NOVEMBER **2005**

news

sackers extra

pensions reform

The new funding standard – the Regulator's role

After a series of delays, the new statutory funding objective (SFO) will finally replace the much maligned minimum funding requirement on 30 December 2005. It is the Pensions Regulator's job not only to ensure that trustees and employers comply with the SFO, but it will also intervene where necessary. Here we look at the Regulator's recently released consultation paper[1] detailing its proposed approach towards its latest regulatory role[2].

SFO

What is it?

- The new SFO is set out in the Pensions Act 2004 which will be supplemented by regulations, a Regulator code of practice and guidance, and actuarial guidance.
- SFO requires a DB scheme to have "sufficient and appropriate assets to cover its technical provisions".

SFO process

In brief

- Trustees will have to:
  - prepare a statement of funding principles and a schedule of contributions; and
  - with actuarial advice, devise a recovery plan for eliminating any deficit (which must be sent to the Regulator).

The process

The Regulator's role

- Trustees will generally need to agree the various SFO elements with the employer (trustees who have unilateral power to set the contribution rate under scheme rules will only need to consult).
- If the parties cannot agree, trustees have to notify the Regulator of the failure to agree.
- The Regulator can then intervene and, in effect, fix the employer's contribution rate and/or reduce future service benefits.

The Regulator's approach

Trigger mechanisms

- Despite its potentially hard hitting regulatory powers, the Regulator sees itself as a referee and not a player on the scheme funding field.
- The Regulator's focus will be on those schemes which pose the greatest risk to members/the PPF. It will use trigger mechanisms to help identify such schemes.
- The triggers for attracting Regulator investigation (although not necessarily intervention) centre on a scheme's funding target and the proposed recovery period for correcting a deficit (the strength of an employer's covenant will also come into play).

1 http://www.thepensionsregulator.gov.uk/pdf/schemeFundingConsultation.pdf

2 Please also see our Sackers Extra Alert: "Scheme Funding – consultation published" dated 23 March 2005

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The Triggers

Funding

- Based on its analysis of the FRS17 and PPF assessment of liabilities for typical schemes, the funding trigger will usually be 70% to 80% of the full buy-out cost.
- But even schemes whose funding target exceeds this range may be subject to scrutiny if, for example, the Regulator regards the employer as having a weak covenant.
- Schemes which are less than 110% funded on the minimum funding requirement basis will also come under the microscope[3].

The Triggers

Recovery period

- A recovery period will trigger the Regulator's attention if:
  - it lasts 10 years or more;
  - it lasts for less than 10 years but the employer's financial position is such that the Regulator reasonably believes the deficit could be cleared more quickly;
  - the recovery plan is significantly back-end loaded (contributions are higher towards the end).

Intervention

The factors

- In deciding whether to intervene in a scheme the Regulator will consider a number of factors, including:
  - trustees' decisions and the actuarial advice provided to them;
  - the specific circumstances of the employer/scheme;
  - any independent advice taken by trustees as to the scheme's wider circumstances;
  - whether trustees/employers have taken any other steps to mitigate funding risk (the Regulator is considering whether to take account of contingent assets, such as letters of credit, here).

3 The Regulator may look at whether trustees have taken all appropriate actions to improve funding in advance of an SFO valuation or whether they have considered bringing it forward

This edition of Sackers Extra News is part of a series focusing specifically on Pensions Reform to keep you abreast of the key issues throughout this period of change.

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