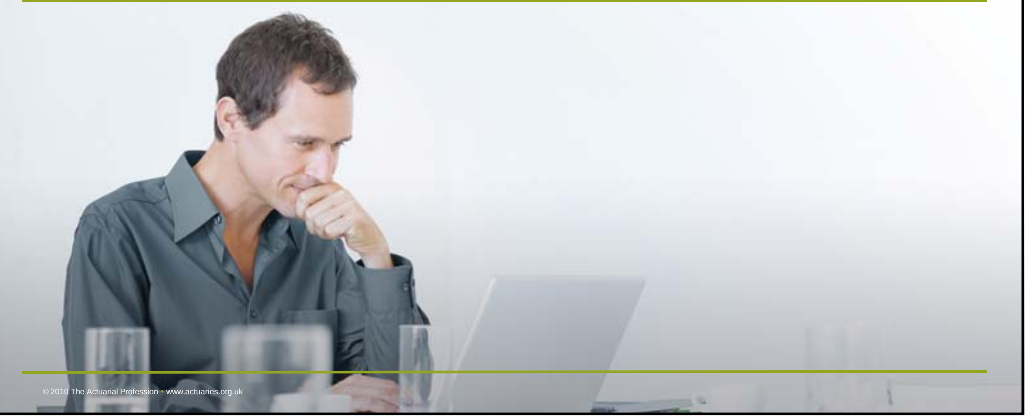
The Actuarial Profession
making financial sense of the future

De-risking by incentive exercises
Rob Dales



Agenda

- Regulator guidance
- July 2010 webinar
- Current approaches and trends
- Questions/discussion

Final incentives guidance set out by regulator

- TPR is concerned members may be disadvantaged
- Such exercises are not in most members' interests
- IFA advice to all members
- Information should be clear, fair and not misleading
- Trustees should engage in process and apply a high level of scrutiny
- 5 principles….

Principle 1 : Clear, fair and not misleading

- Information tailored to the audience
- Avoid jargon, overstating positions and omitting essential information
- Clear indication of value of benefits given up
- Fully outline risks involved in accepting the offer
- British code of Advertising, Sales Promotions and Direct Marketing clarify what is clear, fair and not misleading

Principle 2 : Open and transparent

- All parties aware of the reasons for the offer
- All parties aware of interests of other parties
- Communicate relationships of all parties
- No undue pressure to accept
- Reasonable timeframe to decide
- Basis of remuneration of advisers clear
- Adviser selection process used

Principle 3 : Manage conflicts of interest

- Conflicts identified, managed and/or removed
- Multiple interests (Trustee is a director, success fees)
- Disclose conflicts to relevant parties

Principle 4 : Trustee consultation

- Trustees engaged from the start of the process
- Ensure interests of scheme and members properly addressed
- Question and challenge the appropriateness of an offer
- Manage scheme investments/cash flows

Principle 5 : Independent financial advice

- Independent and impartial advice made available and promoted in strongest terms
- Offer should be dependent on members taking advice
- Advice should be tailored to members individual needs
- Employer should consider paying for advice
- TPR accepts members may go against advice
- Trustees to be comfortable with selection of advisers

July 2010 Webinar

- Carl Davey from the Pension Regulator Webinar
- Rob Dales - Company actuary
- Jonathan Webb – IFA
- Jim Boyle – Scheme actuary

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Question and answers to the audience

- Question – what impact do you think the guidance from the Regulator will have on incentivised transfer exercises?
- Answer – most people think that there will be no change in activity
- Question – what impact do you think the guidance will have on pension increase exchange exercises?
- Answer – no change

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Is the Regulators intention to raise the bar in relation to such exercises or is to discourage employers from running them altogether?

- CD – the Regulator's guidance has the intention of encouraging good behaviours. We think that there are / is activity in this area that puts member's benefits at risk.

- RD – I don't think there is a great deal of reaction from employers, it is good to see there's now a consistent approach. Now a clear dictate from a regulator so employers have got to make sure practice is good. There is concern that there is a lot of information there that we are required to provide to members.

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How important and legitimate is it for employers to be able to run such exercises?

- RD – it is very important that employers have got the opportunity to manage their liabilities legally and legitimately. The employer is giving the member a choice. Giving members a choice has got to be good as long as it's an informed choice.

- JB – the high level principles are welcome and all echoes with what the actuary code says. It will lead to trustees getting more involved and hopefully in the feasibility stage.

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How do you think the IFA community will react?

- JW – I think that the IFA's have been doing this well and they're doing a good job for their clients and it is at the end of the day all about suitability for the member to understand the options being put in front of them.
- It will be good to see if we can drive the poor practices out of the market and that's why we also welcome the overriding higher principles of the consultation document.
- CD - some of the examples we have seen have been quite extreme

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Is the employers' gain likely to be the member's loss?

- RD no, I don't agree with that statement. If members are making an informal decision and taking the option that they think is right for them, then I don't think that anybody can say that's their loss. This guidance is all based on what's in the members' retirement interest rather than their financial interest.
- These exercises should require members to take IFA advice.
- Regarding the employers gain, employers only do these exercises because they see financial gains, but that's only because trustees are starting to set higher and higher targets for technical provisions.

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Have most members made decisions that are unlikely to be in their interests?

- JW – The IFA has clear guidelines on advising on DB transfers
- Our job is to make sure members understand the offer and implications of their decisions
- Members consider their current financial position
- The IFA's role is really to engage with the members to understand their personal circumstances. The starting position's always got to be that a member's best interest is to stay with a promise of a certain level of income, however, we've got to be aware that our approach to advice is holistic. Unfortunately it will be short term gain for long term pain.

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Cash incentives distort the member's decision

- CD – in the context of retirement provisions, members are taking these offers against advice and in an overwhelming amount of cases, those are cash enhancements. The cash part of the enhancement is distorting member's decisions.
- RD – members have got to take advice. Part of that advice is for the IFA to sit down with a member and explain to him fully, what the options are. If that is done properly we can say it's the members own decision. So there is nothing wrong with giving members the right information, letting them make an informed decision and that includes cash or not.
- If you don't offer cash take up is much lower
- CD – Cash adds risk to an exercise. Members make poor decisions without understanding what they are giving up – there may come a time when they seek redress for these decisions

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What should the trustees do when they first learn the transfer exercise is imminent?

- JB – engage with the employer as early as possible. It is not just the level of the enhancement but fundamentally the objectives of the employer and where the pension scheme is going. Trustees should go back and look again at the employer covenant, the technical provisions, the CETV basis. They should have the authority to comment on what the outcome might be but should not be involved in setting the enhancement.
- CD – Trustees should be a “guard” in the process
- RD – my view is that the role of the trustees is to make sure members are not misled in the communication process, not to dictate. As long as members are taking advice and trustees have the final say in the communications, I think that’s where their role stops.

What do you think best practice should be in relation to insistent customers?

- JW - insistent customer in the IFA world is a member that receives a recommendation from an IFA not to proceed but still proceeds, perhaps just because they’re taking their augmentation as cash
- The IFA needs to be able to show the member was informed of the consequences of his decision
- CD – I don’t think the regulator has a view

The Regulator says that the same principles apply to pension increase exchange exercises?

- JW - this element came as a bit of a surprise to us. We're not aware that the FSA has any code of conduct or code of business. Our current practice is to offer the information help line where we discuss things such as longevity, inflation risk, the crossover point– but Not advice.
- RD - I would be disappointed if that is the outcome, but Trustees don't insist members take advice at the point of retirement.
- CD - I think we have a problem here then don't we because these pension increase exercises for a member are equally as complex at deciphering what is in their interest in an ETV

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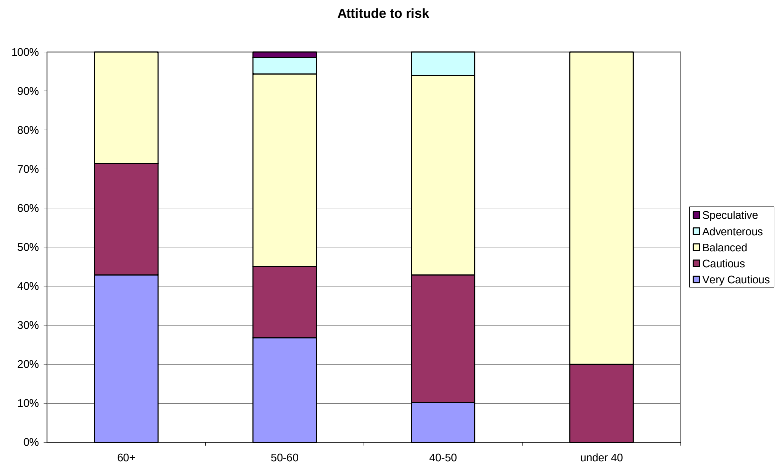
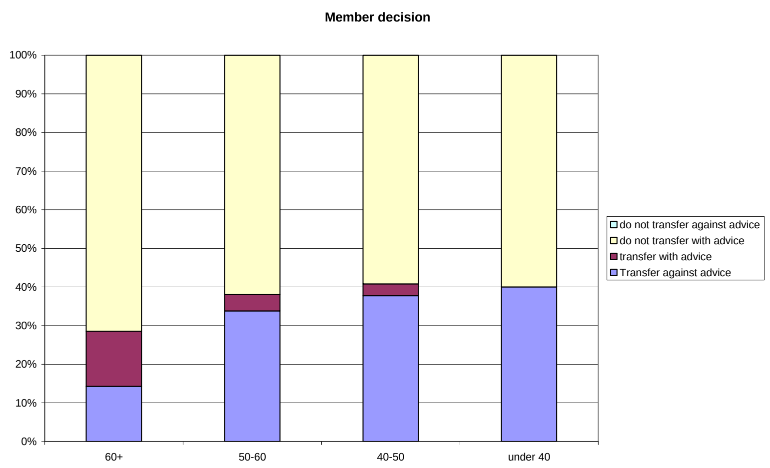
Current approaches - ETV

- Flat % or target a critical yield
- Selective group
- Insist on advice
- Involve Trustees in communications
- 3 months to decide
- Opt in / opt out
- Default fund
- Cash option

ETV Experience



ETV Experience



Current approached - PIE

- Option at retirement
  - No advice requirement
  - More information than normal quotation
- Pensioners
  - Help line but not advice
  - Detailed information pack / break even calculation
  - 30% - 40% take up
- 60% - 80% of value exchanged

Questions / Discussion