The Trustee toolkit downloadable

Funding your DB scheme

Scenario one

In this scenario you and your fellow trustees get to grips with the triennial actuarial valuation for the DB section of the scheme. You have preliminary discussions about the valuation process.

You think about the implications of the requirement to meet the statutory funding objective – one of the ways of measuring the liabilities and funding position of the scheme. There are several other ways of measuring the liabilities which you also have to consider.

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:

- The statutory funding objective
- Valuing the scheme's liabilities

Glossary

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

The Pensions Regulator

The draft valuation

The next trustee meeting is scheduled in a couple of weeks. It will be the first one since Edmund led the buy-out of the company and became managing director.

Agenda

1. Minutes of last meeting.
2. Matters arising.
3. Welcome to new trustee.
4. Triennial valuation: Preliminary discussion.
5. Q&A session with actuary.
6. AOB.

With the papers are some notes from the actuary.

The meeting

The meeting has begun and you're already on item three.

Charlotte says: "As you know Edmund is now the managing director since the management buy-out, so he is no longer part of the trustee board. The new financial director, John Lane, has joined us as a new employer-nominated trustee (ENT). Welcome John.

And we were just about to move on to item four, the preliminary discussion about the draft triennial valuation, which we now need to embark on. Robert will be joining us later to answer questions, but I thought we should have a general discussion first and make sure we're all up to speed."

Tony says: "I'd like a reminder of the purpose of the statutory funding objective before Robert arrives."

Charlotte responds: "And as we have a few new trustees since the last triennial valuation I thought this might be useful."

John says: "Thanks Charlotte, it would be good to make sure I'm on the same page as everyone else."

Charlotte says: "One of the purposes of the regular valuation is to check whether the statutory funding objective is being met. We undertake a triennial valuation, which is the one we are doing now, and interim reviews each year. We then have to make decisions about the future provision of the scheme. We will set this out in a schedule of contributions and, if the scheme is in deficit on an ongoing basis, we'll also need a recovery plan stating how we intend to make good the deficit."

Decision point: Statutory requirements

Which one of the following statements best describes what the trustees need to do?

1. Trustees need to use a set of prescribed assumptions for valuing the technical provisions to ensure that the valuation satisfies the requirements of the statutory funding objective
2. Trustees need to assess the difference between the scheme's assets and the cost of securing benefits immediately with insurance policies
3. Trustees need to choose a set of prudent assumptions for valuing the technical provisions to ensure that the valuation satisfies the requirements of the statutory funding objective
4. Trustees need to use a set of assumptions prescribed by the Pension Protection Fund (PPF) to check whether or not the scheme meets the statutory funding objective

Answers at the back

Need help with this question? Read the Tutorial 'The statutory funding objective'

Robert arrives

Robert is here and Charlotte moves on to measuring the liabilities. Charlotte says: "Thank you for joining us Robert. The first step in setting our funding objective is to measure the liabilities. There are several ways of measuring the liabilities and each one is appropriate for a particular purpose. Isn't that right Robert?"

Robert replies: "Yes it is. Each measure answers a different question and you need to know the answers to each question. Some assumptions are prescribed and others you need to choose prudently. I will provide advice on what assumptions to choose."

Decision point: Which measure is which?

Can you match the statements below to the measures they are describing?

Measures: Scheme funding, Solvency, PPF, Accounting

1. Assumes that all active members leave service on the valuation date. Assumptions are prescribed.
2. Trustees choose a set of prudent assumptions to determine the level of technical provisions.
3. Must be disclosed in the employer's accounts. Some assumptions are prescribed.
4. The difference between the value of the scheme's assets and the cost of securing insurance company annuities to buy out benefits accrued to date.

Answers at the back

Need help with this question? Read the Tutorial 'Valuing the scheme's liabilities'

Rounding up

In the next scenario Robert, the actuary, will report his initial results for the scheme funding valuation, and you will see how the calculations for past service and future service liabilities are made.

> 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: Statutory requirements

The third statement is correct.

For the purposes of the statutory funding objective the scheme must have sufficient and appropriate assets to meet its technical provisions. A valuation must be obtained to certify whether this is the case, or whether a recovery plan is required.

Furthermore, the trustees are responsible for choosing a set of prudent assumptions on which the valuation is based, after taking advice from the actuary.

Decision point: Which measure is which?

1. PPF, 2. Scheme funding, 3. Accounting, 4. Solvency.

The funding position under the accounting measure must be disclosed in the employer's accounts as the scheme is an unsecured creditor of the employer.

With the solvency measure, the funding position of the scheme is the difference between the value of the scheme's assets and the cost of securing insurance company annuities to buy out benefits accrued to date. Because insurance company annuities are very expensive, it has the effect of increasing the size of the liabilities. This means that the deficit, if there is one, is likely to be larger than that produced by the other measures.