The Trustee toolkit downloadable

Funding your DB scheme

Tutorial five: Individual and bulk transfers

By the end of this tutorial you will better understand:

- how individuals may transfer out of a defined benefit scheme
- what a cash equivalent transfer value is
- the trustee's responsibilities when an employer may wish to incentivise members to transfer out of a DB scheme
- what trustees need to consider when the employer wishes to transfer out member benefits in bulk
- the duty to notify The Pensions Regulator (TPR) if a transfer would exceed more than 5% of the scheme assets or £1.5 million

This tutorial is part of Scenario three.

Glossary

A detailed glossary of technical terms can be downloaded from the Resources tab when you log in at www.trusteetoolkit.com

The Pensions Regulator

Case study: Individual transfers out

Here you will learn about individual transfers out.

Jenny used to work at Calendar Graphics Limited and contributed to the Calendar pension scheme. When she left that employment, she became a deferred member of the pension scheme.

A new job and a new scheme

Jenny now works at Great Graphics Limited and has joined the scheme offered by her new employer. Jenny wants to have all her pensions in one place and would like to transfer her Calendar Graphics pension into the Great Graphics pension scheme, but she does not understand how to do this.

Cash Equivalent Transfer Value (CETV)

Jenny is entitled to request a CETV from the Calendar Graphics pension scheme. The trustees are responsible for setting the basis for calculating the size of the CETV. This will normally be a valuation of the benefits that Jenny has accrued, on a 'best estimate' basis. Where there is a deficit in the scheme, the trustees can choose to reduce the CETV below this level, so that the CETV reflects that underfunding.

Deciding whether to transfer

Once Jenny has the quotation for the CETV, she has to decide whether to proceed with the transfer. The CETV cannot be taken as cash and must be paid into another pension scheme, whether occupational or personal pension, or taken in the form of an annuity.

The CETV may not be sufficient to give Jenny the same level of benefits in the Great Graphics pension scheme as she is entitled to under the Calendar Graphics pension scheme, and she should consider seeking independent financial advice before deciding whether to transfer.

Useful links
Read the transfer value guidance at www.tpr.gov.uk/en/document-library/scheme-management-detailed-guidance/administration-detailed-guidance/transfer-values

Case study: Incentives to transfer out

Here you will learn about offering incentives to transfer out.

Williams & Jenkins Limited has an underfunded pension scheme which it is struggling to pay for. The management tells the trustees that it is going to offer deferred members of the pension scheme an incentive to take a CETV and leave the scheme.

The current CETV policy

Gregory is one of the trustees and knows that it would be possible to notify deferred members of their right to request a CETV. However, the trustees' CETV policy reflects the scheme deficit. This means that transferring members do not get the current equivalent of their full scheme benefits because to pay such values would reduce the level of security for the remaining members.

Risks to members

He understands that poor choices by members can have an adverse effect on the amount of pension they receive. This is especially the case where the transfer is conducted in a manner which does not ensure the likelihood of most members making properly informed choices.

If properly advised, these members could feel that it would be unwise to transfer out. Gregory warns the other trustees that there is a risk that members could be worse off as a result of the transfer.

The employer

The employer might want members to take a CETV because it would remove the risks associated with providing defined pension benefits. CETVs include no margins for prudence, so taking one would improve the funding position of the scheme. The employer could enhance the CETV to members but any enhancement would be at its own expense.

The trustees' legal obligations and powers

Gregory knows that TPR is of the view that trustees should start from the presumption that incentive exercises are not in most members' best interests.

Trustees should approach an incentive exercise cautiously, making sure they understand the extent of their legal obligations (including under legislation, trust law and their scheme's governing documentation). Trustees may not be central to a transfer incentive exercise but they must understand their powers and obligations. There could also be a conflict of interest, especially for any trustee with a role or shareholding in the employer.

The trustees' other responsibilities

They should also understand the proposal and see that members are properly informed, offered and encouraged to take independent, impartial and accessible financial advice and treated fairly.

One particular risk is that members could exchange a DB scheme for a defined contribution (DC) arrangement. This means that the the member would assume the risk of the investment performance and of annuity prices increasing, perhaps without understanding the implications of their decision.

Trustees should also consider the funding impact on both the scheme and the employer's covenant as using cash to fund the exercise could have implications for both of these.

Useful links
Read the guidance on incentive exercises at www.tpr.gov.uk/en/document-library/scheme-management-detailed-guidance/administration-detailed-guidance/incentive-exercises

Find out more about the industry working group's 'Incentive exercises for pensions: A code of good practice' at www.incentiveexercises.org.uk/the-code-of-practice

Pension flexibilities

Reforms introduced on 6 April 2015 now offer greater flexibility to members of DC schemes to access their pension savings. These reforms make some changes to the transfer rights of members and the obligations of DB scheme trustees.

Further guidance is available to assist DB pension scheme trustees to manage requests and their impact on TPR's website.

Useful links
DB to DC guidance: www.tpr.gov.uk/en/document-library/scheme-management-detailed-guidance/administration-detailed-guidance/db-to-dc-transfers-and-conversions

Case study: A bulk transfer

Andrews Fabrication Group is selling Storeys Machinery Limited to Warren Industries plc. This has big implications for the Storeys Machinery employees. The employees of Storeys Machinery will no longer be eligible for membership of the Andrews Fabrication Group scheme and will need to join the Warren Industries scheme for future service.

The agreement

Andrews Fabrication Group and Warren Industries have agreed to a bulk transfer of these members' accrued rights from the Andrews Group scheme into the Warren Industries scheme.

Because they are both private sector employers, there is no obligation on either Andrews Fabrication Group or Warren Industries to agree to a bulk transfer between the two schemes.

However it may be beneficial for the active members being transferred because they may retain the linkage of their past service benefits to future salary increases.

The proposed transfer

A bulk transfer usually results in a significant increase or decrease in a scheme's assets or liabilities, so all parties need to think carefully about the implications of any bulk transfer, and trustees should always take professional advice.

The employer and trustees of the Warren Industries scheme must decide whether the scheme should accept the liabilities of the Storeys Machinery employees who are members of the Andrews Fabrication Group scheme, even if they bring with them enough funding to cover their accrued pension benefits on an ongoing funding basis. This is because if the trustees decide to wind up the scheme in the future, the costs of buying out benefits is likely to be significantly higher than the value of those benefits on the scheme funding basis.

The calculation

Assuming that Warren Industries plc is prepared to accept the Storeys Machinery employees who are members of the Andrews Fabrication Group scheme, the corporate transaction between the companies will specify the basis on which the transfer will be calculated.

There may be a shortfall in the amount that the Andrews Fabrication Group trustees can transfer compared to the amount that the Warren Industries plc scheme requires. If so, this must be made good by the employers, and will probably influence the purchase price.

The trustees consider the transfer

Trustees are not party to the agreement reached by the employers. However, the trustees of both the Andrews Fabrication Group scheme and Warren Industries plc scheme need to consider the security of the benefits of their respective memberships both before and after the transfer.

The trustees take advice

The trustees of the Andrews Fabrication Group scheme need to decide what proportion of their assets is held in respect of the members who are transferring. They should seek advice and generally not agree to transfer more than this proportion, even if it is not sufficient to cover the liabilities for those members. Otherwise, they risk leaving the remaining members in a worse position after the transfer.

Additionally, the Andrews Fabrication Group trustees should take advice about the implications of the transfer for the likelihood of the members receiving their benefits in full.

The trustees of the Warren Industries plc scheme should think carefully before accepting a bulk transfer which might leave their own scheme in a worse funding position than previously.

Member consent

As is usual, the members of the Andrews Fabrication Group scheme have been asked whether they want to be included in the bulk transfer. Those who do not consent will become deferred members of the Andrews Fabrication Group scheme.

There are some circumstances where pension liabilities are transferred between schemes without members' consent. In such cases the responsibility for making appropriate decisions on behalf of members lies with the trustees.

As part of the decision making process, they have to obtain an actuarial certificate confirming that members' rights in the new scheme are, broadly, no less favourable than the rights to be transferred.

When to notify TPR

If the trustees are considering making or receiving a transfer payment that would be more than 5% of the value of the scheme assets or in excess of £1.5 million, they should consider whether they have a duty to notify TPR.

Useful links
Find out more about when and how to notify TPR at www.tpr.gov.uk/code2.