DWP Department for Work and Pensions

# The Financial Assistance Scheme

## Guidance on method and assumptions to use when undertaking a valuation under Regulation 22 of the Financial Assistance Scheme Regulations 2005

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# Guidance on method and assumptions to use when undertaking a valuation under Regulation 22 of the Financial Assistance Scheme Regulations 2005

# Section 1: Overview

## Effective date of guidance

1. This version of the valuation guidance applies to schemes with a *Calculation Date*[1] on or after 30 September 2010, which, on the date of the publication, have not yet received notification of approval of their valuation by the *FAS Scheme Manager*.

## Revisions made to previous version

2. This is version GA1.2 of the guidance. It replaces version GA1.1 to provide clarification on:

    - The assumption to be used for the valuation of pensioner liabilities where the qualifying scheme –

        - had already started to wind-up between 6 April 1997 and 18 March 2002 and on 19 March 2002 was still in the process of winding-up; and
        - had a sponsoring employer that was not insolvent at the time the winding-up commenced ("Pre 2002 schemes").
        - The revised guidance clarifies that for these schemes, pensioner liabilities, including increases, should be valued on a buy out basis rather than a Minimum Funding Requirement basis (see Section 6)

3. In addition, the guidance has been amended to provide updated information on when schemes should pay arrears to the estates of deceased members before assets transfer.

# Introduction

4. The Pensions Act 2004 as amended ("the Act") and the Financial Assistance Scheme Regulations 2005 (SI 2005/1986) as amended ("the Regulations") set out the conditions that must be met for a scheme to qualify for the Financial Assistance Scheme (FAS).

5. Relevant *Beneficiaries* of qualifying schemes which have completed wind-up (usually by the purchase of annuities or payment of transfer values or lump sums) will continue to receive a top-up payment from the FAS in line with the

[1] Italicised terms in this guidance are defined in the Glossary in Section 7.

Regulations. Qualifying schemes which have not already completed wind-up – and that do not purchase annuities in the future as a consequence of a binding commitment or permission from the *FAS Scheme Manager* – will transfer their assets to government. If a *Beneficiary's* liability was (or will be) discharged by payment of a lump sum (e.g. a transfer value or a winding-up lump sum) and/or purchase of an annuity, that *Beneficiary* will generally receive a top-up assistance payment calculated in the same way as a *Beneficiary* of a scheme which completed wind-up, even if the scheme's remaining assets are subsequently transferred to government.

6. As part of the rules and processes governing the transfer of assets to government, the assets of the transferring scheme that are available to discharge the liabilities in respect of each *Beneficiary* of the scheme must be calculated and this amount is the *Beneficiary*'s *Asset Share*.

7. A valuation under Regulation 22 will determine the *Asset Shares* of eligible Beneficiaries of schemes which are transferring assets to government. The *Asset Shares* will determine, based on standard assumptions, whether Beneficiaries would have received more than standard FAS assistance had an annuity been purchased with their share of scheme assets. In addition, it is intended that some Beneficiaries will be entitled to commute some of their assistance in exchange for a FAS lump sum on reaching normal retirement age. For such Beneficiaries, the Asset Share may affect their entitlement to a lump sum, since the amount of assistance which can be given up for a lump sum can be no higher than the value at retirement of the Notional Pension that could have been purchased with the Beneficiary's Asset Share.

8. Following the valuation, a *Notional Pension* will be calculated for each *Beneficiary* under regulation 27. This is the regular notional annual income that could have been provided by the scheme if its final funding position had been known at the start of wind-up[2]. The *Notional Pension* payments are deemed to start from the earlier of:

   - the date the person was (or is expected to be) entitled to assistance; or
   - the date that the scheme started paying a pension to the *Beneficiary*,

   but in any case no earlier than the start of wind-up.

9. The *FAS Scheme Manager* will seek to reconcile payments actually made during the wind-up period with the amount of the *Notional Pension*. However, if deceased *Beneficiaries* have been overpaid, they will effectively be excluded from the valuation as described below. If deceased *Beneficiaries* who never became entitled to FAS (e.g. early retirees) have been underpaid, the *FAS Scheme Manager* will not have the power to pay the estates of such *beneficiaries*, so trustees will be expected to make relevant payments to estates on the approval of the *FAS Scheme Manager*, whilst the Government considers extending the legislation in order that such payments can be made by the *FAS Scheme Manager*. Further information on these *Beneficiaries* is provided in paragraph 30 below.

[2] The date of the start of wind up is determined in accordance with Regulation 3 of the Regulations

10. The *FAS Scheme Manager* will instruct trustees to obtain an actuarial valuation and must approve the *Valuation Actuary* appointed for this purpose. In most cases the Government expects that the existing scheme actuary will be appointed as the *Valuation Actuary*.

# Purpose of this guidance

11. This guidance on method and assumptions should be followed by actuaries undertaking valuations to determine the *Asset Shares* of *Beneficiaries* in FAS qualifying schemes that are transferring assets to government. The procedures in this document should be considered as applying only to these schemes. The guidance should not be considered as applying more generally to schemes in wind-up nor as indicating the Government's view of how procedures should be applied in a wider context.

12. The *FAS Scheme Manager* will use the basis described in this document to calculate *Notional Pensions*. Where liabilities are calculated on a buy-out basis, this will be the same basis as is used by the *Valuation Actuary* to calculate the *Asset Shares*.

13. A glossary of key terms is appended to this document. Actuaries may also find the associated document containing example calculations helpful.

14. If actuaries have any queries on the practical application of this guidance please contact the Pension Protection Fund (PPF) caseworker or the scheme's allocated actuarial contact at the PPF

# Waiving valuation requirements

15. The Government anticipates that full valuation calculations will not be required in all cases, for example if the results of the valuation would not have a material effect on *Beneficiaries*' benefits. The *FAS Scheme Manager* is provided with powers under the Regulations to waive certain valuation requirements where it is of the opinion that it is appropriate to do so. In many such cases, the Government expects FAS caseworkers and trustees to have established whether any of these flexibilities might apply in the case of a particular scheme in advance of the valuation being commissioned and the *FAS Scheme Manager* will advise the *Valuation Actuary* as to the parts of the guidance which do and do not apply. If, during the course of the valuation, the *Valuation Actuary* identifies any calculations that are not necessary or cost effective to undertake then they should discuss with the *FAS Scheme Manager* whether relevant requirements might be waived.

# Data

16. The Government accepts that schemes may not always have all the data required to carry out the required calculations. Prior to the valuation being commissioned, the scheme caseworker will work with the trustees and

administrators to ensure data is as complete as possible and any data problems are resolved.

17. The *Valuation Actuary* should contact the scheme administrators prior to the valuation to ensure that the administrators can provide the necessary data required for the valuation. Where the administrators cannot do this, the *Valuation Actuary* should work together with them and the trustees to ensure that data problems are resolved prior to the valuation.

18. The *Valuation Actuary* will be asked to confirm that, based on evidence sheets provided by the caseworker, they do not foresee any data issues with the valuation. Therefore once the valuation is commissioned, the full data required for the valuation should be available to the *Valuation Actuary.*

19. It is important to ensure that data sets used for the S1 form and validation template are consistent. Therefore where any data issues are identified after the valuation is commissioned, the *Valuation Actuary* should ensure that administrators are aware of these issues and steps are taken to ensure consistency of both data sets.

## Valuation reporting

20. The valuation results should be addressed to the *FAS Scheme Manager* and the trustees or managers of the scheme. Although the Regulations require the trustees or managers to obtain the valuation it is anticipated that trustees may not always wish to receive a copy of the results and that in many cases it will be pragmatic for the results to be submitted directly to the *FAS Scheme Manager*. *Valuation Actuaries* should discuss such arrangements with the trustees or managers of the scheme. The *FAS Scheme Manager* and the trustees or managers must be able to rely on the results, so any caveat given should allow for this.

21. The results of the valuation should be provided to the *FAS Scheme Manager* within the timescale agreed when the *FAS Scheme Manager* commissions the valuation. Agreement of these timescales will involve the *FAS Scheme Manager*, the *Valuation Actuary* and the scheme trustees or managers. The agreed timescale will not need to build in a time allowance for data cleansing because the valuation will only be commissioned by the *FAS Scheme Manager* following the completion of a data audit.

22. The results should be submitted in the form of a completed spreadsheet (the “validation template”) containing *Beneficiary* and scheme data and calculation results. The validation template should be provided to the *FAS Scheme Manager* or trustees or managers of the scheme by the *Valuation Actuary* and this will be deemed to satisfy the requirement for the *Valuation Actuary* to sign the report. The validation template is available from the *FAS Scheme Manager*. The *Valuation Actuary* may submit a partially completed validation template including the calculation of liabilities but excluding allocation to *Asset Shares* if accounts are not yet finalised. This will enable validation by the *FAS Scheme Manager* to start as soon as possible. A fully completed validation template

cannot be submitted until audited accounts (or equivalent information[3]) are available.

23. It is not necessary to report liabilities in priority classes in which the coverage is nil. The procedure described in this document describes the calculations required in order to calculate all priority classes. The *Valuation Actuary* may input zero amounts for calculations that are not necessary due to the coverage in certain priority classes being nil.

24. The information provided in the completed validation template and at the request of the FAS scheme manager will be comprehensive, and further information will not be taken into account. We therefore consider that it is very unlikely that actuaries will have to submit any further information in addition to the template in order to comply with Technical Actuarial Standard – Reporting (TAS R) issued by the Board for Actuarial Standards (BAS). However, this is ultimately a matter for the judgement of the individual actuary. If the actuary wishes to provide any further information in relation to TAS R or other Technical Actuarial Standards, the actuary may use the "additional information" section in the "Valuation Summary" tab of the Validation Template.

# Process after submission of the valuation

25. Once the completed validation template has been submitted, the *FAS Scheme Manager* will decide whether it has been prepared in accordance with the Regulations and this guidance. If it is satisfied, then it will approve the valuation and notify the trustees or managers of the qualifying pension scheme of the approval.

26. If the *FAS Scheme Manager* is not satisfied that the valuation has been prepared in accordance with the Regulations, then it will commission another valuation report. Any further valuations will have the same *Calculation Date* as the first valuation.

27. A valuation becomes binding once the *FAS Scheme Manager* has approved it and once the period for a review of the approval of the valuation has expired or, if application for review has been made, after that review has been completed.

28. Once the valuation has become binding, the *FAS Scheme Manager* will give notice of this to the trustees or managers and the Pensions Regulator and send a copy of the valuation to the trustees or managers of the scheme.

29. Generally, once assets transfer, the *FAS Scheme Manager* will calculate *Notional Pensions* for *Beneficiaries* included in the valuation and reconcile scheme and FAS payments during wind-up, making arrears payments in respect of any underpayments and adjustments in respect of any excess

[3] The FAS Regulations provide that in circumstances where audited accounts are not readily available and the FAS scheme manager is of the view that it is not necessary for audited accounts to be prepared, the value of assets at the calculation date may be established on the basis of such information as the FAS scheme manager considers appropriate. Such cases will be identified by the FAS Scheme Manager in consultation with scheme trustees before the valuation is commissioned.

payments accordingly. However, there are exceptions to this approach where arrears of pension are due to certain Beneficiaries who die before assets transfer to government.

## Death before the transfer of assets

30. If a Beneficiary is entitled to arrears of a scheme pension at their date of death but is not entitled to a FAS payment at that point, trustees, rather than the FAS scheme manager, should pay any arrears of scheme pension that are due to the estate before assets transfer.

31. In cases of doubt, actuaries should seek advice from caseworkers.

# Section 2: Valuation approach

## Effective date of the valuation

1. There should already be an agreed date of the start of the scheme's winding-up process ('*Commencement Date*'), as determined under Regulation 3 of the FAS Regulations.

2. It is expected that the *Commencement Date* will normally be the same as the Crystallisation Date referred to in Regulation 4 of the Occupational Pension Schemes (Winding Up) Regulations 1996 (SI 3126/1996) (as amended) (the "Winding Up Regulations") will usually be the *Commencement Date*. Relevant FAS schemes, which have been winding up for some time, would have used the Crystallisation Date to allocate members' liabilities to statutory priority classes. If the two dates differ, trustees should contact their PPF caseworker.

3. The date for the purposes of the calculation of the *Asset Shares* (the '*Calculation Date*') will be the last day of the month in which the *FAS Scheme Manager* instructs the trustees or managers of the scheme to obtain the valuation. References in this guidance to "wind-up period" or "wind-up process" refer to the period from the *Commencement Date* to the *Calculation Date*.

## Approach to the calculation

4. This guidance refers to the framework of legislation and guidance that would have applied to schemes winding up. This is because the valuation in FAS schemes transferring assets to government should generally be carried out in the same way as the asset share calculation that would have been prepared had the scheme completed wind-up, subject to the exceptions set out in this guidance document.

5. Where winding up legislation is summarised in this guidance it should not be taken as a definitive statement of the law.

6. Under the terms of the FAS legislation, wind-up must have commenced in the period 1 January 1997 to 22 December 2008. The actuarial guidance note GN19: Retirement Benefit Schemes – Winding-up and Scheme Asset Deficiency issued by the Board for Actuarial Standards (BAS) should be followed by the *Valuation Actuary*. Version 4.5 of GN19 is applicable for the purposes of this valuation for schemes that commenced winding-up between 1 January 1997 and 5 April 2005. The appropriate version of GN19 for schemes that commenced winding-up between 6 April 2005 and 30 November 2008 is version 4.8. If a scheme commenced winding-up from 1 to 22 December 2008 then the calculations should be carried out as if version 4.8 of GN19 applied to the calculations.

7. However, the provisions of GN19 relating to the selection of the effective date of the calculation do not apply (see paragraph 3 above) and the completed validation template submitted by the *Valuation Actuary* will be deemed to be

addressed to the *FAS Scheme Manager* and the trustees or managers of the scheme.

# Beneficiaries covered by the calculation

8. *Asset shares* are to be calculated for the *Beneficiaries* described in paragraph 2 of Regulation 22 with reference to Regulation 21(2). If this guidance conflicts with the FAS Regulations, the Regulations will prevail.

9. The calculation will cover the following *Beneficiaries*:

   - all *member*s of the scheme who are alive at the *Calculation Date*;
   - all other *Beneficiaries* who are in receipt of a payment from the scheme at the *Calculation Date* (including survivors, surviving dependants and other *Beneficiaries* to whom the scheme, as a result of the death of a *member*, has a liability to provide a benefit); and
   - all *Beneficiaries* who died during wind-up as described below.

   *Beneficiaries* who have had their benefits partially discharged by an annuity will be excluded from the calculation, as described in paragraph 17 below.

10. *Beneficiaries* of the scheme on the day before the *Commencement Date* who died during the wind-up process are included in the valuation. The *Asset Share* calculation for such *Beneficiaries* included in the calculation should only include allowance for payments made to that *Beneficiary*, and not include allowance for pension payments arising as a result of the death of the *Beneficiary* as these payments will instead be allowed for in a separate *Asset Share* calculation carried out for the recipient of those payments. More details of this are described in paragraph 12. In practice, if an overpayment has been made to these deceased *Beneficiaries*, then a negative *Asset Share* will be initially calculated for them and then they will be excluded as described in section 3, paragraph 14.

11. If the *Beneficiary* died during wind-up but before the *Calculation Date*, then the calculation of liabilities should be based on the benefits payable during the period from the start of wind-up to the *Beneficiary's* actual date of death.

12. Separate calculations should be carried out for a *member* who died during wind-up and any *Beneficiaries* who received payments arising from the death of that *member*. Payments made after the death of the *member* should be allocated between the *member* and *beneficiaries* as follows:

    - The *Asset Share* calculation for each *Beneficiary* should only include allowance for payments made to that *Beneficiary* and not those made to the *member* whose death gave rise to the *Beneficiary's* pension.
    - Any lump sums paid or due on the death of such a *member* should be included in the assets and liabilities for the *member* whose death gave rise to them.

- If a death gives rise to a pension paid to a *Beneficiary*, that pension should be included in the assets and liabilities for that *Beneficiary*, even if the pension is temporary or is paid at a higher rate for a short period after the *Beneficiary's* death.
- However, if a continuing pension (e.g. a five year guarantee) is paid to the deceased *member*'s estate (and not to another *Beneficiary* directly), then this should be included in the assets and liabilities for the deceased *member*.

13. The *Asset Share* calculation for *member*s who are alive at the *Calculation Date* should include allowance for contingent payments to survivors and surviving dependants of these *member*s.

14. *Beneficiaries* who transferred-out of the scheme during wind-up or had their liability discharged by purchase of an annuity in their name before assets transfer to government will receive assistance calculated in the same way as for comparable *Beneficiaries* of schemes which complete wind-up. They are not included in the valuation. However, a Beneficiary who received a lump sum by commutation but is still entitled to receive benefits from the scheme should be included in the valuation.

15. The FAS scheme manager will provide directions on how *members* whose liabilities were fully discharged by payment either of a winding-up lump sum or a trivial commutation lump sum should be allowed for. In general it is expected that the FAS scheme manager will direct that such *members* should be excluded from the valuation. If such *members* are included in the valuation the total amount paid to the member during wind-up should be treated as an expense of the scheme (and thus effectively afforded first priority). The payments made to such members will not be included in the *Adjusted Assets* or the *Adjusted Liabilities*. This will result in a nil *Adjusted Asset Share* and *Asset Share* being determined for such members.

16. *Beneficiaries* whose liabilities were partially discharged by a partial transfer or payment of a State Scheme Premium should also be included in the valuation. If the *Valuation Actuary* is not sure whether a *Beneficiary's* transfer was partial or full, he or she should refer to the scheme's caseworker for guidance. A *member* whose only benefit is a Guaranteed Minimum Pension and whose liabilities are discharged by payment of a State Scheme Premium should be excluded from the valuation.

## Initial valuation to assess *Beneficiaries* partially discharged by an annuity

17. Some *Beneficiaries* whose benefits were partially discharged by an annuity during wind-up will not be included in the final valuation figures. However, the *Valuation Actuary* will need to include them in an initial valuation in order to assess the value of assets that should be used to complete the discharge of their benefits via the purchase of annuities. Details of these *Beneficiaries* will be included in the results submitted to the *FAS Scheme Manager*, but with a flag to indicate their status. *Beneficiaries* who have received a partial transfer value or

for whom a State Scheme Premium has been paid will continue to be included in the valuation unless they are excluded for some other reason.

18. In an initial valuation, and any final valuation that includes members with partial annuities, the value of future annuity payments should be calculated according to the guidance on the valuation of assets and included in the *Adjusted Assets*. The amount of annuity payments paid direct to the *Beneficiary* or paid to the scheme and then passed on by the scheme to the *Beneficiary* before the *Calculation Date* (along with any other payments made to the *Beneficiary)* should be included in the *Adjusted Assets* and deducted from the *Beneficiary's Adjusted Asset Share* in order to calculate the *Beneficiary's Asset Share*.

19. If a *Beneficiary's Asset Share* calculated in the initial valuation is lower than the value of future annuity payments to be made from the annuity purchased in that *Beneficiary's* name, then the member should be included in the final valuation in the same way as in the initial valuation.

20. If a *Beneficiary's Asset Share* calculated in the initial valuation is equal to or higher than the value of future annuity payments to be made from the annuity purchased in that *Beneficiary's* name, then the member's liabilities and *Asset Share* should be set as nil in the final valuation. Payments made by the scheme to the *Beneficiary* during wind-up should not be included in the *Adjusted Assets* and neither should the value of future annuity payments. They should be flagged in the validation template as described in the validation template guidance. However, *Beneficiaries* whose liabilities have been partially discharged by an annuity but who would not stand to gain from further annuity purchase will also be included in the final valuation. The caseworker will indicate which *Beneficiaries* should be included in the final valuation because of this.

# Discretionary benefits in the calculation of liabilities

21. All discretionary benefits actually paid during wind-up to *Beneficiaries* covered by the calculation should be included in the calculation of *Adjusted Assets*.

22. In the case of schemes that started winding-up before 6 April 2005, benefits paid due to the exercise of discretion by the trustees or managers before the *Calculation Date* should be included in the calculation of liabilities in section 3, paragraphs 4 and 5 except any that are excluded under the paragraphs below because they also involved exercise of a Beneficiary option.

23. In the case of schemes that started winding-up from 6 April 2005, discretionary benefit entitlements should be adjusted if necessary in line with section 73A(7) of the Pensions Act 1995 and regulations 6 and 7 of the winding-up regulations.

24. Future awards of discretionary survivor benefits should be included to the extent that they are covered by section 4, paragraphs 23 to 29.

# Beneficiary options in the calculation of liabilities

25. If a *Beneficiary* received a lump sum during wind-up as a result of commuting pension, then the calculation of liabilities for periods before and after the *Calculation Date* should be based on the pension that would have been paid if the commutation had not taken place. However, if a Beneficiary commuted all their benefits for a winding-up or a trivial commutation lump sum (including any such payments paid on death), then the payments that they actually received will be treated as the amounts due to them and there will be no further liability of the scheme to them, as described above.

26. If a *Beneficiary* retired early or late during wind-up, then the calculation of liabilities for periods before and after the *Calculation Date* should be based on the pension that would have been paid if the early or late retirement had not taken place and as if the *Beneficiary* had retired (or will retire) at their *scheme Normal Pension Age* or the start of wind-up if later.

27. Similarly, if the *Beneficiary* took any other option within the scheme during wind-up, then the calculation of liabilities should be based on the benefits that would have been paid if that option had not been taken.

28. If a *member* who died during wind-up exercised an option before the start of wind-up which affects another *Beneficiary's* benefits, then the liabilities calculated in respect of the surviving *Beneficiary* should be calculated based on the benefits payable as a result of the option being taken.

29. Note also, the guidance on future exercising of *Beneficiary* options in section 4, paragraphs 34 -35.

# Basis of calculation

30. In calculating the value of liabilities, paragraph 3.1 of version 4.5 of actuarial guidance note GN19: Retirement Benefit Schemes – Winding-up and Scheme Asset Deficiency refers the actuary to actuarial guidance note GN27: Retirement Benefit Schemes – Minimum Funding Requirement and to Regulation 4 (varied where applicable by Regulation 4A, 4B or 4C) of the Winding Up Regulations.

31. These references indicate the circumstances in which calculations are to be carried out using either the Minimum Funding Requirement (MFR) basis approach or an insurance company buy-out basis approach. The MFR basis is described in actuarial guidance note GN27 and related legislation.

32. Relevant FAS schemes should follow the basis of calculation set out in winding up legislation and actuarial guidance notes subject to the exceptions set out in this guidance. Sections 4 and 5 of this document provide further guidance on the assumptions to be used by FAS schemes when a buy-out basis is to be used in calculations.

33. MFR liabilities should be calculated excluding the expense allowance.

34. The MFR allows for an alternative basis for schemes that have a "gilts-matching policy" for liabilities relating to various classes of *Beneficiary*. Use of the gilts-matching policy basis requires the last Statement of Investment Principles (SIP) to state that the trustees' policy is to meet all liabilities (excluding liabilities in respect of any money-purchase benefits other than underpin benefits) in respect of the chosen classes of *Beneficiaries* from investments in gilt-edged securities.

35. Schemes may have switched asset classes to gilts as part of the preparation for transfer of assets. For the purposes of FAS valuations and asset transfer we consider that it is possible for schemes to switch into gilts without the last SIP as at the *Calculation Date* stating that a gilts-matching policy has been adopted and thus for an equity MFR basis to apply.

36. The MFR basis is different for members who are a "pensioner" and a "non-pensioner" as defined in s124 of the Pensions Act 1995. Members should be treated as being a "pensioner", "non-pensioner" or both depending on whether they are entitled to present payment of benefits or a tranche of benefits. This effectively means that liabilities calculated on an MFR basis assigned to pensioner priority classes will be calculated according to the "pensioner" assumptions and those assigned to non-pensioner priority classes will be calculated according to the "non-pensioner" assumptions. "Dubery" members will therefore be both a "pensioner" (in relation to benefits to which entitlement has arisen) and "non-pensioner" (in relation to benefits to which entitlement has not yet arisen). The MFR pension age and the end of the "switch-over period" should be determined with regard to "non-pensioner" liabilities only. A "non-pensioner" will only have one MFR pension age that will be determined with regard to the date that the member's non-pensioner liabilities come into payment.

37. Under the MFR calculation, GN27 specifies that non-pensioners should be assumed to retire at MFR pension age. If a member has benefits that come into payment at an age other than MFR pension age, the *Valuation Actuary* should use the early/ late retirement adjustment factors that the scheme would apply for that member.

38. Regulations 4(4) and 4(5) of the Winding Up Regulations allow the actuary to adjust the liabilities calculated under the statutory priority order for schemes commencing wind-up from 6 April 1997 to 5 April 2005. Similar adjustments are permitted under regulations 4(5) to 4(8) of the Winding Up Regulations for schemes commencing wind-up from 6 April 2005. Such adjustments can be applied in respect of FAS schemes using this guidance. If, in the *Valuation Actuary*'s opinion, such an adjustment is deemed necessary in a FAS scheme then it should be made and the *FAS Scheme Manager* should be informed of this on the template. The reason for the adjustment should also be stated. It is anticipated that the most common adjustment would be to calculate liabilities on a buy-out rather than MFR basis. If this is the adjustment made, then the basis described in this guidance should be adopted as the buy-out basis. When

deciding whether an adjustment is required, actuaries should note that the basis described in section 4 will be applied for calculations of *Beneficiaries*' *Notional Pensions* with the same effective date of calculation.

39. Section 6 provides a summary of which basis applies to the different priority classes.

# Priority order

40. In prioritising the allocation of assets against liabilities, actuaries should follow the statutory requirements that would have applied in the particular circumstances of their schemes. The following summarises the relevant provisions as they will apply to FAS schemes following this guidance. .

41. If the wind-up is deemed to have commenced during the period 1 January 1997 to 5 April 1997 (during which a statutory priority order did not apply), the valuation should be carried out following the priority order requirements of the rules of the scheme concerned.

42. If the wind-up is deemed to have commenced during the period 6 April 1997 to 22 December 2008, then the *Asset Shares* should be calculated using the relevant priority order under section 73 of the Pensions Act 1995 (as amended). Section 6 summarises these priority orders and the assumptions required to calculate them. If the scheme's assets are more than sufficient to cover the statutory priority order liabilities, then the scheme's priority order should be used to allocate the remaining assets.

43. There is a body of case law relating to statutory priority order calculations. It is expected that this will be taken into account when the valuation is carried out. Particular points to note are:

    (a) *Beneficiaries* are classified as having entitlement to pension that has arisen if they were able to claim their pension unencumbered at the crystallisation date. They do not have to have actually claimed or have received the pension.

    (b) A *Beneficiary* may have some benefits that are classified as "pensioner" and others that are classified as "deferred" (a "Dubery" *member*).

44. A single *Asset Share* should be calculated for any "Dubery" *members*, even if assets come from pensioner and deferred liability classes. A "Dubery" *member* typically has benefits payable from different dates and the crystallisation date falls between those two dates. This would also include a *member* of an NRA65 scheme with a GMP payable from age 60 who had not retired and was aged between 60 and 65 at the crystallisation date.

45. The liabilities associated with money purchase assets should be treated as having a priority above the liabilities that are allocated through the statutory priority order calculation. Where such liabilities relate to an underpin arrangement note needs to be taken of the specific section on underpins at paragraph 65 below.

46. In practice, since assets relating to these money purchase benefits are not going to be transferred to government, the *Valuation Actuary* can simply note the aggregate amount of the assets which is not to be transferred.

47. Where the scheme's rules are unclear on any point material to the outcome of the valuation the *Valuation Actuary* should seek instructions from the trustees or managers and inform the *FAS Scheme Manager*. Any consequent material assumptions made should be disclosed in the results reported to the *FAS Scheme Manager* (and consequently copied to the trustees or managers).

# Equalisation of benefits

48. Where the only source of inequality is the difference between Guaranteed Minimum Pensions (GMPs) for men and women then benefits must be equalised for all *Beneficiaries* without the need to find a comparator[4]. *Valuation Actuaries* may follow the procedure described in the boxed text in paragraphs 49 to 57 below to achieve this equalisation. However, we recognise that there is no single defined method for equalising Asset Shares and alternative approaches may also be valid.

49. The purpose of the procedure is to check if *Beneficiaries* could receive higher assistance if their *Asset Share* liabilities in respect of service after 17 May 1990 were calculated on the benefit basis appropriate for the opposite sex and to change the benefit calculation if this necessary.

50. If a different equalisation procedure has been followed, the *Valuation Actuary* should ask the *FAS Scheme Manager* about how to allocate to priority classes the liabilities for benefits that have been changed as a result of the equalisation exercise.

# Possible equalisation procedure

51. The *Valuation Actuary* calculates liabilities for each *member* with service between 17 May 1990 and 5 April 1997 inclusive on the benefit basis applying to their true and opposite sex in respect of that period. Actuarial assumptions used continue to be those relating to each *member*'s true sex. The *Valuation Actuary* calculates liabilities for each *Beneficiary* included in the valuation who is not a *member* based on the benefit structure applying to the true and opposite sex of the *member* whose service gave rise to the rights in the scheme in respect of that *member*'s service from 17 May 1990 to 5 April 1997. Liabilities relating to service prior to 17 May 1990 are calculated based on the *member*'s true sex. The opposite sex calculation includes all benefits, not just the GMP so that the total pension at leaving service is unchanged but the balance between GMP and excess will be different, providing that total pension is higher than the GMP.

[4] A comparator is a comparable colleague of the opposite sex.

52. The *member* data used to calculate liabilities on the opposite sex basis is the same as that used when trustees assess which sex benefit basis to provide when entering data on the S1 form. (Further guidance on completing the S1 form is provided in the Guidance on Equalising Expected Pension which also covers legal points relating to which benefits should be equalised.)

53. Amounts payable during wind-up on the opposite sex basis are also used for the *Adjusted Liabilities* calculation.

54. For the purposes of allocating *Adjusted Liabilities* to priority classes, entitlement to a GMP arises at GMP payable age. This is 60 for a GMP calculated using the female formula and 65 for a GMP calculated using the male formula.

55. Section 6 summarises the statutory priority classes. When allocating liabilities to priority classes for a *Beneficiary* whose scheme started winding up between 6 April 1997 and 9 May 2004 inclusive, the GMP is treated as falling into priority classes (c) and (e) when the entitlement to payment of that GMP had not arisen or would have not arisen (if the *member* had been the opposite sex) at the start of wind-up. If entitlement had arisen or would have arisen (if the *member* had been the opposite sex), then it is treated as falling into priority classes (b) or (d).

56. A *member*'s benefits accrued after 17 May 1990 are either calculated entirely on a female basis or entirely on a male basis. The benefit calculation that is used for the valuation is the one that generates the higher *Asset Share* for the *member*. The result of the process described in paragraphs 49 to 57 will be to determine the sex that will be used to calculate benefits for each *Beneficiary* in the valuation.

57. For most *Beneficiaries*, the benefit calculation used is the one that generates the higher total *Adjusted Liability* for that *Beneficiary*.

58. There are some exceptions to the rule in the paragraph above, for instance, the female benefit calculation may produce a higher sum of the *Adjusted Liabilities* in priority classes (aa) to (e) (i.e. up to and including increases on contracted-out rights) but the male benefit calculation may produce a higher sum of the *Adjusted Liabilities* in classes (aa) to (f) (i.e. including all liabilities) on the priority order for schemes that started winding-up between 6 April 1997 and 9 May 2004 inclusive. If such a *member* is only funded to the level of GMP, then the female calculation would give a higher *Asset Share*. This could occur if female GMP were more valuable than male but if the male excess were more valuable than the female and sufficiently that the total male liabilities were more valuable than the female. Members 3 and 4 in the second scheme shown in the attached examples document are examples of this sort of member. More generally, the exceptional cases are *Beneficiaries* for which *adjusted liabilities* summed up to and including a certain priority class are higher on a different sex calculation than *adjusted liabilities* summed up to including the next priority class.

59. For any of these exceptional cases, the benefit basis used is the one that generates the higher *Adjusted Asset Share* for that *Beneficiary*, based on the funding level of the scheme. In other words, if the valuation were carried out with the benefit calculation swapped to that of the other sex from the one actually used for any individual *Beneficiary*, that individual would end up with a lower *Adjusted Asset Share* than in the actual calculation. This method is described in the valuation description in section 3. The calculation method shown is designed to provide a method that will efficiently identify the correct benefit basis for all *member*s.

# Allowance in calculation for payments since commencement of wind-up

60. The standard asset share calculation approach should be adapted to allow for payments made by the scheme during wind-up, in comparison with the payments that would have been made had the final funding position of the scheme been known at the outset. Schemes should not in general pay arrears or recover excess payments made since the start of wind-up since the *FAS Scheme Manager* will reconcile these and some of these may be offset by under or excess payments of FAS payments over the period from start of wind-up to asset transfer.

61. Further adaptations to the asset share calculations are required where any assets remain unallocated once the calculations have been carried out using the statutory priority order and basis described above.

62. The calculation procedure below can lead to negative *Asset Shares* for some *Beneficiaries* for whom past excess payments are so large as to exceed the value of future payments due to the *Beneficiary*. Section 3, paragraph 14, describes the iterative method to be used to remove such *Beneficiaries* from the valuation if they died before the *calculation date*, by effectively reducing the *Asset Shares* of other *Beneficiaries*. Schemes in this position may be aware of this situation without the need for detailed calculations. If the trustees or managers want to avoid reductions in *Asset Shares* of other *Beneficiaries* as a result of this process, then they may, with the agreement of their caseworker, seek to recover excess payments from these deceased *Beneficiaries* who would otherwise be excluded from the valuation, before the *Calculation Date*. This should be carried out in advance of the *Calculation Date* to avoid delays in completing the valuation process. If the valuation results show that such a pre-valuation recovery is too large, then the FAS regulations allow for the excess to be repaid to the estate as long as the deceased Beneficiary was entitled to FAS payments.

63. The situation is different for deceased *Beneficiaries* who were not entitled to receive Assistance before they died. The FAS Scheme Manager does not have the power to take action in respect of excess payments (or under payments) made to such *Beneficiaries.* Trustees should take this into account when deciding what actions to take in respect of these members before the valuation

is carried out. (See also paragraph 30 of section 1 in relation to these members.)

64. The impact of the adaptations is outlined in section 3 below.

## Underpin benefits

65. The Government is reviewing the treatment of underpin benefits in the FAS valuation and will provide further guidance on this matter in due course. If actuaries are undertaking valuations for schemes that provide underpin benefits they should contact the PPF caseworker or the scheme's allocated actuarial contact at the PPF.

## Money purchase benefits

66. Regulation 22(7) of the Regulations provides that when valuing the assets of the scheme, the *Valuation Actuary* shall disregard any assets representing the value of any rights in respect of money purchase benefits under the scheme rules. Liabilities relating to money purchase benefits should also be disregarded. It is the intention that money purchase assets should be transferred out of the scheme rather than transferred to government.

## Voluntary contributions

67. Under FAS Regulations and processes, the trustees or managers of the scheme may choose to discharge any defined benefit deriving from voluntary contributions before remaining assets transfer to government. This includes any such benefits that are in payment out of scheme resources that may have initially accumulated on a money purchase basis[5]. Where trustees intend to discharge such benefits, relevant assets and liabilities should be disregarded in the valuation report. If trustees do not intend to discharge such benefits, the relevant assets and liabilities should be included in the valuation report.

## State Scheme Premiums

68. If a State Scheme Premium (SSP) has been or will be paid in respect of a *Beneficiary*, then the liabilities for that *Beneficiary* should exclude the GMP that the scheme no longer has to provide. This covers GMP payments made at any time after the start of wind-up, so covers payments made before the *Calculation Date* and those due to be made after the *calculation date*. If a SSP is due but not paid, it should be included in the scheme expenses. It is recognised that the approach adopted for SSPs in the valuation is not consistent with the approach adopted when calculating *Standard Assistance*[6].

[5] Voluntary contributions should include any employer contributions matching contributions made by members, following the view of the Court of Appeal in *Bridge*.

[6] In calculating *Standard Assistance* the GMP is included and a deduction made in respect of the amount of the premium to help ensure that members receive at least 90% of the pension accrued at wind-up regardless of the amount they receive from the State as a consequence of reinstatement.

# Valuation of assets

69. Actuaries should refer to the accompanying accounts guidance, '*Information on the preparation of relevant accounts and guidance for actuaries to value particular assets to support FAS valuations*'.

# Section 3: *Asset Share* calculation

1. Scheme assets should be valued as at the *Calculation Date* in line with the accounts guidance.

2. The total amount of scheme payments actually made between the *Commencement Date* and the *Calculation Date* is to be determined for each *Beneficiary* covered by the calculation - except those who received a winding-up lump sum or a trivial commutation lump sum - then aggregated and added to the asset value in step 1 above. No interest should be applied in this calculation. In addition to the adjustments made to the assets in the scheme accounts made as a result of the Accounts Guidance, the following items should be deducted[7]:
   - Expenses and running costs that will be incurred by the scheme after the *Calculation Date* to complete the process of asset transfer and wind-up if these are excluded from the accounts;
   - Any assets which are to be used to discharge liabilities in respect of voluntary contributions in respect of defined benefits that will be discharged outside of government; and
   - Any assets which are to be used to discharge the scheme's pension liabilities to or in respect of a qualifying *Beneficiary* not included in the valuation.

3. The result of this calculation is the *Adjusted Assets*. If this amount is negative, then all *Beneficiaries* have a nil *Asset Share*.

4. The *Valuation Actuary* should calculate the liabilities for each *Beneficiary* covered by the calculation and in each priority class in respect of payments due after the *Calculation Date*, using the relevant basis and priority order, as described in sections 4 and 6.

5. The total amount of the payments (equivalent to those in steps 2 to 3 above) that would have been made between the *Commencement Date* and the *Calculation Date*, had the scheme continued as a going concern, should be calculated for each *Beneficiary*, split by priority class. No interest should be applied in this calculation. Note the treatment of *Beneficiary* options taken during wind-up discussed in paragraphs 21 to 29 of section 2. This amount will be zero for members whose liabilities were discharged by a winding-up lump sum or a trivial commutation lump sum during wind-up.

6. For each *Beneficiary* covered by the calculation, the *Valuation Actuary* will add on the total amount of payments that would have been made in each priority class determined in step 5 above to the liabilities in each priority class in respect of future payments calculated in step 4. The results of this calculation are the *Adjusted Liabilities* for each *Beneficiary*.

[7] Regulation 22(7) lists all the items to be deducted from the scheme assets.

7. The *Adjusted Liabilities* calculated in step 6 above are summed in each priority class across all *Beneficiaries*.

8. The *Adjusted Assets* in steps 2 to 3 above are allocated towards covering the *Adjusted Liabilities* in each of the priority classes, according to the relevant priority order. If the as yet unallocated *Adjusted Assets* are larger than the *Adjusted Liabilities* in any priority class, then the *Adjusted Liabilities* in that priority class will be fully covered and the remaining *Adjusted Assets* should be reduced by the *Adjusted Liabilities* in that priority class before moving on to the next priority class. In the first priority class in the priority order in which the *Adjusted Assets* are less than the *Adjusted Liabilities*, the proportion of *Adjusted Liabilities* covered in that priority class is equal to the *Adjusted Assets* available for that priority class divided by the *Adjusted Liabilities* in that priority class. No *Adjusted Assets* are allocated to priority classes below the one in which the *Adjusted Assets* are exhausted.

9. If benefits have not been equalised in respect of GMPs, then under the equalisation method set out in this guidance the benefit basis on which liabilities are calculated may need to be swapped during the allocation of assets to priority classes for certain *Beneficiaries* as described in paragraph 59 of section 2. The method is described in the boxed text below:

(a) Identify the *Beneficiaries* who may need to have their benefit basis swapped (e.g. those described in paragraph 58 of section 2).

(b) Identify the priority classes in which the benefit basis may need to be swapped for those *Beneficiaries* (e.g. priority class (f) in the example in paragraph 58 of section 2). Initially calculate *member* benefits on the calculation that gives a higher *adjusted liability* in priority classes reached before the priority class in which the benefit basis may need to be swapped (e.g. priority classes (aa) to (e) in the example).

(c) Allocate *Adjusted Assets* to *member*s as described in step 8 until one of those priority classes is reached. If the unallocated *Adjusted Assets* are sufficient to cover the whole of the priority class on either benefit basis, then the benefit basis should be swapped over for the relevant *Beneficiaries* (for this and all prior priority classes) and then the next priority class should be considered. If *Adjusted Assets* are not sufficient to cover the priority class on either basis then further calculations are required.

(d) The *Valuation Actuary* calculates for each *Beneficiary* for whom the benefit basis may swap within that priority class the percentage coverage in that priority class which would mean that the *Adjusted Asset Share* would be the same for that *Beneficiary* on both benefit bases.

(e) The *Valuation Actuary* then calculates for each *Beneficiary* the percentage coverage in that priority class if the benefit basis were swapped for that *Beneficiary* and all other *Beneficiaries* for whom the percentage calculated in stage (d) was lower than for the *Beneficiary* being considered.

(f) The benefit basis is swapped for all *Beneficiaries* for whom the percentage calculated in stage (e) is higher than the percentage calculated in stage (d). *Adjusted Assets* can then be allocated according to the benefit basis now selected. *Adjusted Assets* will run out in the priority class in which the swapping was considered in stages (d) to (f).

10. Having followed the process outlined in paragraphs 1 to 9 above, there may be *Adjusted Assets* remaining unallocated at the end of this procedure if some or all of the priority order liabilities are calculated on an MFR basis. If this is the case then further priority classes should be set up in the scheme priority order. The liability in each remaining priority class should be the difference between the liability calculated on the FAS buyout basis in respect of future payments for that priority class and the amount of the liability in that priority class calculated on the basis required for the statutory priority order calculation. The remaining *Adjusted Assets* should be allocated to these additional scheme priority classes in the same way as step 8. The "swapping" process required to equalise in respect of GMPs may extend into these priority classes.

11. For completeness, if there are *Adjusted Assets* unallocated after the further process in step 10 above has been followed, then the scheme is in surplus on a buyout basis. FAS-eligible schemes are not expected to have sufficient assets for this to be relevant but if this does occur, then the remaining *Adjusted Assets* should be allocated according to the scheme rules.

12. The *Adjusted Asset Share* allocated according to the priority order for each *Beneficiary* covered by the calculation is equal to:
    - the *Adjusted Liability* for that *Beneficiary* in each priority class that was fully covered by *Adjusted Assets*, plus
    - the proportion of *Adjusted Liabilities* covered in the class in which *Adjusted Assets* are exhausted multiplied by the *Adjusted Liabilities* for that *Beneficiary* in that priority class.

13. Finally, the accumulated value of payments made to that *Beneficiary* as per paragraphs 2 to 3 is deducted from the *Adjusted Asset Share* to obtain each *Beneficiary's Asset Share*.

14. Having followed the process outlined in paragraphs 1 to 13, some *Beneficiaries* may end up with a negative *Asset Share*. These *Beneficiaries* have effectively been overpaid by the scheme during wind-up. Under these circumstances, the *Asset Shares* of such *Beneficiaries* who died before the *calculation date* should be set to zero and the process outlined in paragraphs 1 to 12 should be repeated excluding these *Beneficiaries* and all payments and all future payments as per paragraphs 2, 3, 4 and 6 relating to them. This process may need to be repeated if more deceased *Beneficiaries* have a negative Asset Share as a result. Deceased *Beneficiaries* who have been removed from the valuation calculations should still be included in the validation template submitted to the *FAS Scheme Manager* and a nil *Asset Share* reported. *Beneficiaries* who are alive at the *Calculate Date* with a negative or nil *Asset*

*Share* should be included in the validation template with the negative or nil Asset Share that has been calculated for them.

15. The sum of the *Asset Shares* calculated plus the expenses and other items deducted in paragraphs 2 to 3 should equal the assets determined in paragraph 1.

16. The information the *Valuation Actuary* passes to FAS is specified in separate guidance. Some of this information is used to calculate assistance and some to check the *Asset Share* calculations. The outputs from the calculation which will be used for benefit calculations in addition to data on the S1 form are, for each *Beneficiary*:

    - *Asset Share*; and
    - payments made by the scheme during wind-up (split pre- and post-FAS eligibility[8] and split into lump sum and pension).

    And in addition for some *Beneficiaries*:

    - certain details of benefit structure, in particular in relation to dependants' benefits; and
    - Split of benefits accrued pre- and post-6 April 1997.

[8] The Validation template guidance provides more detail on this split of payments.

# Section 4: Basis for use when calculating liabilities on a buy-out basis

## Financial basis

### Calculation of yields as at the Calculation Date

1. Yields should be measured as at the close of business on the *Calculation Date*. For any dates where yields are not available the yields for the nearest preceding date should be used. Yields should be calculated to the nearest 0.01%. Expressions of the form (Yield Z +/- k%) should be calculated as an arithmetic addition/ subtraction and not a geometric addition/ subtraction.

### Discount rate in deferment

2. For a non-pensioner, the liability should be obtained by discounting the value of the benefit projected to the date at which it is assumed to become payable. The discount rate for the period of deferment should be the adjusted gilt yield shown below.

   Discount rate in deferment = Yield A (i) – 0.1%

   (i) Yield A should be determined daily as the annualised yield on the FTSE Actuaries' Government 20 year Fixed Interest Index.

### Increases in deferment

3. If benefits are re-valued in deferment, then the benefit at the date at which it is assumed to become payable should be projected from the *Calculation Date* using the following assumptions.

### Benefits increasing at a fixed rate in deferment

4. Where the benefits increase in line with a fixed rate, increases should be assumed to apply in line with the specified fixed rate.

### Benefits increasing in deferment in line with the full Retail Prices Index (RPI) or the full Consumer Prices Index (CPI)

5. Where benefits increase in deferment in line with the full RPI or full CPI, the assumed future rate of increase of the RPI or CPI should be the rate shown below.

   Assumed annual rate of RPI or CPI increases in deferment
   = (1+Discount rate in deferment)/(1+Adjusted net index-linked gilt yield) -1

Where:

Adjusted net index-linked gilt yield = Yield B (ii) – 0.3%

(ii) Yield B should be determined daily as 50% of the sum of the FTSE Actuaries' Government Securities Index-Linked annualised Real Yields over 15 years assuming:

a) 5% inflation; and

b) 0% inflation.

## Benefits increasing in deferment in line with the RPI or the CPI subject to a cap

6. Where benefits increase in deferment in line with the RPI or the CPI but subject to a cap, the assumed future rate of annual increase in deferment should be the rate shown below.

   Increase = lower of (assumed annual rate of RPI or CPI increases in deferment) and (cap%)

   Where cap% is the annualised level of the limit on the increases granted. For statutory revaluation, this is 5%.

7. The same treatment should be applied for caps which apply over the whole period of deferment (as the caps in statutory revaluation do) as for any which are applied for each year of deferment.

## Benefits increasing in deferment in line with National Average Earnings (NAE) (Section 148 orders)

8. Where benefits increase in deferment in line with NAE, the assumed future rate of annual increase in deferment should be the rate shown below.

   Increase = assumed annual rate of RPI increases in deferment + 2%

## Benefits increasing in deferment in line with limited revaluation

9. Where benefits increase in deferment in line with NAE but subject to a cap, the assumed future rate of annual increase in deferment should be the rate shown below.

   Increase = lower of (assumed annual rate of RPI increases in deferment + 2%) and (cap%)

Where cap% is the annualised level of the limit on the increases granted. For Limited Revaluation of GMPs, this is 5%.

## Benefits increasing in deferment in other ways

10. Whilst the scenarios described above are intended to cover the majority of revaluation practices within schemes, it may be that the benefit structure in a particular scheme does not fit within the options above. In such circumstances the *Valuation Actuary* should agree their proposed method with the *FAS Scheme Manager*.

## Discount rate in payment

11. For both a pensioner and a non-pensioner, for the period from which payments are assumed to commence, the liability should be obtained by discounting the projected benefits at the following (adjusted) yield:

    Discount rate in payment = Yield C (iii) + 0.6%

    (iii) Yield C should be determined daily as the annualised yield on the FTSE Actuaries' Government 15 year Fixed Interest Index.

## Increases in payment

12. Increases to benefits in payment should be assumed to be at the rates described below. The calculation should only include allowance for increases that are awarded without the requirement for the scheme's trustees or managers to exercise any discretion.

## Benefits increasing at a fixed rate

13. Where the benefits increase in line with a fixed rate, pension increases should be assumed to apply in line with the specified fixed rate.

## Benefits increasing in payment in line with the full RPI or the full CPI

14. Where benefits increase in payment in line with the RPI or the CPI, the assumed future rate of annual increase in payment should be the rate shown below.

    Assumed annual rate of RPI or CPI increases in payment
    = (1+Discount rate in payment)/(1+Adjusted net index-linked gilt yield) -1

    Where:

    Adjusted net index-linked gilt yield = Yield D (iv) + 0.1%

(iv) Yield D should be determined daily as 50% of the sum of the FTSE Actuaries' Government Securities Index-Linked annualised Real Yields over 5 years assuming:

a) 5% inflation; and

b) 0% inflation.

## Benefits increasing in payment in line with the RPI or the CPI subject to a cap (limited price indexation)

15. Where benefits increase in payment in line with the RPI or the CPI but subject to a cap on the maximum annual increase, the assumed future rate of annual increase in payment should be the rate shown below.

Increase = lower of (assumed annual rate of RPI or CPI increases in payment) and (cap%)

Where cap% is the level of the upper limit on the annual increases granted.

## Benefits increasing in payment in line with the RPI or the CPI subject to a floor

16. Where benefits increase in payment in line with the RPI but subject to a minimum annual increase, the assumed future rate of annual increase in payment should be the rate shown below.

Increase = higher of (assumed annual rate of RPI or CPI increases in payment) and (floor%)

Where floor% is the level of the lower limit on the annual increases granted.

## Benefits increasing in payment in line with the RPI or the CPI subject to both a cap and a floor

17. Where benefits increase in payment in line with the RPI or the CPI but subject to both a minimum and maximum annual increase, the assumed future rate of annual increase in payment should be the rate shown below.

    Increase = Assumed annual rate of RPI or CPI increases in payment subject to:

    a minimum of floor% and
    a maximum of cap%

    Where:
    floor% is the level of the lower limit on the annual increases granted
    cap% is the level of the upper limit on the annual increases granted.

### Benefits increasing in payment in other ways

18. Whilst the scenarios described above are intended to cover the majority of indexation practices within schemes it may be that the benefit structures in particular schemes do not fit within these five options. In such circumstances the *Valuation Actuary* should agree their proposed method with the *FAS Scheme Manager*.

### Mortality for use when undertaking valuations

19. The mortality tables to be used in respect of a *member* and the *member*'s dependant, pre and post retirement, shall be PCMA00 (for males) and PCFA00 (for females), as appropriate, in each case with the medium cohort mortality improvement rates, and with a 1.25% floor to the annual improvements for males, and a 1% floor to the annual improvements for females, all applying from the year 2000.

20. These mortality tables are published by the Continuous Mortality Investigation for ages 50 and above. For ages below 50, the table extensions set out in the Continuous Mortality Investigation's Working Paper 26 shall be used. For each individual, the set of mortality rates used shall be those applicable to that individual's year of birth.

## Other assumptions for use when undertaking valuations – assumptions for contingent benefits

### Proportions married

21. Where the scheme provides for survivor pensions:

**For pensioners**

22. Where the scheme makes provision (including discretionary provision) for survivor pensions for adult dependants with a wider definition than just spouse or civil partner an assumption consistent with 85% (males) or 75% (females) at scheme Normal Retirement Age (NRA).

23. Where the scheme does not make provision for survivor pensions for adult dependants, other than spouses or civil partners, an assumption consistent with 75% (males) or 65% (females) at scheme NRA.

24. Using a proportion married assumption consistent with 85% / 75% (males) or 75% / 65% (females) at scheme NRA may require mortality rates for calendar years before 2000 for a "strictly correct" calculation of the proportion married assumption to apply for older pensioners. In such circumstances prudent assumptions should be used.

**For non-pensioners**

25. Where the scheme makes provision (including discretionary provision) for survivor pensions for adult dependants with a wider definition than just spouse or civil partner the assumption must be, at the assumed date of retirement or earlier death, 85% (males) or 75% (females).

26. Where the scheme does not make provision for survivor pensions for adult dependants other than spouses or civil partners the assumption must be, at the assumed date of retirement or earlier death, 75% (males) or 65% (females).

## Contracted-out schemes

27. Note that for schemes which are contracted out on a protected rights basis, statute requires payment of a survivor's pension to a wider category than just the legal spouse. Scheme rules should therefore be treated as including these statutory requirements, i.e. assume 85% (males) or 75% (females).

## Age difference between member and dependant

28. Females are assumed to be three years younger than males.

## Children's pensions

29. No specific additional allowance is to be included for prospective children's pensions. Children's pensions already in payment should be assumed to cease at age 18 if the rules specify that the pension ceases when the child leaves full time education. Children's pensions already in payment where the child is aged over 17 at the *Calculation Date* should be assumed to cease at the maximum age a child's pension could be payable by the scheme under normal health. Pensions in payment to children known to be disabled should be assumed to

cease in line with scheme rules (it is anticipated that pensions to disabled children will often be payable for life - reflecting HMRC rules).

## Pensions ceasing at a date other than death

30. Remarriage rates should be assumed to be zero. Rates of cessation of a pension due to recovery from ill health should be assumed to be zero. Pensions ending on a date that was already known and certain at the *calculation date* should be assumed to finish at that date. If the scheme provides pensions that cease on another contingency, the *Valuation Actuary* should adopt a prudent assumption.

## Expenses

31. The expenses specified in this section should be applied whatever the investment strategy of the scheme and, in particular, even if all scheme benefits are secured by immediate and deferred annuity policies.

### Scheme expenses to be incurred before assets are transferred

32. Expenses to be incurred before assets are transferred should be deducted from the scheme's assets before the *Asset Share* calculations are undertaken, as discussed in section 3. It is expected that schemes reaching the end of the transfer of assets process will, in liaison with the *FAS Scheme Manager*, agree fixed fees with those individuals and organisations who will provide services to the scheme before the scheme transfers assets. In most cases, the actual expenses should therefore be known by the time that the calculation is carried out.

### Benefit installation / payment expenses

33. A further 2% should be added to liabilities in respect of benefit payment expenses. This should be allocated to the same priority class as the underlying benefit payment for the *Asset Share* calculation[9].

## Beneficiary options

34. The benefits valued should be the standard benefit structure provided by the scheme. No allowance should be made for *Beneficiaries* choosing to take an option unless the terms of the option are fully specified in the scheme rules, the *Beneficiary* has an unfettered right to take up the option, and the liability ascribed to a *Beneficiary* would be increased if the *Beneficiary* were assumed to take up the option.

[9] This expense allowance only applies when liabilities are calculated on a buy-out basis. A different expenses allowance is used when calculating liabilities on an MFR basis. The winding-up regulations state that when statutory priority order liabilities are calculated in an MFR basis that the MFR expense allowance is excluded from the liabilities.

35. For example:

- If the scheme rules define a NRA of 65 but also specify that *member*s may take their pension unreduced at age 64 then the scheme NRA should be taken to be 64 and *member*s should be assumed to retire at age 64.
- If the rules specify that *member*s may take their pension early but that the trustees or managers decide what the reduction is, then the scheme NRA should be taken to be 65 and *member*s should be assumed to retire at age 65, even if the trustees or managers have decided to allow *member*s to retire at 64 with an unreduced pension.
- Similarly if trustee consent is required for the *member* to take the pension unreduced at 64, then the scheme NRA should be taken to be 65 and the *member* should be assumed to retire at age 65.

# Section 5: Appendix – example calculations of financial assumptions

With a *Calculation Date* of 31 October 2008 the following yields would apply:

## Yields in deferment

### Discount rate in deferment

The relevant yields to calculate Yield A are:

| | Semi annual | Annualised (rounded to nearest 0.01%) |
|---|---|---|
| FTSE Actuaries' Government 20 year Fixed Interest Index | 4.83% | 4.89% |

Discount rate in deferment

= Yield A – 0.1%

= 4.89% – 0.1%

= 4.79%

### Benefits increasing in deferment in line with the full RPI or full CPI

The relevant yields to calculate Yield B are:

| FTSE Actuaries' Government Securities Index-Linked annualised Real Yields over 15 years assuming: | Semi annual | Annualised (rounded to nearest 0.01%) |
|---|---|---|
| a) 5% inflation | 1.26% | 1.26% |
| b) 0% inflation | 1.35% | 1.35% |

Adjusted net index-linked gilt yield

= Yield B – 0.3%

= 50% x (1.26% + 1.35%) – 0.3%

= 1.31% - 0.3%

= 1.01% rounded to nearest 0.01%

Assumed annual rate of RPI or CPI increase in deferment

= (1+Discount rate in deferment)/(1+Adjusted net index-linked gilt yield) – 1

= (1+4.79%)/(1+1.01%) – 1

= 3.74% rounded to nearest 0.01%

## Benefits increasing in deferment in line with the RPI subject to a cap

Increase = lower of (assumed annual rate of RPI or CPI increases in deferment) and (cap%)

Where cap% is the annualised level of the limit on the increases granted.

For example, where benefits increase in deferment in line with the RPI or CPI subject to a 5% cap:

Increase = lower of (assumed annual rate of RPI increases in deferment) and (5%)
= lower of (3.74%) and (5.00%)
= 3.74%

## Benefits increasing in deferment in line with NAE (Section 148 orders)

Increase = assumed annual rate of RPI increases in deferment + 2%
= 3.74% + 2%
= 5.74%

## Benefits increasing in deferment in line with Limited Revaluation

For example, where benefits increase in deferment in line with limited revaluation subject to a 5% cap:

Increase = lower of (assumed annual rate of RPI increases in deferment + 2%) and (cap%)
= lower of (3.74%+2%) and (5%)
= lower of (5.74%) and (5%)
= 5%

# Yields in payment

## Discount rate in payment

The relevant yields to calculate Yield C are:

| | Semi annual | Annualised (rounded to nearest 0.01%) |
|---|---|---|
| FTSE Actuaries' Government 15 year Fixed Interest Index | 4.84% | 4.90% |

Discount rate in payment

= Yield C + 0.6%
= 4.90% + 0.6%
= 5.50%

## Benefits increasing in payment in line with the full RPI or CPI

The relevant yields to calculate Yield D are:

| FTSE Actuaries' Government Securities Index-Linked annualised Real Yields over 5 years assuming: | Semi annual | Annualised (rounded to nearest 0.01%) |
|---|---|---|
| a) 5% inflation | 1.56% | 1.57% |
| b) 0% inflation | 1.69% | 1.70% |

Adjusted net index-linked gilt yield

= Yield D + 0.1%
= 50% x (1.57% + 1.70%) + 0.1%
= 1.64% + 0.1%
= 1.74% rounded to nearest 0.01%

The discount rate in payment was found to be 5.50% above.

Assumed annual rate of RPI or CPI increases in payment

= (1+Discount rate in payment)/(1+Adjusted net index-linked gilt yield) – 1
= (1+5.50%)/(1+1.74%) – 1
= 3.70% rounded to nearest 0.01%

## Benefits increasing in payment in line with the RPI or CPI subject to a cap (Limited Price Indexation)

Increase = lower of (assumed annual rate of RPI or CPI increases in payment) and (cap%)

Where cap% is the level of the upper limit on the annual increases granted.

For example where benefits increase in payment in line with the RPI or CPI subject to a 2.5% cap:

= lower of (3.70%) and (2.5%)
= 2.5%

# Section 6: Appendix – priority orders and actuarial bases

1. This section refers to the existing framework of legislation and guidance notes for schemes winding up. This is because the valuation in FAS schemes transferring assets to government should generally be carried out in the same way as the asset share calculation would have been prepared had the scheme completed wind-up, subject to the requirements and exceptions set out in this guidance document.

2. Generally, the priority order for allocating assets against liabilities and the valuation basis to be used in calculations will be determined by the date that FAS schemes' commenced wind-up and whether the sponsoring employer was solvent or insolvent at the date that winding-up commenced. Further information on each of these activities is set out below.

## Allocating the assets of the scheme

3. If winding-up commenced from 1 January to 5 April 1997, then the scheme's rules should be followed when allocating assets.

4. The statutory priority orders, showing the text from section 73 of the Pensions Act 1995 as it applied at different dates, are set out below. Assets should be allocated first to liabilities described in paragraph (a), then those described in paragraph (aa) (if any), then those described in paragraph (b) and so on. Liabilities described under separate numbered paragraphs (i), (ii) and (ia) under the same lettered paragraph have equal priority.

5. If winding-up commenced 6 April 1997 to 9 May 2004 the following order of priority applies:

   (a) any liability for pensions or other benefits which, in the opinion of the trustees, are derived from the payment by any member of the scheme of voluntary contributions,

   (aa) where–

      (i) the trustees or managers of the scheme are entitled to benefits under a contract of insurance which was entered into before 6th April 1997 with a view to securing the whole or part of the scheme's liability for any pension or other benefit payable in respect of one particular person whose entitlement to payment of a pension or other benefit has arisen and for any benefit which will be payable in respect of that person on his death, and

      (ii) either that contract may not be surrendered or the amount payable on surrender does not exceed the liability secured by the contract (but excluding liability for increases to pensions), the liability so secured,

(b) in a case not falling within paragraph (aa), where a person's entitlement to payment of pension or other benefit has arisen, liability for that pension or benefit and for any pension or other benefit which will be payable in respect of that person on his death (but excluding increases to pensions),

(c) any liability–

(i) for equivalent pension benefits (within the meaning of section 57(1) of the National Insurance Act 1965), guaranteed minimum pensions, protected rights, section 9(2B) rights (within the meaning of regulation 1(2) of the Contracting-out (Transfer and Transfer Payment) Regulations 1996), or safeguarded rights (within the meaning of section 68A(1) of the Pension Schemes Act 1993) (but excluding increases to pensions), or

(ii) in respect of members with less than two years pensionable service who are not entitled to accrued rights under the scheme, for the return of contributions,

(d) any liability for increases to pensions referred to in paragraphs (aa) and (b),

(e) any liability for increases to pensions referred to in paragraph (c),

(f) so far as not included in paragraph (c) or (e), any liability for–

(i) pensions or other benefits which have accrued to or in respect of any Beneficiaries of the scheme (including increases to pensions), or

(ii) future pensions, or other future benefits, attributable (directly or indirectly) to pension credits (including increases to pensions).

6. If winding-up commenced 10 May 2004 to 5 April 2005 the following order of priority applies:

(a) any liability for pensions or other benefits which, in the opinion of the trustees, are derived from the payment by any member of the scheme of voluntary contributions,

(aa) where–

(i) the trustees or managers of the scheme are entitled to benefits under a contract of insurance which was entered into before 6th April 1997 with a view to securing the whole or part of the scheme's liability for any pension or other benefit payable in respect of one particular person whose entitlement to payment of a pension or other benefit has arisen and for any benefit which will be payable in respect of that person on his death, and

(ii) either that contract may not be surrendered or the amount payable on surrender does not exceed the liability secured by the contract (but excluding liability for increases to pensions),

the liability so secured.

(b) in a case not falling within paragraph (aa), where a person's entitlement to payment of pension or other benefit has arisen, liability for that pension or benefit and for any pension or other benefit which will be payable in respect of that person on his death (but excluding increases to pensions),

(c) any liability for–

  (i) pensions or other benefits which have accrued to or in respect of any members of the scheme (but excluding increases to pensions), or

  (ia) future pensions, or other future benefits, attributable (directly or indirectly) to pension credits (but excluding increases to pensions),

  (ii) (in respect of members with less than two years pensionable service) the return of contributions,

(d) any liability for increases to pensions referred to in paragraphs (aa) and (b);

(e) any liability for increases to pensions referred to in paragraph (c).

7. If winding-up commenced 6 April 2005 to 22 December 2008 the following order of priority applies:

(a) where–

  (i) the trustees or managers of the scheme are entitled to benefits under a relevant pre-1997 contract of insurance entered into in relation to the scheme, and

  (ii) either that contract may not be surrendered or the amount payable on surrender does not exceed the liability secured by the contract,

  the liability so secured;

(b) any liability for pensions or other benefits to the extent that the amount of the liability does not exceed the corresponding PPF liability, other than a liability within paragraph (a);

(c) any liability for pensions or other benefits which, in the opinion of the trustees or managers, are derived from the payment by any Beneficiary of voluntary contributions, other than a liability within paragraph (a) or (b);

(d) any other liability in respect of pensions or other benefits.

"corresponding PPF liability" in relation to any liability for pensions or other benefits means–

(a) where the liability is to a member of the scheme, the cost of securing benefits for or in respect of the member corresponding to the compensation which would be payable to or in respect of the Beneficiary in accordance with the pension compensation provisions if the Board of the Pension Protection Fund assumed responsibility for the

scheme in accordance with Chapter 3 of Part 2 of the Pensions Act 2004 (pension protection), and

(b) where the liability is to another person in respect of a member of the scheme, the cost of securing benefits for that person corresponding to the compensation which would be payable to that person in respect of the member in accordance with the pension compensation provisions if the Board assumed responsibility for the scheme in accordance with that Chapter;

"relevant pre-1997 contract of insurance" means a contract of insurance which was entered into before 6 April 1997 with a view to securing the whole or part of the scheme's liability for–

(a) any pension or other benefit payable to or in respect of one particular person whose entitlement to payment of a pension or other benefit has arisen, and

(b) any benefit which will be payable in respect of that person on his death.

# Placing a value on the liabilities of the scheme

8. In valuing the liabilities of the scheme, relevant FAS schemes should follow the approach as set out in Regulation 4 of the Winding-Up Regulations. The bases to be used by FAS schemes for this calculation are summarised below:

| Date wind-up commenced | Solvent employer | Insolvent employer |
|---|---|---|
| 6 April 1997 to 10 June 2003 | Combination 1* | MFR[10] |
| 11 June 2003 to 14 February 2005 | Buy-out ** | MFR |
| 15 February 2005 to 22 December 2008 | Buy-out | Buy-out |

* This reflects that FAS schemes subject to this guidance had not completed wind up on 19 March 2002

** This reflects that relevant FAS schemes subject to this guidance had not completed wind up on 15 March 2004

9. The “combination 1” basis applies where a scheme had not completed wind-up on 19 March 2002. It uses buy-out for liabilities “in respect of any entitlement to the payment of any pension or other benefit (including any increase in a pension) that has arisen under the scheme on or before the crystallisation date”[11] and MFR for all other liabilities

[10] “MFR” here means the basis on which schemes are required to calculate liabilities for particular categories of benefits under regulations 7 and 8 of the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 (SI 1996/1536) as applied with amendments by the Winding Up Regulations.

[11] Regulation 4A(1)(b) of the Winding-up Regulations as inserted by the Occupational Pension Schemes (Minimum Funding Requirement and Miscellaneous Amendments) Regulations 2002 (S.I. 2002/380).

10. As is allowed under regulation 4(4)[12] of the Winding Up Regulations a downwards adjustment of the liabilities is allowed for all priority classes. In line with Regulation 4(5)[13] an upwards adjustment in the liabilities is only permitted for the following priority classes:

| Date wind-up commenced | Solvent employer | Insolvent employer |
|---|---|---|
| 6 April 1997 to 10 June 2003 | (aa), (b) and increases to pensions or other benefits in those priority classes | (aa) and (b) |
| 11 June 2003 to 14 February 2005 | All priority classes | (aa) and (b) |
| 15 February 2005 to 22 December 2008 | All priority classes | All priority classes |

11. The only adjustments under Regulation 4(5)[14] of the Winding-up Regulations that are anticipated are to calculate liabilities on a buy-out basis rather than MFR. Assuming that, a summary of the basis is as follows:

| Date wind-up commenced | Solvent employer | Insolvent employer |
|---|---|---|
| 6 April 1997 to 10 June 2003 | Combination 1 | Combination 2 |
| 11 June 2003 to 14 February 2005 | Buy-out | Combination 2 |
| 15 February 2005 to 22 December 2008 | Buy-out | Buy-out |

12. “Combination 1” is buy-out for liabilities “in respect of any entitlement to the payment of any pension or other benefit (including any increase in a pension) that has arisen under the scheme on or before the crystallisation date” and MFR for all other liabilities. There is flexibility to increase liabilities in priority classes (aa) and (b) and increases to pensions or other benefits in those priority classes to the extent that they would otherwise be calculated on the MFR basis.

13. “Combination 2” is MFR but with flexibility to increase liabilities in priority classes (aa) and (b) to buy out.

[12] Or Regulation 4(6) for post 5 April 2005 wind-ups
[13] Or Regulation 4(8) for post 5 April 2005 wind-ups
[14] Or Regulation 4(8) for post 5 April 2005 wind-ups

# Section 7: Appendix – Glossary

***Adjusted Assets*** – The total value of scheme assets as at the *Calculation Date* as adjusted in line with the Accounting Guidance plus the total aggregate amount of scheme payments made to *Beneficiaries* covered by the valuation between the *Commencement Date* and the *Calculation Date* minus future expenses and assets to be discharged outside of government (section 3, paragraphs 2 to 3).

***Adjusted Asset Share*** – The amount of assets allocated to a *Beneficiary* in accordance with the *Adjusted Assets* by reference to the *Beneficiary*'s *Adjusted Liabilities* (section 3, paragraph 11). In other words, the amount available to secure the benefits at wind-up. The *Adjusted Asset Share* is always zero or positive.

***Adjusted Liabilities*** – The liabilities for *Beneficiaries* covered by the valuation in respect of payments due after the *Calculation Date* calculated in accordance with the relevant basis and priority order plus the total amount of payments that would have been made to the *Beneficiary* between the *Commencement Date* and the *Calculation Date* had the scheme not started to wind-up (section 3, paragraph 6).

***Asset Share*** – The '*Adjusted Asset Share*' minus the total amount of defined benefit scheme payments made to the *Beneficiary* between the *Commencement Date* and the *Calculation Date*. Some negative *Asset Shares* so calculated are adjusted to zero, but some *member*s may have a negative *Asset Share* (section 3, paragraphs 12 to 13).

***Beneficiary*** – A person entitled to benefits from the pension scheme (section 2, paragraph 8) who has an *Asset Share* calculated for them. Section 2, paragraphs 8 to 14, set out the scheme *Beneficiaries* to be covered by the calculation.

***Calculation Date*** – The date as at which the valuation is undertaken. The *calculation date* is the last day of the month during which the *FAS Scheme Manager* instructs the trustees or managers of the scheme to obtain the valuation (section 2, paragraph 3).

***Commencement Date*** – The date of the start of the scheme's winding-up process, as determined under regulation 3 of the FAS Regulations which reflects relevant winding-up legislation (section 2, paragraph 1).

**The *FAS Scheme Manager*** – The body that manages the FAS. The FAS is administered by the Pension Protection Fund and the Scheme Manager is the Board of the Pension Protection Fund. Before 10 July 2009, the Department for Work and Pensions administered the FAS and the *FAS Scheme Manager* was the Secretary of State for Work and Pensions.

***Member*** – Any active, deferred, pensioner or pension credit *member* of the scheme as defined in section 124 of the Pensions Act 1995.

***Notional Pension*** – A regular notional income that could have been paid by the scheme if the final funding position of the scheme had been known at the start of wind-up (section 1, paragraph 8). The Regulations make distinction between a

*Notional Pension* and a Survivor *Notional Pension* but when the term is used in this document it covers both types.

***Scheme Normal Pension Age* (*NPA*)** – The age at which any pension or part of a pension would have been payable to that *Beneficiary* for life without actuarial adjustment under the rules of the qualifying pension scheme (disregarding any rule making special provision as to early payment on the grounds of ill health or otherwise).

***Standard assistance*** – The amount that would be payable by the FAS to a *Beneficiary* were a *Beneficiary* to receive no payment from their scheme either before or after their liabilities were discharged as a result of having insufficient funds. (i.e. payments based on 90% of Expected Pension).

***Valuation actuary*** – The person approved by the *FAS Scheme Manager* to carry out the valuation of the scheme under regulation 22.

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