The Actuarial Profession
making financial sense of the future

Current Issues in Pensions
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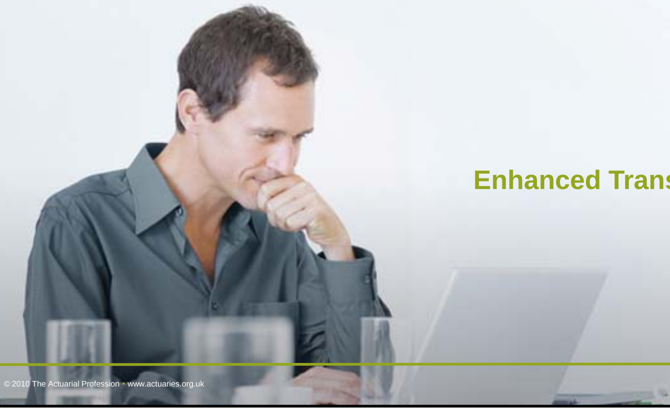


**Enhanced Transfer Values – A Debate**

The Case for ETVs



## Overview

- Not advocating that ETVs are right for all members
- ETVs are a good thing for some members
- The views expressed are not necessarily those of the speaker nor of his employer
- Aim to generate a lively debate

## Should schemes be paying Transfer Values?

- Transfer values are a right for many pension scheme members
- Transfer values represent the expected cost of providing benefits within the scheme
- Transfer values can give members the opportunity to get better (higher or more suitable) benefits outside the scheme without jeopardising the security of the benefits for remaining members
- However, taking a transfer value and paying into a personal pension could lead to lower benefits, and certainly leads to uncertain benefits
- Many members are happy with the exchange of ‘guarantee’ for possibility of higher benefits

## Some members will be better off having taken a transfer value

- Members with no spouse or dependant
- Members with a much older spouse
- Impaired lives
- Members who don’t need or want pension increases
  - Most annuities taken from DC pots are non-increasing
- Death in deferment
- Some members believe they can obtain a higher pension by transferring out
- More options and flexibility with DC

# Rough and ready comparison of emerging benefits for different types of member

Typical Transfer Value basis

DC Fund Growth Assumptions

8% per annum growth to age 60

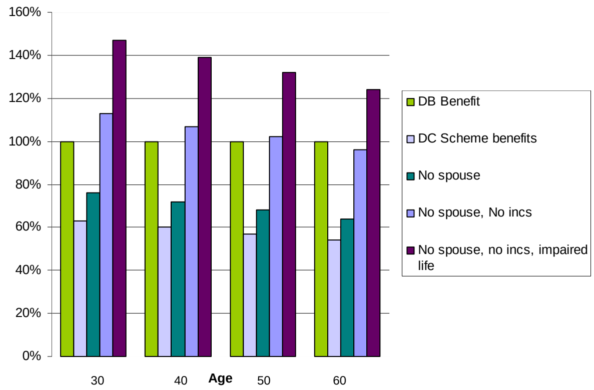
4% per annum growth thereafter

1% pa annual management charge

Annuity rates from FSA website

Allowance for mortality improvements in DC Benefits

**Comparison of Emerging benefits**








# Rough and ready comparison of emerging benefits for different types of member

Typical Transfer Value basis

DC Fund Growth Assumptions

6% per annum growth to age 60

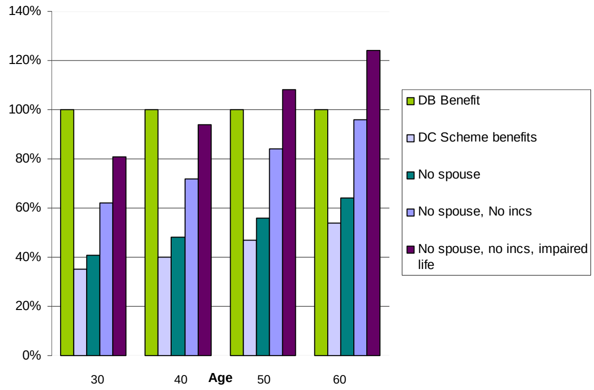
4% per annum growth thereafter

1% pa annual management charge

Annuity rates from FSA website

Allowance for mortality improvements in DC Benefits

**Comparison of Emerging benefits**



## If schemes pay transfer values, what is wrong with employers paying an enhancement?

- Trustees determine the assumptions used in the calculation of the Initial Cash Equivalent and Cash Equivalent Transfer Value
- The level of the CETV is that which the trustees deem to be a fair exchange from all members' perspectives for a particular member's otherwise deferred benefits
- The enhancement from the employer seeks to create a position whereby more members are comfortable with the exchange of deferred pension for the Cash Equivalent
- If Trustees and Scheme Actuaries are comfortable with the level of transfer value payable from a scheme, why should they be uncomfortable with a higher level being paid?

## What is the issue with ETVs?

- Advocate that there is nothing inherently wrong with the principle of an Enhanced Transfer Value for certain scheme members
- The higher the level of enhancement, the greater the number of members for whom an ETV may be appropriate
- The issue is more to do with the communication, and the need to ensure that members receive appropriate advice, and that communications are clear, fair and transparent
- Essential that the issues relating to sharp practice around ETVs does not lead to the demise of ETVs in general

## What could be construed as sharp or unfair practice?

- Obviously unfair
  - Take the ETV before the cash runs out!
  - No advice provided
- Could be unfair
  - The IFA is paid on commission
  - Many insistent transferees
- Debatable
  - High proportion of cash within the enhancement
  - Cash for Christmas?
  - Same enhancement for all?

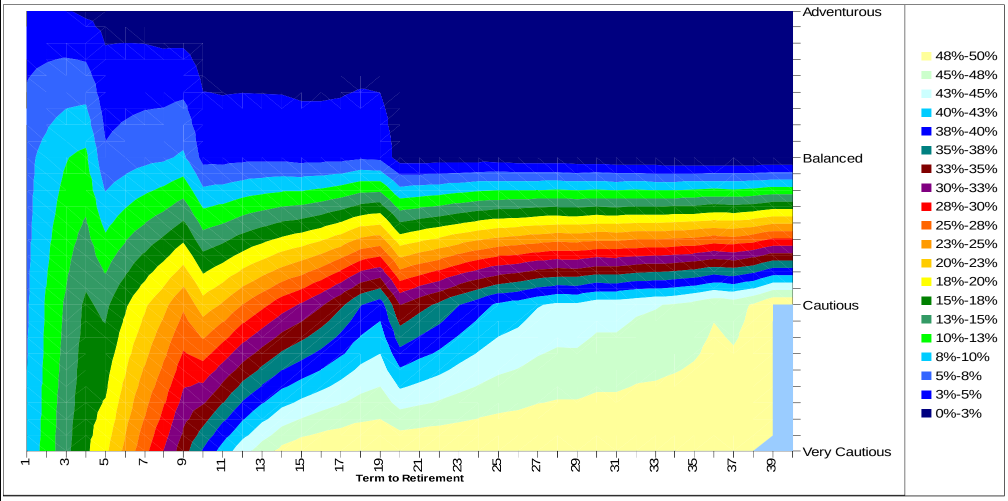
## What's wrong with cash?

- Many members will transfer out just to get their hands on cash now
- They will do this despite the IFA advising that they should not
- Member could take the cash and invest in their personal pension and replicate the benefits of an enhancement to the transfer value
- Members could use the cash now to pay down debt
- Some members will squander the cash
- But it is the member choice, and in effect all they are doing is unlocking their wealth early
- And the cash is on top of what the trustees were paying anyway

## What is an appropriate level of enhancement?

- It depends …
- Critical Yield?
  - Age
  - Attitude to risk
  - Level of CETV
- Technical Provisions?
  - Subject to a minimum or maximum
- Less than critical yield?
  - X% payable as an enhanced transfer value or as cash

## Percentage enhancement required for a recommendation dependent upon attitude to risk

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## What about the guarantees?

- In taking a transfer value members are exchanging ‘guaranteed’ benefits for one which is subject to the vagaries of the investment markets
- But what about the benefits being given up?
- What is the benefit being given up?
  - How many scheme sponsors will be solvent in twenty or thirty year’s time?
  - How many pension schemes will actually end up in the PPF?
  - What guarantees are there that the PPF will be providing the same level of benefits in twenty years time?

## How good are the guarantees?

- Based on PPF Banding insolvency probabilities
  - Crude, and assumes each year that insolvency probabilities are independent
- For a company in Band 1, probability of insolvency over a 20 year time horizon is about 4%
- For a company in Band 4, the probability increases to 13%
- For a company in Band 7, the probability increases to 33%
- For some sponsors the comparison particularly for younger members should be the transfer value against the PPF benefits

## What is wrong with giving members choice?

- On retirement members can choose to take tax-free cash – often this is on much poorer terms than that implicit in a transfer value
- Many members prefer non-increasing benefits to indexed benefits
- Most members do not have the ‘average’ demographic profile of the scheme
- Members know more about their personal circumstances than we ever will
- Essential though to ensure that members have full information – especially relating to life expectancy, emerging benefits and impact of inflation

## Aggregate Experience

| Category | Number of Members | Proportion |
|---|---|---|
| Total Population | 24940 | 100% |
| Registrations | 12772 | 51% of total population |
| Fact Finds Returned | 9635 | 75% of registrations |
| No Transfer (Red report) | 3932 | 41% of fact finds returned |
| Yes Transfer (Amber/Green Report) | 5661 | 59% of fact finds returned |
| Transfers | 4872 | 20% of total population |
| Insistent Transfers | 1068 | 22% of transfers |

## Summary

- Not advocating that ETVs are right for all members
- Members could be better off by exercising their transfer value option
- Enhancement leads to the option being potentially beneficial for more members
- Essential that communication is clear and fair
- Members need to understand the risks and benefits of exercising the option and of not exercising the option
- As well as being a benefit to the employer, can be of benefit to the transferring members and those remaining within the scheme

## Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

JLT Pension Capital Strategies Ltd

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