



Institute
and Faculty
of Actuaries

Freedom and Choice: the impact on DB

Glasgow and London: Hilary Salt

Leeds: Alastair Kennis

Bristol: Richard Gibson

London: Scott Pinder



Agenda

- Experience so far
- Implications of changes for factors
- Barriers to change
- How does administration change?
- Advice Issues
- Effect on funding valuations
- Cash flow, investment and LDI implications

Experience So Far

- ABI figures from September 2015:
 - Covers insurance activity for April, May and June
 - No DB vs DC split (as DB may be taken via DC)

Type	Numbers	Total Amount	Average Amount
All pot as cash*	87,000	£1.30bn	£15,000
Income drawdown payment*	264,000	£1.10bn	£4,200
Move to annuity	17,800	£0.99bn	£55,600
Move to drawdown vehicle*	19,600	£1.30bn	£68,000

- A specialist medical underwriter reported that its individual annuity business had halved since April 2014
- In one survey, a third of schemes providing transfer quotes at retirement

Expectations: Treasury impact assessment

- Currently 40,000 transfers out per year
- 120,000 DB benefits crystallise each year
- Additional transfers based on:
 - Individual discount rates based on a member's level and type of debt
 - Transfer value of 80% of technical provision
 - Produces spookily accurate 7.6% extra transfers: 9,000 per year
 - Total number of transfers needing advice 23,449
- Additional costs of:
 - Checking members have obtained advice: £440,000
 - Familiarisation: £290,000
 - Cost of advice (where none taken previously): 2.11m

Implications for Scheme factors

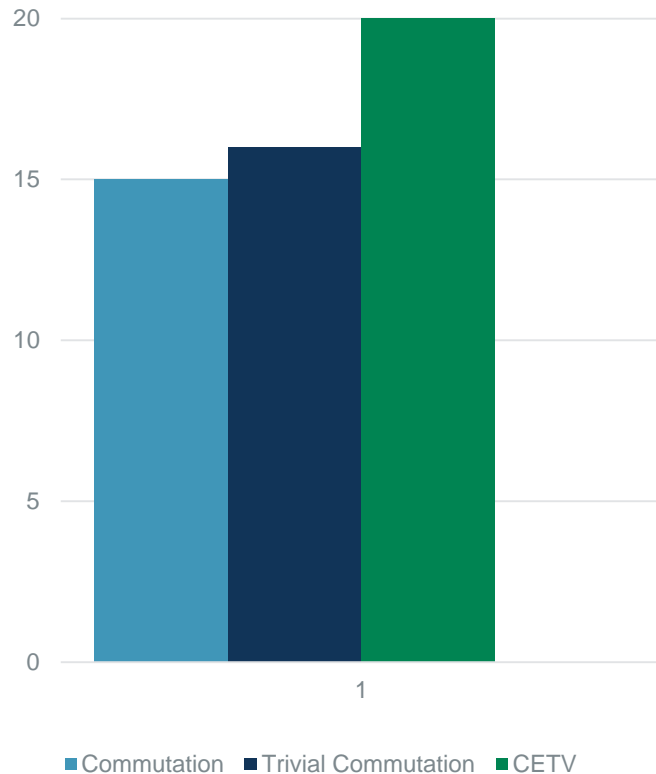
Consistency of
scheme factors

Fixed vs varying
factors

“Underwriting”
factors

Barriers to change

Consistency of factors



- Commutation and trivial commutation factors tended to be below (sometimes significantly below) cash equivalent transfer values
- Regulatory control over transfer values but not other factors
- Inconsistency leads to odd member outcomes and perceived or actual inequity
- Move to aligning trivial commutation with CETVs
- Discussion on aligning commutation with CETVs

Comparing outcomes: £10,000pa pension

In scheme commutation at 15 to 1

Maximum cash = $£10,000 \times [(20 \times 15) / (20 + 3 \times 15)] =$

£46,154

Commutated pension = $£46,154 / 15 = £3,077$

Remaining pension = $£10,000 - £3,077 =$

£6,923 pa

Transfer all to DC at CETV of 20 to 1

CETV of $£10,000 \times 20 = £200,000$

Take one quarter cash:

£50,000

Remaining fund of $£150,000$

In lay terms, supports a pension of

£6,923 for 22 years

Partial Transfer to DC

Transfer $£3,077$ of pension: $£3,077 \times 20 = £61,540$

Retain scheme pension of

£6,923 pa

Take one quarter tax free =

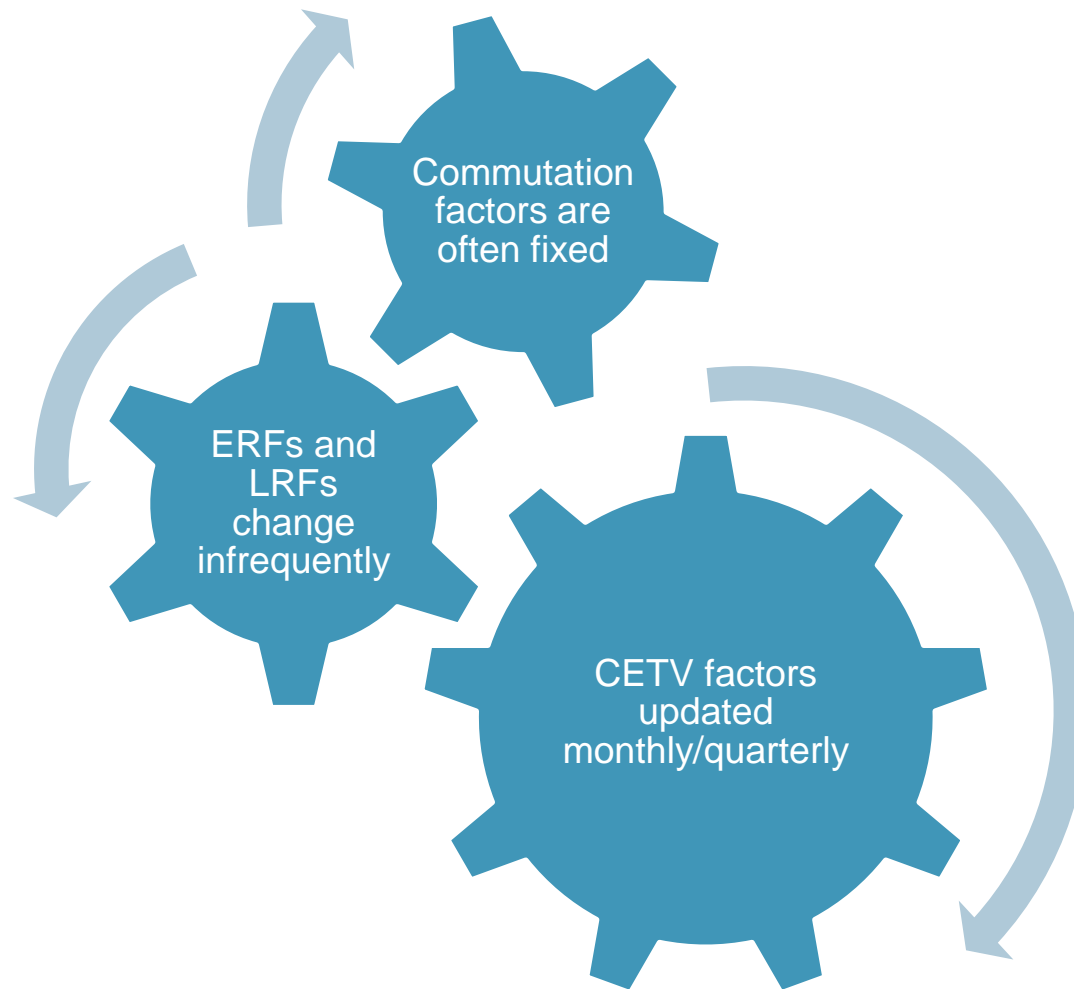
£15,385

Remainder taxed:

£46,155

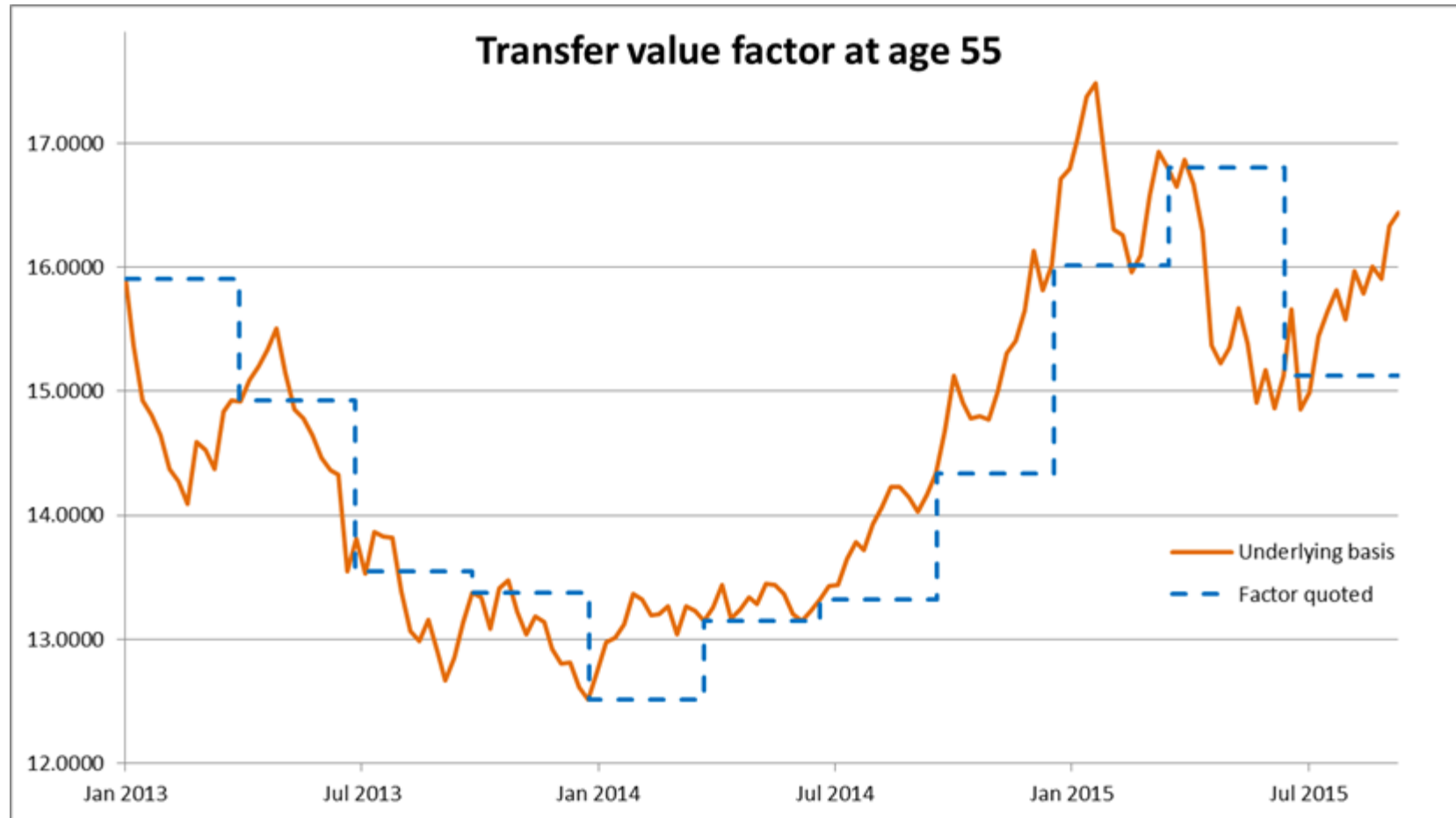
a marginal tax rate below 33% gives a better outcome

Fixed factors relative to financial conditions?



Does this make consistency difficult to achieve?

How much do factors vary?



“Underwriting” factors

- At retirement, members will have a reasonable idea of:
 - Their gender
 - Their “marriedness” – and whether that is likely to change
 - Their state of health
 - Their future behaviour
 - The longevity of their parents and siblings
 - Their expectations of inflation

Or will they ???

- So there is a potential for selection against the scheme

Underwritten CETVs

Standard unisex transfer value: £300,000		
	Man	Woman
Different for men and women	£275,000 (-8.3%)	£330,000 (+10.0%)
With partner	£280,000 (+1.8%)	£335,000 (+1.5%)
Without partner	£240,000 (-13.0%)	£315,000 (-4.5%)
Plus 3 year age rating	£255,000 (-7.3%)	£305,000 (-7.6%)
Minus 3 year age rating	£295,000 (+7.3%)	£355,000 (+7.6%)
Inflation 1% pa higher	£290,000 (+5.5%)	£345,000 (+4.5%)
Inflation 1% pa lower	£255,000 (-7.3%)	£310,000 (-6.1%)

- Legislative basis?
- Member expectations

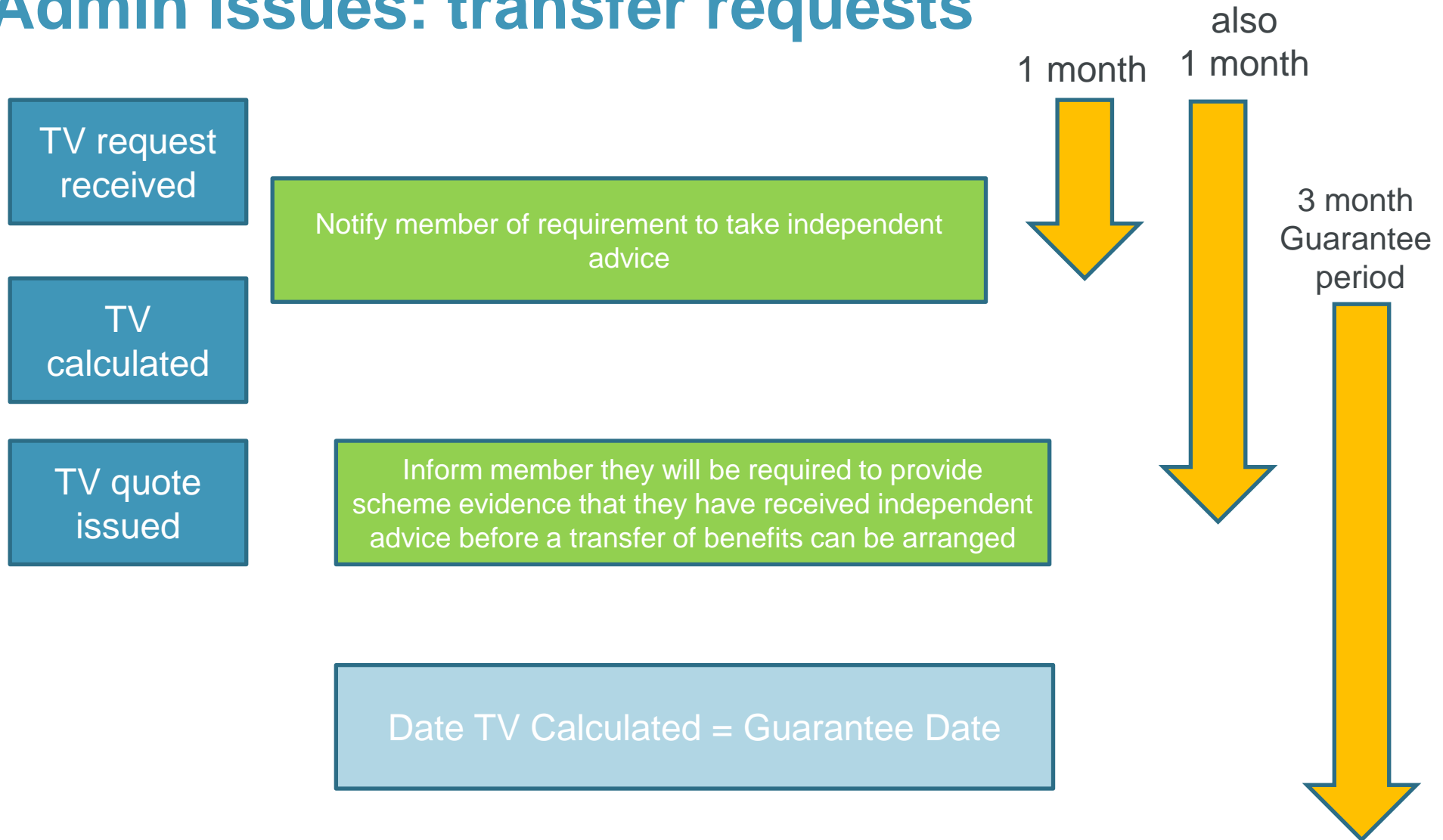
Barriers to Change

- Allowance in valuations for commutation factors
 - Commutation factors set in rules (public service schemes)
 - General stickiness of commutation factors
 - Perceived difficulties of non unisex factors
 - Administration challenges
-
- More widely – the challenges of introducing individualism into collective vehicles

Administration Issues: retirements

- Any DC AVCs bring a retirement case “in scope”:
 - Redesign of communications
 - Longer lead in time with wake up pack
 - Pension Wise booklet
 - Complex AVC decision
- Members in general facing more complex decisions at retirement
- IFA involvement
- Lots lots lots lots lots more questions...

Admin issues: transfer requests



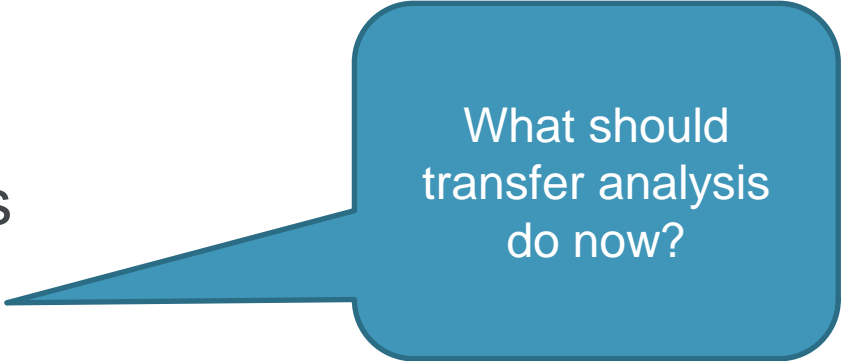
Admin Issues: Checking advice obtained

- Check appropriate independent advice has been obtained from an FCA authorised adviser
- Check Adviser statement contents
- Do not need to obtain a copy of the advice and recommendation provided to the member (trustees probably don't want to know)
- Overseas transfers are problematic – may need advice in both countries
- Employer funded advice: disclose analysis to member's alternative adviser?

KEEP DETAILS

FCA Pension Transfer Rules

- Require a Pension Transfer Specialist to provide advice on all transfers
 - DB to personal pension
 - DB to Occupational DC
- Require a transfer value analysis
 - Transfers
 - Conversions
 - Money purchase with guaranteed annuity rates
- Looking to review COBS
 - Consultation later in 2015... *“Once we have a better sense of how the market is likely to develop”*



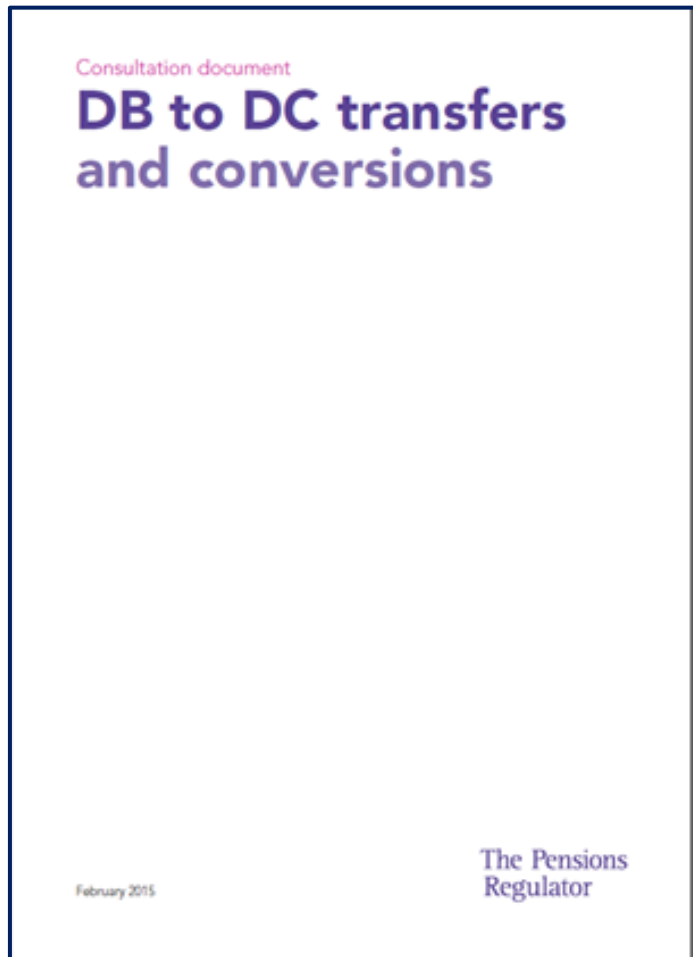
What should
transfer analysis
do now?

Partial Transfers – Practical Limits

- Are they offered throughout or only at retirement
 - Only once or many withdrawals?
 - Need benefit limits
 - Minimum transfer out?
 - Minimum residual pension
 - Minimum proportion of pension to avoid selection against commutation factor
 - BUT:
 - Can discharge awkward benefits (LPI min3% max 5%)
 - They give opportunities to remove tricky GMPs
 - Can treat as a non-selective decrement?
- Overall an admin saving?



Guidance from tPR



..Trustees have a
duty to act in the
members' best
interests

..likely to be in the best
financial interests of the
majority of members to
remain in their DB
Scheme

..unlikely that ..application
of best estimate
assumptions ... would
provide benefits of equal
value as those given up

Advice

..Requiring members to obtain...advice.. does not make trustees responsible for checking what advice was given, what recommendation was made or to confirm whether the member is following that recommendation.

The adviser is required to provide the member with a confirmation in writing which the member is to submit to trustees to enable them to check that appropriate independent financial advice has been obtained by the member.

No statutory right to transfer

- Within 1 year of NPA
- Schemes rules need to permit transfer if this to be an option for members
- Non statutory transfers could be on different terms?
- Underfunded on CETV basis? Can you reduce a non statutory transfer value?
- Legal implications on indemnities

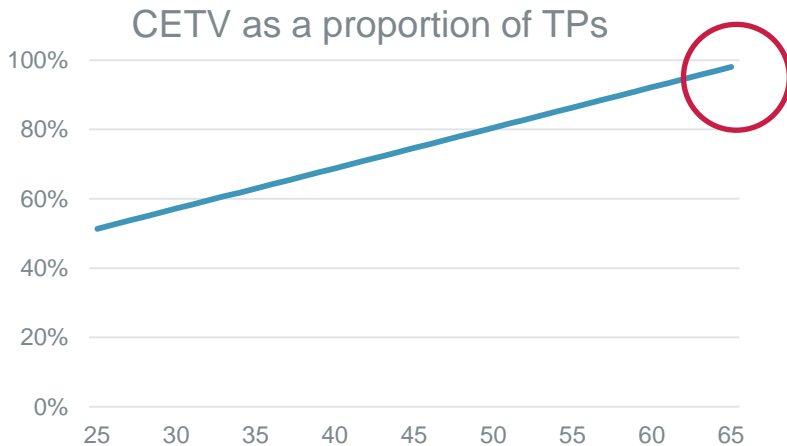
IEMB: Code of Good Practice

- Revised code to be issued
- Boundary examples from recent forum
- Outside code:
 - Including TV in retirement pack
 - Writing at 55 as well as NRA
 - New options
 - Access to IFAs
 - New (glossy) comms
 - Catch up exercises
 - Open ended trivial commutation
- Code applies:
 - Time limited trivial commutation
 - Pension increase options
 - Time limit may be implied eg advice available if you apply now

Effect on funding valuations

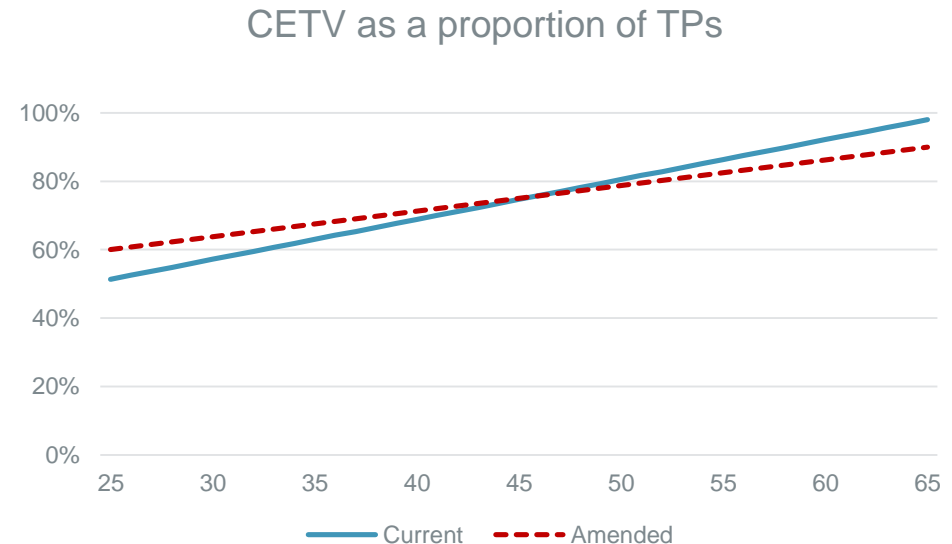
- Traditionally no decrement for transfers out in valuations:
 - Funding
 - Accounting
 - Best estimate
- Is it reasonable to now make some allowance?
 - Pros:
 - Unlikely to be none
 - Welcome cost reduction
 - Cons:
 - Removes margins
 - Makes factors difficult to change

CETVs versus Technical Provisions



- Very little (no?) margin against TPs for those transferring at retirement
- Dual discount rates so TPs and CETVs bond based post retirement
 - Margins vs best estimate returns may differ
- Advance allowance in TPs for commutation

- Rebalance CETVs from old to younger members
- Technically by amending pre/post retirement discount rates or using single discount rate (consider neutral basis?)



Effect on Investment Strategies

- Cash flow issues
 - Bringing forward of cash requirements can mean liquidity issues
 - Particular issue for smaller schemes with “lumpy” benefits
- Unwinding LDI
 - Impact on average duration and stress tests
 - Need to rerun analyses and provide new advice
 - May need to sell assets at “wrong” yield
 - Illiquidity problems (not considered when holding long term)

Questions

Comments

The views expressed in this [publication/presentation] are those of invited contributors and not necessarily those of the IFoA. The IFoA do not endorse any of the views stated, nor any claims or representations made in this [publication/presentation] and accept no responsibility or liability to any person for loss or damage suffered as a consequence of their placing reliance upon any view, claim or representation made in this [publication/presentation].

The information and expressions of opinion contained in this publication are not intended to be a comprehensive study, nor to provide actuarial advice or advice of any nature and should not be treated as a substitute for specific advice concerning individual situations. On no account may any part of this [publication/presentation] be reproduced without the written permission of the IFoA [*or authors, in the case of non-IFoA research*].