



Alexander Forbes

The Journey to Wind-Up

DB to DC: Targeted Conversion





Is your DB scheme still open to future accrual?

- *Are you shocked by your latest valuation results?*
- *Are the contribution requirements restricting your growth?*
- *Are you concerned that changing arrangements will affect retention of staff?*
- *Are you unable to reward staff with decent pay increases because of the knock on effect on your defined benefit (DB) pension costs?*

These questions are being asked by companies all over the UK. Now is the time to act.

Many companies in the UK are having to deal with the uncertainties of sponsoring a DB pension scheme. The 2007 annual survey by National Association of Pension Funds (NAPF) revealed around only a third of private sector defined benefit (DB) schemes remain open to new members.*



Companies that have closed their DB schemes to new entrants (keeping it open for existing members) may think they have greatly reduced uncertainties. The reality is that, in most cases, the impact of closing to new entrants will reduce uncertainty only very slowly, since it will be decades before all existing employees retire or stop working for the company.

What can be done to reduce risks?

One solution is to convert your DB scheme to a targeted defined contribution (DC) pension scheme for future accrual, for **all** active members.

A targeted DC pension scheme will offer the members defined contributions, which aim to replicate the future benefits that each one would have received had the DB pension scheme continued unchanged. And importantly should:

- *allow you to set budget with more certainty over the longer term*
- *remove risk – company pension contributions will not fluctuate due to volatile financial markets*
- *allow you to reward all staff more equitably*

We have been helping large, medium and small companies implement this solution for more than 20 years and we have completed more than 250 such exercises.

We can help throughout all of the conversion process, from the design of the scheme to the communication to members. All stages can be tailor-made to suit your particular company requirements.

* Source: http://www.pensionsworld.co.uk/news/news2008/february/napf_surveys.htm



How does it work?

The actuarial team at AFFS have developed a range of software to help in the design of a targeted DC pension scheme. Our 'SWITCH' program calculates the contribution rates each individual member requires if they are to achieve the same level of benefits that the DB scheme would have provided. These rates are based on each member's profile, and ensure compliance with age discrimination regulations.

We can provide an initial conversion feasibility study with minimal data and cost.

Making the right decisions for your scheme

Our consultants and actuaries will meet with you to discuss the results of the initial feasibility study and to describe the whole process in more detail.

Our interactive models allow alternative structures to be investigated, including cost/budgetary analysis.

The graph (right) illustrates the expected future contribution requirements of keeping the DB pension scheme open to future accrual versus the proposed targeted DC pension scheme. The shaded part highlights the greater uncertainty attached to the contribution levels of DB schemes.

Contribution projector model

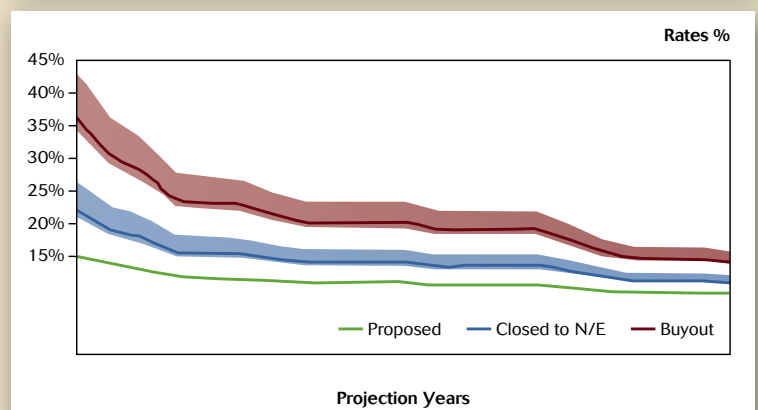
(Projected average contribution rate up to year 20)

ABC Pension Scheme		
Employer rates Only	NO	
Stepping Rates	NO	
Allow for New Entrants	YES	
Employer Rate	5.00%	
Employee Rate	5.00%	
Allow for Budget	NO	
Target Benefit	80.0%	
Withdrawal Rate	MEDIUM	
Current Funding Rate	20.00%	

Employer rates Only		
These are Combined Rates (Er+Ee)		
Years	Rate %	Rate £000
0	15.2%	109
2	13.6%	104
4	12.8%	106
6	12.5%	110
8	12.2%	116
10	12.2%	123
12	12.0%	130
14	11.9%	138
16	11.3%	141
18	11.1%	148
20	11.0%	157

Rates %

THE NEW PROPOSED RATES ARE PREDICTABLE UNLIKE PUC AND AAM
RATES EXCLUDE ANY DEFICIT FUNDING



Consultants are available for group presentations and to meet each member individually.

Member Communication

Effective communication to members is essential for a successful conversion. Our team of consultants can help members understand and appreciate the benefits of the new arrangement.

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For the new arrangement, a personalised member information pack will be prepared before the meeting. This includes details of the new arrangement, explanation of investment choices, and an illustration of the required future contributions (based on realistic actuarial assumptions), plus a provider illustration (using the Financial Services Authority standard projection rates).

Our team can also help in company negotiations with trade unions during the consultation period.

What happens to the DB benefits already accrued?

There are a number of possible options:

- Fully wind-up the DB scheme (although cost may be prohibitive)
- Transfer accrued benefits to another pension arrangement (with consent from members)
- Continue to run DB scheme as a closed scheme
- 'Managed Wind-Up' (ceasing accrual, offering transfers, reviewing investment strategy and buy-out)

How will ceasing future benefit accrual in the existing DB scheme affect the funding position of the scheme?

If the scheme ceases future accrual all remaining active members become deferred pensioners of the DB scheme. As deferred pensioners, their pension entitlements are typically linked to increases in price inflation instead of salary inflation.

Since most actuarial funding valuations assume salary inflation is greater than price inflation, ceasing future accrual will generally result in a one-off improvement in the funding position. A one-off deterioration may occur for schemes that offer high rates of fixed increases on deferred pensions between leaving and retirement. In these cases we can still provide an acceptable and risk reducing solution.

Example scheme

Pension scheme costs before and after ceasing accrual. Although the overall costs remains similar, the employer will have more certainty over future costs,

	Current	Proposed
	DB scheme	Targeted DC scheme for future service & closed DB scheme
Future Pension Cost	25.0%	23.5%
DIS Lump Sum	1.0%	1.0%
DIS Spouse	0.0%	1.0%
Expenses	2.5%	1.0%
Total	28.5%	26.5%
Less		
Employee Contribution	5.0%	3.5%+
NIC rebate	2.5%	Nil
Net Employer Contribution (Future service)	21.0%	23.0%
Deficit funding contributions (Past service)	5.0%	2.0%
TOTAL	26.0%	25.0%

Uncertainty

and as the graph earlier showed, these will trend downward as older members retire.

Employees' contribution before and after will remain the same net of tax and NIC.

The benefits of targeted conversion

For the company

- Removes risk – company pension contributions for future service will not be effected by volatile financial markets
- Allows company to reward all staff more equitably
- Allows company to set budget with more certainty over the longer term

For the member

- Flexible pension benefits – can choose retirement age, level of pension increases and level of dependant's benefits to suit their own needs
- Investment choice – member chooses their own investments – most providers allow members to manage their account online
- Members in poor health may benefit from more flexibility
- Choice of retirement options including phased retirement and income drawdown
- Benefits already accrued can be retained in DB scheme, or transferred to new arrangement to take advantage of the extra flexibility available

Our recommendations

If you are still sponsoring a DB scheme open to future accrual we recommend that you review the position immediately. Our consultants and actuaries will be happy to discuss your needs and range of options with you.

If you would like to discuss your pension scheme with our experts please call

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