

# The Trustee toolkit downloadable

## DB recovery plans, contributions and funding principles

### Scenario two

In this 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.

At the same meeting you also consider the contributions for future service.

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:

- ▶ Recovery plans
- ▶ Future service funding methods

#### Glossary

A detailed glossary of technical terms can be downloaded from the Resources tab when you log in at [www.trusteetoolkit.com](http://www.trusteetoolkit.com)

## A meeting with the employer

The meeting between you, Charlotte, Alicia and Edmund to discuss the DB section of the scheme is approaching. Charlotte has called you to confirm the time.

“Hi, it’s Charlotte. Thanks again for volunteering to talk to Edmund with me. Just a quick reminder that we’re meeting him in his office at 10 o’clock tomorrow. I’ve emailed you a brief list of things that we need to talk about.

I know his actuary wants him to use the current unit method for working out the technical provisions in order to reduce the liabilities. He also wants to use some weaker assumptions. It might be a long meeting. We need to discuss the:

- ▶ recovery plan
- ▶ method for calculating technical provisions
- ▶ future service contributions

See you there.”

## In Edmund’s office

You arrive at Edmund’s office and everyone else is already there.



Charlotte says: “Thanks for agreeing to meet us Edmund – there are a lot of issues that we need to discuss.”

Edmund says: “I wanted to have this meeting too. I know that the deficit has increased recently, and this changes my situation. There’s a limit to what the company can commit to the scheme. I’ve been talking to my actuary about ways in which we could reduce the company’s payments.

Charlotte, we’ve briefly spoken about using the current unit method to calculate the technical provisions, so I thought we could start there. I’d also like to discuss the possibility of using weaker assumptions.”

Charlotte replies: “That’s a good starting place. We talked about this at our last board meeting, and we all have some nervousness about it and would prefer to discuss the projected unit method.”

Alicia comments: “The problem with the current unit method is that it would make the liabilities appear lower, and could be considered to be imprudent, especially if we combine it with weak assumptions. We are all very conscious of the large loan the newco has taken on.”

## The method is agreed

The discussion continues and Edmund finally agrees that the projected unit method should be used instead of the current unit method. But he’s also got another suggestion that would help him reduce his payments.

Edmund says: “I discussed another option with my actuary. He said that increasing the recovery period would be a possibility. That way the company could reduce the size of the individual payments, but make more of them in the long run.”

Alicia says: “That might be an option, and it’s more likely to be within The Pensions Regulator’s (TPR) guidelines than the other ideas we’ve been discussing.”

Charlotte suggests: “We could consider a modest extension or perhaps look at back-end loading the contributions or increasing contributions from the loan.”



### Decision point: Recovery plans

The discussion about how to handle the recovery plan continues. Which two statements made during that discussion are true?

1. Because of the current difficulties, we could back-end load the contributions rather than ask for an increase now
2. We can lengthen the recovery period because we have a large number of active members
3. We can’t use different assumptions for the recovery plan from the ones used to measure technical provisions
4. We could always ask The Pensions Regulator (TPR) how long the recovery period for our scheme should be

[Answers at the back](#)



Need help with this question? Read the Tutorial ‘Recovery plans’

## Future service contributions

The four of you decide to look at options for extending the recovery period slightly and to back-end load some increased contributions. The discussion then moves on to the contributions for future service.

Alicia says: “A major concern for me is the feeling I have that the membership appears to be getting older on average, although I may be wrong.”

Charlotte agrees: “The scheme has been closed to new members for some time now, so active membership is falling and members are very likely to be getting older on average.”

Alicia adds: “This isn’t helped by the fact that there’s a high turnover of staff, which has increased the number of deferred members over the years and reduced the level of contributions. To get round this problem, maybe we could reopen the DB section of the scheme to new members.”

Edmund says: “I’m aware of all this but I really don’t want to reopen the DB section of the scheme. I think it would be far too costly in the long run, and new employees have the DC scheme that they can join.”



### Decision point: Future service contributions

The discussion continues and Charlotte points out that you all need to agree a method for calculating what the future service contributions will be. Taking into account what you have just been discussing with Edmund and the others, which of these methods do you think the trustees should use to calculate the regular contributions for future service for the DB section of the scheme?

1. Projected unit credit method
2. Attained age method
3. Entry age normal method

[Answers at the back](#)



Need help with this question? Read the Tutorial ‘Future service funding methods’

## Rounding up

In the next scenario you and your fellow trustees begin work on the schedule of contributions.

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: Recovery plans

The first and second answers are correct.

TPR accepts that a recovery plan should be tailored to meet the needs of the scheme (considering the risks the scheme faces) and the employer (considering their plans for sustainable growth). Some back-end loading can be appropriate where the employer could afford to pay the higher rate contributions when they would be due. If the scheme had fewer active members, there would be a shorter period before pension benefits fell due, so there would be less scope to lengthen the recovery period.

If the capital from the loan is being used to grow the business, the trustees are right to take into account the additional short term strain on the employer's cash flow, rather than demanding higher contributions now.

TPR makes clear that it will become interested if trustees produce a recovery plan that is unsuitable for their scheme. However, TPR does not commonly become involved in recovery plans until they have been produced and submitted. Trustees are free to use different assumptions in the recovery plan from the ones they have used in the technical provisions providing these are appropriate.

## Decision point: Future service contributions

Attained age method is correct.

The projected unit credit method assumes that the age profile of the scheme will stay broadly the same. But as the scheme is closed to new members the age profile will change, probably making this method inappropriate. This is because the contribution rates with an ageing membership are likely to increase over time.

The entry age normal method is also unsuitable. It assumes that there will be new joiners who will all be a similar age at entry and remain in service until retirement. However, there's no one entering the scheme, as it's closed.

Without new members the average age of the membership is likely to increase. The attained age method takes account of such ageing among members so this is the method they should choose for calculating future service contributions.