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# Pension Post

**A client with a preserved pension has the option of taking a transfer value from a defined benefit (DB) scheme. They ask you 'Do I stay or do I go?'**

**Below is a commentary from Technical Guidance Ltd which we hope you find useful when advising clients.**

# DB schemes - Do I stay or do I go?

## Option 1

### Leaving a preserved pension in the DB scheme

In this case, the deferred pension will be adjusted each year between now and the member's NRA by the lesser of 4% pa and CPI (which could be negative or positive).

The main risk of leaving the benefit in the scheme is that the member doesn't get the full pension promised because one or more of the following happen:

- the trustees could reduce benefits through a Section 50 reduction before the member reaches NRA; a Section 50 order is where the trustees apply to the Pensions Board to reduce benefits for current members and deferred members, as an alternative to winding up the scheme with a deficit.
- the scheme could wind up with a deficit before the member reaches NRA; pensioners currently get priority and only what's left is available to provide transfer values for other members who have not yet reached NRA. In schemes with large deficits, the transfer value could be nil. In any case, whatever transfer value is paid will not reproduce the member's deferred pension entitlement.
- the scheme could wind up with a deficit after the member reaches NRA; the member wouldn't get their full pension if there aren't enough funds for all pensioners at that time, or if the current pensioner priority rule is changed before then to give less priority to pensioners on wind up.
- the trustees could provide the member with a Sovereign Annuity in retirement, and the Government backing the annuity could default causing a reduction or cessation of the pension.

Standard Life

**The risk factors above are largely related to:**

- the risk that the employer will not have the financial commitment and/or capability to fully fund the scheme on a long term basis.
- how far away from NRA the member is and how many will become pensioners before him or her. The further down the queue, the higher the risk.

The preserved pension is therefore a form of IOU, a piece of paper backed by anticipated future employer contributions, promising a future benefit subject to many risks.

## Option 2

### Take a transfer value

The initial reaction of the member to the transfer value shown is usually one of horror. They compare the transfer value to the deferred pension and in many cases the transfer value may be a low multiple of the deferred pension. e.g. a transfer value of €100,000 for a deferred pension of €40,000 pa payable in 9 years time.

| Option 1 – Deferred pension | or | Option 2 – Transfer Value |
|---|---|---|
| €40,000 pa commencing in 9 years time | | €100,000 now |

Anyone with common sense will realise that both of these alternatives can't be right; one of them has to be an imposter. And unfortunately the imposter is usually the deferred pension. The transfer value is the honest figure, hard as it may be to believe that.

This is because the transfer value broadly represents what the member would **actually** get from the scheme if it wound up today; in effect the transfer value figure is the only asset currently backing his deferred pension.

The transfer value is the canary in the coalmine. A very low transfer value compared to the alternative deferred pension tells you there's a hole in the scheme funding.

The lower the transfer value is relative to the deferred pension, the more likely it is that the member won't get the full deferred pension. The transfer value is almost certainly never going to reproduce the deferred pension alternative.

If the scheme is in deficit, the transfer value will be reduced to reflect the degree of deficit in the scheme currently. The higher the deficit, the larger the reduction.

If the employer's financial commitment to the scheme is in doubt, the question may then become **when** to take the transfer value rather than **if**, as the scheme is highly likely to wind up at some stage anyway with a deficit leading to a loss of part or all of the deferred pension.

## Timing your decision

There are a number of factors which might, by waiting for a period before taking the transfer value, either increase or decrease the transfer value from its current level, either marginally or significantly:

| Factors which might increase the transfer value from its current level | Factors which might decrease the transfer value from its current level |
|---|---|
| ► The funding position of the scheme could improve so that the reduction in the full transfer value payable may be reduced or eliminated altogether. However this is likely to happen only if the employer makes significant additional contributions to the scheme.<br>► The pensioner liability might be reduced, and hence potentially increase transfer values for deferred members, through a combination of one of more of the following:<br>– The current absolute pensioner priority rule could be changed to limit pensioner priority in some way<br>– Bond yields and hence annuity rates could rise, from current lows, reducing pensioner liabilities<br>– Section 50 of the Pensions Act might be amended to allow reductions in pensions in payment. The trustees might then reduce pensions in payment, rather than wind up the scheme<br>– The trustees might buy Sovereign Annuities for pensioners.<br>► The employer might pump more money into the scheme, possibly as part of a wind up deal with the trustees and unions.<br>► Delay: the longer the member waits and the nearer they get to their NRA, their transfer value should increase, assuming the funding position of the scheme doesn't change. | ► A reduction in the current revaluation of deferred pension entitlements; currently it's the lesser of CPI and 4% pa, but there are suggestions that this could be reduced; a lower rate of revaluation will lead to a lower transfer value, all other things being equal.<br>► A further deterioration in the solvency position of the scheme, caused by a number of factors including:<br>– The employer not paying the full contribution rate recommended to fully fund the scheme.<br>– A further reduction in bond yields and/or increase in longevity, driving down annuity rates even further and hence increasing pensioner liabilities.<br>– More members reaching NRA ahead of the member, and hence jumping to the top of the wind up queue with other pensioners.<br>As the pensioner liability increases, it will absorb more and more of the scheme assets, assuming the current wind up order is not changed, and may leave very little, and potentially nothing, for the deferred members on later wind up or where a deferred member opts for a transfer value before then.<br>– A downturn in investment markets, driving down the value of scheme assets and increasing the deficit.<br>► A Section 50 reduction in the member's deferred pension entitlement. Note that a Section 50 order can currently reduce benefits for active and deferred members only; it can't reduce the pension being paid currently to pensioners. |

## Time limits on taking a transfer value

The statutory right to take a transfer value payment runs for two years from the date of leaving service. After that the right to take a transfer value is subject to the scheme rules and the trustees allowing for it, which is not guaranteed.

## Death

A member should be aware that if he or she maintains a preserved pension in the DB scheme and dies before NRA, the **full** transfer value is payable to their estate, i.e. the payment is **not** reduced if the scheme is in deficit, as it would be if the member asked for the transfer value during their lifetime.

## Information

There are a number of items of information that should be sought before advising a member of a DB scheme to retain their deferred pension in the scheme or take a transfer value:

1. The member's current deferred pension entitlement and the current alternative transfer value. Is the transfer value reduced from its 'full' amount, and if so, by how much?
2. A copy of the scheme's latest actuarial valuation report. This will help to identify if the scheme is failing to meet the funding standard, and if so by how much.
3. If the scheme does not meet the funding standard, is there a funding proposal to make up the deficit? If so, what is the proposal and is the scheme on track to make up the deficit or has it veered off course from the funding proposal?
4. Are the trustees contemplating a Section 50 reduction in benefits? If so, by how much?
5. Are there any plans to wind up the scheme?

## Waterford Glass ECJ judgement

The European Court of Justice ruling in April 2013 on the Waterford Glass scheme may make the State liable for part of the deficit in a DB scheme where the scheme winds up, following the insolvency of the employer. The full implications of the ruling are not yet clear, as the matter has been referred back to the High Court in Ireland.

This will have no direct impact on transfer value calculations, but may be a factor to consider if a member is considering taking a transfer value from a DB scheme which is in deficit, where the employer's continued financial solvency is in doubt. Remaining in the scheme with a deferred pension in such a case may copper fasten the member's entitlement to some State top up of their deferred pension, on subsequent insolvency of the employer.