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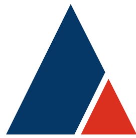

PENSION CAPITAL STRATEGIES
Innovative Alternatives

THE PCS ALERT
The latest in DB Pensions

TRANSFER VALUES – WHY IS IT STILL SUCH A MESS?

Dear Sid

This is my second letter on this subject and matters have improved little since October 2006 when I wrote my first letter:

- Companies are still missing out on opportunities to generate significant shareholder value
- Members are still losing out on the opportunity to take a fair transfer value
- Trustees are still missing out on the opportunities to reduce risk and offload pension liabilities (as well as continuing to treat members unfairly).

Since October 2006 we have had the consultation on and publication of new regulations from the Department of Work & Pensions, which do little to encourage significant change in the current position (more on that shortly). These new regulations come into effect in October this year. So companies and trustees are currently facing decisions on whether and how to amend transfer value calculations. Now is therefore the time to act to get this mess sorted out once and for all.

Where are we at the moment?
It is useful to look at the IAS19 value (i.e. the amount recorded in the company's books for the value of the pension liability) as a benchmark for considering the relative size and generosity of transfer values. Surprising as it may seem, there are still many companies and trustees offering transfer values which are less than 50% of the IAS19 value. Some are as low as 25% of the IAS19 value. Not surprisingly, with such terms on offer, these pension schemes see very little transfer activity.

But surely this is madness? Most shareholders would be delighted to see the pension liabilities disappear off the balance sheet for the payment of just the IAS19 value (which is still far less than the company would have to pay an insurance company to get rid of the same pension liability). Indeed in the last PCS survey of equity analysts' views on pensions nearly 90% of analysts thought the IAS19 value was either fair value or underestimated the "true" value of the pension liability.

The latest PCS Research
PCS has researched the transfer values on offer to the directors of FTSE 100 companies (as recorded in their latest annual reports). As you might expect, these make interesting reading. You might imagine that transfer values for directors would be more generous than for ordinary members, but if they are all in the same pension scheme then directors have to be treated the same as other members when it comes to the calculation of transfer values.

PCS found that even amongst FTSE 100 company directors, transfer values were surprisingly ungenerous and, for the large majority, consistently below IAS19 levels. The most and least generous transfer values on offer to directors in the latest accounts were:

Best	Estimated multiple for a 50-year-old*	Worst	Estimated multiple for a 50-year-old*
AMEC	22.4	Lloyds TSB	12.1
Rolls-Royce	19.1	Experian	12.1
BAT	18.1	Royal and Sun Alliance	12.1
National Grid	17.3	Hammerson	12.1
HBOS	17.2	BAE Systems	12.0
Smith and Nephew	17.1	Land Securities	11.8
BP	16.9	Severn Trent	11.8
International Power	16.6	Next	11.3
Yell	16.1	Centrica	11.3
GlaxoSmithKline	16.1	Reed Elsevier	11.2

** This is our estimate of the transfer value expressed as a multiple of the accrued pension derived from the directors' disclosures included in the latest Annual Reports.*

Some of the differences highlighted in the table on the previous page will be down to variations in benefits and varying market conditions, but it is clear that there are wide variations in practice amongst the FTSE 100 when it comes to policy on transfer values. In our experience, outside the FTSE 100 and away from directors' benefits, variations in transfer values are still larger.

So what do the new rules say?
The new regulations suggest a minimum approach to calculating transfer values on a "best estimate" basis, derived from the investments the trustees hold underlying the member's benefits. Inevitably this will result in transfer values which are considerably less than IAS19 levels.

It is interesting to compare the debate on transfer values in the UK with a similar debate in Canada a few years ago. Canadian transfer values are far more generous than UK transfer values. When new standards were introduced in Canada recently, all the complaints were about how unreasonably low the resulting transfer values would be - despite the fact that they were still comfortably more generous than IAS19 levels.

In the UK, there has been a surprisingly limited response from the usual pension lobby groups on transfer values, with little or no support for addressing the miserly level of transfer values currently and improving the lot of the poor pension scheme members. The Government, possibly with an eye on Public Sector finances and the implications of a less parsimonious approach on transfer values, has responded with regulations which will encourage little or no improvement in matters.

What should be done?
The deep irony is that there is a rare (for pensions) "win-win" situation for all concerned here. More generous transfer values can benefit companies, trustees and pension scheme members alike. Moreover the idea of giving cash incentive payments to members to encourage transfers-out should also be considered. Provided the member receives independent financial advice, we believe this is a very sensible approach (again of benefit to companies, trustees and members alike). Done well, a transfer value strategy can result in happy members and a significant reduction in pension scheme liabilities.

PCS and JLT have joined forces to put together a standard process for managing pension liabilities through the sensible use of transfer values. This combines the necessary advice to companies and trustees as well on the provision of all important independent financial advice to members.

Now this is the time for companies and trustees to act to avoid all the previous pitfalls and failings on transfer values.

Yours sincerely

For further information on the services PCS can offer you, please email us at solutions@pensionstrategies.co.uk or visit our website at www.pensionstrategies.co.uk to register your interest. Alternatively call Charles Cowling on 0161 242 5388 or Rob Dales on 0113 203 5883.

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