Presentation to the ACA conference at Hilton, Gatwick on 5 February 2016 by David Jarman, Senior Actuary at Capita Employee Benefits.

Aim of the presentation is to give the audience my thoughts on some of the key challenges facing actuaries advising trustees on CETV bases in 2016. Equally described as "issues / challenges to Trustees".
These are my thoughts and do not necessarily represent the views of my Employer. I'm a practicing scheme actuary and not a research actuary.
Does not cover in any detail: the members view, an IFA's views, a Regulators views.
Will pick out some of the things I see as latest developments.
three distinct periods of yields in the time periods on the Bank of England Website: a high level of interest rates in the early to mid 90's; prolonged period of interest rates within a 1% band between 4% and 5% - this covered the period 1998 to Mid 2011 – including the initial part of the banking crisis. Then from end-2011, when there lower yields by the credit crisis, Chinese investment and QE.
Very crudely, and simplisticly, looking only at impact of falling gilt yields, for a male aged 55 retiring at 65 – this meant transfer values 3x bigger at the peak compared to those in 1992 and almost 50% bigger than those at the start of the financial crisis. This is despite the change of statutory revaluation from CPI to RPI in 2011. You can see the limited impact of the change to CPI – when compared to the transfer value in general.
So we are left in a period of historically high transfer values, and with funding levels looking equally poor (due to the lower gilt yields) what should trustees be doing about transfer values? Options appear to me to be: Just pay the high transfer values –appears good value as below the current TP – with the exception of people at retirement where a cash allowance. But will hindsight show this to be paying the right transfer value or a very generous transfer value? depends upon what happens with discount rates. should we consider adjusting the basis to make transfer values less generous (within the regulations and guidance), or should we be reducing transfer values via an insufficiency report.
Useful to consider the regulations and guidance: I've marked some key passages in red.
Must have regard to investment strategy – but what does "regard" to mean? Does it mean reproduce it as it is today? Or consider how it may develop over time? –suggest both. Assumptions when taken as a whole should lead to the best estimate - may have lots of "best estimate" bases and if you add in trustees' views as well, then there is quite a reasonable range of transfer values that could be adopted.
Further, looking at the regulatory guidance: Best estimate again with helpful recognition that it is not a precise concept and it can be useful to be pragmatic. Reference to investment strategy again, but also the funding plan and anticipated changes in the funding plan – only suggests considering consulting the investment adviser. One of the problems we have come across is that the SIP not sufficiently accurate – record what is happening today, no plan for how the strategy will develop. Seek clarification when giving advice.
Consider the SIP - current investment proportions and view policy expected to mature –often not written down anywhere. Trustees' views are changing over time – particular with reference to flight plans and de-risking. Important to discuss the approach – some trustees adamant do not wish to reflect de-risking in their CETV basis.
Generally I would suggest we see two types of approach to investment strategy: Bonds post retirement and growth assets pre-retirement lends itself to dual discount rate approach. Alternative is more modern approach. Risk is reduced using LDI and the growth assets there to produce a return over the long term. Single discount rate may be appropriate, however flight path gives concern over the use of a single discount rate.
Impact on transfer values of moving to a single discount rate approach –a reduction especially for those close to retirement - perhaps a 15% fall at retirement. Makes people at these ages less likely

to take the CETV: Good if you're concerned that CETVS are too high, but not great if trustees / employers are looking to reduce liabilities.
Flight Paths - If funding levels improve, then more risk may be taken off via swaps and the expected returns will fall as a lower proportion of growth assets are taken. So as the scheme matures less risk is taken, discount rates should fall and this should be reflected in your CETV basis? Trustees pushing towards this – held back only by a lack of decision about the time frame and detail of the flight path. How could you reflect this? curve of returns reflecting the expected returns each year?

Need to consider the actual returns achieved in each asset class: Gilts relatively easy – index or reference point – should you make an adjustment for AMCs? Corporate bonds again relatively easy but to what extent do you allow for the actual credit quality and underlying assets of the actual funds – should there be an adjustment for the risk of corporate bond default – suggest in theory yes – but how much especially when looking closely at underlying assets. Equities – probably hardest asset class and there are various options here: A fixed rate; Some specific modelling on scheme assets or consultant internal model; Gilts plus – suggest the most common approach – anywhere from +2% to +5% - what is reasonable range?; RPI plus – built up as assumed inflation + NDY + dividend growth – produces much higher returns so potentially attractive. Concern however is if gap is not particularly big, then if gilt yields were to rise and inflation to fall then CETVS could eventually be higher than TP's – so need to monitor. Then need to decide on returns on other asset classes. Graph shows the potential impact on CETVs of making using an RPI plus equity growth rate compared to a gilts plus basis – 10% lower for someone 6 years out almost 50% lower for younger members.
RPI set by reference to an average point on the curve, but if we have a pre and post retirement discount rate, then could end up with different RPI's for the period pre-retirement and post retirement – too complex? More recent development is RPI by reference to a swap curve. Advantages are that the swap market is much wider but inflation risk premium? – some justification. Are people using Swap curves? And what about inflation risk premia?– I suggest there is a trend for reductions
Other elements of the CETV basis: CPI – 2 reference documents suggesting around 1.3% difference. 1.0% appears to be the norm?
Options for Pension increases: Straight from RPI assumption or more typically B-S. different volatilities applied to RPI and CPI – how common is this? CPI deliberately managed by the govt?
Mortality - Neutral basis or perhaps the TP basis and remove some prudence. Post code mortality? Are people adjusting mortality for the possibility that people taking TVs might on average have lower life expectancies? With new S2 and 2015 projections, with the lower life expectancies being calculated, are these being adopted for CETVs? Long term rates: seen a steady trend for increasing LTRs – but are these now slowing down? Yes. - but not yet into reverse.
Proportions married: nothing new - only innovation use of a post code analysis to derive statistics. On age differences assume 3 years is standard - anything else?
CETVs inconsistent with cash factors and chance actuaries could be asked for justification: Suspect some circumstances justifications may be a bit weak. Health status, smoothing, harder to reduce cash factors in future, only an option (tax differences!). Will this be an area of future challenge within schemes?
Trivial commutation - set so consistent with those members getting a standard cash option or consistent with those people extinguishing all of their liabilities?
Non-statutory CETVS: What is non-statutory? what do the rules say about them? should they be same basis as statutory? (fairness says yes). Can you reduce a non-statutory TV for underfunding? If the answer is No then may want to have different bases if you do have to offer a CETV. Do they have to be guaranteed for 3 months? Strengthening of the discharge.
Equalisation - multiple NRAs. Various options: Value at different NRAs; Single NRA and a LRF / ERF applied – but real need to consider preservation and how up to date your current factors are. Lots

of questions that need resolving – e.g. if a LRF is applied to a GMP, and the resultant amount is greater than the statutory GMP, how is the excess valued – as GMP or as excess. To what extent is it OK to simplify calculations. GMP equalisation.
Insufficiency reports: need to consider regulatory guidance, decision depends on circumstances – imminent insolvency reduce – or put CETVs on hold. Weak covenant – reduce? (But less certain).
Strong covenant poorly funded scheme – depends on extent of underfunding – look to get top ups paid by e'er?
Reductions – who decides what type of reduction – the Actuary after discussing with trustees? Or Trustees?
PPF or Flat rate reduction – preference is flat rate but depends upon circumstance and mix of membership
The corporate perspective: Desire to set CETVs at the right level.
I have had clients raising concerns over potential challenges to trustees over the setting of their basis – is there any substance to this? Is this happening? I've not heard of any.
Scheme targeting buy out? – to what extent should this be allowed for in the CETV basis.