

## Enhanced Transfer Value Exercises (“ETVs”) – What is your role?

In the current environment many sponsoring employers are looking to reduce their defined benefit pension obligations and reduce balance sheet risk by offering deferred pensioners financial incentives to transfer their benefits out of pension schemes.

Trustees can expect that as a minimum, their sponsor will have considered the feasibility of such an exercise and many will have received a formal approach. But how do these exercises work and what should trustees do when they receive an approach from their sponsor?

### What is an ETV exercise?

All deferred pensioner members of defined benefit pension schemes have a statutory right to take a transfer value of their benefits from the scheme. This transfer value is calculated on a basis determined by the trustees and the Scheme Actuary and reflects the return that members could expect to receive were they to invest in a private pension. Transfer values may be reduced when schemes are underfunded to avoid a reduction in security for remaining members.

Transfer values are generally lower than members' liabilities on a funding or solvency basis. Trustees are required to include a margin for prudence in funding assumptions and insurers include reserving requirements and profit margins in their bases. This means that if members transfer out the scheme's funding position on these measures will usually improve.

An ETV is where an employer actively encourages members to consider transferring their benefits out of the scheme.

### Advantages for the employer

From the sponsor's perspective, members transferring out of the scheme will:

- remove risk from the employer balance sheet
- help control future cash funding requirements
- move the scheme towards a position where it has greater ability to secure its liabilities with an insurer

Sponsors may therefore be willing to provide additional resources to fund either a cash payment and/or an addition to the standard transfer value to encourage deferred pensioners to take the transfer option.

There is no legislative or regulatory reason why these offers cannot be made to members. However the sponsor does need to ensure that the offer made is fair to members.



The Financial Services Authority issued guidance in 2008, which requires all exercises to involve an Independent Financial Adviser (“IFA”). This advice is generally paid for by the sponsoring employer.

The IFA will base their advice to members on their individual risk profile and the level of transfer value enhancement. If this is sufficiently high then members may receive a positive recommendation but will be warned of the associated risks.

Members will often have the option to take the uplift as a cash lump sum, which will be subject to both tax and National Insurance. This is frequently seen as an attractive option, although by not investing the uplift in a pension fund members will reduce their retirement income. The IFA's advice will take this into account if they choose this option.

The sponsor and IFA will also normally put in place a default personal pension provider with an insurance company, to which members can transfer their fund if they do not wish to select their own pension arrangement.

### Form of offer

Offers generally take one of the following forms:

- a flat offer, which increases transfer values for all members by the same level (e.g. 10%)
- a targeted offer, which aims to provide all members with an enhancement that will mean an IFA will give a recommendation to transfer
- a combination of the two.

Flat offers have become less common recently as sponsors look to use their resources more efficiently. They also recognise the fact that such offers are less appropriate for members close to retirement.

## Things to consider when you receive an ETV proposal from your sponsor:

This is a complex area and trustees will have a lot to consider. Trustees will want to consider all aspects of the offer being made before deciding whether to provide their support to the sponsor.

**The duties of trustees** – Trustees have a responsibility to act in the interests of all members of the scheme. This includes those who are receiving the offer as well as those who will remain in the scheme afterwards.

**Working together with the sponsor** – This will enable you to better understand their motives and objectives and gather further information. It may also generate goodwill for future negotiations e.g. scheme funding.

**Taking appropriate advice** – Speak to your Scheme Actuary and legal advisers to determine a plan of action and to ensure that all of your risks have been appropriately addressed.

**The Pensions Regulator's statement** – tPR's Regulatory code of practice no. 10 covers inappropriately constructed and communicated offers and practices. These include encouraging take-up through limiting funds and making the offer "first come first served" as well as applying excessive pressure on members through phone calls and other methods.

**The current transfer value basis** – Ensure that the payments being made where members choose to transfer their benefits are of an appropriate level. Is any reduction being applied to the amounts paid as a result of underfunding in the scheme? Will the payment of full transfer values worsen the funding position of the scheme? If the scheme is in deficit it will usually be inappropriate to pay unreduced transfer values as this will be detrimental to remaining members.

**The funding position of the scheme** – What is the overall impact of the exercise on the scheme? Does it improve the position on a funding or a buyout basis? Should an additional payment to the scheme be sought?

**Impact on sponsor covenant** – By lessening pension risk it is likely that the sponsor's covenant will be strengthened. These exercises will usually result in a sponsor of the same strength standing behind a scheme that is smaller and has a reduced solvency deficit.

**Data cleansing / address tracing** – These exercises will require member data that is as complete as possible and may give trustees the opportunity to address historic data issues and trace members with no address records.

**Provision of data** – The sponsor will require data from the trustees in order to make its offer. The trustees need to ensure that they consider the issues raised in the Data Protection Act before releasing data for this purpose. This will generally be done through a "warm-up" letter, which states the sponsor's intention to make an offer and invites members to respond if they do not wish to be included in the exercise.

**The form of the offer** – The trustees' concern will be to ensure that the offer being made is reasonable. To a large extent this concern is mitigated through the use of an IFA, who will not provide recommendations to transfer unless the offer being made is fair to members.

**Member communications** – The trustees should be involved in reviewing the member communications. This will give the trustees the opportunity to ensure that the exercise is being communicated to members in an appropriate fashion.

## For further advice and information please contact:

Assurance – Pensions		Human Resource Services		Pension Advisory	
Andrew Evans	020 7804 3887	Marc Hommel	020 7804 6936	Peter Sparshott	020 7212 4165
Duncan Brown	01727 892 235	Richard Cousins	020 7804 3119	Mark Sambidge	020 7213 1340
Fong Choo Gan	01727 892 201	Chris Massey	020 7804 3637	Selina Cheung	020 7804 5403

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers LLP, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2010 PricewaterhouseCoopers LLP. All rights reserved. 'PricewaterhouseCoopers' refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom) or, as the context requires, other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Ref 20010JUNPENNEWSOCT / Design: hb6183