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Are transfer values at the right level?

The IFoA's Current Pensions Review Working Party
Pensions Conference – 5 June 2018

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5 June 2018

Agenda

The purpose of today's session is to provide some background to the working party and then gather your thoughts and views on the appropriate level of transfer values and how these should be calculated. We will cover:

- Background to transfer values
- Current transfer activity and levels
- Discussion questions

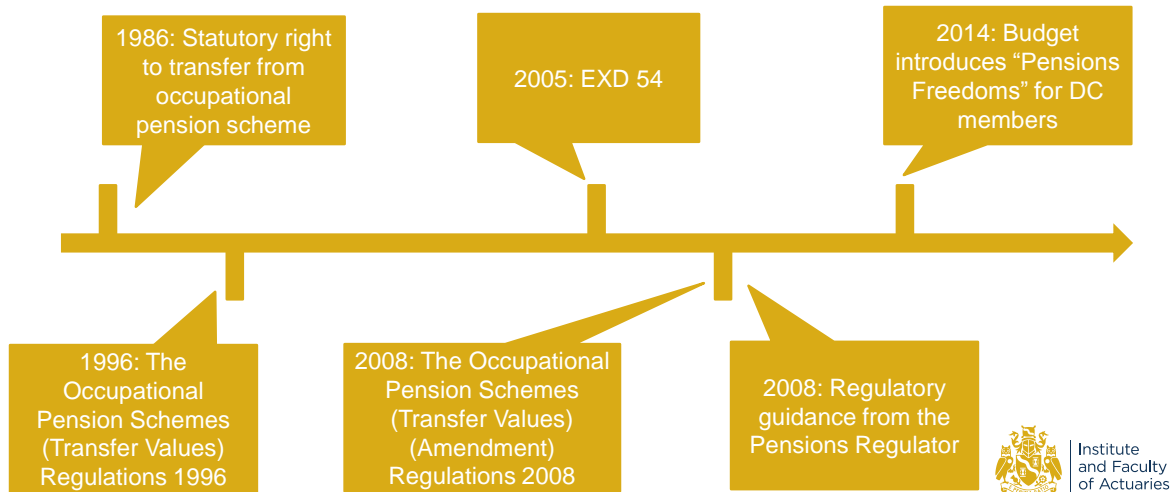


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Background to private sector transfer values in the UK



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How do public sector transfers compare?

- Public sector transfer values operate under the same fundamental principles as private sector transfer values, although with a number of differences in the implementation
- These differences include:
 - Consistent financial assumptions used across the public sector (different from those used in private sector)
 - Existence of "transfer club" between public sector schemes, where CETV amount doesn't determine the benefit provided
 - No statutory right to transfer out of unfunded public sector schemes
 - Accept DB transfers in – unlike many private sector schemes

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Current transfer activity (1)

- Since pensions freedoms were introduced, transfer activity from occupational DB schemes has increased – see figure below



Source: ONS, MQ5: Investment by Insurance Companies, Pension Funds and Trusts, table 4.3. These estimates are for the value of transfers in and out of all self-administered occupational pension funds (including local government funds as well as those sponsored by private and third sector employers). These include some DC to DC transfers, DB to DB transfers and transfers back to the State scheme.

Source: Willis Towers Watson, "Perspectives: the impact of defined benefit transfers on the pensions industry"



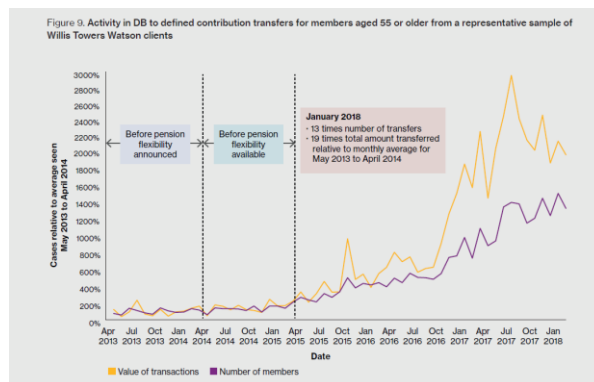
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Current transfer activity (2)

- In particular, the number of members over age 55 who are transferring has increased significantly



Source: Willis Towers Watson, "DB member choice survey 2018 – The continued rise of pension flexibility"



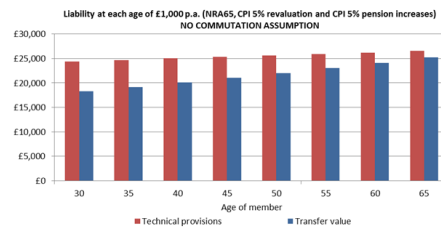
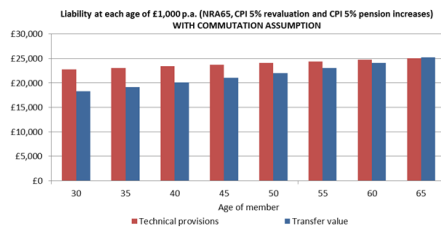
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CETV amounts versus technical provisions

- The charts below compare CETVs with the technical provisions reserve at various ages for a hypothetical scheme. In the chart on the left, the technical provisions reserve includes an allowance for cash commutation; there is no allowance for commutation in the chart on the right.



Why have CETV amounts increased?

- There are several factors that may have contributed to the increase in CETV amounts, including:
 - Falls in gilt yields
 - Investment de-risking
 - Improvements in life expectancy
 - Larger pensions being valued
 - More service and higher salaries
 - Larger proportion of pension receiving guaranteed increases
 - Shift in views on best estimate
 - Attitudes to transferring

Our deliberations

- This has all led us to consider the question “are transfer values at the right level?”
 - Activity has increased – does this mean transfer values are too high?
 - Does it matter if transfer values are “too high”?
 - Members are transferring even where they would not be able to replicate their scheme benefits – does this mean transfer values are too low?
 - Does it matter if transfer values are “too low”?
 - The pensions landscape has changed and most members will receive advice before transferring – does this mean that transfer values are at the right level for those who are advised to transfer but too low for those who aren’t?

The questions we would like to ask

- What is the purpose of a transfer value?
- What should a transfer value represent?
- Is the increased level of transfer activity a cause for concern?
- What are relevant factors to take into account when setting transfer values?
- What are appropriate assumptions for calculating transfer values?
- What adjustments could/should be made from the best estimate transfer value?

Q1 – what is the purpose of a transfer value?

- Purpose could be
 - To provide the member with “fair value” for their pension benefits
 - To enable the member to replicate their benefits in another scheme
 - To provide members with access to a wider range of options and flexibilities than are available in a DB scheme
- Transfer values are also used for divorce calculations and scheme modifications

Q2 – what should a transfer value represent?

- Legislation defines the *minimum* transfer value
 - “the amount at the guarantee date which is required to make provision within the scheme for a member’s accrued benefits, options and discretionary benefits” – legislation
 - “the expected cost of providing the member’s benefits within the scheme” – tPR guidance
- Is expected cost *within the scheme* an appropriate minimum and starting point?
- What about other approaches, eg
 - Mark to market
 - Technical provisions reserve as starting point

Q3 – is the increased level of transfer activity a cause for concern?

- Pensions freedoms were not brought in with DB pensions in mind – is increased activity an unforeseen consequence?
- What about the impact of ETV exercises on levels of activity?
 - Has this become less significant following the introduction of pensions freedoms?
- Is the current level of transfer values driving the current levels of activity?
 - If transfer values halved, would activity drop? If so, why?
- Is greater flexibility a good thing for members?
- But are members able to make the “right” decisions?
 - Advice requirement for transfers above £30,000 may alleviate these concerns
 - Who should decide what the “right” decision is?



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Q4 – what are relevant factors to take into account when setting transfer values?

- Is it legitimate to take account of market forces?
- Does the legislative context influence the appropriate level?
- Should member options be taken into account?
- Should the cost of providing the benefits elsewhere be taken into account?
- Should individual member circumstances and/or selection be taken into account?
- Should partial transfer values become more common?



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Q5 – what are appropriate assumptions for calculating transfer values?

- Should the value of a member's benefits depend on the scheme they are in?
- Should mortality assumptions take account of national mortality, the scheme as a whole or individual mortality assumptions?
- To what extent should investment de-risking be allowed for when setting the discount rate?

Q6 – what adjustments could/should be made from the best estimate transfer value?

- Legislation allows for transfer values to be reduced if the Scheme Actuary produces an *insufficiency report*. Although many schemes are underfunded, relatively few reduce transfer values in this way.
- Legislation also allows for transfer values to be paid at more than the minimum level if there are legitimate reasons for doing so.

Q7 – do you have any further comments on CETVs?



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Getting in touch with the Working Party

- Contact today's speakers:
 - Robert Inglis, robert.inglis@btinternet.com
 - Helen Nicholas, helen.nicholas@willistowerswatson.com
- Coming soon – take part in our survey



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