to the trustees or managers,

(b) by a prescribed method, or

(c) by contributions made before the end of that period,

shall, if not a debt due from the employer to the trustees or managers apart from this subsection, be treated at that time as such a debt.

(6) Where an increase in value is secured by a prescribed method, the increase is to be treated for the purposes of this section as being of an amount determined in accordance with regulation.

(7) The Authority may in prescribed circumstances extend (or further extend) the period applicable under subsection (3).

(8) If subsection (4) is not complied with-

(a) section 3 applies to any trustee who has failed to take all such steps as are reasonable to secure compliance, and

(b) section 10 applies to any trustee or manager who has failed to take all such steps.

Sections 56 to 60: Supplementary.

61. Regulations may modify sections 56 to 60 as they apply in prescribed circumstances.