Joint ACA/APL Meeting
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Meaning of: “in members’ interests”

Why do we care?

- Section 37 of the Pensions Act 2005 (payment of surplus to employer) restricts powers under ongoing schemes to pay surplus to employer

- No payment can be made to an employer unless “the trustees are satisfied that it is in the interests of the members”

History of this provision

- 1986 tax laws encouraged schemes to reduce surpluses by reducing contributions, increasing benefits or paying surplus to the employers
- Many scheme rules prevent payments to the employer
- Occupational Pensions Board was given power to modify schemes to allow such payments

The 1990 Modification Regulations

OPB could modify scheme to allow payments to the employer only if: "the trustees or managers of the scheme are satisfied that it is **in the interests of the beneficiaries** that the surplus be reduced or eliminated in the way or ways specified in the application for the [modification] order"

Pensions Act 1995

Changed “beneficiaries” to “members”

- Is there a difference?
  - dependants of deceased members?
  - employers themselves?

- In 1990, a payment to the employer as part of a “package” that included benefit improvements could be “in the interests of beneficiaries” even though security for benefits would be reduced

Investment Regulations 2005

Regulation 4 requires assets to be invested:

(a) in the best interests of members and beneficiaries

[i.e. people other than members, who are entitled to the payment of benefits under the scheme]; and

(b) in the case of a potential conflict of interest, in the sole interest of members and beneficiaries.

Refund to employer: whose decision is it anyway?

Parliament

"a fair balance between members and sponsoring employer" (Malcolm Wicks)

"might be in members' interests … if there is some question about the solvency of the company"

(Baroness Hollis)

Policy intention (appears to be): look after employer as well as members

Refund to employer: whose decision is it anyway?

Parliament

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Legislation:*“ the power may be exercised only if the trustees are satisfied that it is in the members’ interests”*

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Trustees

Legislation does not reflect (what) policy intention (appears to be)

Trustees have to decide what the members' interests are

We can probably all agree on:

- maximum security for the pensions benefits members are expecting

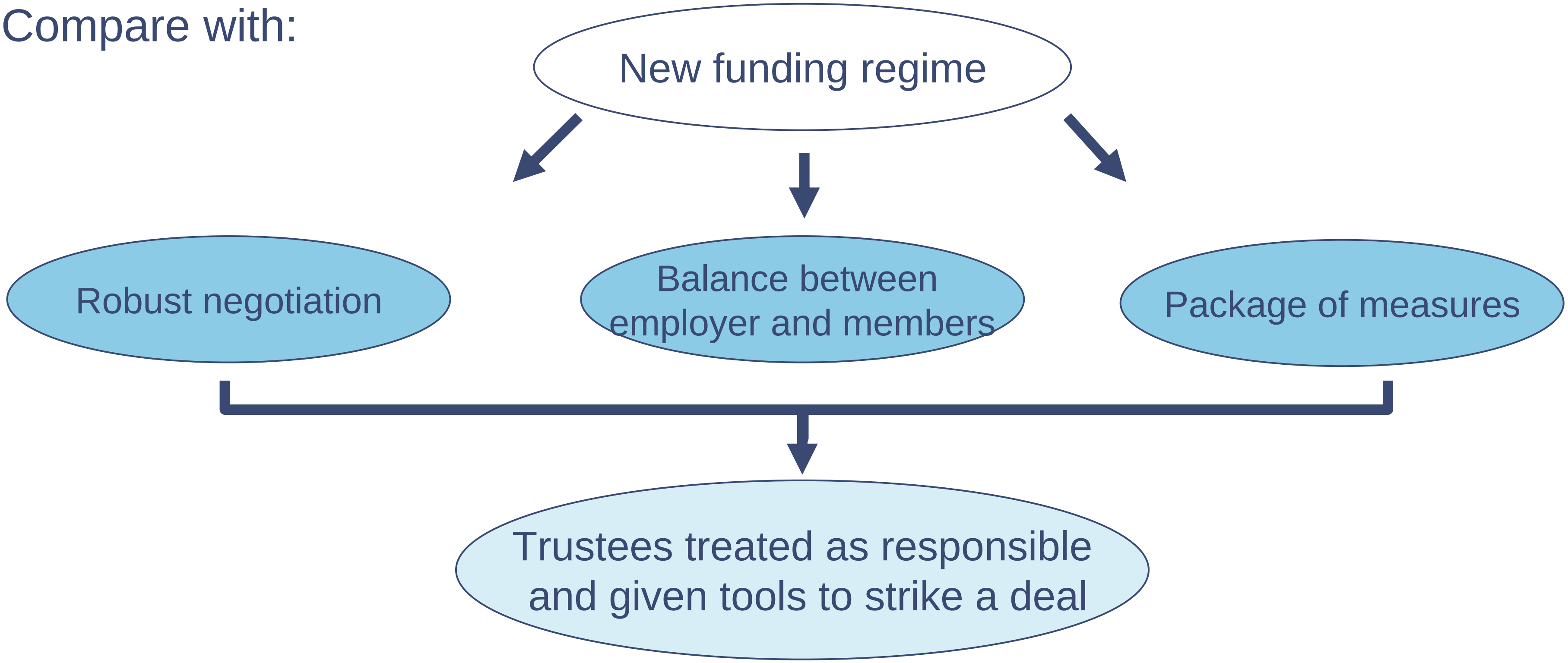
But what about..?

- impact of priority liabilities - i.e. not all members' interests are the same
- job security with the employer*
- job prospects with another employer*
- balance of powers
- salary linkage*
- replacement /compensation if scheme closed*
- possibility of discretionary benefits

* relevant only to active members

Trustees have to implement public policy

Compare with:



Should it be the same for refunds to employers?

Meaning of “prudent”

Why do we care?

Section 113 of the Pensions Act 2004: “The [PPF] Board may invest for the purposes of the prudent management of its financial affairs”

IORP Directive, Article 18

Member States shall require institutions located in their territories to invest in accordance with the "prudent person" rule and in particular …

Calculation of technical provisions

Scheme Funding Regulation 5(4)

- Economic and actuarial assumptions must be chosen **prudently** (allowing appropriate margins for adverse deviation)

- The rates of interest used to discount future payments of benefits must be chosen **prudently**

- Mortality tables and demographic assumptions must be based on **prudent** principles

Meaning of “prudent”

- Context seems to suggest “cautious”

- OED (Compact, 1996):

  1 (of a person or conduct) careful to avoid undesired consequences; circumspect”

- [NB “circumspect” is then defined as: “wary, cautious, taking everything into account”]

More meanings of “prudent”

1. Wise in handling practical matters; exercising good judgment or common sense.

2. Careful in regard to one's own interests; provident.

3. Careful about one's conduct; circumspect.

Prudent-Person Rule: A legal maxim restricting the discretion in a client’s account to investments that a prudent person seeking reasonable income and preservation of capital might buy for his or her own portfolio.

Trust law

"The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider; the duty rather is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide"

(*Re Whiteley* (1886) 33 Ch D 347, at 355 per Lindley MR)

Application to scheme funding

- The "prudent person" test has mainly been applied in an investment context
- Under traditional trusts, the balance is between the risk of loss and the hope for gain; gains and losses both accrue to the beneficiary
- Under DB schemes, gains and losses accrue to the employer; members' interests are affected only if employer is insolvent

Another view of prudence

SSAP 2 (no longer in force) refers to four fundamental accounting concepts:

Consistency

Accruals

Going concern

Prudence

Prudence – relevant where there is uncertainty

- do not anticipate positive outcomes (gains, assets)
- allow for negative outcomes (losses, liabilities)

Application by actuaries to scheme funding

- Assume worst case future experience
- Duty of care
- Traditionally risk-averse

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Strong technical provisions – buy out basis?

TPR's position

- Important because TPR influences behaviour
- Code of Practice:
  - level of prudence consistent with overall confidence trustees want to have that the resulting technical provisions are adequate to pay the benefits
  - not obliged to attempt to eliminate all risk – in particular legislation does not require the technical provisions to be a buyout basis
- Triggers represent TPR's view of prudence
- Triggers weaker than actuaries would arrive at on their own

TPR allows actuaries to help our clients reach more acceptable outcomes

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