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Securing member's benefits on winding up

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Key actuarial issues to consider on wind up

- What does securing member's benefits really mean?
- Determining resources of the scheme
- Timing of transfer value calculations on wind up
- Investment approach on wind up
- Utilisation of surplus

Securing members' benefits

- Standard approach has typically been to:
  - Purchase annuities for pensioners/widow(er)s
  - Pay transfer values for actives/deferred pensioners (GN11)
- In practice have relied on Section 48(3) power to transfer without consent and reference to the 'actuarial value' of the benefits
- Wording of individual Trust Deed and Rules may push Trustees down alternative route

Securing members' benefits (cont)

- Some wording could imply that securing deferred annuities is the required position for Trustees
  - Older legal documentation often reflect different market and legislative position
- Significant cost and practical issues if this is the case:
  - Limited market for deferred annuities
  - Purchase costs are very high relative to typical transfer value for active and deferred member
  - Not necessarily in the member's interest
- Will impact significantly on the dynamics/choreography of the wind up

Securing members' benefits (cont)

- Practical problems arise in processing members' transfer options
- Key options are:
  - New employer's pension scheme
  - Qualifying personal policy (buy out bond or PRSA)
- The completion of the wind will typically require the inclusion of a 'default' investment option
  - Indexed funds
  - Lifestyle options
- Transfers would only be made to the default option should members fail to provide an alternative option within an agreed timeframe

Securing members' benefits (cont)

- Default option needs to be carefully positioned
  - Not a recommendation
  - Should reflect competitive charges/nil commission terms
  - Should reflect an appropriate investment structure
  - Need for independent advice
- If the Trustees can objectively justify their choice at point of wind up are they still potentially exposed?
- Care should be taken given Trustees indemnity from the fund or the employer may not have any value going forward

Determining resources of the Scheme

- David will touch on what the resources include and exclude
- Other key issue is ‘realisable value’ of assets
  - Determining value of illiquid assets may not be straightforward and can take time (i.e. VC funds)
  - Value of unitised assets in a ‘fire sale’ situation could differ from quoted bid value particularly for larger funds

Timing of calculation of transfer values

- Legislation does not specify an effective date (i.e. date of wind up versus date of payment)
- Both approaches seem to be used in practice for active and deferred pensioners
- Basing calculation on date of wind up with ‘roll forward’ has clear advantages:
  - Liability is crystallised
  - Methodology is easily communicated to members (no surprises)
  - Limits investment mis-matching issues

Timing of calculation of transfer values (cont)

- Main issue is that this approach will produce different transfer values than if based on date of payment:
  - Transfer values may be higher or lower
  - As time passes, figure is more likely to be lower
  - Hence delay in completing wind up may impact negatively on value of member's benefits
- Trustees may have limited control over duration of the wind up (i.e. litigation)
- May impact on weighting of any surplus allocation

Investment approach on wind up

- Generally recognised that an investment strategy based on a ‘long term view’ is no longer appropriate
- Emphasis tends to be on matching liabilities and securing benefits
- Matching pensioner liabilities is pretty straightforward (i.e. a long bond fund)
  - Pension benefits also normally secured early in the wind up process
  - Exceptions are schemes with unusual pension increase policies or discretionary policies

Investment approach on wind up (cont)

- Matching active and deferred liabilities is more difficult
  - Impossible to match GN11 transfer value basis for actives and deferred pensioners if effective date of calculation is linked to date of payment
  - If transfer value calculations are based on effective date of wind up then matching becomes much easier:
    - Liabilities crystallise and are analogous to a ‘DC’ money pot
    - Investment approach would favour an approach which guarantees a positive ‘roll forward’ factor (i.e. cash or a guaranteed equity product if expected payout timeframe is known)

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Utilisation of surplus

- Question of when does surplus arise?
  - GN11 transfer values versus deferred annuity costs
  - Dependant on wording of the Trust Deed and Rules
- Employer will clearly have an interest in this issue
- Answer will impact on distribution of surplus between priority classes (i.e. pensioners versus actives and deferred pensioners)
- In my experience Trustees are reluctant to favour a particular membership category although there may be objective reasons:
  - Actives and deferred pensioners are usually losing a ‘guaranteed’ benefit
  - Members close to retirement may do less favourably than their pensioner peers
- Perception of fairness can often be an important issue for Trustees
- Trust Deed and Rules will typically give little direction on how surplus should be applied but there is some guidance in legislation

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Issues to consider going forward

- Is there a need to specify in legislation an effective date for calculating transfer values for active and deferred members (i.e. at date of Wind Up)?
- Is there a need to provide further protection for Trustees who offer a 'default option' ?
  - Similar legislation is already in place for Trustees of DC schemes which offer a 'default' option
- The question of conflicts and separate advisers for Company and Trustees
  - How practical is this for smaller schemes?
- Significant practical problem of dealing with incomplete member records
  - Tracing deferred pensioners can prove particularly difficult

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