

PENSIONS ACT 2004

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 3 – Scheme Funding

Summary

792. This Part of the Act sets out the statutory framework for the scheme funding requirements which will replace the Minimum Funding Requirement (MFR). The MFR, introduced from April 1997, applies to most private sector defined benefit occupational pension schemes. Schemes currently subject to the MFR are required to hold a minimum level of assets to meet their pension liabilities, as assessed on the basis of the MFR test, and to make good any shortfalls against the MFR within specified timescales. In carrying out MFR valuations actuaries must use a prescribed actuarial method, and a prescribed set of actuarial assumptions.
793. Under the arrangements set out in this Part of the Act, schemes will not be required to fund to a common funding measure. Instead the scheme will have to meet a statutory funding objective which can take account of the particular circumstances of the scheme. Pension scheme trustees, having taken advice from the actuary, will be required to agree with the sponsoring employer a strategy for funding the pension commitments and for correcting any funding deficits, and to set this out in a statement of funding principles. The new funding framework carries forward the existing statutory requirements for regular actuarial valuations and for a scheme to have in place a schedule of contributions.

Introductory

Section 221: Pension schemes to which this Part applies

794. This section sets out the scope of the scheme funding provisions. It provides for this Part of the Act to apply to every occupational scheme apart from money purchase schemes. The section also provides a power for regulations to exclude other schemes from all or part of this Part, and the intention is that the scheme funding provisions will broadly apply to those schemes to which the Minimum Funding Requirement currently applies, subject to the scope of the provisions of the requirements of the European Directive [2003/41/EC](#) on the activities and supervision of institutions for occupational retirement provision (the IORP Directive).

Scheme funding

Section 222: The statutory funding objective

795. *Subsection (1)* requires schemes subject to this Part to be funded to meet a statutory funding objective that they have sufficient and appropriate assets to cover their technical provisions. This requirement reflects the provisions of the IORP Directive.

796. *Subsection (2)* defines a scheme's "technical provisions" as the amount required, on an actuarial calculation, to provide for its liabilities. *Subsection (3)* gives powers to prescribe the liabilities to be taken into account for these purposes and the manner in which assets, liabilities and technical provisions should be determined.
797. *Subsection (4)* enables regulations to provide for trustees or managers to choose the method and assumptions appropriate for the calculation of their scheme's technical provisions according to alternative prescribed methods and assumptions, and in line with prescribed principles. The Regulator is required under *section 90(2)(d)* (codes of practice) to issue a code of practice giving practical guidance to trustees on their duties under Part 3 of the Act, including determining the basis for calculating their scheme's technical provisions.
798. *Subsection (5)* prevents a scheme from taking advantage of any provision in the scheme rules that would otherwise permit the liabilities taken into account for the purposes of this Part to be limited to the assets held by the scheme.

Section 223: Statement of funding principles

799. *Subsection (1)* requires the trustees or managers of a scheme to prepare, periodically review and if necessary revise a statement of funding principles. The statement of funding principles is a written statement of the trustees' policy for ensuring that the statutory funding objective is met, and such other matters as may be prescribed.
800. *Subsection (2)* requires that the statement records any decisions by the trustees or managers on:
- the methods and assumptions to be used in calculating the scheme's technical provisions; and
 - the period over which a failure to meet the statutory funding objective would be rectified and the manner in which it will be rectified.
801. *Subsection (3)* enables regulations to set out the period within which the statement of funding principles must be prepared, and setting out requirements for its review and, where necessary, revision. It is intended that the statement of funding principles should be reviewed at least every three years.
802. *Subsection (4)* enables the Regulator to impose a civil penalty on trustees or managers who do not take reasonable steps to comply with these requirements.

Section 224: Actuarial valuations and reports

803. This section requires the trustees or managers of a scheme to arrange for a written valuation of the assets and technical provisions of the scheme from the scheme actuary. *Subsection (1)* provides for such valuations to be undertaken annually, although valuations may take place every three years if the trustees arrange for actuarial reports for the intervening years.
804. *Subsection (2)* defines the various terms used in this Part:
- an actuarial valuation is a written report, valuing the scheme's assets and calculating its technical provisions, prepared and signed by the scheme actuary;
 - the effective date of an actuarial valuation is the date by reference to which the assets are valued and the technical provisions are calculated;
 - an actuarial report is a written report, prepared and signed by the scheme actuary, on changes to the scheme's technical provisions since the last actuarial valuation;
 - the effective date of an actuarial report is the date to which the information in the report relates.

805. *Subsection (3)* cross-refers to *subsection (1)* and stipulates that the intervals of not more than one year referred to in *subsection (1)* are the intervals between the effective dates of successive actuarial valuations or reports.
806. *Subsection (4)* enables regulations to require the trustees or managers to ensure that a valuation or report is received by them from the scheme actuary within a prescribed period of its effective date.
807. *Subsection (5)* makes clear that the requirements of this section do not affect any power or duty of the trustees or managers to obtain valuation or reports more frequently, or on other occasions than those required by *subsection (1)*.
808. *Subsection (6)* enables regulations to set out further requirements in relation to the actuarial valuation or report, such as its format and content.
809. *Subsection (7)* requires the trustees or managers to make the valuation or report available to the employer within seven days of its receipt.
810. *Subsection (8)* enables the Regulator to impose a civil penalty on trustees or managers who have not taken reasonable steps to comply with *subsection (1), (4) or (7)*.

Section 225: Certification of technical provisions

811. *Subsection (1)* requires that the actuary must certify the calculation of the scheme's technical provisions when carrying out an actuarial valuation.
812. *Subsection (2)* requires that the certificate must state whether, in the actuary's opinion, the calculation of the technical provisions is made in accordance with regulations under [section 222](#). The requirement for the calculation of the technical provisions to be certified reflects the provisions within the IORP Directive.
813. If, within the timescale allowed for the valuation to be completed, the actuary cannot certify that the calculation of the technical provisions meets those requirements, *subsection (3)* requires him to notify the Regulator within a reasonable period. The Regulator is required under [section 91\(2\)\(a\)](#) to issue a code of practice setting out what a reasonable period is in these circumstances. The Regulator is able to impose a penalty on an actuary who fails to make this report.

Section 226: Recovery plan

814. This section sets out requirements for a recovery plan where it appears to the trustees or managers of a scheme from an actuarial valuation that the statutory funding objective is not met.
815. *Subsection (1)* requires the trustees or managers to prepare a recovery plan (or, if a plan is already in force, to review and if necessary revise it) within a prescribed time.
816. *Subsection (2)* provides that the recovery plan must set out the steps to be taken to meet the statutory funding objective, and the timeframe over which this is to be achieved. Additionally, *subsection (3)* provides that the recovery plan must be appropriate to the nature and circumstances of the scheme and any prescribed requirements, and *subsection (4)* enables regulations to require the trustees or managers to take account of such matters as may be prescribed.
817. *Subsection (5)* enables regulations to prescribe the circumstances in which a recovery plan may, or must, be reviewed and (if necessary) revised.
818. Under *subsection (6)* the trustees or managers must (except in circumstances which may be set out in regulations) send a copy of the recovery plan to the Regulator within a reasonable period of its preparation or revision, along with any information prescribed by regulations.

819. *Subsection (7)* provides for penalties to apply to trustees or managers who have failed to take reasonable steps to comply with these provisions.

Section 227: Schedule of contributions

820. *Subsection (1)* provides that the trustees or managers must prepare, periodically review and, where necessary, revise a schedule of contributions. *Subsection (2)* provides that a schedule of contributions is a statement setting out the contribution rates payable to the scheme by or on behalf of the employer and the active members of the scheme, and the dates on or before which the contributions are to be paid.
821. *Subsection (3)* enables regulations to specify the period within which the schedule must be prepared, reviewed, and if necessary revised, and the period for which the schedule is to be in force. It is intended that the period to be covered by the schedule will be five years where the valuation shows that the statutory funding objective was met.
822. *Subsection (4)* contains a regulation making power to prescribe further requirements in relation to the schedule. The intention is to use this power, for example: to require the employer to sign the schedule; and to require that contributions relating to the recovery plan to make good a deficit are shown separately on the schedule.
823. *Subsections (5)* and *(6)* require the actuary to certify the schedule of contributions where he is satisfied that it is consistent with the statement of funding principles; and where he is satisfied that the rates of contributions in the schedule are such that:
- where the valuation shows that the funding objective was not met, the statutory funding objective can be expected to be met by the end of the period in the recovery plan determined by the trustees or managers; or
 - where the valuation shows that the funding objective was met, the statutory funding objective can be expected to continue to be met for the period covered by the schedule. The schedule will not be in force until the actuary has so certified it.
824. The schedule will not be in force until the actuary has so certified it.
825. *Subsection (7)* requires the trustees or managers to send, within a reasonable period, a copy of the schedule of contributions to the Regulator if the valuation shows that the statutory funding objective was not met.
826. *Subsection (8)* empowers the Regulator to impose a penalty on trustees or managers who do not take reasonable steps to comply with these requirements.
827. *Subsection (9)* requires an actuary who is unable to certify the schedule of contributions to notify the Regulator within a reasonable period and empowers the Regulator to impose a penalty on an actuary who fails to comply without reasonable excuse.
828. Where the Regulator has imposed a schedule of contributions under the power conferred by *section 231*, *subsection (10)* of this section disapplies certain provisions of this section.

Section 228: Failure to make payments

829. This section applies where an amount payable in accordance with the schedule of contributions by or on behalf of the employer or an active scheme member is not paid on time. *Subsection (2)* imposes a requirement on the scheme's trustees or managers, to report to the Regulator and the members the failure to make the payment, but only if they have reasonable cause to believe that the failure is likely to be of material significance to the Regulator in the exercise of its functions. This subsection also includes a power to prescribe circumstances in which the requirement to notify the Regulator will not apply.

830. *Subsection (3)* ensures that the amount of the unpaid contributions shall be treated as a debt on the employer to the trustees or managers, where this would not otherwise be the case.
831. *Subsection (4)* provides for civil penalties to apply to a trustee or manager, an actuary or auditor, who fails to report to the Regulator a material failure to make a payment to the scheme; and an employer who fails to make a payment.
832. *Subsection (5)* makes it clear that these provisions also apply to payments due under a schedule of contributions which has been imposed by the Regulator (under *section 231*).

Section 229: Matters requiring agreement of the employer

833. *Subsection (1)* of this section imposes a requirement on the trustees or managers of a scheme to obtain the agreement of the employer: to any decision about the methods and assumptions which are to be used by the actuary in calculating the scheme's technical provisions; to any matter which is to be included in the scheme's statement of funding principles; to any recovery plan; and to any matter to be included in the schedule of contributions.
834. *Subsection (2)* applies where the trustees or managers of a scheme conclude that they will not be able to obtain the employer's agreement (within prescribed time limits) to any of these matters. In these circumstances this section confers a power on the trustees or managers (if the employer agrees) to modify the future accrual of benefits under the scheme in order to obtain the employer's agreement.
835. *Subsection (3)* prohibits any modification under *subsection (2)* that would adversely affect the subsisting rights of any scheme member or their survivor. For the purposes of this legislation the definition of "subsisting right" and "survivor" is given in Section 67A of the Pensions Act 1995.
836. *Subsection (4)* requires the trustees or managers to record any such modification in writing, and to notify active scheme members (that is, those who will be affected by the change) within one month of the modification taking effect.
837. *Subsection (5)* imposes a requirement on the trustees or managers to report a failure to reach agreement with the employer on any of the matters set out in *subsection (1)* to the Regulator, in writing, within a reasonable period.
838. *Subsection (6)* provides for civil penalties to apply to a trustee or manager who fails to take all reasonable steps to comply.

Section 230: Matters on which advice of actuary must be obtained

839. *Subsection (1)* imposes a requirement on the trustees or managers of a scheme to obtain advice from the scheme actuary before making any decision about: the methods and assumptions which are used by the actuary in calculating the scheme's technical provisions; preparing or revising the scheme's statement of funding principles; preparing or revising a recovery plan; preparing or revising the schedule of contributions; or modifying the scheme as regards the future accrual of benefits.
840. *Subsection (2)* provides a power for regulations to impose obligations on scheme actuaries to comply with any prescribed requirements when providing advice to the scheme's trustees or managers on these matters.
841. *Subsection (3)* provides for these regulations to require the actuary to take account of prescribed guidance. Such guidance would be prepared and reviewed by a prescribed body, such as the Faculty and Institute of Actuaries, and approved by the Secretary of State. It is intended that such guidance would specify factors and considerations which the actuary would be required to take into account when providing advice to the scheme's trustees or managers within *subsection (1)*.

842. *Subsection (4)* provides for civil penalties to apply to a trustee or manager who fails to take all reasonable steps to comply.

Section 231: Powers of the Regulator

843. This section confers powers on the Regulator to take action aimed at resolving difficulties arising in the operation of the scheme funding provisions. *Subsection (1)* specifies the circumstances in which these powers may be used, and the powers themselves are set out in *subsection (2)*.
844. The powers conferred by this section will be exercisable where it appears to the Regulator (whether as a result of a report made to the Regulator or otherwise) that:
- the trustees or managers have failed to comply with the requirement in *section 223* with respect to the preparation and revision of the statement of funding principles, or to review and revise such a statement;
 - the trustees or managers have failed to obtain an actuarial valuation as required by *section 224(1)*;
 - the actuary is unable to certify the calculation of the scheme's technical provisions or its schedule of contributions;
 - the trustees or managers have failed to comply with the requirements of *section 226* with respect to the preparation and revision of a recovery plan;
 - the trustees or managers: have failed to comply with the requirements of *section 227* with respect to the preparation and revision of a schedule of contributions;
 - the actuary is unable to certify a schedule of contributions;
 - the employer has failed to make payments in accordance with the schedule of contributions (or payments treated as a debt under *section 228(3)*, and that failure is of material significance to the Regulator in the exercise of its functions.
 - the trustees or managers have been unable to reach agreement with the employer within the prescribed timescale about one or more of the matters on which agreement is required under *section 229*.
845. *Subsection (2)* confers the following powers, any (or all) of which the Regulator will be able to use by means of an order:
- to modify future benefit accruals under the scheme;
 - to give directions about the manner in which the scheme's technical provisions should be calculated, including the methods and assumptions which should be used in the calculation;
 - to give directions about how, and over what period, any failure to meet the statutory funding objective should be rectified;
 - to impose a schedule of contributions on the scheme setting out the contributions to be paid and the dates by which they are to be paid.
846. *Subsection (3)* prohibits any modification under *subsection (2)* that would adversely affect the subsisting rights of any scheme member or their survivor. For the purposes of this legislation the definition of "subsisting right" and "survivor" is given in Section 67A of the Pensions Act 1995.
847. *Subsection (4)* provides a power to make regulations specifying requirements with which the Regulator must comply when exercising these powers. *Subsection (4)* makes it clear that these powers for the Regulator are additional to any others proposed by this Act, or conferred by the [Pensions Act 1995 \(c.26\)](#).

Supplementary provisions

Section 232: Power to modify provisions of this Part

848. This section provides a power for regulations to modify the provisions of this Part as they apply in prescribed circumstances. It mirrors the current section 61 of the Pensions Act 1995, which provides a similar power for regulations to modify the operation of the Minimum Funding Requirement. The operation of the Minimum Funding Requirement legislation is modified under section 61 in respect of specified types of scheme including, for example schemes in wind-up, shared cost schemes, multi-employer schemes, schemes without active members, schemes which are partially guaranteed by Ministers of the Crown, and schemes which are exempt from the requirement to appoint an actuary.

Section 233: Construction as one with the Pensions Act 1995

849. This section makes it clear that words used in this Part of the Act should be interpreted as having the same meaning as they do in Part 1 of the Pensions Act 1995.