NOVEMBER 2003

news

sackers extra

Funding DB Schemes – setting the contribution rate

Following on from our autumn workshop, "Piggy in the Middle", we take a fresh look at the often difficult area of setting the employer's contribution rate in a defined benefit (DB) scheme. This newsletter focuses, in particular, on the issues for trustees.

DB funding

The legal requirement

- DB schemes must currently meet the statutory Minimum Funding Requirement (MFR), although many schemes fund at a higher level than MFR due to the terms of the scheme rules.
- Trustees and employers must work together to set an employer contribution rate that is both manageable in the short-term and capable of sustaining the scheme in the long-term.

The trustees

Setting/agreeing the rate

- What rate needs to be paid depends upon the scheme rules and who sets the employer contribution rate.
- The trustees' primary responsibility is to safeguard scheme members' financial interests.
- Trustees therefore need to work with the scheme actuary to ascertain an appropriate employer contribution rate.
- To achieve this, trustees should discuss with their actuary the factors being used in the actuarial valuation as early as possible.

The actuary

Advising trustees

- The scheme actuary will have a formal appointment under s.47 of the Pensions Act 1995 to act for the trustees (not the employer). Trustees can only rely on the appointed actuary's advice.
- The same actuary may also advise the employer, unless there is a conflict of interest.
- For example, if the trustees and employer need to agree the contribution rate and have trouble doing so, the employer may have to appoint its own actuary.

SACKER & PARTNERS

Important factors

What should trustees consider?

- In ascertaining the contribution rate, trustees should review (among other things):
  - the scheme's contribution rule;
  - the strength of the employer's covenant (i.e. what level of funding has been promised?);
  - the scheme's existing liabilities, including any past service deficit;
  - the cost of providing future benefits;
  - the likely longevity of the new rate.

Agreeing the rate

The employer's interests

- Alongside their responsibilities to members, trustees need to take account of the employer's interests, in particular, its ability to pay.
- But trustees must not be afraid of testing the employer's commitment by asking questions:
  - what is the employer's financial position?
  - is it a case of "can't pay" or "won't pay";
  - can the employer afford to make a cash injection?

The paper trail

- Trustees should keep written records of their questions, the answers given and any advice generally received on setting the rate.

Legislative changes

Draft winding-up regulations

- Although not yet in final form, draft regulations issued on 11 June 2003 require a solvent employer to buy benefits out in full on winding-up the scheme.
- If trustees have unilateral power to wind up a scheme, assuming the regulations remain unchanged, they could provide a significant negotiating tool if trustees cannot agree the employer's rate.
- Other proposed changes to DB funding requirements from Spring 2005 may further strengthen the trustees' position.

Conclusions

- Throughout their discussions, trustees and employers need to remember that their partnership is essential to the scheme's long-term survival.
- Effective communication between the parties is therefore crucial.

This newsletter is one of a series produced by our Schemes in Transition Unit (SITU) established specifically to assist clients in the process of changing pension provision. If you would like further information on setting contribution rates, please contact Jane Kola or Janet Brown.

Jane Kola Partner jane.kola@sacker-partners.co.uk
Janet Brown Solicitor janet.brown@sacker-partners.co.uk

SACKER & PARTNERS

Solicitors specialising in pensions law

29 Ludgate Hill
London EC4M 7NX
Tel 020 7329 6699
Fax 020 7248 0552

enquiries@sacker-partners.co.uk
www.sacker-partners.co.uk

Nothing stated in this document should be treated as an authoritative statement of the law on any particular aspect or in any specific case. Action should not be taken on the basis of this document alone. For specific advice on any particular aspect you should consult the usual Solicitor with whom you deal. **© Sacker & Partners November 2003**