The Trustee toolkit downloadable

DB recovery plans, contributions and funding principles

Scenario one

In this scenario you and your fellow trustees look at your scheme's rules for setting the contribution rate, and consider whether legislation has any impact on your handling of this process.

You also decide which valuation method you wish to use for calculating your scheme's technical provisions.

As you work through this scenario you will be tested on your knowledge at decision points. Here you will have the option to work through a related technical tutorial before returning to the scenario or you can skip the tutorial. You can always work through the tutorial separately later if you would prefer. This scenario includes two tutorials:

- Determining the contribution rate
- Accrued benefits funding methods

Glossary

A detailed glossary of technical terms can be downloaded from the Resources tab when you log in at www.trusteetoolkit.com

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Upcoming meeting

You find you have a voicemail from Charlotte and an email with the agenda. The voicemail says:

"Hi, it's Charlotte. I just wanted to remind you of our meeting later this week. It's an important one so can you take a look at the agenda I've emailed you and make sure you come prepared with any questions you might have."

Agenda

1. Minutes of past meeting.
2. Matters arising.
3. Valuation methods.
4. Lawyer briefing.
5. Any other business.

The meeting begins

The meeting is underway and you're soon on to item three on the agenda, valuation methods.

Charlotte says: "So we have now agreed on the prudent assumptions we're going to use, but before we meet with Edmund to discuss the contributions we need to review and agree the valuation method for setting the technical provisions."

Adrian asks: "I thought the scheme rules say that we, as trustees, set the contribution rate?"

Rodney says: "I didn't think we needed Edmund's agreement as employer."

Charlotte says: "I see Beatrice is here already for our briefing later, so let's bring her in and check the steps we need to take."

Getting agreement to the contribution rate

Beatrice is happy to join the trustees early and answer their questions. She says: "As I'm sure you're all aware, the scheme rules say that as trustees you set the contribution rate. Legislation came into effect some time ago which changed the way that all schemes go about this. The regulator's code of practice sets out the regime in detail. The precise position for each scheme still depends in part on what is written in its scheme rules.

Before we look at your scheme in particular, I'll talk you through the paragraphs in the code which deal with the way schemes set contribution rates. This will show you the emphasis that the code puts on trustees and employers working together."

Decision point: Employer and trustees

Beatrice explains how schemes with different rules in respect of setting contributions are affected. Take a look at the sample rules below. To comply with the legislation, choose the option which best describes how trustees and employers are required to interact with each other in the following situations. The rules state that...

Options: Agree, Consult, Consult and agree

1. ...the contribution rate is set by the actuary. What is the trustees' duty in relation to the employer?
2. ...the contribution rate is set by the employer alone. What is the employer's duty in relation to the trustees?
3. ...subject to conditions, the contribution rate is set by the trustees. What is the trustees' duty in relation to the employer?
4. ...without conditions, the contribution rate is set by the trustees. What is the trustees' duty in relation to the employer?

Answers at the back

Need help with this question? Read the Tutorial 'Determining the contribution rate'

The impact on the scheme

Beatrice advises how this affects this particular scheme.

John says: "Now I understand what effect legislation has in general, but what does it mean for our scheme?"

Beatrice answers: "Your scheme rules state that the contribution rate is set by you, the trustees."Adrian says: "So after everything you've just said, that means we need to consult Edmund before making a decision."

Beatrice says: "Yes, that's right Adrian. You do need to consult Edmund, but you don't need his agreement."

John says: "Even so, I think that we should try and set a contribution rate that would suit Edmund. After all, the newco has taken on a large debt and we don't want the contributions to send it into insolvency."

Alicia says: "No one wants that John, but we've got to think about what's best for the members. I think it's a good idea to consult the employer – that way we can find out how much it's reasonable to ask for. But that might be more than what you, Edmund and the other directors would ideally want to pay."

Charlotte agrees: "Alicia's right, we've got a duty to put the members' interests first. We're here as trustees and we can't let any personal or professional conflicts stop us from discharging our responsibilities."

Valuation methods

Beatrice leaves for now and the discussion turns to valuation methods.

Charlotte says: "As well as consulting Edmund about contribution rates, we also need to discuss the valuation method for calculating our technical provisions with him. The regulator's code of practice states that it is up to the trustees to decide which method to use. But we should consult Edmund about it as well.

Our two main options are the current unit and the projected unit methods. I've spoken to Edmund briefly about this, and the employer's actuary is suggesting the current unit method, but I'm not so sure that it's a good idea. We need to make sure we know about both methods, so we can discuss the issue with Edmund."

Decision point: Which method?

The board discusses the different valuation methods for calculating the technical provisions. The scheme is an ongoing final salary scheme, closed to new members, has a high proportion of active members, relatively few deferreds and a small group of pensioners. Bearing in mind these characteristics, which two of the following statements about the different methods are true?

1. All schemes using the current unit method will see a reduction in liabilities compared to using the projected unit method
2. Trustees considering wind-up will often use the current unit method
3. The projected unit method does not allow for increases in benefits for active members
4. Trustees of schemes with a significant proportion of active members should consider using the projected unit method to reflect the true extent of the scheme's liabilities

Answers at the back

Need help with this question? Read the Tutorial 'Accrued benefits funding methods'

The meeting moves on

The board has decided that they should argue for the projected unit method, and they have solid reasons to support this decision when they talk to Edmund. Charlotte tells the board that she will set up a meeting with Edmund, in his role of employer. She thinks it will be easier if only a few of the board meet him and then report back to the others. She is looking for volunteers. Charlotte herself will go, of course, and Alicia jumps in quickly to say that she would like to attend the meeting. You would like to be part of the discussions so you volunteer too. With all that decided, the meeting is soon wrapped up.

Rounding up

In the next scenario you and two of your fellow trustees meet Edmund, your employer, to agree the method for calculating the technical provisions and discuss how to handle the recovery plan.

Now that you have completed this scenario we would recommend that you begin to work through the 'Check your scheme' worksheet for this module.

Answers

Decision point: Employer and trustees

1. Agree, 2. Consult and agree, 3. Consult, 4. Consult.

The general trend in the legislation and in the code is to ensure that the trustees consult with the employer before making a decision about the contribution rate. So if the scheme rules say that only the trustees or only the employer has the power to set the contributions, this is overridden so they must consult each other before the decision is made. However, if the rules say that the trustees have the power, they do not need the agreement of the employer.

If a third party sets the contribution rate, the trustees must take into account the recommendations of the third party with regard to calculating the technical provisions and preparing the recovery plan. Then they must agree the contribution rate with the employer.

Decision point: Which method?

The second and fourth answers are correct.

The current unit method is commonly used by schemes considering winding up. Not all schemes will see a reduction in their liabilities by using the current unit method. If a scheme has only deferred or pensioner members then there will be no difference in the liabilities.

Both methods allow for increases but the current unit method only allows for increases in past service benefits in line with inflation. You should consider the projected unit method as it is commonly used for schemes like yours with mostly active members.

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