January 2010

PENSION CAPITAL STRATEGIES
Innovative Alternatives

THE PCS ALERT
The latest in DB Pensions

Exchanging pension increases

Many companies are running exercises where members reaching retirement are offered the opportunity for exchanging non statutory pension increases for a higher tax free cash sum or a higher non increasing pension. The basis of this exchange is normally such that the cost of the alternative benefits is cheaper for the scheme to provide.

Why are companies offering this option?

The principal reasons for companies asking Trustees to change the scheme rules and offer this additional option are:

- Increasing pensions are expensive to provide, especially when interest rates are low, inflation is rising and longevity increasing.
- The exchange is on the basis that the cost of the alternative benefits leads to a reduction in deficit, partially as a result of the member taking a higher tax free cash sum.
- Whilst there is an initial increase in pension payment (and PPF levy) the overall liability reduces due to the increased cash payment and conversion terms offered to members.
- This option does not involve the company paying for an incentive.
- Whilst the savings will only emerge over time (as members retire) it should be possible to build an appropriate assumption in to Technical Provision calculations.

Why would members exchange pension increases?

Defined benefit pension schemes provide members with limited choice at retirement which has no reflection of their personal circumstances. There are a number of reasons why a member would exchange increases even if they are told the value of the alternative benefit is lower, namely:

- Research shows that members with a choice (i.e. those who have to purchase an annuity at retirement from a defined contribution scheme) predominantly select a level pension to maximise the initial income.
- For many pension scheme members an increasing pension in retirement is franked against state benefits thus they may be no worse off without the increases.
- A higher initial pension leads to a higher tax free cash sum payable on retirement.
- Many members see the offer as good value (even where they are told the value is lower than the original benefits) as their expectations on life expectancy are shorter than assumed in valuing the liabilities.
- The cost of living in retirement does not necessarily increase with inflation as the level of activity reduces with age. Members want the highest income when they are most active, not when they die.

Can this be offered to pensions in payment?

Subject to the Trustees agreeing to the appropriate Rule changes it is possible to offer this to pensioners but the option of higher tax free cash is not available. Offering to current pensioners can give an immediate impact on the deficit.

The Pensions Regulator has welcomed members having choice to make their own financial decisions but does not want to see members being misled.

Correctly planned and implemented exercises can be a win-win for members, companies and trustees. The first steps to such an exercise would be a feasibility study to analyse current membership and model potential outcomes.

For further information on how we might help, please contact Rob Dales on 0113 203 5883, Charles Cowling on 0161 242 5388 or Simon Taylor on 020 7992 5112. Alternatively e-mail us at solutions@pensionstrategies.co.uk or visit our website at www.pensionstrategies.co.uk to register your interest.

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