TPT Retirement Solutions

DB Pension Schemes: Key terms

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This document will help to explain some of the terms you may see or hear in our communications for a defined benefit (DB) pension scheme.

Accrual rate

This is the rate at which a member builds up benefits in a **defined benefit** (DB) scheme. For example, in a scheme with a final salary 1/60th accrual rate, the pension is calculated as 1/60 x pensionable salary x pensionable service. Alternatively for a CARE 1/60th accrual rate, the pension is calculated as: 1/60 x pensionable salary in one year, each year's pension is increased in line with price inflation up to a maximum of 5% in any one year.

Accrued benefits

The benefits that members have already built up in the scheme.

Actuarial assumptions

The **actuary** makes assumptions to estimate the cost of the **liabilities** of the scheme. The assumptions fall into two categories - financial and demographic.

Financial assumptions will influence the estimated cost of providing member benefits (e.g. the amount of investment return, the rate of inflation) and demographic assumptions influence the timing and probability of the benefit amount being paid (e.g. when members will take their benefits, how long members will live).

Assumptions are used to determine the value of the estimated **liabilities** of the scheme at a point in time, but are only an estimate of the ultimate cost of providing member benefits.

Actuarial valuation

This is an assessment of the **assets** and **liabilities** of the scheme by an **actuary**, usually every three years. The **actuary** will work out how much money needs to be put into the scheme to make sure member benefits can be paid in the future.

Actuary

An expert on pension scheme **assets** and **liabilities**, life expectancy and probabilities (the likelihood of things happening).

Assets

Contributions already paid into the scheme, which are invested solely to provide funding for member benefits.

CARE (Career Average Revalued Earnings)

A defined benefit scheme where the member builds up pension which is related to their earnings each year.

Closed to accrual
A scheme where all members have stopped building up any new benefits.

Covenant (or employer covenant)
The employer's legal obligation and financial ability to support its **defined benefit** (DB) scheme now and in the future.

Deferred member
A member of a pension scheme who is no longer building up new benefits in the scheme but has not yet taken their benefits. Someone would become a deferred member if they left the employer they were with when they joined the scheme or chose not to contribute to the scheme anymore.

Deficit
Where the value of scheme **assets** is less than the **liabilities**, the difference between the two is known as the **deficit**.

Deficit contributions
Payments made by the employers participating in the scheme to eliminate the **deficit** over an agreed period of time (as set out in the **Recovery Plan**).

Defined benefit (DB)
A type of pension scheme where the amount a member gets at retirement is based on a formula which takes into account salary, **accrual rate** and length of service.

Discount rate
The discount rate is one of the **actuarial assumptions**. It is an estimate of the return on investments in the future. This is used by the **actuary** to work out how much money needs to be put into the scheme to make sure member benefits can be paid in the future.

Final salary
A **defined benefit** scheme where the member's **salary** at (or close to) retirement forms part of the formula for calculating the benefits due.

Funding level
This is a measure of the scheme **assets** compared to the **liabilities**, usually expressed as a percentage.

Gilts
Gilts are fixed-interest loan securities issued by the UK government which guarantee to pay the holder a regular income (yields) in the form of interest for a set period of time, until the bond matures, after which the loan must be repaid. **Defined benefit** (DB) schemes use gilt yields as an indicator of the long-term return they are likely to get in their **discount rate**.

Growth assets
Investments which are expected to provide higher returns. They include investments such as shares and property. They tend to carry higher levels of risk, but have the potential to deliver higher returns over longer investment time frames.

Liabilities
The cost of the benefits which the pension scheme will have to pay to members. This includes benefits currently in payment and those expected to be paid at some time in the future to members. The cost of benefits payable in the future is an estimate, based on **actuarial assumptions**.

Liability-focused assets (or defensive or matching assets)
Investments which are expected to provide stable returns with lower risk and more aligned with the **liabilities**. They include investments such as **gilts** and **liability driven investment**.

Liability-driven investment
Pension scheme **liabilities** are typically due to be paid over decades and the cost of these is directly linked to inflation, interest rates and how long members live. An LDI solution invests some of the **assets** to help reduce the impact of any changes. So if interest rates or inflation changes, **assets** and **liabilities** rise or fall together and the funding level of the pension scheme should be less volatile.

Multi-employer scheme
A pension scheme that has more than one employer.

Orphan liability
When an employer leaves the scheme, it is required to pay a **withdrawal debt**. The withdrawal debt is paid into the Scheme's **assets**. The **liabilities** built up by the members of that employer become 'orphan' i.e. they have no employer or 'parent' associated with them. These **assets** and **liabilities** are shared amongst the remaining participating employers in the scheme based on each employer's overall share.

Paid up member
A member who is no longer paying contributions or building up new benefits, but their benefits are still linked to their salary.

Pensioner
A member who is currently receiving their retirement benefits in the form of regular payments.

Pension Protection Fund (PPF)
A statutory fund established to pay compensation to members of eligible **defined benefit** (DB) schemes, when there is a qualifying insolvency event in relation to the employer and where there are insufficient **assets** to cover a certain level of benefits promised to members.

Recovery Plan
A documented agreement between the Trustee and employer which sets out the contributions that will be paid to eliminate the **deficit** over an agreed period of time.

Solvency basis (or 'buy out' basis)
A method of calculating the value of the estimated **liabilities** which assumes that the scheme ceases at the calculation date and all member benefits are secured with an insurance policy. The **actuarial assumptions** in this calculation are very prudent because no contributions will be paid in the future, the **assets** are expected to be invested in **liability-focused assets** and insurance company fees are included (on the latest market prices).

This leads to the highest estimated cost of the **liabilities** of the scheme and is used to allocate the share of the **withdrawal debt** to each employer.

Technical provisions (or 'ongoing' basis)

A method of calculating the value of the estimated **liabilities** which assumes that the scheme will continue into the future until all benefits are paid to members. This method is used in the **actuarial valuation** which determines the **deficit contributions** payable by each employer.

Withdrawal debt

Since 2005 it has been a legal requirement that any employer withdrawing from a **defined benefit** (DB) multi-employer scheme that has a deficit pays a 'one-off' debt to the scheme. This provides funding for the benefits that its members have built up and is calculated on the **solvency basis**.

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