An tÚdarás Pinsean
The Pensions Authority

Financial management guidelines for defined benefit schemes

These guidelines set out what practices the Authority expects trustees to follow, at a minimum, in order to understand and manage the funding and investment of their defined benefit scheme. The provisions are divided into four parts:

1. Data about the scheme that the trustees should have available to them

2. Governance practices relevant to financial management

3. Processes that the trustees should follow

4. Analysis that the trustees should undertake in order to arrive at decisions

Trustees should ensure that they have access to adequate actuarial and investment advice. However, the responsibility for the scheme always rests with the trustees, who should therefore ensure that they understand the advice they receive and the decisions they as trustees are required to take.

It is hoped that these guidelines will be of assistance to trustees in outlining good practice. This should be aimed at even where it is not mandatory. Where in the guidance it is stated that action should be taken, this refers to recommended good practice.

An tÚdarás Pinsean
The Pensions Authority

1. Scheme data

The following is the minimum information that the trustees of defined benefit schemes should have available to them and within what timeframe:

Information	How often	When
Scheme asset value	At least annually	Within one month of year end
Investment return relative to benchmarks and targets	Annually	Within three months of year end
Investment allocation relative to strategy	Annually	Within three months of year end
Scheme liabilities and solvency position (including progress relative to funding proposal, where relevant)*	At least annually^	Within three months of year end
Costs compared to budget (where borne directly by the scheme)	Annually	Within three months of year end

*For larger schemes estimates of membership numbers should be used where appropriate in order to avoid delay. For all schemes, liability estimates should be used where appropriate.

^In the event of major investment losses or increases in liabilities the scheme should review its funding position as soon as practicable.

2. Governance

The following governance practices are especially relevant to the financial management of the scheme and for the purpose of reviewing scheme data:

- There are regular scheduled trustee meetings. The frequency is a matter for the trustees. At least two meetings a year are likely to be necessary and it is likely that larger schemes will need to meet at least quarterly. All decisions about financial management should be approved at formal trustee meetings, apart from exceptional circumstances. These meetings should have pre-circulated agendas and papers and written records of attendance, proceedings and decisions.

- Trustees should ensure that any delegation of their functions is permitted by the trust deed and is formally decided at a trustee meeting and clearly recorded. Trustees should take great care in selecting the person or organisation to whom they delegate a specific function and should monitor and review the actions of that person or organisation at regular intervals. Trustees should consider whether a trustee sub-committee reporting back to the full trustee board would be an effective approach to handling some issues.

- The trustees should have engaged a scheme actuary and whatever other advisors they feel to be appropriate. In all cases, the trustees should be satisfied that they are the primary client of the advisor and that any relationship the advisor has with other parties does not affect on this primary relationship. The advisor should be required to confirm that there is no conflict of interest. The trustees must also consider carefully whether occasional rotation of advisers would be in the best interests of the members of the scheme.

- Where the employer bears some or all of the costs of running of the scheme, there should be a written agreement between the trustees and the sponsoring employer(s) setting out the terms, including any restrictions on the freedom of trustees to incur costs.

- The trustees should have a written statement of investment policy principles (this is a legal requirement for larger schemes), which describes the investment strategy of the scheme clearly and specifically.

- Trustees should ensure they have a full understanding of their investment powers under the scheme rules and the requirements of the statutory investment regulations.

- Trustees should have a clear understanding of the contribution provisions under the trust deed and rules of the scheme and should ensure that the steps required to determine contributions payable are properly followed.

3. Processes

In addition to their responsibilities under the Pensions Act, the following tasks should be undertaken by trustees periodically:

Task	**Frequency**
Review of investment strategy	Three yearly
Review of contribution and funding adequacy*	Three yearly
Preparation/review of risk matrix*	Annually
Discussion with employer about contributions and related issues	Annually
Review of investment manager performance	Three yearly
Review of scheme costs (where costs are charged to the scheme)	Three yearly

* Section 4 below considers these tasks in more detail.

The reviews of investment strategy and contribution adequacy should be undertaken sooner in the event of any major change to the circumstances of the scheme.

4. Analysis

The trustees have responsibility for the ongoing management of the scheme and must invest the contributions and provide the money necessary to meet the benefits set out in the scheme rules.

Two important aspects of the financial management of a defined benefit scheme are:

(a) Are the scheme contributions adequate to provide the benefits of the scheme in the short and long term?

(b) What is the risk that the benefits cannot be paid?

Contributions

In consultation with the scheme actuary, the trustees should consider the following:

- What contribution rate is needed to provide current and future benefits as set out in the scheme rules?

  Because of future uncertainty, trustees should examine the costs of providing benefits under a range of different assumptions, and pay particular attention to results that don’t assume significant future investment outperformance.

- Given the current contribution rates by members and employers, what rate of long-term investment return will be required to pay benefits?

  Trustees should consider whether the required investment return is reasonable or could only be possible by undertaking risky investment. They should also consider whether the required return is consistent with the current investment strategy.

- If the scheme currently meets the funding standard, what combination of contribution and investment return will be needed to maintain solvency relative to the standard over the next three years? If the scheme does not meet the funding standard and has a recovery plan in place, are the assumed rates of contribution and investment return in that plan sustainable and achievable?

  The funding standard is a statutory measure of solvency whose purpose is to protect members’ benefits. However, it is important to remember that it is a minimum standard only.

- How willing and able is the sponsoring employer to maintain the contribution rates needed to pay the benefits?

  Trustees should regularly discuss the sustainability of the current contribution rate with the employer. Such discussions should also cover the question of what would happen in the event that deficits occur in the future.

Risk management

As well as assessing whether the scheme is adequately funded, the trustees must understand the risks to which the scheme is subject, i.e. what events may harm the scheme's ability to meet its obligations. The trustees should undertake an annual risk assessment which identifies the biggest risks, assesses how likely they are to occur, assesses what impact they would have if they came to pass, and examines what the scheme should be doing to limit the risk.

There is a wide range of risk management templates available: the following is a high level overview of the process that trustees should follow, in consultation with their advisers and, where appropriate, the employer:

(a) Identify the greatest risks.

The risks may vary from scheme to scheme, but the greatest risks for a typical defined benefit scheme are

- Longevity increasing by more than expected
- Investment losses or lower than anticipated returns
- Liabilities increasing because of falling interest rates
- The sponsoring employer being unable or unwilling to pay the necessary contribution rate
- Scheme liabilities increasing because of unexpected growth in member earnings

(b) Assess risk likelihood

Although it is rarely possible to put a meaningful numerical value on any risk, trustees should at least be able to assess likelihood as high, medium or low.

(c) Impact

Trustees should make a broad estimate of the likely impact on the scheme solvency and cost of any of the risks, in consultation with the scheme actuary.

(d) Mitigation

Where a risk is such that the future of the scheme would be threatened, trustees should decide what steps they should take to limit the impact. This may involve reducing the likelihood or the impact of the risk arising or deciding on the steps that will be taken if the risk comes to pass.

Results of the analysis

The purpose of the above analyses is to identify threats to the ability of the scheme meet its liabilities and to allow the trustees to consider what they should do in response. Trustees need to recognise and be knowledgeable about risks and to make a conscious, informed decision of what action, if any, is being taken – taking no particular action to mitigate a risk is also a decision provided consideration has been given to how one will deal with the outcome if the risk materialises.

It is not possible to generalise about what steps should be taken, but trustees should bear in mind their responsibility to balance the financial interests of all members of the scheme. Some risks will have different effects on different classes of members. This is a challenge for trustees given their responsibility to balance the interests of all members of the scheme.

Version 1.0 22 May 2015