**Defined Benefit Arrangements**

**Assignment 3**

*(Part 4 – Scheme Funding and Investment Strategy)*

*Recommended Time: 3 hours*

1. **Outline a member’s statutory rights to a Cash Equivalent Transfer Value (CETV) and briefly explain the basis of the CETV calculation.**

**20 marks**

Relevant section of the manual is Part 4 Chapters 5.3 and 5.3.1.

Format: descriptive

Answer should cover:

* The Pension Schemes Act 2015
* The 3 categories of benefit
* Partial transfers
* Link to the value of the preserved benefits
* Calculation represents cost to scheme of providing benefits
* Discount rate
* Inclusion of discretionary benefit
* Member option to increase the value of the benefits
* Allowance for expenses

1. **You are the Scheme Actuary. Prepare a short paper outlining to the Trustees the content of a Scheme Funding Report.**

**10 marks**

Relevant section of the manual is Part 4 Chapter 2.1.

Format: formal, with a short introduction and summary

Answer should cover:

* Timescale for producing the Report-the report must generally be produced within 15 months of the effective date of the valuation. The report must be made available to scheme members on request.
* The purpose of the Report
* The information that the Report must contain such as the results of the valuation, including the current funding levels on the technical provisions basis, the funding level on the assumption that the scheme wound up on the valuation date, the future service cost and, if agreed, details of future contributions

1. **You are the Sponsoring Employer’s pensions adviser. The Company is currently in discussion with the scheme trustees to agree a de-risking strategy for the scheme. Prepare a report for the Employer covering:**

* **A typical de-risking strategy**
* **A brief outline of 3 solutions used to mitigate or remove investment risk**
* **The factors which should be considered when deciding the level of risk to be taken**

**30 marks**

Relevant section of the manual is Part 4 Chapters 6.7 and 6.8.

Format: formal report with introduction, clearly headed sections, conclusion, and recommendation

Answer should cover:

* Traditionally Asset Liability Modelling was carried out every three years following an actuarial valuation with somewhat static goals. More recently trustees have looked to take a more dynamic approach, with many adopting a de-risking strategy. A de-risking strategy effectively looks to take risk off the table by moving the assets towards a portfolio of assets that better match the characteristics of the scheme’s liabilities. This often involves setting defined targets (in terms of the funding level) which will trigger a de-risking action (such as switching growth assets into better matching assets such as bonds and/or liability driven investment (LDI) solutions
* An example of a strategy and the funding level triggers
* A short explanation of the following, including why they are suitable (up to 7 marks each):
  + LDI
  + Longevity Swaps
  + Buy-ins/buy-outs… Under both buy in and buy out arrangements all the financial and longevity risks are passed to the insurer. In return the insurer charges a premium that is payable, normally, immediately. There are cases where some of the premium has been deferred for a number of years, but this is an exception rather than the norm. The choice between buying out or buying in the liabilities is complicated. Under the buy in approach, as the bought in members continue to be members, the scheme will still be responsible for ensuring that all necessary disclosure requirements are met for those members and will still be responsible for the actual payment of benefits. As the scheme is simply insuring its liability for these benefits, however, the purchase of a buy in is simply an investment decision for the trustees and does not require the extensive member communication exercise that is needed before benefits are bought out.

1. **You are the Chair of a Trustee Board. A new trustee has emailed you asking you to briefly explain what is meant by Benefit Outgo and Contribution Income. Prepare a response which briefly explains what is meant by these terms.**

**5 marks**

Relevant section of the manual is Part 4 Chapter 1.3.2.

Format: email with appropriate headers

Answer should cover:

* What is benefit outgo and how is its value arrived at
* What is contribution income and how is its benefit arrived at
* The answer should be relatively short to ensure that the explanation is clear yet concise.

1. **You are preparing a training session for PMI students on the accounting standards applicable to companies with DB pension liabilities. Write notes on the various accounting standards that are used by companies when providing the financial impact of the pension scheme in their company accounts.**

**10 marks**

Relevant section of the manual is Part 4 Chapters 4.2 and 4.3.

Format: informal, list/bullets

Answer should cover:

* UK accounting standards:
  + IFRS
  + Companies Act 2006
  + Differences between FRS 100, FRS 101, and FRS 102
  + Surplus/deficit shown on balance sheet
  + what is reflected in the profit and loss account
* International and US accounting standards:
  + IASB
  + IAS19
  + FASB

1. **Explain the key features of the following:**
2. **Statement of Funding Principles (5 marks)**
3. **Recovery Plan (5 marks)**
4. **Schedule of Contributions (5 marks)**

**15 marks**

Relevant section of the manual is Part 4 Chapters 3.4, 3.5 and 3.6.

Format: descriptive, with some bulleting if preferred.

Answer should cover:

* SFP timescale and what is included - The trustees must prepare the SFP within 15 months of the valuation date. It should be made available to members on request and should cover:
* • the trustees’ policy for ensuring that the SFO is met
* • the methods and assumptions used
* • the period over which any shortfall will be made up
* • certain other information prescribed in The Occupational Pension Schemes (Scheme Funding) Regulations 2005/3377
* Why a Recovery Plan is necessary
* The Code of Practice identifies issues which trustees should take into account when considering the structure of the recovery plan. These include:
* • the employer’s business plan, expenditure commitments and sustainable growth plans
* • the scheme’s membership profile
* • the position of the scheme if the employer were to become insolvent
* RP must include a date by which the deficit will reduce to zero
* The Schedule of Contributions (SoC) must:
* • set out the rates of contribution by members and the employer and also the dates on which contributions are to be paid
* • identify any special contributions, such as those which form part of the recovery plan or are required to meet expenses
* • be sufficiently clear to enable the trustees to monitor contributions
* • avoid any cross reference to other scheme documents
* Scheme Actuary must certify the SoC

1. **Describe why a scheme’s funding level is a key factor to consider when choosing an investment strategy.**

**10 marks**

Relevant section of the manual is Part 4 Chapter 6.1.2.

Format: descriptive prose, no requirement for a formal report

Answer should cover:

* Considerations for a scheme in surplus-Although trustees of a scheme with a surplus of assets over liabilities have scope to follow a higher risk/return seeking strategy, there is little value in building up a large and growing surplus. A large surplus may ultimately be refunded to the scheme’s sponsor less a tax charge, depending on the rules of a particular scheme
* Considerations where a scheme is in deficit or funding level is 100%
* Answer should demonstrate an understanding of the various considerations