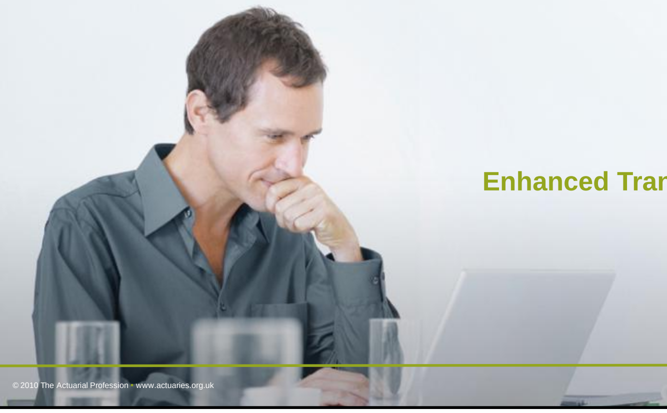
The Actuarial Profession
making financial sense of the future

Current Issues in Pensions
Simon Taylor
JLT Pension Capital Strategies



Enhanced Transfer Values – A Debate

The Case for ETVs

9 November 2011

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

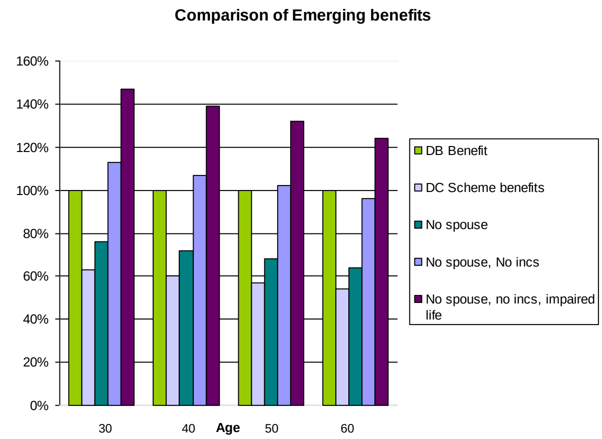
8% per annum growth to age 60

4% per annum growth thereafter

1% pa annual management charge

Annuity rates from FSA website

Allowance for mortality improvements in DC Benefits



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

Typical Transfer Value basis

DC Fund Growth Assumptions

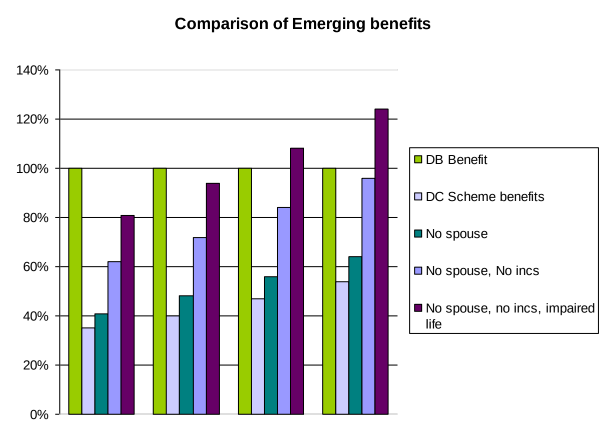
6% per annum growth to age 60

4% per annum growth thereafter

1% pa annual management charge

Annuity rates from FSA website

Allowance for mortality improvements in DC Benefits



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?

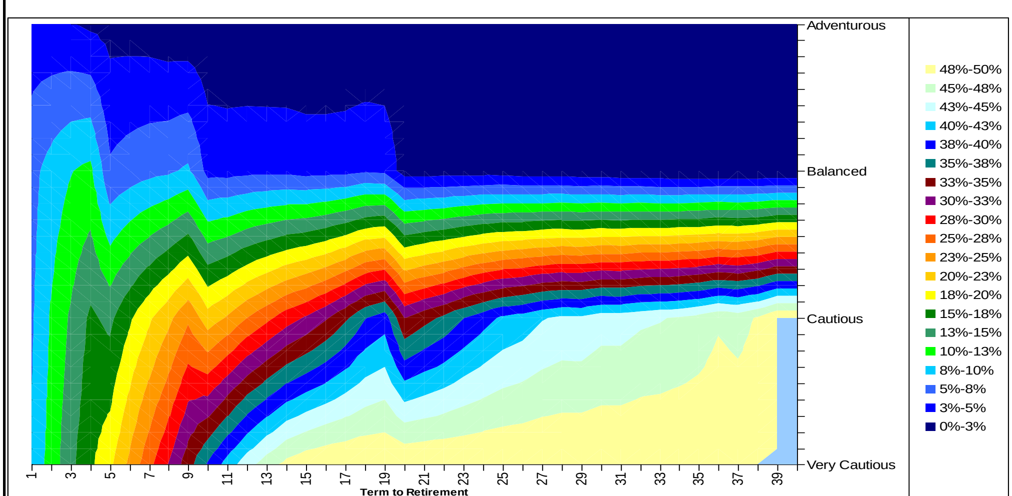
What's wrong with cash?

- 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



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

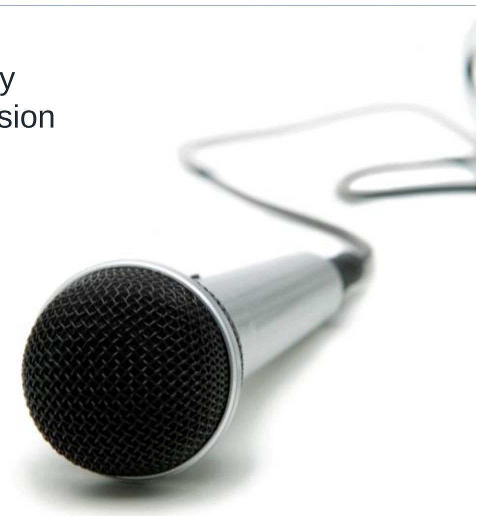
Category	Number of Members	Proportion
Total Population	24940	100%
Registrations	12772	51% of total population
Fact Finds Returned	9635	75% of registrations
No Transfer (Red report)	3932	41% of fact finds returned
Yes Transfer (Amber/Green Report)	5661	59% of fact finds returned
Transfers	4872	20% of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

Authorised and regulated by the Financial Services Authority
a member of the Jardine Lloyd Thompson Group
6, Crutched Friars,
London EC3N 2PH