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CONSULTING ACTUARIES

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Carl Davey
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Dear Carl

Guidance on transfer incentives

I am writing on behalf of the Association of Consulting Actuaries in response to your consultation on the above guidance.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and are subject to the code of professional conduct of the Actuarial Profession. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

General Comments

We welcome the attention that the Regulator is paying to this area since we share the Regulator's concerns that any incentive exercises should be carried out with the members' interests at the forefront. Reports that in some cases members have been misled or pressurised are worrying. From the ACA's perspective, actuaries' professional duty of care would provide some measure of protection for members in such incentive exercises. This guidance should provide welcome assistance to trustees, and encourage employers to frame any such offer in a way which will meet trustee requirements (and the Regulator's ideals). Our main comments are that:

1. The guidance instructs trustees to start from the premise that a transfer incentive offer is not in the best interest of members. We do not agree with this statement. We do feel that this is not the most helpful message to give as it can create an environment of conflict from the outset. Similarly your suggestion that cases where the outcome for members is beneficial "are likely to be in a minority and very possibly a small minority" is another example of an unnecessarily negative tone in the (otherwise generally sensible) guidance. We feel that to get maximum ‘buy in’ to the guidance, it must be seen to be reasonable. A more reasonable approach is that trustees should start from the premise that the offer is being made in furtherance of the employer’s interests; and that the offer therefore is not **necessarily** in the best interests of the members. In practice – thanks in large part to the attention that the Regulator has brought to this issue – we believe that the proposals now being tabled by sponsoring companies usually contain benefit to both sides. It is generally recognised that it is too wasteful in terms of management time and expense for an employer to construct a one-sided deal that is ultimately bound to be rejected by an informed trustee body.

2. The requirement that the employer should make available and promote independent advice is inconsistent with the subsequent statement that most offers should **require** members to take advice (in any event it would be more correct to suggest that members are required to ‘be given’ advice – they might not actually take that advice). In our view, the guidance to trustees should state that enhanced transfer offers should normally require members to be given advice, and that the Regulator would expect them to depart from this only in exceptional circumstances (for example where the members are known to be financially sophisticated individuals). Regarding pension increase exchange offers, we believe that a different approach is called for. In some cases, the decision to be made is both significant and non-trivial; and the age of the members might suggest that assistance is more likely to be required. However, in many situations, the amounts involved might be relatively small and the requirement to take advice might result in anxiety in some members. Furthermore, the availability of suitable independent advisers able or willing to assist could be an issue. If the purpose of the exercise is to reshape the benefits in order to enable them to be secured by way of buy out, a mandatory advice requirement could result in the exercise being aborted for some or all of the pensioners, to the possible detriment of the members concerned. We therefore believe that (given the nature of the exercise) the employer should consider whether to provide advice, and trustees should consider whether the decision taken is appropriate for members. It is particularly appropriate to allow such flexibility for pension increase exchanges, but it may also be appropriate for some transfer enhancement exercises.

   More generally, in the area of advice, the guidance overlaps somewhat with the existing regulatory processes: where transfers are made subject to financial advice, there is the protection that that advice is regulated by the FSA, and it would therefore be inappropriate for trustees to make any presumption about an option which is communicated by an FSA-regulated firm to one the scheme’s members.

3. The title of the guidance is misleading – it refers only to transfer incentives when it is clear that the principles apply equally to other incentive offers and pension increase exchange. If the title were widened it would become clearer that the Regulator’s requirements (for example around taking advice) apply in all cases. However different considerations will apply for enhanced transfer exercises and pension increase exchange exercises – the comment in above illustrates this.

The guidance gives the impression that pension increase exchanges have been included as an afterthought without taking account of the different considerations - as a result many of the comments on pension increase exchange exercises are confusing. It would be more helpful to include them as a separate section, or (as suggested below) separately indentified within the main sections.

4. The guidance places expectations and responsibilities on trustees that they do not necessarily have the ability to meet. It should be clearer about the different roles played by employer and trustee, and place less onus on trustees to intervene in a transfer incentive exercise. In particular, trustees have no authority to direct employers how to calculate the incentive, or which IFA to appoint. It would be more proportionate if their responsibility was limited to providing (where they consider necessary) separate commentary on the offer, rather than being closely associated with the offer presented by the employer.

5. We do not agree that it will be possible to judge the success of this guidance (against its objective of improving market practices) by 'the level of member understanding, and the focus on member outcomes'.

We hope that you find our comments of assistance. If you would like to discuss our response, please contact me (Charles.young@hymans.co.uk or 020 7082 6228) or Jillian Pegrum (jillian.pegrum@aonconsulting.co.uk or 020 8970 4419).

Yours sincerely

Charles Young
Chairman
Pension Schemes Committee

Enc: Appendix

Appendix

Guidance on transfer incentives

General questions

1. Do you agree that the principles-based approach adopted in this guidance is the right approach to take to protect members' benefits?

Such an approach will encourage trustees and employers to consider carefully the underlying thinking behind such exercises, and clearly accords with the Regulator's approach in other areas. However in order to ensure that employers frame any incentive offer properly, and that trustees apply the right decisionmaking actions, a 'checklist' approach does have advantages – at least when it comes to ensuring that all the relevant considerations have been covered (for example within section 4).

As regards the titles of the principles set out in section 2, we believe that these are not quite appropriate – more properly the different descriptions apply to the communication of the exercise (principle 1) and the exercise overall (principles 2).

2. Do you think the guidance will fulfil the purpose of ensuring that offers are made with full appreciation of the risks being taken by all parties, and with the utmost regard for member outcomes?

Although the overall concepts are designed to lead to an incentive exercise which is carried out with the members' best interests in mind, in some cases the guidance will lead to incentive offers being unduly constrained with possibly detrimental effects on members (for example cash being left out of an offer where it would have been suitable for a member).

3. Are there any additional messages for trustees and/or employers that you would like to see in the guidance?

See comments below. Although an incorrectly framed incentive offer will be detrimental to member interests, the guidance is silent on the aspects of the current scheme which could be detrimental to members if they were to remain in the scheme – for example if the employer becomes insolvent. Clearly a sensible offer should not place undue weight on these issues, but they do need to be borne in mind in some circumstances.

The focus of the guidance appears to be that if a transfer incentive exercise is started, and take-up is high, this would make the exercise automatically bad and we do not agree that this is necessarily the case.

Specific questions on each section:

Section 1: Definition

This section is intended to outline who the guidance is for and who may be interested in the content of the guidance. It also seeks to explain the purpose of the regulator producing guidance in this area and to define the area of consideration.

4. Does this section clearly outline the area that this guidance covers, to whom it is intended to apply, and the scope of regulator's expectations with respect to those operating or involved in this area?

As stated above in the general comment, the guidance is intended to cover not just transfer incentives but, for example pension increase exchange. Therefore the subheadings should be amended to acknowledge this and give 'modification' incentives their own description. More generally, any issues that need to be borne in mind for such offers then need to make clear that they apply in all cases (unless they are specific to transfer incentives or other exercises).

The comment that the guidance 'is not intended to apply to proposals for schemes being closed to future accrual' is misleading (we never thought it did apply) and should either be deleted or given more clarification.

The last two paragraphs (setting out the starting view that such proposals are against the members' interests) probably do not sit well in the definition section.

Section 2: Understanding the principles

This section outlines the principles which should apply to any exercise being conducted. It expands what is meant by the principles, and provides some points of consideration when considering and conducting incentive offers.

5. Do you think the principles outlined in the guidance are comprehensive, and encompass what should be considered best practice?

Other than the comment above that the headings of principles 1 and 2 are misleading, we feel that overall they are acceptable.

The discussion on financial advice refers to your guidance on relations with advisers – but that does not give sufficient detail here. It also majors on IFAs – but there could be others appropriately qualified (or better qualified) to give advice who do not fall within the category of IFA (particularly for example in the case of pension increase exchange where there is no comparison between various products).

We were concerned by the comment that an offer should provide '.. the cost of purchasing equivalent benefits on the open market today (ie a deferred annuity)'. This is not required for CETVs and seems excessive as advice is being obtained. There is no market for deferred annuities for individual members, and volatility in the bulk annuity market means that it is not practical to provide an accurate figure based on a bulk exercise. There is a similar point on the requirement for values to be quoted for Pension Increase Exchange exercises - this might be one way of communicating the message clearly, but the guidance should not be so prescriptive and should allow alternative approaches.

Section 3: Problems and concerns that can arise for members

This section is intended to encourage trustees and employer to think about the members' perspective, the nature of the decision for them and their needs in making that decision.

6. Does this section achieve its intentions?

We do not agree with the comment 'The regulator finds it difficult to see how an offer involving cash incentives would lead to sound decisions being made.' Provided the cash offered is structured carefully as part of the proposal, and appropriate advice is given, we do not see that it would distort the decision-making to the extent that an offer becomes inappropriate. In many cases an equivalent cash payment is offered as an alternative to an enhancement (or part of an enhancement) to the transfer value. In practice many members choose the cash payment over the transfer enhancement, but the overall value of the package may have been sensibly structured given each member's personal circumstances.

Given the other financial transactions that members of the public are considered to be capable of undertaking, such as deciding whether or not to contribute to a company defined contribution pension scheme, it seems inconsistent to suggest that members are not capable of weighing up the advantages and disadvantages of an offer that includes cash.

7. Are there any points from a member's perspective that need emphasising?

There should be emphasis on how the member should understand, question and challenge any offer, including the consequences of taking up or not taking up the offer. In particular the guidance does not mention the possible risks of remaining in the defined benefit scheme (PPF, employer covenant risk, inflation).

In addition, the members' own risk perspective is not covered – how risk-averse particular members are will impact on the success or otherwise of the exercise. Nor is consideration given to the specific circumstances of the member or the scheme. For example whether the member is close to retirement will affect the decision – or whether there are particular protections under the scheme rules which would be lost on transfer. Equally, the transfer option may have advantages for specific groups of members, such as unmarried members who will obtain no benefit from the spouse's benefits provided by the transferring scheme, or a member who may get enhanced annuity terms in the DC market, for example because he or she smokes or has an impaired life expectancy.

Section 4: Key points of note when considering an incentive offer

This section outlines the key risks and considerations for employers and trustees when considering or becoming involved in an incentive exercise.

8. Are there any other key considerations that you feel should be included in the guidance?

Some of the specific legislative issues are not spelt out, only alluded to. For example the alienation and forfeiture provisions of PA95 are not mentioned, nor is case law - other than a subtle reference to the Ilford case 'Any attempt to exploit the protection of the PPF is likely to attract sanction from the regulator.' Clearly legal advisers would be expected to cover these points (not just legal issues specific to the scheme), but if they are not mentioned in the guidance employers may disregard legal comments on the matter as not relevant.

Trustees could be steered to seek a compromise for the scheme as part of such an exercise – for example if long-term savings for the employer are partly passed to the scheme as additional contributions.

We think the guidance should require trustees to consider the effect on the security position (rather than "ensure that the funding position of the scheme does not deteriorate"). This is based on the view that the security position may be improved by a transfer exercise even if there is a temporary fall in funding level (e.g. quantum of deficit may be reduced even if funding level is decreased).

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