Institute and Faculty of Actuaries

Pensions Conference 2015

24 – 26 June
Hilton, Glasgow

19 June 2015

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DB to DC Transfers

Chair:
Speaker: Charles Cowling, Jonathon Webb

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Agenda

Case Study

Freedom & Choice - Implications

Trustee / Company issues

Member issues

Case Study Revisited

In conclusion …

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Case Study

Example Company: Old industry, still profitable, reasonable medium term outlook, but may struggle in the longer term unless it can find new markets *(maybe a DB pensions consultancy !)*

Enterprise value	~	£50 million
Profits	~	£3 million per annum
Legacy DB pension scheme	~	£50 million

But it's got a 50:50 equity / bond investment strategy (not hedged) and largely as a result of the fall in interest rates it's now got a large deficit

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XYZ Pension Scheme

Latest financial position:

Assets	=	£30 million
Technical Provisions	=	£50 million
TP Funding Level	=	60%
Recovery Plan	=	£1.3 million pa for 15 years
Solvency liabilities	=	£75 million
Solvency funding level	=	40%
Trustee covenant assessment	-	Moderate

Question: **How would you set transfer values ?**

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XYZ Pension Scheme

Transfer Value options:

Insufficiency report	=	£60,000	
Best estimate assumptions	=	£90,000	*(Gilts+4% pre-ret)*
Technical Provisions	**=**	**£100,000**	***(Gilts+3% pre-ret)***
Gilts +2% pre-ret	=	£110,000	
Gilts +1% pre-ret	=	£120,000	
Gilts `	=	£130,000	
Solvency	=	£140,000	

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Freedom & Choice - Implications

- More members taking transfers
  - Advice to members?
  - Increased scrutiny of TV assumptions
- Increased cash-flow requirements
  - TV guarantees
- Impact on Pension Scheme funding
- Impact on remaining members
- **Review transfer value assumptions**

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Freedom & Choice - Implications

Opportunity?	Threat?
Removing liabilities at a discount to buy-out cost	**Remaining assets need to work harder to fill gap**
Actions: • Review TV assumptions so IFAs more likely to recommend transfer • Undertake [enhanced] TV exercises • Communicate TV option in member material	**Actions:** • Insufficiency reports • Reduced transfer values • Highlight risks to members

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Trustee / Company Issues

- Investment implications
  - Paying TVs will impact on expected return on assets in recovery period
  - Longer the period the lower the impact *(probably)*
  - Consider impact of TV guarantees
- Sponsor covenant
  - Any increase / reduction in £deficit may be important
  - Any reduction in solvency deficit increases affordability of eventual buy-out (and increases future member security)
  - There's always the PPF *(Hush – care needed!)*
  - Immediate security vs Future security *(TPs largely irrelevant)*

Trustee / Company Issues

- Sponsor willingness to fund
  - May view increasing funding for TVs a "valuable" spend
  - Much cheaper than buy-out
- Trustee willingness to "fund"
  - May be in interests of all members
  - Will reduce buy-out deficit (even if increases TP deficit)
  - May increase security for all members
  - Reducing TVs may ***reduce*** security for remaining members

Member Issues

- Member can "sell" bond-based asset at historic low yields (high values)
- Member has cash, no longer exposed to sponsor covenant risk
- Particularly attractive for:
  - single members
  - members in ill-health
  - members with debts
  - members wanting to finance large capital spend (eg property)
  - inheritance tax planning
- Flexible retirement planning based on individual circumstances
- Divorce cases
- Tax

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JLT

DAILY EXPRESS

MADELEINE BREAKTHROUGH

Police hunt intruder who attacked five other British girls in Portugal

PENSIONS AND SAVINGS JOY FOR ALL

Chancellor's great news for 'makers, doers and savers'

BUDGET 2014 AT A GLANCE

FULL COVERAGE PAGES 2,3,4,5,6,7 and 12&13

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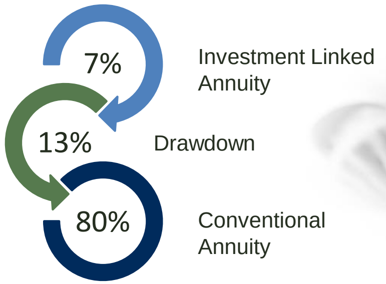
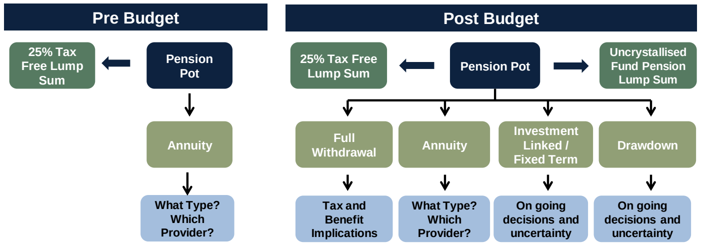
What did people opt for pre Budget 2014?



Source : ABI . New business stats 2013 (12 months)
Illustrative only, not to scale

Required Member Decisions



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The Story So Far

Members are already thinking about how their options are changing, some examples of how conversations have changed thus far:

I want to take all my fund as cash.

What do you mean I have to pay tax?

I don't want an annuity, but I want to guarantee my income for the rest of my life!

Still a large percentage of retirees wanting the guarantee an annuity gives.

Increase in awareness of and acceptance of pros and cons of Fixed Term Annuities

Lots wanting cash as tax efficiently as possible, but also interest in blended solutions

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Member Awareness

- Trustees dilemma
  - Don't make members aware of options – and risk future censure?
  - Do provide access to advice – and be seen as promoting transfers?

Currently seeing exceptional demand to make offers to over 55s and embedded service

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Insights

- Requirement to have suitably qualified advice – capacity and ongoing scrutiny
- Members must present an 'advice confirmation letter'

  Some product providers transact regardless of recommendation
  - The rise of the 'insistent client'
  - Some product providers wont accept them!

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Case Study Revisited – 15 years on

Example Company: Definitely old industry, still profitable (just), but outlook is poor (it hasn't migrated to new markets) and profits are in decline

Enterprise value	~	£25 million
Profits	~	£1.5 million per annum
Legacy DB pension scheme	~	£50 million

Pension Scheme Trustees (and Scheme Actuary) were nervous about covenant risk and so filed an insufficiency report for TVs.

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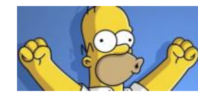
XYZ Pension Scheme

No transfers out, but Recovery Plan worked as planned and in 15 years:

Assets	=	£50 million
Technical Provisions	=	£50 million
TP Funding Level	=	100%
Solvency liabilities	=	£62.5 million
Solvency funding level	=	75%

Everybody happy ?

XYZ Pension Scheme



But what if TV policy had been more generous:

Transfer Values	:	Gilts +1.5% (pre-ret)
Transferred out	:	£20m of TP liabilities
		£23m of assets

Pension scheme finances:

Assets	=	£27 million
Technical Provisions	=	£30 million
TP Funding Level	=	90%
Solvency liabilities	=	£35 million
Solvency funding level	=	77%

XYZ Pension Scheme

What if take up of TVs is even greater (all DPs transfer out):

Transfer Values	:	Gilts +1.5% (pre-ret)
Transferred out	:	£30m of TP liabilities
		£34m of assets

Pension scheme finances:

Assets	=	£16 million
Technical Provisions	=	£20 million
TP Funding Level	=	80%
Solvency liabilities	=	£20 million
Solvency funding level	=	80%

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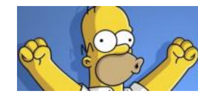

XYZ Pension Scheme

	Scenario A	Scenario B	Scenario C
Assets	£50m	£27m	£16m
TP liabilities	£50m	£30m	£20m
Funding level	100%	90%	80%
Solvency liabilities	£62.5m	£35m	£20m

Which scenario would you prefer:

- As a Company
- As a Trustee
- As a Member

So which was the better transfer value policy ?

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In conclusion …

Transfer values have become even more complicated:

- For members
- For Trustees
- For Companies

Should not automatically assume that:

- Any transfer out is always advantageous; nor,
- That a reduction in funding level is a bad thing

In conclusion …

Making transfers out punitive will:

- Miss opportunities to reduce the £deficit
- Will reduce transfer activity and increase ultimate buy-out cost (and hence may reduce future security)
- Restrict member freedoms
- And keep them exposed to the company

Making the transfer value basis too generous:

- May impact immediate security of remaining members
- May mean the assets have to work harder

In conclusion …

Need to strike the right balance between transferring and remaining members whilst reducing risk to the sponsor (and therefore to the scheme) considering **both** immediate and future security

And

Got to get the process right !

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Questions Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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