The Trustee toolkit downloadable

DB recovery plans, contributions and funding principles

Tutorial one: Determining the contribution rate

By the end of this tutorial you will better understand:

- the differing roles and responsibilities between the trustees and employer in determining the contribution rate
- the importance of having an open and collaborative relationship with the employer in determining the contribution rate
- the need to consult with the scheme actuary when determining the calculation and assumptions used for determining the contribution rate

This tutorial is part of **Scenario one**.

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 Tincars scheme

The board of trustees of the Tincars scheme are discussing contribution rates. The more experienced trustees explain that normally trustees must reach agreement with the employer on key funding matters such as contribution rates. However, the legislation requiring the employer's agreement is modified for schemes where the rules give someone other than the employer the power to determine the contribution rate.

Who sets the contributions?

The experienced trustees explain the different legal positions that apply if the scheme rules of the Tincars scheme said each of the following:

- The sponsoring employer has the power to determine the contribution rate. Regardless of the rules of these schemes, the trustees and the employer are required to reach agreement about the contents of the schedule of contributions.
- Without any conditions, the trustees determine the contribution rate and only they can reduce or suspend contributions. The trustees are required to consult the employer before setting the contribution rate, but the employer's agreement is not required.
- Subject to conditions, the trustees have the power to determine the contribution rate and only they can reduce or suspend contributions. The trustees are required to satisfy the conditions set out in the scheme rules and to consult the employer about the contribution rate, but the employer's agreement is not required.
- Someone other than the trustees or the employer (eg the actuary) advises about or determines the contribution rate. The trustees must take into account the recommendations made by the other person about:
  - the method and assumptions for calculating the technical provisions
  - the preparation of the recovery plan (if there needs to be one)

  The trustees are then required to obtain the employer's agreement

Why consult with the employer?

The trustees look at the scheme rules for the Tincars scheme and see that the trustees can, without any conditions, determine the contribution rate and only they can reduce or suspend contributions.

Consult with the sponsoring employer

One of the newer trustees does not understand why they need to consult with the sponsoring employer before setting the contribution rate, if they do not need the employer's agreement. The other trustees explain that setting the contribution rate is always a difficult task. Although the employer must meet its obligations to the scheme, the trustees have to try to strike the right balance between the needs of members and the needs of the employer. The two need not necessarily conflict. The Pensions Regulator accepts that a strong ongoing employer alongside an appropriate funding plan is the best support for a pension scheme.

Example: Contribution rate

For example, where there is an ongoing deficit and the employer is unable to afford the level of contributions that it was previously paying, the trustees could consider extending the timescale for making good the deficit to reduce pressure on the employer in the short term.

If they do not take affordability into account, they could end up setting a contribution rate that the employer is not currently able to meet potentially:

- preventing growth in the employer
- damaging its future profitability

In extreme circumstances, this could potentially force it into insolvency. This course of action may not be in the interests of members.

Salaries

The trustees need to take future salary increases into account when they are setting the contribution rate and the employer is in the best position to let them know what these increases are likely to be. The employer will also know about possible changes to the workforce, and therefore to the number of members.

Wind up?

If there are no active members (ie the scheme is closed to future accrual) the trustees may be considering the eventual wind-up of the scheme (in this case, their statutory funding objective may be to reach 100% funding on a buy-out (solvency) basis). If this is the case, trustees are likely to suggest markedly increased contributions from the employer in their consultation.

Advice from the actuary

The trustees all agree that it would be useful to have an ongoing dialogue with the employer. They then go on to discuss who else they need to talk to. The trustees need to get advice from their scheme actuary when they choose the method and assumptions for calculating their technical provisions. They should also seek advice from the scheme actuary if they are considering a modification to the scheme for future accrual, or when preparing or revising their:

- Statement of Funding Principles (SFP)
- recovery plan
- schedule of contributions

This advice will usually take the form of a range of scenarios from which the trustees can select the most appropriate solution for their scheme.