BOARD FOR ACTUARIAL STANDARDS

PENSION SCHEME INCENTIVE EXERCISES: CONSULTATION PAPER

JUNE 2012

FOREWORD BY THE CHAIRMAN

In recent years pension scheme members have increasingly been offered incentives to take their pension in a different form. As financial pressures on trustees and scheme sponsors grow it is likely that many more pension scheme members will be offered an enhanced transfer value or an option to exchange a pension with indexation for a higher flat-rate pension. These members can be faced with very difficult decisions in a complex area which is of significant importance to their financial future. It is therefore important that incentive exercises are carried out professionally and that members receive the information they need so they can make an informed decision.

I am pleased that various bodies have taken steps to improve the regulatory framework for incentive exercises. The FSA has recently changed the assumptions which IFAs must use when analysing the merits of transfers out of DB pension schemes. And a DWP-sponsored industry working group has produced a Code of Practice which provides clear guidance to those involved in these exercises. This consultation builds on these initiatives. Bringing the actuarial work in these exercises into the scope of our TASs will help to ensure that trustees and employers involved in incentive exercises have the actuarial information they need before they make key decisions.

Your views are important, and we look forward to receiving them.

Jim Sutcliffe
June 2012

CONTENTS

1 INTRODUCTION

BACKGROUND

1.1 The FRC's Board for Actuarial Standards (the BAS) is responsible for setting technical actuarial standards in the UK. It is an operating body of the Financial Reporting Council (the FRC).[1]

1.2 The BAS maintains a set of Technical Actuarial Standards (TASs). These include three Generic TASs, applying across the range of actuarial work, on *Data*, *Modelling* and *Reporting Actuarial Information* and four Specific TASs applying to specific areas of actuarial work in *Pensions, Insurance*, *Transformations* and *Funeral Plans*.

AUDIENCE AND AIMS OF THIS DOCUMENT

1.3 This document has been written for anyone that is likely to be involved in preparing or using actuarial information concerning pension scheme incentive exercises. The intended audience includes actuaries, pension scheme trustees, pension scheme sponsors, regulators and pension scheme members.

1.4 This document proposes that actuarial work concerning incentive exercises is brought into the scope of the *Pensions* TAS. It also proposes new principles to be included in the *Pensions* TAS and considers whether further principles might be included at a later stage.

1.5 Our consultation seeks views on these proposals and is one of a number of initiatives which aim to ensure that trustees, sponsors and pension scheme members have the information they need to make decisions in connection with incentive exercises.

1.6 We are also interested in views from respondents on what other action could be taken by the BAS, or other bodies, to ensure that scheme sponsors and trustees, where appropriate, have the information they need to make good decisions and to support pension scheme members in making what can be very complex and difficult decisions.

1.7 We would welcome views on the matters addressed in this paper, and in particular on the questions listed in section 6.

CONTENTS AND STRUCTURE OF THIS CONSULTATION PAPER

1.8 In section 2 we consider the background to this consultation, covering the different types of incentive exercise, public interest concerns and the existing regulatory safeguards. In section 3 we set out proposals to bring actuarial work concerning incentive exercises into the scope of the *Pensions* TAS.

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[1] The Financial Reporting Council is the UK's independent regulator responsible for promoting confidence in corporate reporting and governance.

1.9 In section 4 we propose new principles for inclusion in the *Pensions* TAS which cover the reporting of the changes in risks faced by, and the impact on, pension scheme members who accept incentive offers. Section 5 contains an impact assessment of our proposals and section 6 invites respondents to comment on the questions in the paper. Appendix A sets out the proposed changes to the text of the *Pensions* TAS.

RESPONSES TO THIS CONSULTATION PAPER

1.10 Details of how to respond to this paper are set out in Section 6. Comments should reach the FRC by 7 September 2012.

1.11 Subject to the nature of the responses to the consultation we intend to publish the revised *Pensions* TAS in October 2012 with the changes being effective for work performed for aggregate reports completed on or after 1 December 2012.

2 BACKGROUND

INTRODUCTION

2.1 The Pensions Regulator (tPR) has described an incentive exercise as:

"an exercise where a sponsoring or associated employer of a defined benefit pension scheme seeks to remove some or all of its liabilities by persuading members to transfer or modify benefits[2]"

2.2 The persuasion is usually facilitated by the sponsoring employer providing some form of financial incentive. Employers offer incentive exercises to reduce risk or costs or both. Incentive exercises have grown in popularity in recent years as pension scheme deficits have increased and employers have looked at ways of reducing or eliminating pension risks.

2.3 Actuaries are usually involved at some stage in incentive exercises - particularly when the level of incentive is being determined. However there is no requirement for the advice of an actuary to be taken.

FORMS OF INCENTIVE EXERCISE

2.4 The most common incentive exercises are enhanced transfer values (ETVs) and pension increase exchanges (PIEs). However there are variants of these exercises and other forms of incentive exercise might be offered.

Enhanced transfer values

2.5 ETV exercises involve an enhancement to the statutory minimum transfer value (known as the cash equivalent transfer value or CETV) of the member's benefits in the scheme, a cash payment in addition to the CETV, or a combination of the two. They are offered on the condition that those benefits are transferred out to another pension arrangement which is almost always a defined contribution (DC) scheme.

2.6 ETVs can be attractive to pension scheme members as a transfer to a defined contribution scheme might give them more flexibility on, for example, when they take their pension, the level of pension increases and the amount or the form of dependants' benefits. ETVs might also be more attractive to certain categories of members such as those without dependants or those in poor health. However members transferring to a DC pension scheme give up a defined benefit (DB) and will be subject to investment risk and the risk associated with the variable price of annuities.

2.7 A scheme sponsor can benefit from an ETV exercise through a decrease in their exposure to the inherent risks in supporting a DB scheme. Employers can also, depending on the terms of the ETV exercise, benefit from a reduction in pension scheme contributions and a reduction in pension scheme liabilities shown on the company's balance sheet.

2.8 In August 2011 KPMG published research[3] on the level of ETV activity to date. This research was based on a survey of ten firms of Independent Financial Advisers (IFAs) engaged in ETV exercises. The findings from that research include:

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[2] TPR guidance on incentive exercises - December 2010

[3] KPMG survey - August 2011

- over 90,000 defined benefit scheme members had been offered ETVs in the previous three years, with a further 70,000 expected the following year;
- on average, around one in four members accepted the offer; and
- extrapolating the historical take up rates across the DB schemes believed to be considering ETVs suggested that as many as 750,000 scheme members might transfer benefits out of DB plans in the next 5-10 years. This might reduce total DB scheme liabilities by as much as 10% or £100bn.

Pension increase exchange exercises

2.9 A PIE exercise involves an offer to the member to exchange the right to non-statutory post-retirement pension increases (usually in respect of benefits accrued from employment before 1997) in return for a higher flat-rate pension within the scheme. The offer can be made to current pensioners or the scheme rules can be amended to allow members to exchange part of their pension at retirement. Unlike when an ETV is taken up, the responsibility for paying the pension after the option is exercised remains with the scheme trustees.

2.10 PIE offers are usually made so that there will be an expected financial gain to the scheme which will often result in lower long-term employer contributions to the scheme.

2.11 PIE offers can be attractive to members for two reasons. Firstly current income is increased and secondly, where the offer is made available at retirement, the maximum tax free cash sum available to the member is often increased.

2.12 PIEs are a recent development which have been offered to members of several large pension schemes. As with ETVs we understand that many employers are considering PIE exercises.

Total pension increase exchange exercise

2.13 A total pension increase exchange exercise involves a member being offered the option to transfer their benefits to an immediately vesting personal pension. This allows the member to take a pension which does not increase and which has no contingent dependants' pensions. The attraction to the member is that the initial pension might be significantly higher than the scheme pension. Unlike the PIE described above the member can take the entire pension as a non-increasing pension.

PUBLIC INTEREST CONCERNS

2.14 The Pensions Minister, Steve Webb MP, has expressed his concern about incentive exercises. At the September 2011 NAPF conference he said:

I will not stand by while some companies try to get people in vulnerable situations or with limited financial knowledge to sign away their rightful pension entitlements. People accepting these offers could unwittingly find themselves worse off.

These bribes, such as offering larger pensions upfront to give up valuable inflation indexing, or cash lump sums to transfer out of a more generous scheme are being hidden behind confusing language. I have no problem with firms managing their liabilities responsibly, but despite warnings early this year, I'm still seeing examples of this kind of bad practice.

I am taking urgent legal advice and working with my colleagues across Government on stopping these kinds of dodgy deals.

CURRENT SAFEGUARDS

2.15 The current safeguards for pension scheme members concerning incentive exercises include an industry Code of Practice, guidance from tPR on ETVs, requirements on actuaries involved in such exercises arising from the Actuarial Profession's Actuaries' Code and FSA requirements for IFAs advising members on transfers to personal pension schemes.

Industry Code of Practice

2.16 Following his comments at the NAPF conference, the Pensions Minister established a working group to develop a code of practice for incentive exercises. The working group was overseen by a steering group, chaired by the Department of Work and Pensions (DWP), which comprised of organisations including the NAPF, the ABI, the CBI and the Association of Independent Financial Advisers.

2.17 The working group published a Code of Practice[4] on 8 June 2012. The Code introduced seven principles:

1. No cash incentives should be offered that are contingent on the member's decision to accept the offer.
2. For ETVS and similar exercises, advice should be provided to the member. For PIEs and similar exercises, either:
    - advice should be provided to the member, or;
    - a value requirement should be complied with and guidance should be provided to the member.
3. Communications with members should be fair, clear, unbiased and straightforward.
4. Records should be retained by the various parties involved in an exercise so that an audit trail is maintained that can be examined in future. When providing advice, the member adviser should record and report on insistent customers to the other parties.
5. Exercises should allow sufficient time for members to make up their mind with no undue pressure applied.
6. Incentive exercises should only be offered to members who are over age 80 on an "opt-in" basis. Members' advisers should adhere to a vulnerable client policy when providing advice.
7. All parties involved in an incentive exercise should ensure that they are aware of their roles and responsibilities and act in good faith in the areas over which they have direct control.

The Pensions Regulator's guidance

2.18 In January 2007, tPR issued guidance on ETV exercises for trustees, scheme members, managers of DB schemes and employers who sponsor DB schemes. The guidance stated that:

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[4] Industry code of practice – June 2012

- trustees and employers must give scheme members full and proper information so that members fully understand the implications of transferring out of a DB scheme; and

- trustees should consider carefully and apply a high level of scrutiny to all inducement offers.

2.19 There was a view amongst some in the pensions industry that the 2007 tPR guidance endorsed ETV exercises provided there was good process and communication.

2.20 In December 2010 tPR issued further guidance[5] expressing its concern that members of pension schemes may be disadvantaged by incentive exercises, particularly if they are not conducted in a manner that makes it most likely members will make a fully informed choice. This guidance stated that:

- Trustees should start from the presumption that such exercises and transfers are not in most members' interests, and they should therefore approach any exercise cautiously and actively. There will be members whose personal circumstances mean it is more likely that they would benefit from accepting such an offer. However, these cases are likely to be in a minority and, very possibly, a small minority. High quality financial advice is key to identifying those members.

- Fully independent financial advice should be made accessible to all members and promoted in the strongest possible terms. In almost all circumstances, the structure of the offer should require that members take financial advice before accepting.

- Employers should ensure that any offers made are consistent with the principles outlined in the guidance.

- Members to whom an offer is being made should be presented with the appropriate information in a way that is clear, fair and not misleading, to enable them to make a decision that is right for them.

- Trustees should engage in the offer process and apply a high level of scrutiny to all incentive exercises to ensure members' interests are protected. Trustees should ensure that they are comfortable that the selection, remuneration and broader commercial interests of advisers are aligned with members' interests.

- No pressure of any sort should be placed on members to make a decision to accept the offer.

Professional obligations of actuaries

2.21 Section 5.2 of the Actuaries' Code[6] states that "*Members will take such steps as are sufficient and available to them to ensure that any communication with which they are associated is accurate and not misleading, and contains sufficient information to enable its subject matter to be put in proper context*". Although there is no requirement for actuaries to be involved in communications to members, they can play an important part in making sure the communications are clear and not misleading.

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[5] TPR guidance on incentive exercises – December 2010

[6] The Actuaries Code

2.22 On 17 November 2011, the Actuarial Profession wrote to pension actuaries with a briefing note[7] which provided an update on the work the Institute and Faculty of Actuaries has done and is continuing to do to support both its members and in the wider public interest with regard to incentive exercises.

FSA requirements for IFAs

2.23 When a financial adviser advises a scheme member to transfer their pension benefits from an occupational DB pension scheme to a personal pension scheme or stakeholder pension scheme, the FSA requires the adviser to take reasonable steps to ensure that the personal recommendation is suitable for that member in light of their personal and financial circumstances. This means that the adviser must obtain from the member such information as is necessary for the adviser to understand the essential facts about them. The adviser will use a system known as TVAS (transfer value analysis system) to determine the "critical yield" which is the estimated investment return required in the DC scheme to purchase a pension equal to that provided by the DB scheme. The critical yield and the member's individual circumstances will influence the adviser's recommendations.

2.24 On 1 May 2012[8] the FSA changed its rules and guidance on pension transfer value analysis assumptions in the Conduct of Business Sourcebook (COBS). The changes included:

- updated mortality assumptions;
- clarification of the assumptions to be made for pension indexation; and
- a requirement that the comparison provided to the member is illustrated on growth rates that take into account the likely returns of the pension fund assets.

2.25 FSA rules do not cover all incentive exercises. In particular, advice given to members being offered PIEs is not regulated by the FSA.

TECHNICAL ACTUARIAL STANDARDS

2.26 Actuarial work concerning incentive exercises is not explicitly in the scope of the TASs. However some such work might already be in the scope of the *Pensions* TAS – for example if there is advice on pension scheme contribution requirements or if there is a change to the pension scheme documentation.

2.27 In developing the *Pensions* TAS we consulted[9] on whether actuarial work in relation to incentive exercises should be in scope. Respondents noted that tPR had issued guidance on incentive exercises. They noted the ethical nature of elements of the work and suggested that the Actuarial Profession, rather than the BAS, should address this matter. Having considered the responses to that consultation we decided not to include this work within the scope of the *Pensions* TAS but stated that we might decide to include the work within the scope of the TASs at some future date.

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[7] Enhanced transfer values and pension increase exchange exercises – November 2011

[8] Pension transfer analysis assumptions – May 2012

[9] Pensions: consultation - June 2009

3 BRINGING INCENTIVE EXERCISES INTO THE SCOPE OF ACTUARIAL STANDARDS

INTRODUCTION

3.1 In this section we consider whether actuarial work concerning incentive exercises should be brought into the scope of the TASs and if so which TASs. We also consider the additional wording required including the definition of an incentive exercise.

BRINGING WORK INTO THE SCOPE OF THE PENSIONS TAS

3.2 As described in section 2, pension scheme incentive exercises are becoming more common with significant numbers of members having been offered incentives to transfer out of a defined benefit scheme or to take a different form of benefits. Members offered incentives face difficult and complex choices. It is therefore important that they are provided with clear and sufficient information so they can take informed decisions.

3.3 Actuarial work is carried out at various stages of these exercises and can influence the terms of incentives offered and the communications to members. We therefore propose to bring actuarial work concerning incentive exercises into the *Pensions* TAS. This will result in the work being within the scope of the Generic TASs on *Data*, *Modelling* and *Reporting Actuarial Information*.

3.4 Bringing actuarial work concerning incentive exercises into the scope of the *Pensions* TAS is just one of a series of actions to strengthen the regulatory framework, which includes the industry Code of Practice, guidance from tPR and changes to rules for independent financial advisers, and should be seen in that context.

PURPOSE OF THE PENSIONS TAS

3.5 One of the purposes of the *Pensions* TAS (paragraph A.1.2) is that actuarial information provided to pension scheme governing bodies, sponsors and other users is relevant, comprehensible and sufficient to support decisions about the financing of the pension scheme and decisions which affect the benefits payable to members of the pension scheme, and includes information on risk and uncertainty.

3.6 Bringing actuarial work on incentive exercises into the scope of the *Pensions* TAS is consistent with this purpose.

DEFINITION OF AN INCENTIVE EXERCISE

3.7 There are several types of incentive exercise but they have the common characteristic that the member receives an invitation to change the form of their benefits. The industry Code of Practice includes a definition of an incentive exercise. For consistency we intend to include the same definition in the *Pensions* TAS. This definition is:

> "An invitation or inducement provided to a member to change the form of their accrued defined benefit rights in a UK registered **pension scheme**, which meets both of the following tests:

- one objective of providing the invitation or inducement is to reduce risk or cost for the **pension scheme** or sponsor(s); and
- the invitation or inducement is not ordinarily available to members of the **pension scheme**."

ACTUARIAL WORK CARRIED OUT IN CONNECTION WITH INCENTIVE EXERCISES

3.8 There is no regulatory requirement for an actuary to carry out work for scheme sponsors or trustees in connection with incentive exercises. However we understand that actuarial input is provided in most cases. There are several stages of work carried out during an incentive exercise where there might be actuarial work. These include:

- carrying out a feasibility study to determine whether there is any (usually financial) advantage to the pension scheme or sponsor from carrying out an incentive exercise;
- assisting the entity considering an exercise to set the terms of the offer;
- calculating the enhancement or alternative form of benefit;
- providing information to trustees to enable them to assess the offer;
- drafting and reviewing communication material to be provided to members; and
- supporting the provision of information and advice (both generic and member specific) concerning an incentive exercise to members of the pension scheme.

3.9 Actuarial involvement varies in each of these areas from case to case while some of the actuarial work might be for employers, some for trustees and some for members.

3.10 There are other areas of work which actuaries might be involved in which we have not included in the list of work in scope as we do not consider them to be actuarial work. These include:

- project management;
- administrative work to implement any changes to members' and dependants' benefits;
- arranging a transfer of assets and liabilities; and
- the selection of an individual financial adviser to provide advice to members.

ADDITIONAL TEXT FOR THE PENSIONS TAS

3.11 We propose to include a new paragraph in the Pensions TAS (C.1.29) to bring the actuarial work concerning incentive exercises into the scope of the *Pensions* TAS. A new paragraph C.1.30 gives examples of actuarial work which will be in scope. A new paragraph C.1.31 gives an example of work which we consider not to be actuarial work. The proposed text is set out in Appendix A.

COMMENCEMENT DATE

3.12 Subject to the nature of the feedback we receive to this consultation we hope to publish the revised version of the *Pensions* TAS in October 2012.

3.13 We consider that most practitioners will already be providing their clients with comprehensive information on the nature of incentive exercises and therefore compliance with the *Pensions* TAS should not normally result in a significant amount of additional work. We therefore propose to make the changes to the *Pensions* TAS effective for work performed for aggregate reports completed on or after 1 December 2012.

Section 3 discusses bringing incentive exercises into the scope of the *Pensions* TAS:

The BAS would welcome responses to the following questions:

1 Do respondents agree that actuarial work concerning incentive exercises should be brought into the scope of the *Pensions* TAS?

2 Do respondents agree that bringing actuarial work on incentive exercises into the scope of the *Pensions* TAS is consistent with the existing purpose of the *Pensions* TAS?

3 Do respondents agree that the definition of an incentive exercise should be consistent with the definition in the industry Code of Practice?

4 Do respondents have any comments on the proposed text in paragraphs C.1.29 to C.1.31 which bring actuarial work concerning incentive exercises into the scope of the *Pensions* TAS?

5 Do respondents agree that, if the changes to the *Pensions* TAS are published on or before 31 October 2012, they should become effective for work performed for aggregate reports completed on or after 1 December 2012?

4 ADDITIONAL PRINCIPLES FOR THE PENSIONS TAS

INTRODUCTION

4.1 In this section we consider additional principles which might be included in the *Pensions* TAS. The proposed additional text is set out in Appendix A.

PRINCIPLES FOR INCENTIVE EXERCISES

4.2 We consider that it is important that trustees and scheme sponsors involved in incentive exercises understand how members might be affected so they can make informed decisions about the action they take and the communications they provide to members. We therefore propose to include principles on reporting changes in the material risks faced by members and an assessment of the impact on members of incentive exercises.

REPORTING CHANGES IN MATERIAL RISKS

4.3 Members who agree to offers to change the form of their benefits are likely to be subject to a change in the risks they face. For example, a member accepting an ETV and transferring to a DC pension scheme will be taking on investment risk in the period up to retirement and the risk that annuities will be more expensive at the point of retirement. They will no longer be exposed to the covenant of the scheme sponsor but will have lost the protection of the Pension Protection Fund. They will be exposed to the credit risk of the DC scheme provider, although this might be partially mitigated by the Financial Services Compensation Scheme.

4.4 In paragraph D.6.2 we propose a new principle in the *Pensions* TAS:

> **Aggregate reports** shall indicate how the exercise of an option provided by an **incentive exercise** might lead to changes in the **material** risks to the benefits of representative members and dependants.

4.5 Paragraph D.6.3 sets out examples of changes in material risks resulting from a move from a defined benefit pension scheme to a defined contribution pension scheme which might occur when a member accepts an ETV offer.

4.6 Paragraph D.6.4 sets out examples of the material risks which might change when a member accepts a PIE offer.

ASSESSMENT OF IMPACT

4.7 The amount and timing of pension payments will change for members who accept offers to change the form of their benefits. The way in which members are affected will depend on various factors; for example when they annuitise. Different members will be affected in different ways but in practice it should be possible to select a number of representative members to make an assessment proportionate. Representative members might be chosen with different age, service and pension amounts to reflect the range of members in a scheme.

4.8 In paragraph D.6.5 we propose a new principle in the *Pensions* TAS:

> **Aggregate reports** shall describe the impact of the exercise of an option provided by an **incentive exercise** on representative members and dependants by:
>
> a) indicating any **material** changes to the cash flows;
>
> b) quantifying the extent of any change in the value of the benefits; and
>
> c) describing the circumstances in which the benefits of the representative members and beneficiaries might be adversely affected.

4.9 Paragraph D.6.6 sets out examples of what description of the impact of an incentive exercise might need to include as follows:

- a plausible range of potential gains or losses for representative members and beneficiaries;
- the key characteristics of representative members and beneficiaries for whom the impact of the incentive exercise is expected to be significantly different from that applying to other members and beneficiaries; and
- the circumstances in which the potential effect is likely to be more or less favourable for representative members and beneficiaries.

4.10 Paragraph D.6.7 notes that material changes to cash flows might include any changes to the rate of increases of pensions in payment.

PRINCIPLES FOR FUTURE INCLUSION

4.11 At this stage we have limited additional principles in the *Pensions* TAS to those on changes to material risks and the impact on cash flows and benefits. These principles cover information which will be provided to sponsors and trustees. We also want to consider whether any further principles might be included in the *Pensions* TAS which would help to ensure that members being made incentive offers have the right information to help them make informed decisions. Communications to members are usually carried out by or on behalf of trustees or scheme sponsors. We therefore would like to consider what additional information might be given to these entities which might then be passed to members.

4.12 We are open-minded about when any additional principles might be included in the *Pensions* TAS. These might be included at an early stage or included when we carry out our first major review of the TASs in around two years.

4.13 Members being offered ETVs might find it useful to have an indication of the cost of securing their DB benefits with an insurance company. They might also benefit from receiving a valuation of the benefits which are covered by the Pension Protection Fund. Such a valuation might be carried out using the assumptions used to calculate the value of the pension scheme for the annual Pension Protection Fund levy assessment.

4.14 Members being offered PIEs might benefit from being given a valuation of the benefits before and after the exercise of the option so they can make a quantitative assessment of the value of the offer.

4.15 The rate of inflation assumed will often be a very important assumption in assessing the terms of a PIE offer. Members might better understand the underlying risks if they are told what the break even inflation rate is – ie the inflation rate, assuming average life expectancy, at which the value of the benefits before and after the exchange are the same.

4.16 We would welcome views from respondents on what additional reporting requirements might be included in the *Pensions* TAS.

Section 4 proposes new principles for inclusion in the *Pensions* TAS:

The BAS would welcome responses to the following questions:

6 Do respondents have any comments on the principles proposed for inclusion in the *Pensions* TAS? (paragraphs 4.3 to 4.10)

7 Are there any further principles which would support trustees, sponsors and members in their decisions that we should consider including in future revisions of the *Pensions* TAS? (paragraphs 4.11 to 4.16)

5 IMPACT ASSESSMENT

INTRODUCTION

5.1 In this section we consider the benefits and costs arising from the proposed changes to the *Pensions* TAS.

IMPACT

5.2 In paragraph 2.8 we referred to research by KPMG which showed that on the basis of recent trends it is possible that a substantial number of pension scheme members could be offered ETVs in the future. PIEs are a more recent development but there are indications that many sponsors are considering PIEs and there is the potential for many members to be offered PIEs in the future with occupational pension schemes having around 9m[10] pensioners.

5.3 Our proposals would bring actuarial work concerning incentive exercises into the scope of the *Pensions* TAS and introduce principles on the provision of information to trustees and sponsors on the potential change in material risks and the impact on benefits to members. In proposing these changes we aim to ensure that sponsors and trustees are provided with information so they can understand how members might be affected if they accept offers. We consider that this will be beneficial to members.

5.4 We consider that our proposed measures in conjunction with other initiatives such as the industry Code of Practice and the FSA's changes to its rules will help to ensure that members who are offered incentives to transfer or modify their benefits receive sufficient information so they can make informed decisions. We consider that it is possible that the initiatives will result in fewer incentive exercises being carried out and that the level of incentives in some circumstances might be increase.

COSTS

5.5 In practice we expect that in many cases comprehensive actuarial information is already provided to sponsors and trustees and therefore we consider that the cost of complying with the TASs and the proposed additional principles is likely to be modest. In any event, the cost of the additional actuarial work is likely to be small in the context of the potential gains to sponsors and other costs incurred including the design of an incentive offer, communications with members, individual financial advice and implementation.

[10] ONS (2011) Occupational Pension Schemes Survey 2010

Section 5 considers the impact of bringing incentive exercises into the scope of the *Pensions* TAS:

The BAS would welcome responses to the following questions:

8 Do respondents agree with the assessment of the impact of the proposals in section 5?

9 What costs and benefits do respondents consider would arise from the proposed amendments to the *Pensions* TAS?

6 INVITATION TO COMMENT

QUESTIONS

6.1 The BAS invites the views of those stakeholders and other parties interested in actuarial information who wish to comment on the content of this document. In particular the BAS would welcome views on the following issues:

1 Do respondents agree that actuarial work concerning incentive exercises should be brought into the scope of the *Pensions* TAS?

2 Do respondents agree that bringing actuarial work on incentive exercises into the scope of the *Pensions* TAS is consistent with the existing purpose of the *Pensions* TAS?

3 Do respondents agree that the definition of an incentive exercise should be consistent with the definition in the industry Code of Practice?

4 Do respondents agree that the changes to the *Pensions* TAS should be effective for work performed for aggregate reports completed on or after 1 December 2012?

5 Do respondents agree the proposed text in paragraphs C.1.29 to C.1.31 which bring actuarial work concerning incentive exercises into the scope of the *Pensions* TAS?

6 Do respondents agree that the proposed principles should be included in the *Pensions* TAS? (paragraphs 4.3 to 4.10)

7 Are there any further principles which would support trustees, sponsors and members in their decisions that we should consider including in future revisions of the *Pensions* TAS? (paragraphs 4.11 to 4.16)

8 Do respondents agree with the assessment of the impact of the proposals in section 5?

9 What costs and benefits do respondents consider would arise from the proposed amendments to the *Pensions* TAS?

6.2 Respondents are asked to indicate how their comments would address the BAS's aim of increasing the reliance that users of actuarial information can place on it.

RESPONSES

6.3 For ease of handling, we prefer comments to be sent electronically to **incentiveexercises@frc.org.uk**. Comments may also be sent in hard copy form to:

The Director of Actuarial Policy
The Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

6.4 Comments should reach the FRC by 7 September 2012.

6.5 All responses will be regarded as being on the public record unless confidentiality is expressly requested by the respondent. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to publish should be submitted. If you are sending a confidential response by e-mail, please include the word "confidential" in the subject line of your e-mail.

6.6 We aim to publish non-confidential responses on our web site within ten working days of receipt. We will publish a summary of the consultation responses, either as a separate document or as part of, or alongside, any decision.

A PROPOSED CHANGES TO THE PENSIONS TAS

We have set out below the proposed changes to the text of the *Pensions* TAS. New text is underlined.

Status

Insert the following text after the first paragraph under **Commencement**:

This version of the standard applies to work performed for aggregate reports completed on or after 1 December 2012.

Definitions

Insert the following text in B.2.1:

Incentive exercise	An invitation or inducement provided to a member to change the form of their accrued defined benefit rights in a UK registered **pension scheme**, which meets both of the following tests: • one objective of providing the invitation or inducement is to reduce risk or cost for the **pension scheme** or sponsor(s); and • the invitation or inducement is not ordinarily available to members of the **pension scheme**.

Scope

Insert the following text after paragraph C.1.28:

C.1.29 This standard shall apply to actuarial work for a **governing body** or scheme sponsor concerning an **incentive exercise**.

C.1.30 The work described in paragraph C.1.29 includes:

- carrying out a feasibility study concerning an incentive exercise;
- assisting an entity considering an incentive exercise to set the terms of the offer;
- calculating any enhancement or alternative form of benefit;
- providing actuarial information to a governing body concerning an incentive exercise;
- drafting and reviewing communication material to be provided to members; and
- supporting the provision of advice concerning an incentive exercise to members of the pension scheme.

C.1.31 The work described in paragraph C.1.29 does not include arranging the transfer of assets and liabilities and other administrative work to implement any changes to **members**' and dependants' benefits.

Principles

Insert the following text after section D.5:

INCENTIVE EXERCISES

D.6.1 Paragraphs D.6.2 to D.6.7 apply to actuarial work specified in paragraph C.1.29.

Changes in Material risks

D.6.2 **Aggregate reports** shall indicate how the exercise of an option provided by an **incentive exercise** might lead to changes in the **material** risks to the benefits of representative members and dependants.

D.6.3 Changes to the **material** risks resulting from a move from a defined benefit **pension scheme** to a defined contribution **pension scheme** might include:

- the removal of sponsor credit risk;
- becoming exposed to DC scheme provider credit risk;
- becoming exposed to investment market risk for the period up to retirement; and
- becoming exposed to the risk of changes to annuity prices from factors such as movements in interest rates and changes to life expectancy.

D.6.4 The **material** risks which might change when a pension is exchanged for a higher pension with a different rate of indexation or no indexation might include:

- inflation risk;
- longevity risk; and
- sponsor credit risk.

D.6.5 The representative members and dependants will need to have a range of different characteristics so that the impact of how the **incentive exercise** affects different members and beneficiaries can be understood. The different characteristics might include age, salary, marital status and health.

Assessment of impact

D.6.6 **Aggregate reports** shall describe the impact of the exercise of an option provided by an **incentive exercise** on representative members and dependants by:

a) indicating any **material** changes to the cash flows;

b) quantifying the extent of any potential change in the value of the benefits; and

c) describing the circumstances in which the benefits of representative members and dependants are adversely affected.

D.6.7 Indications and quantifications of the impact of the **incentive exercise** might need to include:

- a plausible range of potential gains or losses for representative members and dependants;
- the key characteristics of representative members and beneficiaries for whom the impact is expected to be significantly different from that applying to other members and beneficiaries; and
- the circumstances in which the potential effect is more and less favourable for representative members and beneficiaries.

D.6.8 **Material** changes to cash flows might include any changes to the rate of increase of pensions in payment.

D.6.9 The representative members and dependants will need to have a range of different characteristics so that the impact of how the **incentive exercise** affects different members and beneficiaries can be understood. The different characteristics might include age, salary, marital status and health.

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