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Flexibility at retirement

Nicola MacKay, Towers Watson

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Overview

- 2014 Budget has introduced considerable flexibility for benefits being drawn from a DC arrangement after April 2015:
  - Individuals **will not be required to purchase an annuity** and can draw down 100% of the value of their DC savings pot; the first 25% will be tax free.

- DB members may want to access this flexibility from April 2015 too. With more DB members wishing to understand all their options, the number of requests for transfer quotations is expected to increase significantly.

- All DB Schemes will therefore need to consider how they communicate with members as they approach retirement and review their retirement processes. Possible options include:
  - Making minimal changes and waiting for members to request transfers.
  - Providing transfer values automatically and amending retirement communications to cover all options.
  - Providing advice from financial advisers to retiring members.

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Why would members consider transferring?

Member perspective

• At retirement, the member's circumstances will be clearer and the standard DB scheme pension may not be the best fit for a member's needs. For example:
  • Would purchasing a flat pension via a traditional annuity in retirement be a better "shape", giving a greater income in earlier years and a lower income later?
  • Does the member's spouse need the full scheme reversionary pension of 50%-80% of the member's pension? Or do they have their own source of retirement income? Again a traditional annuity might be appropriate.
  • Transfer to a DC arrangement can increase the tax free lump sum available.
  • They may wish to make use of the new DC flexibility and arrange their income exactly as they like - taking their benefits either as one lump sum or as a series of taxed lump sums as and when suits their needs.

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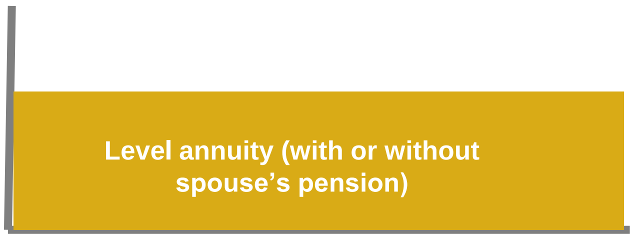
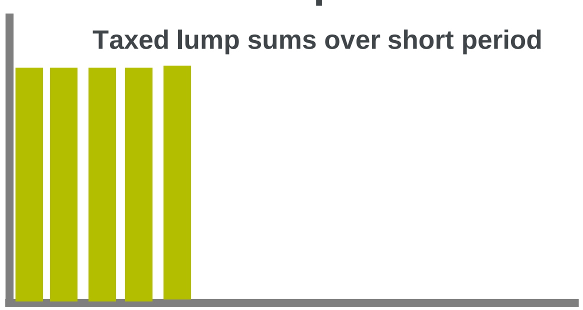
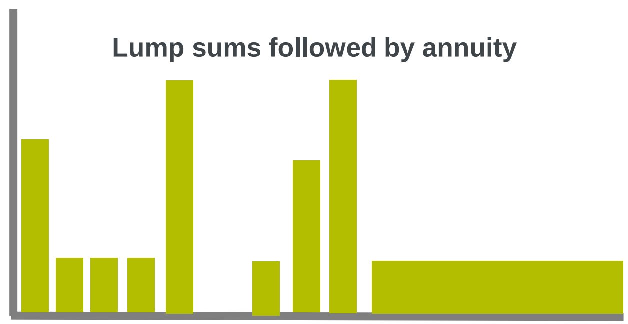
Flexible retirement income options on transfer – post April 2015

Traditional annuity

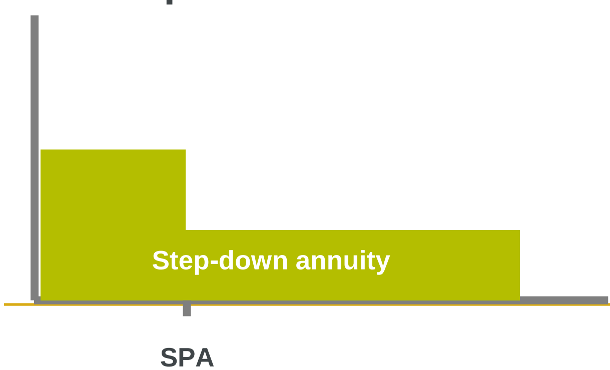


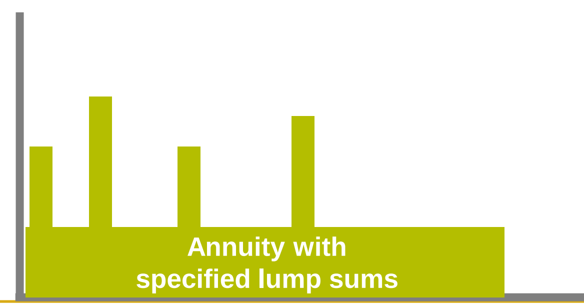
Possible other options





Future options as market evolves?





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DB scheme versus annuity illustration

Existing scheme options

1. Scheme pension

- £10,000 pa
- LPI increases

2. Scheme cash and residual pension

- £7,000 pa
- LPI increases
- £45,000 tax-free cash

Annuity purchase on transfer

3. After transfer cash/pension illustration

- £9,000 pa
- No increases
- £62,500 tax-free cash

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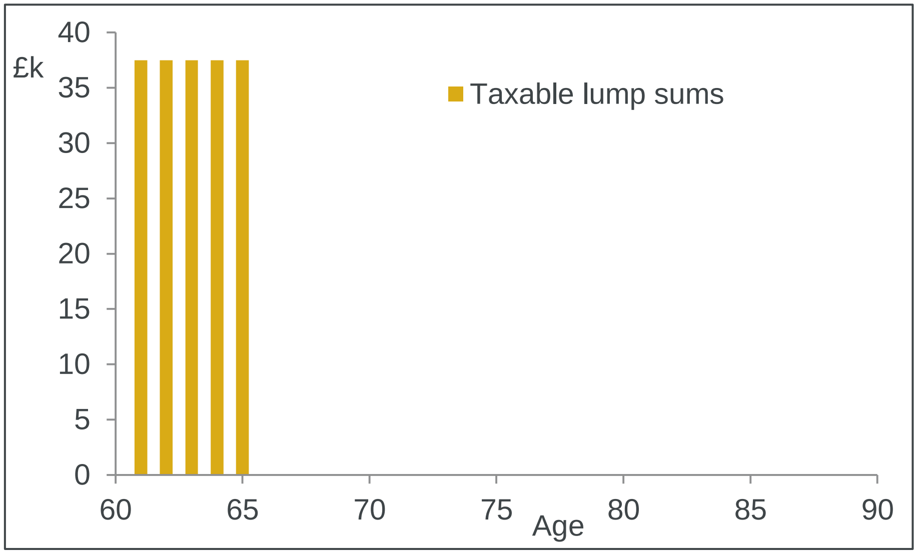
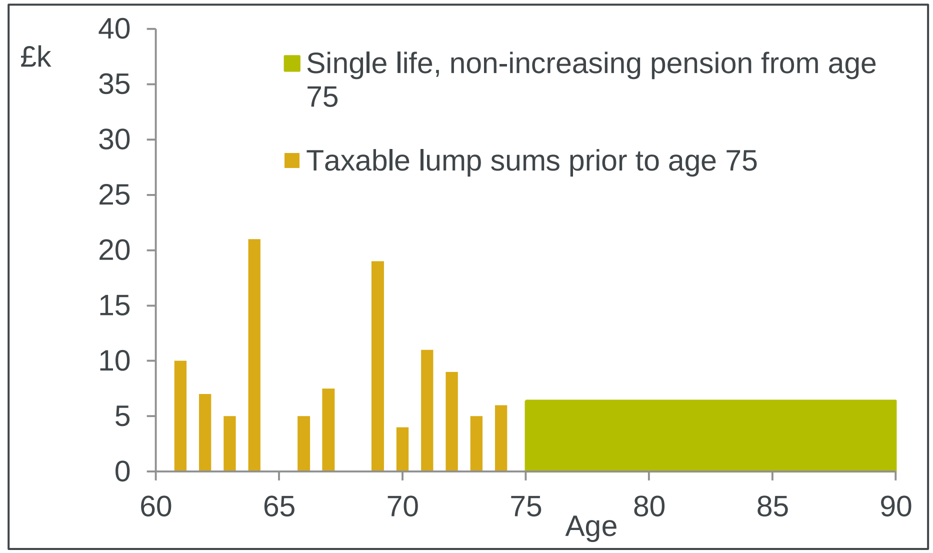
Flexi-access drawdown illustrations – post April 2015

Transfer value of **£250,000**

Taking the transfer value gives a tax-free cash lump sum of **£62,500**.

The member could take the balance as a **single taxed lump sum of £187,500** or there are numerous other alternatives – two are shown here:





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Source: Annuities from The Open Market Annuity Service in August 2014

Regulatory requirements from April 2015

What do we know?

Transfers from private sector DB schemes and funded public sector schemes will be permitted and financial advice will be required on transfer values over £30k.

Transferring schemes must check that individuals have taken advice from a financial adviser authorised by the FCA and independent of the DB scheme.

Employers must meet costs if transfer is within the same scheme or a result of an employer led incentive exercise. This is expected to cover bulk exercises but there may be no such requirement for "business as usual" options.

What is still to come?

Regulatory guidance from FCA for financial advisers (and IFA advice models) to be developed with possible updates to Code of Good Practice on Incentive Exercises.

Consultation on introducing new flexibilities within DB schemes.

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Issues for Trustees

Trustee perspective
• Responsibility to make members aware of all options - a transfer may be in the best interests of some members. Changes to retirement communications and processes will be needed.
• A higher volume of requests for transfer value quotations are expected. Could be more cost effective to have a robust process and provide transfer values automatically.
• More choice means members face more complex decisions. Without support there could be a large number of ad-hoc queries, increasing costs.
• Financial impacts on the scheme of increased levels of transfers.

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Issues for Company

Company perspective

- Are they looking to de-risk or shrink the size of the scheme? Transfers at retirement could help to achieve this aim as they:
  - Remove liabilities and risk from the scheme
  - De-risk at a significantly lower cost than buy-in / buy-out
  - Reduce volatility as scheme is smaller
- Does the CETV basis need to be reviewed?
  - Should the Company look to work with the trustees so that objectives are aligned?
- Will admin costs simply increase but no-one actually transfers or just the “wrong” people?
  - Make sure money is well spent
  - Avoid selection

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Levels of member support at retirement

Minimal support		Full support
"You can take a CETV if you want to – ask for further details"	"You can take a CETV if you want to and this is what it is"	"You can take a CETV if you want to, here it is with details of what it could provide. Advice is available to help you decide"

Minimal support

- Member apathy?
- Few transfers and possibly greater selection risk
- Increased risk of poor member decision making
- Wasted additional admin impact and cost?

- Increased admin and costs
- Review processes to be efficient
- Some transfers and risk reduction

Full support

- Higher member engagement
- More transfers and lower selection risk
- Higher costs due to IFA costs but greater savings/risk reduction?

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Factors which might affect the approach taken

- Level of CETV:
    - Will the transfer value look attractive to members?
    - What is the funding / solvency impact of paying out transfers on the current CETV basis?
- Cashflow implications:
    - Future cashflows could be more unpredictable.
    - Liability duration may be shorter, with implications for hedging of liabilities and assumption setting.
- Cost benefit analysis of providing advice:
    - Is the extra cost of providing members with financial advice worth considering given the likely increased take-up and risk reduction it might achieve?
- Business as usual option or a bulk exercise:
    - Should the option simply be offered to members as they approach retirement? Should an offer be made to deferred members over age 55? Or both?
    - Implications for process changes and provision of advice.
    - Acceleration of impact through a bulk offer exercise.

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Legal & practical considerations

Key considerations	
Rule amendments	Allow transfers in the year up to retirement
Investments	May need to rebalance and / or increase liquidity
Administration and processes	Additional work required, some time-sensitive
Data cleansing	May be needed beforehand
IFA advice models	There could be changes here depending on FCA guidance

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Questions

Comments

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