Society of Actuaries in Ireland

Enhanced Transfer Values

10 April 2017

Disclaimer

The views expressed in this presentation are those of the presenter(s) and not necessarily of the Society of Actuaries in Ireland

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Scene setting

Philip Smith

Legal aspects of transfer values

- History
  - Why do we have them?
- Company/Trustee considerations
  - Who are they for?
  - How should they be calculated?
  - Tricky situations
- Communication aspects

Going back to go forward

Why do we have transfer values?

- Pre 1990 – no preservation, no right to vesting or transfer value unless in the deeds
- Some schemes had some vesting or provided that a TV on request was determined by the "appropriate authority" or the trustees – many didn't
- Standardisation with Pensions Act preservation regime but often bolted onto existing provisions
- Partial winding-up provisions provided for transfers of a group of members (without consent) not necessarily with the same approach as the later leaving service rule (share of fund vs aggregate standard TVs)

?s Are deliberate leavers less loyal? Do they get the "full" value (MFS vs past service reserve) if there is more money than MFS.

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Stakeholders and case study

Paul Torsney

Why would a Company want to run an ETV exercise?

If they are willing to pay to increase the TV available to a level where a required number of members find it attractive to accept

- Why would they willing to do this?
  - Reduce liabilities and hence future volatility
  - Next step on de-risking path
  - Large gap between standard TV and accounting value (if listed)
  - Accounting deficit feeds directly into solvency requirements (certain financial institutions)
  - Reduce future administration costs

Why would Trustees facilitate an ETV exercise?

If they feel the option may be of benefit to (some) members and will not disadvantage remaining members provided the process is well run and members receive sufficient information to make an informed decision

- Trustees are likely to consider the following:
  - Financial advice for members
  - Adherence to scheme documentation
  - Communications that are clear, balanced and honest
  - Clarity that this is a company exercise
  - Particular focus on those close to retirement
  - Information regarding to proposed receiving arrangement
  - Concessions available for scheme as part of exercise

Why might members accept an ETV offer?

If they feel it is in their best interests

- Why might they perceive it be in their best interests?
  - Offer seen as good value
  - Members feels they have investment skill to produce better outcome
  - Concern over sponsor covenant
  - Additional flexibility of DC arrangement
    - Approved Retirement Fund
    - Potential for larger tax-free lump sum
    - Earlier access
    - Details of annuity – single/ joint life, pension increases etc.
  - Improve future prospects of the company
  - Consolidate various pensions

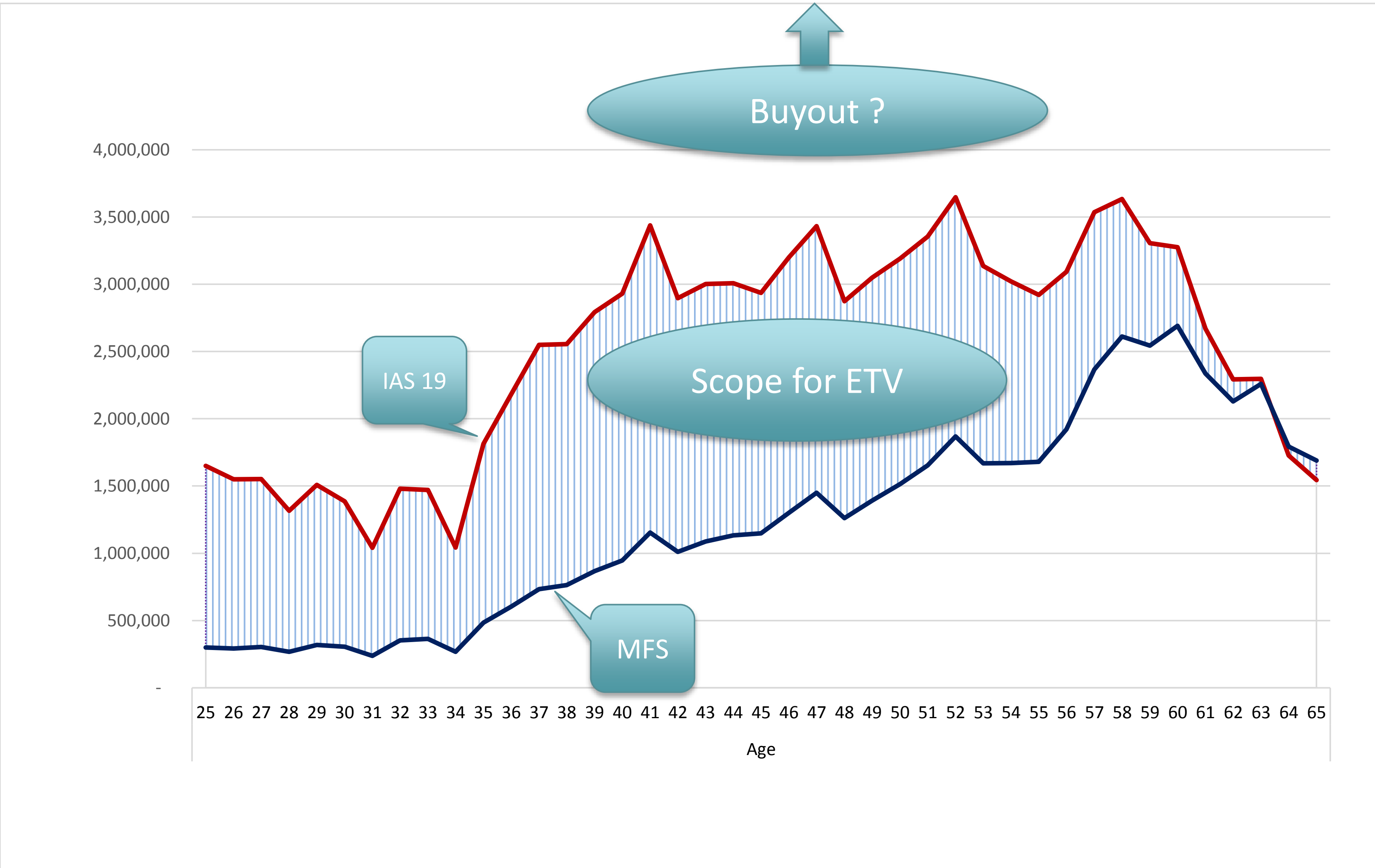
Illustrative case study – ABC Limited Pension Scheme

- Financial institution
- Closed to new entrants 5 years ago
- Closed to future accrual 2 years ago
- Focussed on de-risking investments for last two years
- Strong desire for further de-risking to reduce volatility and free up capital for writing new business
- Willing to commit to cash contributions to achieve this

Illustrative case study – ABC Limited Pension Scheme

€m	MFS	IAS 19
Actives	0	0
Deferred pensioners	50.7	103.3
Pensioners	10.0	7.0
Expenses	1.2	0.0
Reserve	6.1	0.0
Total liabilities	**68.0**	**110.3**
Assets	**70.0**	**70.0**
Surplus / (Deficit)	**2.0**	**-40.3**

ABC Pension Scheme – Liabilities at 31 March 2017



What enhancement to offer?

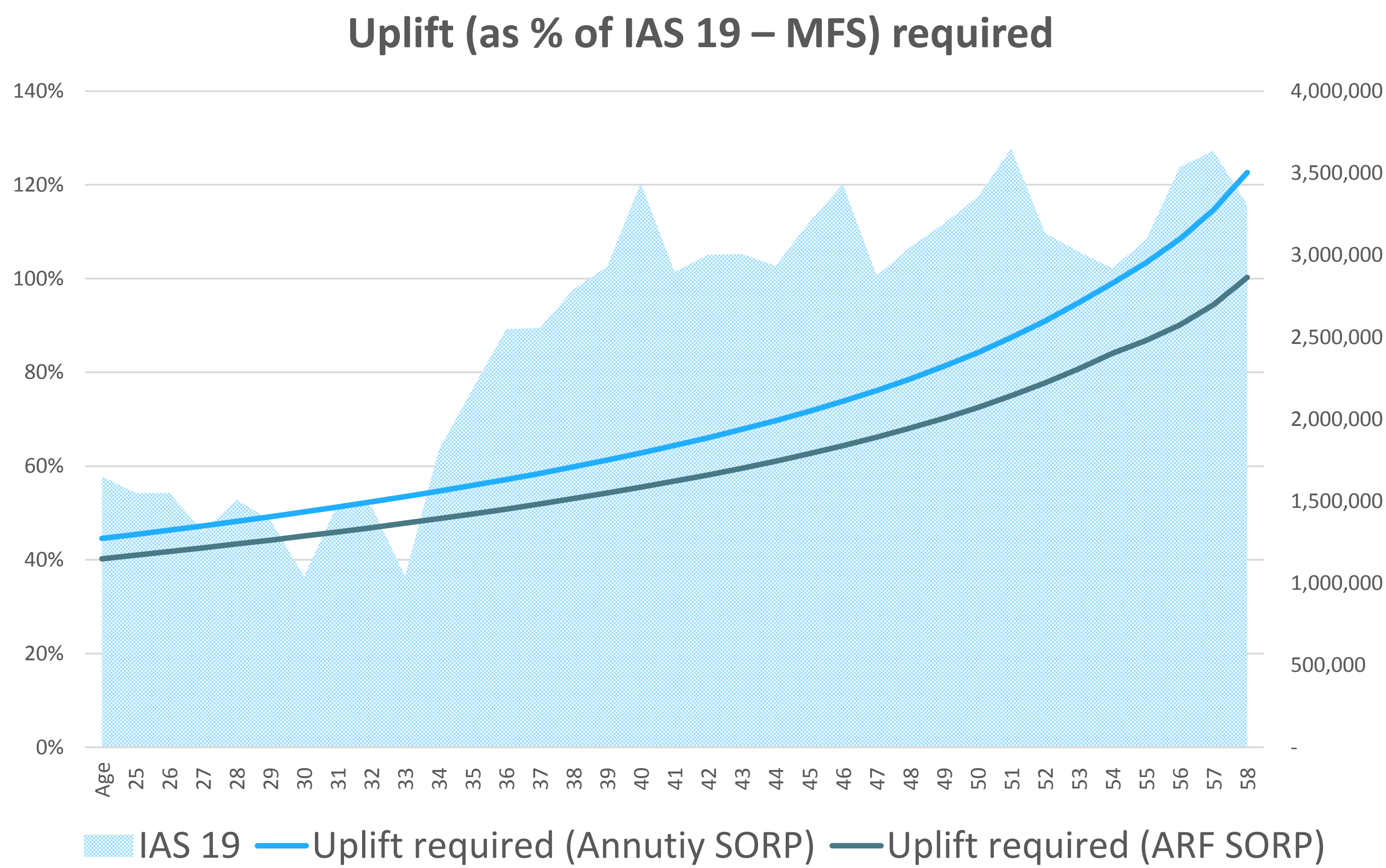
Table of required company contributions at various take-up and uplift rates in €m.

Uplift \ Takeup	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
10%	**0.5**	**1.1**	**1.6**	**2.1**	**2.6**	**3.2**	**3.7**	**4.2**	**4.7**	**5.3**
20%	[illegible]	[illegible]	[illegible]	**4.2**	**5.3**	**6.3**	**7.4**	**8.4**	**9.5**	**10.5**
30%	[illegible]	[illegible]	**4.7**	**6.3**	[illegible]	**9.5**	**11.0**	**12.6**	**14.2**	**15.8**
40%	[illegible]	**4.2**	[illegible]	**8.4**	**10.5**	**12.6**	**14.7**	**16.8**	**18.9**	**21.0**
50%	**2.6**	**5.3**	**7.9**	[illegible]	**13.1**	**15.8**	**18.4**	**21.0**	**23.7**	**26.3**
60%	**3.2**	**6.3**	**9.5**	**12.6**	[illegible]	**18.9**	**22.1**	**25.2**	**28.4**	**31.5**
70%	**3.7**	[illegible]	**11.0**	**14.7**	**18.4**	**22.1**	**25.8**	**29.4**	**33.1**	**36.8**
80%	**4.2**	[illegible]	**12.6**	**16.8**	**21.0**	**25.2**	**29.4**	**33.7**	**37.9**	**42.1**
90%	**4.7**	**9.5**	**14.2**	**18.9**	**23.7**	**28.4**	**33.1**	**37.9**	**42.6**	**47.3**
100%	**5.3**	**10.5**	**15.8**	**21.0**	**26.3**	**31.5**	**36.8**	**42.1**	**47.3**	**52.6**

Surplus	- **35.1**	- **29.8**	- **24.5**	- **19.3**	- **14.0**	- [illegible]	- **3.5**	**1.7**	**7.0**	**12.3**
Funding level	**65%**	**67%**	**69%**	**72%**	**76%**	**82%**	**91%**	**106%**	**140%**	**275%**
Improvement	**5.3**	**10.5**	**15.8**	**21.0**	**26.3**	**31.5**	**36.8**	**42.1**	**47.3**	**52.6**

Uplift = % of (IAS 19 liability – MFS liability). The resulting uplift as a percentage of MFS will therefore differ by age.

Uplift required to replicate outcome using SORP?



What is potential cost at 80% uplift?

Table of required company contributions at various take-up and uplift rates in €m.

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Legal considerations

Philip Smith

Company has a potential ETV basis – what next?

- Company/Trustee considerations
  - Who are the TVs for?
  - How should they be calculated?
  - Tricky situations

Who are the TVs for?

- Actives?
  - Usually no right to a TV on request
  - No statutory right
  - Funded on an ongoing basis

?s Past service reserve starting point? How voluntary is once-off enhancement?

- Actives and deferreds?
  - Same basis? Subject to **minimum** of statutory STV for deferreds. What about higher actives conts paid to future DC?

How should TV/ETV be calculated?

- What is an active's entitlement?
  - A pension
  - A deferred pension
  - A TV (on what basis - s34PA90 does not apply)?
- What is a deferred's entitlement?
  - Deferred pension
  - TV on scheme basis: MFS/STV as a minimum (s39 allows scheme to provide higher benefits)
  - Differentiate on basis of having left?

What does enhancement mean?

- What is an "enhancement"
  - an increase or improvement in the quality or value of something

- Will an "enhanced" MTS/STV transfer value produce the accrued pension at NRD?
  - ETV may result in lower benefit than remaining in Scheme if there is a solid employer covenant
  - Enhancement to MFS/STV is not necessarily an enhancement to a member's entitlement

An "enhancement" which results in a lower benefit than the entitlement it replaces is not an enhancement

Trustee considerations … in theory

- Duty to administer trust deed and rules …
  - The one they have – not the one the employer would wish that they had (subject to the power of amendment)

  … for the settlor (i.e. in accordance with the employer’s intentions and or the stated purpose (of providing pension benefits)
- Duty to act in members’ interests
- Duty to treat different groups of members fairly and equitably – but not equally

Trustees' considerations … in practice

- This is a company driven exercise
- Trustees must check proposals against their scheme provisions
- Provided it is consistent with the scheme provisions then their role is limited to:
  - Checking the fairness and equity of the proposals as they impact different groups
  - Checking the communications at a high level to ensure that there is nothing that is misleading
  - Reserving the right to intervene or communicate if something is contrary to members' interests because it is unfair, inequitable or misleading

Looking at the groups … likely questions

- Actives vs deferreds vs pensioners
- Stayers vs Takers
- Use of ETV fund to support existing arrangements

- To assess the relative positions the Trustees need to know:
  - Will there be a future reorg/wind-up; if so, when?
  - What does the ongoing covenant look like?
  - What is the anticipated take-up and scheme solvency position afterwards?

Careful communication

- Be careful about:
  - What is being “enhanced”
  - Before and after comparisons
  - Projections (on what basis)
  - Fact that DC pot will be projected on SORP basis on the next benefit statement
  - Death benefits; ill health benefits (and cases)
  - Code of practice

Implementing and tricky situations

- Implementation challenges include:
  - Variable NRDs
  - Previous reduction amendments such as: section 50; switch to 1/80ths; switch to CARE; split of UK/Irish scheme – anything with “phasing in”
  - Aggregate benefits (top-up/top hat arrangements)
  - Implementation triggers need for hard and fast decision on what the accrued (and/or preserved) benefit is so that it can be fed into the enhancement formula
  - Pension adjustment orders
  - Near retirement cases – may well be better served by staying put but significant education challenge for IFA
  - IFA selection process to ensure no vested interest
  - Death benefit and ER/IHER aspects and comparisons

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Good practice and conclusions

Paul Torsney

Independent Financial Advice – good practice

- Required before member can accept offer
- Advisor suitably qualified
- Paid for the company
- Independent from the company
- On a fee based rather than commission
- Tailored to specific circumstances of each member
- Sufficient time before deadline for member to consider offer
- Should the outcome be advice and information or a specific recommendation?

Communication – good practice

Based on UK industry code of good practice

- Fair, clear, not misleading and use plain English
- Should include the following:
  - Be clear that this is an option and state what default is
  - Clear description of what is being offered with pros and cons
  - Why employer is making the offer
  - Warnings about potential downsides
  - Contacts details
- If illustrating potential outcomes should used suitably wide range of assumptions
- Opportunity should be provided to other interested parties to comment on communications

Conclusions

- Can be a complex and expensive process that requires careful consideration from company before proceeding
- May be reasonable for Trustees to facilitate the exercise but should ensure that process is well run and appropriate protections in place for members
- May be situations where acceptance by member is win-win but important that member put in suitable position to make that decision

Questions and discussion

- Thank you for your attention
- Questions?