



Alexander Forbes

The Journey to Wind-Up

# *Enhanced Transfers: The Sweet Spot*





# A win-win solution for reducing pension scheme liabilities.

## The problem

Currently, when a defined benefit pension scheme is in deficit, the employer is required to pay a one-off cash lump sum and/or annual deficit funding contributions over an agreed recovery period.

Whilst an injection of cash or regular contributions will improve the funding level, once the capital has been paid into the scheme it is virtually impossible to reclaim it and, importantly, such action does not reduce the scheme's liabilities.

An alternative and more effective approach is to use any available capital to enhance the total values of scheme member's benefits to enable them to transfer out. (The total transfer being the transfer value made from the scheme together with a Company enhancement.) This is an effective strategy that actually reduces the scheme liabilities and so reduces the impact of the scheme on the capital structure of the company.

## Our solution

Our service is aimed at helping employers to fund member transfers from their defined benefit scheme at a level that is:

- *financially attractive to the company*
- *appealing and acceptable to members*
- *satisfactory and in line with the trustees' responsibilities*
- *and meets current regulatory requirements.*

We call the point at which consensus can be reached the 'Sweet Spot' – the win-win position. We have considerable experience in conducting enhanced transfer value or 'Sweet Spot' exercises

helping employers to reduce long-term liabilities by millions of pounds.

## How can we help?

The key objective for the employer is to make the total transfer value attractive enough to the members for them to accept the offer. This is likely to be more successful the closer the value reflects the chance of matching the defined benefit promise within a trust based defined contribution scheme or perhaps a personal pension arrangement.

In these circumstances, members need professional independent advice, which takes account of realistic future investment expectations. If the member and their adviser perceive that there is no value in transferring, then they will not, and the full liabilities will remain within the scheme.

*Sweet-spotting is an effective strategy that actually reduces the scheme liabilities*



We use a traffic light grading system to assess the attractiveness of a transfer value offered to a scheme member.

This system shows at what level an independent financial adviser (IFA) is likely, under rigorous regulatory requirements, to give a positive recommendation to an individual member.

The greater the enhancement offered by the employer, the greater the likelihood of a member accepting the offer but at the expense of less savings being made compared to a buyout basis. Clearly, the employer will have to balance the need to have a sufficiently high transfer take-up rate with the need to make sufficient savings on a buy-out basis.

### Traffic Light Systems



**The transfer value offers no expectation of replicating the benefits**

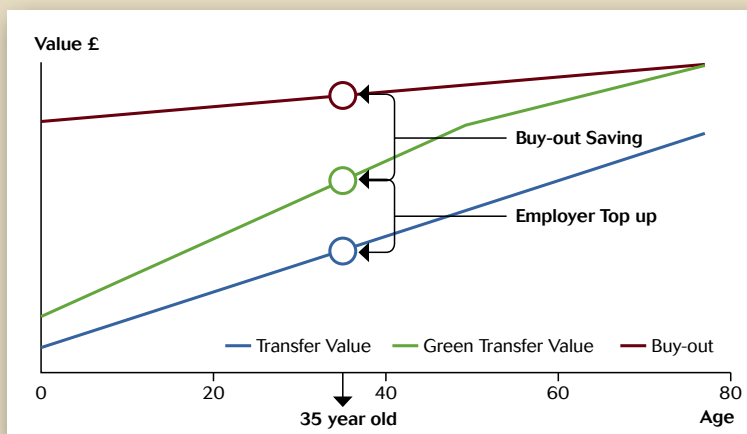


**This might be acceptable but does not offer a realistic expectation that the member may be able to replicate the benefits through a defined contribution arrangement**



**In this case there is an increased prospect that the member may be able to replicate the DB benefits at retirement through a DC alternative**

The graph below shows what the magnitude of liabilities measured on different bases are relative to each other e.g. Buy-out, Cash Equivalent Transfer Value (CETV)\* and Green transfer value. The graph also shows the expected top-up amount for a member aged 35 and the resultant buy-out savings that could be made by the employer.



\*We have used the more familiar term CETV but you may also hear the newer term Initial Cash Equivalent (ICE)

### The process

The exercise will prospectively cover three phases. Each phase is designed to enable the company to assess the appropriateness of progressing to the next stage.

**Phase I (Feasibility study):** We will provide you with necessary information to assess the prospective level of liability that could be removed from the pension scheme, the impact on deficit funding, and the estimated future PPF levy contribution for given levels of top-ups.

To minimise the work involved (and hence costs) at this stage, we will use the membership data and liability values that applied at the last actuarial valuation of the scheme.

In order to optimise the use of the top-up funding from the employer, we show the result of this approximate analysis in order of greatest saving. This analysis allows the targetting and prioritisation of individual offers according to the savings which can be made. An example of how this information is presented in our report is shown below.

Amount of Top-Up (1)	Number of members targeted	Amount of Liability Removed (2)	Amount of Scheme Assets Paid (3)	Potential Net Saving (4) = [(2) - (1) - (3)]	Net Return on Money (5) = [(1) + (4)] / (1)
£250,000	25	£1,000,000	£250,000	£500,000	300%
£1,000,000	60	£3,200,000	£800,000	£1,400,000	240%
£5,000,000	175	£14,000,000	£4,000,000	£5,000,000	200%



**Phase II (Detailed Planning):** This phase will utilise detailed analysis of up to date pension scheme data concentrating on the membership groups identified at Phase I. At this stage, the employer should have a much better idea of what funds are available (either through company reserves or by borrowing) to enhance members' transfer values.

Our interactive model (see below), will help employers refine their offer and identify the most profitable target group of members to achieve the best balance between budget and probability of success. We will then provide written confirmation of the terms of the offer to be made to members, individual CETV amounts (plus agreed top-ups for the targeted group) and project management information.

**Phase III (Implementation):** We can also help with the communication of the offer to members, including group presentations and individual meetings to explain the approach.

### Our Experience

*Our experience in conducting Sweet Spot exercises shows that the take-up rate can vary, depending on:*

- *Communication to pension scheme members*
- *Level of top-up enhancement offered*

*A take-up rate in the range of 40% - 60% is achievable providing the offer is made and communicated at an appropriate level.*

Top-up Amount			
Topping up target	Green TVAS	0%	
Available funds for topping up	£ 1,350,000		
Money spent	£ 1,341,945		
<b>Membership numbers</b>	<b>Cherry Picked</b>	<b>Deferreds</b>	<b>Total</b>
Deferreds	100		153
<b>Cumulative liability values</b>	<b>Cherry Picked</b>	<b>Deferreds</b>	<b>All Deferred Members</b>
Reduced Cash Equivalents	£ 2,203,614		£ 4,348,134
Full Cash Equivalents	£ 2,203,614		£ 4,348,134
<b>Enhanced Transfer Offer</b>	£ 3,545,560		£ 6,848,730
FRS 17	£4,113,897		£ 6,926,885
PPF	£4,210,170		£ 6,839,810
Buy out	£6,565,815		£10,357,081
<b>Potential Savings to Company</b>	<b>Cherry Picked</b>	<b>Deferreds</b>	<b>% Return on money</b>
FRS 17	£ 568,338		142%
PPF	£ 664,611		150%
Buy out	£ 3,020,255		325%
			<b>Scheme funding improvement</b>
			£ 1,910,283
			£ 2,006,556
			£ 4,362,200

Savings
Return on Top-up amount

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

#### North

Andrew Mobberley

0121 712 7900

07770 647169

#### South

Gordon Blum

0208 253 7826

07771 955191

Steve Johnson

0208 253 7883

07824 858513

*Our interactive model helps employers refine their offer*



**Alexander Forbes Consultants & Actuaries**

**Leon House, 233 High Street, Croydon, Surrey CR9 9AF.**

**Tel: 020 8686 0660 Fax: 020 8681 4093 Web: [www.alexanderforbes.co.uk](http://www.alexanderforbes.co.uk)**

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**Alexander Forbes**

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