GN38: Pre-Paid Funeral Plans

Classification
Recommended Practice.

MEMBERS ARE REMINDED THAT THEY MUST ALWAYS COMPLY WITH THE PROFESSIONAL CONDUCT STANDARDS (PCS) AND THAT GUIDANCE NOTES IMPOSE ADDITIONAL REQUIREMENTS UNDER SPECIFIC CIRCUMSTANCES

Definitions
Defined terms appear in italics when used in the standard.

Reference	Definition
Plan Provider	The organisation which is contractually bound to provide benefits under the Pre-paid Funeral Plan.
Pre-paid Funeral Plan ("plan")	A contract whereby in exchange for a payment or a series of payments in advance, the Plan Provider will provide specified funeral benefits.

Legislation or Authority
The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001 No. 544), as amended (the "RAO").

The Funeral Planning Authority Rules.

Application
Actuaries valuing the assets and liabilities of the trust associated with a *Pre-paid Funeral Plan* which is outside the scope of the RAO by virtue of article 60(1)(b) of that order.

The guidance in this note may also be of assistance to actuaries providing advice to *Plan Providers* in other circumstances.

Author
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Status
Approved under Due Process

Version	***Effective from***
1.0	01.09.03

Adopted by BAS on 19.05.06
Ceased to apply from 01.10.11

1 1 General

1.1 All new *plans* entered into on or after 1 January 2002 are required to be regulated by the Financial Services Authority unless they are excluded by virtue of their satisfying the conditions of article 60 of the RAO.

1.2 Article 60(1)(a) of the RAO relates to *plans* supported by whole life assurances with authorised insurers and is outside the scope of this guidance note.

1.3 Article 60(1)(b) sets out a number of conditions under which a *plan* will be excluded from the scope of the RAO. These include the requirement that sums paid by the customer will be held on trust and that the assets and liabilities of the trust must, at least once every three years, be "determined, calculated and verified" by an actuary who is an Fellow of the Institute of Actuaries or of the Faculty of Actuaries.

1.4 This note provides guidance on the verifications and valuations required by article 60(1)(b)(v) of the RAO. It also recommends the provision of significant additional advice regarding the financial circumstances of the trust. The actuary should endeavour to agree with the trustees that this will also fall within the remit of the actuary's work. If the plan provider is registered with the Funeral Planning Authority, the remit should be in accordance with the rules of that Authority.

1.5 In some cases, the trust deed may require elements of this further advice, or advice on other matters, to be obtained by the trustees..

1.6 Some trusts may also have liabilities in respect of plans issued prior to 1 January 2002. Unless strictly segregated assets are held in respect of such liabilities, it will be necessary for the verifications and valuations to include these liabilities and the total assets of the trust.

1.7 The liabilities of the trust to the *Plan Provider* may not mirror the liabilities of *the Plan Provider* to the customer under the plan. In such circumstances, it is recommended that the actuary endeavours to agree with the *Plan Provider* that additional advice should be provided to the *Plan Provider* on the overall financial implications of the liabilities under the *plans* being valued. This may be particularly important if the liability of the trust is or may be limited to paying an appropriate share of the assets, rather than matching the liabilities of the *Plan Provider* to the customer. Subsequent guidance in this note is phrased as if such additional advice is being given to the trustees. However, it should be followed, interpreted appropriately, for any advice being given to the *Plan Provider.*

1.8 Actuaries working for *Plan Providers* which are registered with the Funeral Planning Authority should be aware that under the Authority's rule 4.1.2, *Plan Providers* are required to have arrangements in place to make good any shortfall in the trust funds to ensure that they are sufficient to discharge the *Plan Provider's* liabilities. It is likely that such *Plan Providers* will wish to receive advice on their exposure to future cost under this rule.

1.9 Article 60(1)(b)(iii) requires the appointment of an unconnected investment manager. Article 60(2) excludes from the definition of ‘unconnected’ any “agent of the (Plan) provider”. Although under article 60(1)(b)(v) the actuary is formally providing advice to the trustees of the trust and not to the *Plan Provider*, an actuary intending to act as the investment manager under article 60(1)(b)(iii) may wish to consider the implications of article 60(2), particularly if the scope of the advice is widened so as to include advice to the *Plan Provider* as recommended in 1.7 above.

1.10 Valuations of the assets and liabilities of the trust should be on an ongoing basis, unless any discontinuance provisions already apply or are expected to do so in the foreseeable future. Allowance should be made for such tax and tax reliefs as may be applicable, bearing in mind the legal nature of the trust deed.

2 Verification and valuation of assets

2.1 Transferable securities readily tradable on a recognised market should be valued at market value.

2.2 Other assets should be valued by an appropriately qualified valuer at a prudent open market realisable value. Full account should be taken of the counterparty risk associated with the issuers of securities and tenants of properties.

2.3 The actuary should also take into consideration the value placed or expected to be placed on the assets by the auditor in accordance with UK GAAP. The actuary may use this value unless he or she considers that it materially differs from the one calculated in accordance with 2.1 or 2.2 above (in which case the actuary may wish to discuss the valuation with the auditor).

2.4 The actuary should take reasonable steps to verify that the assets being valued are actually held by the trustees and have not been lent or otherwise encumbered; the actuary may rely in doing so on work carried out by the auditor and on the trust’s own records.

3 Verification and valuation of liabilities

3.1 The liabilities of the trust to make payments will be set out in the trust deed. Payments will primarily be for the provision of funeral benefits for *plan* beneficiaries. However, it is likely that other payments will also be permitted or required, including for example to meet expenses incurred by the *Plan Provider*, to return some or all of a customer’s payments in the event of cancellation of the *plan* or to repay surplus assets to the *Plan Provider*.

3.2 The liabilities to provide funeral benefits may be expressed in the trust deed in a number of ways. These could be, for example, the full market price of a specified funeral arrangement, a proportion of the full market price, the original payment plus any investment return earned or simply a proportionate share of

the assets of the trust at market value. The amount to be paid may vary depending on the level of solvency of the trust.

3.3 Where the liabilities relate to the price or cost of funeral arrangements, a prudent allowance should be made for the future increase in such price or cost, bearing in mind any historic or expected future deviations from the general rate of increase in retail or wholesale prices. Where the liabilities relate solely to asset share, liabilities may be taken as equal to the assets.

3.4 Credit may be taken for contractual future payments from customers.

3.5 Liabilities should be discounted at a rate consistent with the nature of the liabilities. The current return from risk-free fixed-interest investments would be an appropriate benchmark for fixed monetary liabilities. For liabilities related to funeral prices or costs, the returns from risk-free retail prices index linked investments may be an appropriate starting point, although allowance also needs to be made for the risk of adverse deviation between retail prices inflation generally and the rate of increase of funeral prices or costs in particular (see 3.9 below).

3.6 Future mortality assumptions should take account of the demographic profile of the customer base. The actuary should consider whether an allowance is needed for initial anti-selective mortality. This may depend on the extent, if any, of medical underwriting. The actuary should consider carefully in which direction a margin of prudence should be added, depending on whether the liabilities of the trust will increase or diminish if customers live longer.

3.7 No account need be taken of future new business (but see 4.4 below)

3.8 Account should be taken of future discontinuance of individual *plans* where discontinuance increases the liability of the trust. Account may also be taken where discontinuance reduces the liability. In each case, a margin for prudence should be included in the appropriate direction. Any guaranteed minimum payment on individual discontinuance (e.g. return of customer's payment(s)) should be taken into account.

3.9 Account should also be taken of any future disbursements to the *Plan Provider* to cover its expenses of management. An allowance for future inflation should be made and an appropriate margin of prudence added. Future disbursements contingent on the receipt of future new business need not be allowed for

3.10 The actuary should take reasonable steps to verify the extent of the liabilities, including inspection of the records of the trust relating to customers' benefit entitlements, *plan* documentation provided to customers and the latest audited and unaudited accounts of the trust. Discussion of the proposed valuation assumptions with the trustees and/or plan provider is also likely to be of value in this process.

4 Additional advice

4.1 The verifications and valuations required by article 60(1)(b)(v) provide only limited information for the trustees or the *Plan Provider*. It is recommended that actuaries endeavour to agree a remit with the Trustees and/or the *Plan Provider* also to provide the information and advice in paragraphs 4.2 to 4.6 of this guidance note (see also 1.7 above). These paragraphs only to the extent of such a remit, if any.

4.2 A commentary should be provided on the implications of the relative values of the liabilities and the assets with regard to the ability of the trust to continue to meet its liabilities as they fall due, including, in particular, the following:

4.2.1 If the assets exceed the liabilities, an analysis of the adequacy of the excess to withstand reasonably likely adverse changes in the value of investments and in the main economic and demographic factors used to value the liabilities, reasonable assumptions being made regarding correlation between factors. The actuary should also advise the trustees of the minimum level of excess he or she considers appropriate for this purpose.

4.2.2 If the liabilities exceed the assets, the minimum level of excess of assets over liabilities that the actuary considers appropriate to withstand the changes referred to in 4.2.1 above.

In making the assessments referred to in 4.2.1 and 4.2.2, it is likely that the cost of hedging any mismatch of assets and liabilities in the derivatives market will be relevant.

4.3 The actuary should carry out an assessment of the adequacy of the payments required from new customers to provide the benefits under new plans. This assessment should use the same basis used to value the liabilities of the trust. In particular, where the actuary is aware that the trustees intend to follow a mismatched investment strategy, he or she should additionally assess the charge that should be made for the mismatch risk (the cost of hedging the mismatch in the derivatives market is likely to be relevant to this assessment). Account should also be taken of any payments to be made from the trust to the *Plan Provider* to cover its sales and marketing costs.

4.4 The actuary should assess the effect of accepting planned levels of new business on current terms, until the next scheduled triennial valuation, on the future financial position of the trust. If the effect is anticipated to weaken the financial position, the actuary should comment on the effect on the analysis under 4.2 above.

4.5 If the conclusion of 4.2, adjusted as necessary under 4.4, is either that there is or will be no excess of assets over liabilities or that the excess is or will be below the minimum level necessary to withstand the changes referred to in 4.2.1 above, the actuary should provide advice to the trustees on the options available to them if they wish to improve the situation. These might include:

- reducing or completely stopping the volume of new business accepted;
- increasing the payment required from new customers (taking care not to over-anticipate new business volumes, particularly after an increase in price);
- changing the nature of the investments to more closely match the liabilities. The actuary should advise on the types of assets and appropriate proportions to be held of each type. This advice should extend to the distribution of fixed-interest and index-linked securities by duration;
- reducing the benefits payable, either as specified under the trust deed, or by agreeing with the *Plan Provider* (or other provider of funeral arrangements) to accept a lesser payment for the provision of funeral benefits. The creditworthiness of the *Plan Provider* or other provider will be an important factor in assessing the benefit to be derived from taking up this option, particularly if the reduced benefits may be less than the marginal cost of providing the funeral arrangements;
- seeking additional capital from the *Plan Provider* (see 1.8 above) or other sources;
- seeking additional payments from the customers; and
- winding up the trust.

4.6 If the plan contains guaranteed withdrawal values, the actuary should consider the implications for the trust of mass early cancellation; for example in the event that a new or existing provider entered the market offering similar benefits for a lower payment than the withdrawal value or that the *Plan Provider* significantly reduced its own charges, creating a lapse and re-entry option. The liquidity of the investments would be an important factor in this analysis, as would their volatility.

5 The actuarial report

5.1 The report should first set out clearly the results of the valuations and verifications required by article 60(1)(b)(v) of the RAO, including a description of the basis used and the assumptions made. This section of the report should include a summary of the actuary's interpretation of the liabilities of the trust in respect of the plans, in particular drawing attention to any differences between these liabilities and the commitment to customers by the *Plan Provider* under *plans.*

5.2 If the scope of the investigation will be wider than that strictly required by article 60(1)(b)(v), the report should then go on to report on those wider matters.

5.3 If the actuary is reporting also on the financial implications of differences between the liabilities of the trust and the commitment to customers by the *Plan Provider* under *plans*, this should be done in a separate report addressed to the *Plan Provider* unless otherwise agreed with both the *Plan Provider* and the trustees.

5.4 The report should state whether it is in full compliance with this guidance note. If not, the alternative approaches or departures should be described and justified.

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