# Questions for Users of Actuarial Work
# Pension Scheme Funding

**Trustees are required to obtain regular actuarial valuations of their schemes and make decisions about contributions. In doing so they must decide on a funding policy. They must select the actuarial assumptions to be used. These assumptions must be chosen prudently. They are required to draw up a recovery plan if there is a shortfall and they must set out future contribution requirements in a schedule of contributions. The trustees must first obtain advice from their Scheme Actuary. It is important that trustees understand the actuarial advice they are given and provide challenge to the Scheme Actuary providing that advice.**

**We set out below some high level questions which we hope will help trustees in the Scheme Funding process. Most questions are designed to be raised with the Scheme Actuary.**

## Planning

**Scheme Funding exercises are complex and require good management.**

- Is there a timetable in place?
- How is the process monitored?
- Does the process start early enough so that there is sufficient time for data processing, calculation, negotiations with the sponsor and decision making?

## Discount Rate

**A discount rate is required to calculate the Technical Provisions. The discount rate is one of the most significant assumptions – small changes to the discount rate can have a significant impact on the results of the Scheme Funding calculations.**

- How is the discount rate derived?
- How does the discount rate compare with the rate used for other schemes? (eg as reported in publications by the Pension Regulator)
- How comfortable are you that the investment return on scheme assets will be at least as great as the discount rate?
- How does the discount rate compare with the rates of return from low risk assets such as government bonds?

## Mortality

**Life expectancy has continued to improve and new information regularly becomes available.**

- How do the mortality assumptions relate to latest published statistics about mortality rates?
- Do you understand how your actuary has allowed for future changes in mortality rates?
- Do the mortality assumptions make allowance for the specific nature of your pension scheme membership such as the occupation and location of members?
- Does your actuary present mortality assumptions in a way you can understand?

## Other Assumptions

**While the discount rate and mortality assumptions tend to get the highest profile, other assumptions can have a significant impact on the actuary's calculations. These assumptions include:**

- **rates of inflation, pension increases and salary increases;**
- **costs of administration and investment;**
- **membership changes; and**
- **the take up of options such as early retirement, cash commutation and transfer out of the scheme.**

- How are these assumptions chosen?
- Where pension increases are linked to inflation (eg CPI or RPI), possibly with a cap, how are the relevant assumptions derived?
- How much of the future costs of administration and investment are allowed for in the Technical Provisions and how much are assumed to be met from future payments from the sponsor to the scheme?
- Does the calculation of the Technical Provisions assume members exercise options (eg cash commutation) in the future which will be financially beneficial to the scheme?

## Scenario and sensitivity analysis

**It is important that trustees have an understanding of the risk and uncertainty facing the pension scheme.**

- Are models in place to show how different future scenarios would affect the pension scheme?
- Is there a sensitivity analysis carried out for key actuarial assumptions?

## Sponsor Covenant

**The Pensions Regulator states that trustees should take account of the sponsor's covenant when making decisions during the Scheme Funding process.**

- How is your sponsor covenant assessed and how is it taken into account in making Scheme Funding decisions?

## Cash Flows

**Cash flows into and out of a pension scheme will change over time.**

- Are projected cash flows reviewed regularly?
- Are there peaks or troughs in cash flows that need to be recognised and managed?

## Working with your Actuary

**To ensure you get high quality actuarial work it is important that you can rely on your actuary and have an effective working relationship.**

- Do you have a process in place to notify the actuary of significant events which happen after the valuation date and which might affect the funding position?
- Does your actuary have other interests or responsibilities which might affect their perceived objectivity, such as giving advice to both the trustees and the scheme sponsor?
- If there are conflicts of interest how are they managed?
- How well does your actuary explain his or her advice?
- Does actuarial advice reflect the specific requirements of your scheme's trust deed and rules?
- Does your actuary provide appropriate input to the discussion of associated topics such as investment strategy?
- What quality assurance processes does your actuary use?
- How is your actuary's compliance with statutory requirements and professional standards monitored?

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