



Institute  
and Faculty  
of Actuaries

# Member Options at Retirement

Manchester: Hilary Salt

London: Richard Gibson

Bristol: Scott Pinder

Edinburgh: Alastair Kennis



# Effect of new DC flexibilities on DB schemes

- Flexibilities don't (yet) apply to DB schemes directly
- Schemes may extend the option to take a transfer value up to retirement
- Much more interest in transfers out from 55 and up to retirement
- Also higher limits for trivial commutation
- Schemes need to reconsider lots of things
  - here we concentrate on the transfer value basis, trivial commutation and commutation terms



# Background to different factors

## Transfer Values

- Best estimate cost of providing benefits in the scheme
- No allowance for options which reduce value of benefits
  - Trustees must consider discretionary benefits
  - Can reduce TVs with insufficiency report

## Trivial Commutation Factors

- No regulatory control
- Trust Deed and Rules may cover
- “Normal” commutation plus partner or best estimate approach

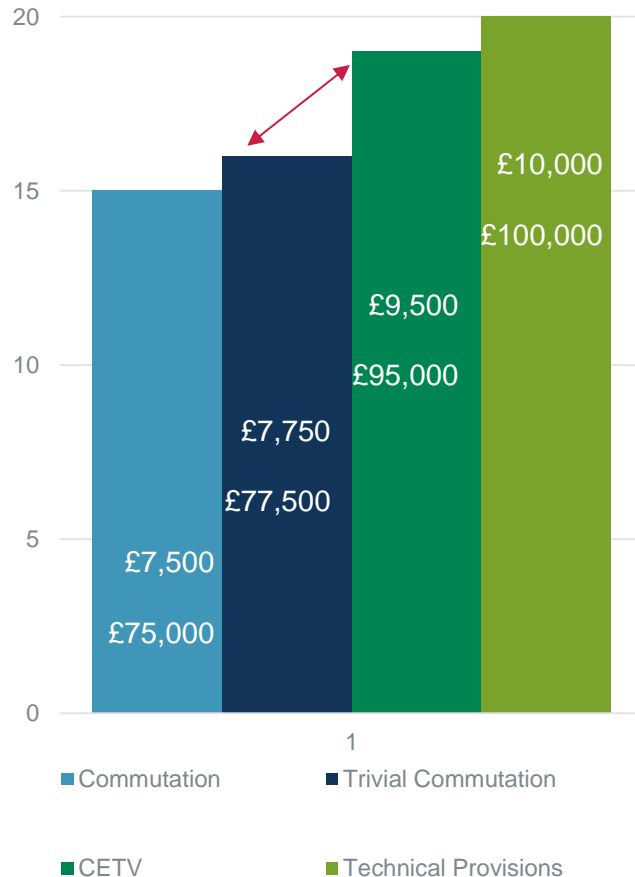
## “Normal” Commutation Factors

- No regulatory control
- Trust Deed and Rules may cover
- Often significantly below best estimate
- 2006 Member options working party and letter to scheme actuaries

# Typical Comparisons

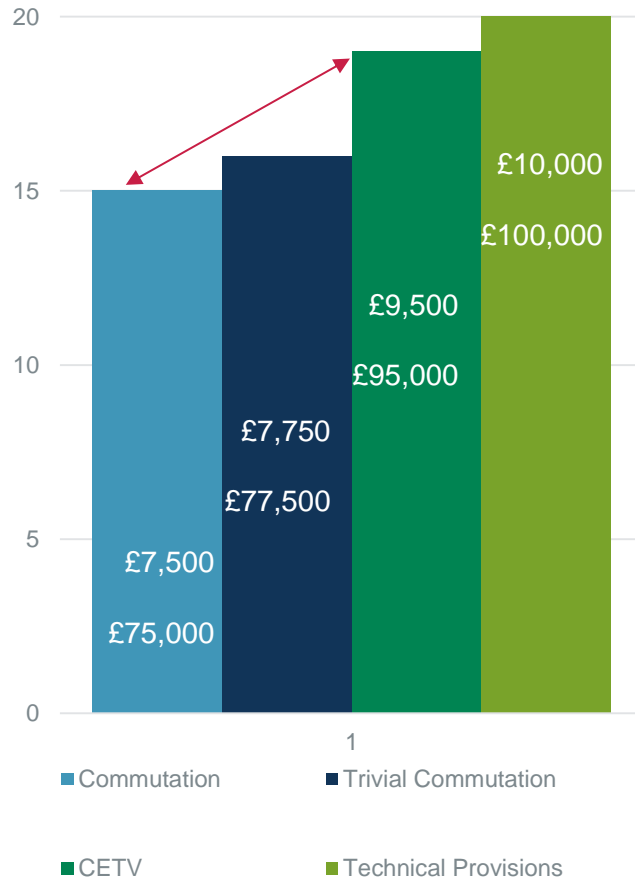
- The relationship between the headline commutation factor, the trivial commutation factor, the cash equivalent transfer value and the technical provisions depends on lots of factors:
  - Preserved retirement age versus expected retirement age used in funding
  - Single discount / dual discount rate
  - Allowance for commutation in the TPS
  - Level of commutation factor
- The following slides consider:
  - A trivial pension amount of £500 pa
  - A non trivial pension amount of £5,000 pa

# Gap between trivial commutation and CETV



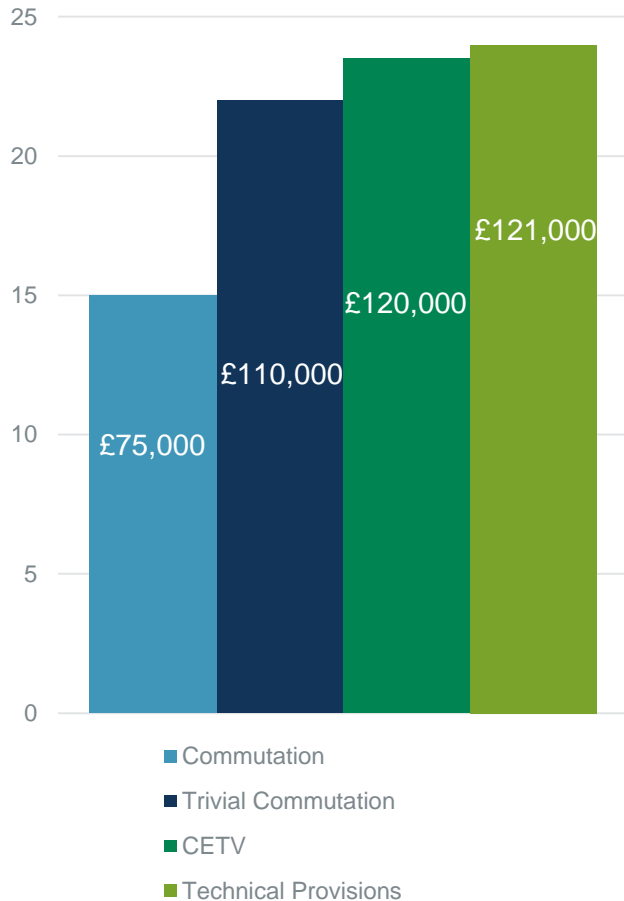
- Trivial commutation factors close to normal commutation factor but with allowance for partner pension
- Member takes trivial commutation directly from the scheme : £7500
- Member takes CETV from the scheme and transfers to dc arrangement (without advice), then takes cash: £9,500
- Should trivial commutation factors be aligned to CETV?
- Note also 5% gap between CETV and TPs

# Gap Between commutation and CETV



- Member might make comparison between:
  - Total value of benefits in the scheme  
= Pension x cf = £75,000, and
  - Available transfer value £95,000
- More likely member might compare:
  - Benefits from scheme: maximum cash of £23,077 and remaining pension £3,462, and
  - Taking a transfer value of £95,000 then:
    - taking one quarter as cash: £23,750
    - The remaining £71,250 as drawdown
- Effect of tax free cash calculations tends to hide the difference

# Very Low Commutation Factors



- Lower pension age example where single commutation factor can have big effect
- Issues already identified with trivial commutation and commutation
- Additional issue that partial transfer to take maximum cash can be better than taking cash from the scheme
- Note also closeness of CETV and TP levels – especially likely with low commutation factors are allowed for in TPs

# Cash Alternatives

## One vehicle

- In scheme:
  - Commute £1,538 for maximum tax free cash £23,077
  - Remaining pension: £3,462
- Transfer all to DC vehicle:
  - CETV: £120,000
  - Tax free cash £30,000
  - Drawdown from £90,000

## Partial Transfer

- Transfer £1,538 of pension
- CETV = £1,538 x 24 = £36,912
- Take one quarter as tax free cash: £9,228
- Take remainder of £27,684 taxed:
  - At 20% = £22,147 + £9,228 = £31,375
  - At 40% = £16,610 + £9,228 = £25,838
- Residual pension in scheme £3,462
- Partner's pension lost on £1,538

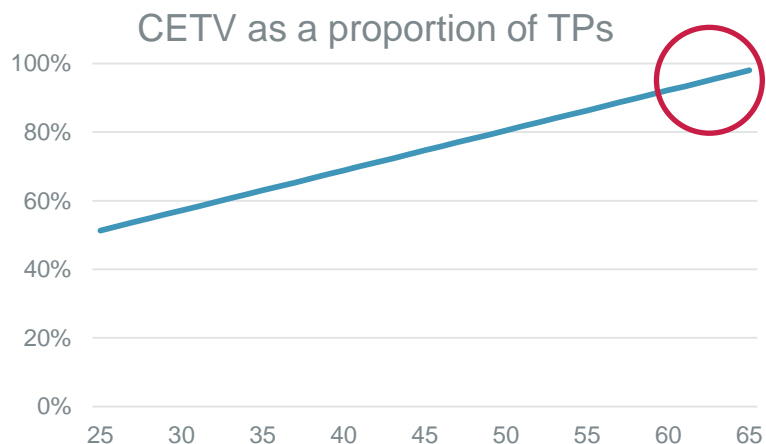


# Member Communications at Retirement

Option	Offer	Encourage	Enforce
Small lump sum at retirement (up to £10,000)	✓	?	✓
Trivial Commutation at retirement (up to £30,000)	✓	?	✗
Transfer Option at retirement	✓	✓	✗
Partial Transfer Option at retirement	✓	✓	✗

- May need rule changes
- “Offer” may mean signposting, an invitation to request a quote, an actual quote
- “Encourage” may mean “just sign these forms” (below £30k), advice and/or offer of a default vehicle

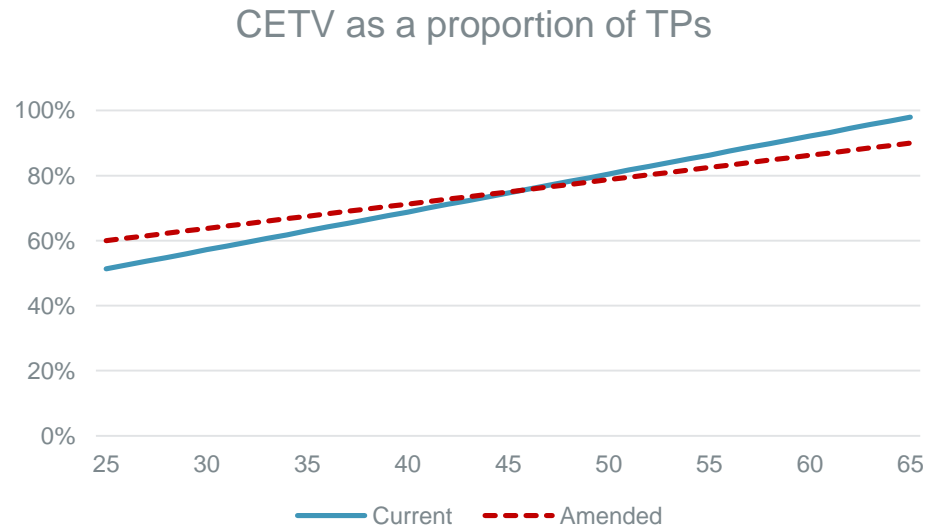
# CETVs



- Dual discount rates so TPs and CETVs bond based post retirement
  - Margins vs best estimate returns may differ
- Advance allowance in TPs for commutation

- Very little (no?) margin against TPs for those transferring at retirement
- Concern for trustees if large numbers of transfers take place
- Selection against the scheme – increased or decreased?
- Underwrite transfer values?
- Insufficiency report is across all members
- Protecting members from themselves?

# Revised CETVs?



- Rebalance CETVs from old to younger members
- Technically by amending pre/post retirement discount rates or using single discount rate (consider neutral basis?)
- Needs in depth discussion with trustees

# Trivial Commutation Exercises

- Offering (imposing) small lump sum and trivial commutation at retirement likely to be standard practice
- But exercises aimed at existing pensioners need careful consideration
- The Code of Good Practice for Incentive exercises covers exercises where:
  - One objective is to reduce the risk or cost of the scheme, and
  - The invitation is not ordinarily open to members
- If the Code applies, then members must:
  - Be offered a balance deal, and
  - Receive guidance

# Does the Code Apply?

*“One-off small / trivial pension exercises to existing pensioners and dependants would generally be expected to meet these two tests. Therefore, generally, we would expect the Code to apply to one-off exercises, but not to apply to “business as usual” activity (although the principles of the Code should be considered, in the normal way, as outlined in the Code). We would not expect the Code to apply where members are not given a choice (although the principles of the Code may be helpful).”*

Incentive Exercises Monitoring Board

*“For the purpose of considering whether the invitation or inducement is “ordinarily available”, the content and context of the invitation or inducement should be interpreted more broadly than simply the financial terms of the offer. For example, an ordinarily available benefit option, that is being offered on ordinary terms, but which is being offered for the first time with an associated incentive (of any form), provision of financial advice, or **potentially even a fundamental change to the communication of the option** is likely to satisfy this second leg, and may therefore be an Incentive Exercise if it also satisfies the first leg of the definition.”*

Practitioner notes to the original Code (highlighting added)



# 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.