

# Corporate Pensions Briefing

June 2008

What effect will the new employer debt regulations have on corporate transactions? What is the right way to view mortality and how can corporates reduce or remove longevity risk? What options are available when considering enhanced transfer values?

Watson Wyatt's Corporate Consulting Group held its latest Corporate Pensions Briefing on 20 May 2008, exploring three topics with particularly high profiles for corporate sponsors at the moment: mortality – analysis and market options; section 75 and revised clearance guidance; and enhanced transfer values (ETVs). The briefing was attended by 43 delegates, comprising senior finance, treasury and pensions executives from companies with defined benefit (DB) pension schemes and their advisers.

This factsheet summarises the survey voting results gathered during the seminar. Headlines from the briefing were:

- Almost **two thirds of respondents** felt that the **Pensions Regulator's (TPR) suggested trigger on mortality went too far** in terms of the level of caution it suggests. A similar proportion of respondents felt that the mortality trigger was the **wrong lever to use** to ensure that funding assumptions are sufficiently prudent.
- **The vast majority** of respondents felt that, since its creation in 2005, **TPR has not interfered too much** in the running of pension schemes. However, only **40 per cent** were **confident** that the regulator would **continue to use its new powers in a proportionate manner** over the next six years.
- **37 per cent** of schemes have **already completed an enhanced transfer value exercise**, or other similar liability mitigation, **or are considering one at the moment**. This is an **increase of 10 per cent** compared to when the same question was asked a year ago. A further 45 per cent of respondents would consider undertaking an ETV exercise in the future.



**Figure 1 | How prudent is TPR's trigger on mortality?**

Has not gone far enough	10%
Got the balance about right	26%
Has gone too far	64%

**Figure 2 | Is TPR using the right lever to ensure prudence?**

Yes	10%
Broadly	21%
No – overall level of prudence that matters	36%
No – the focus should be on education	33%

**Figure 3 | What percentage of men aged 50 today will reach age 95?**

0% – 10%	32%
11% – 20%	24%
21% – 30%	15%
31% – 40%	15%
41% – 50%	7%
51% – 60%	0%
61% – 70%	5%
71% – 80%	2%
81% – 90%	0%
91% – 100%	0%

## Mortality – analysis and market options

The majority of delegates were uncomfortable with TPR's proposed third funding trigger on mortality. 64 per cent felt that by requiring assumptions for future improvements in longevity of at least long cohort with an annual floor on increases, the regulator was being overly prudent given the difficulties involved in returning surplus funds to the sponsor. In this respect, most delegates agreed with views recently expressed by the CBI and the NAPF in their responses to the regulator's consultation. However, 10 per cent of respondents felt that the proposed trigger did not go far

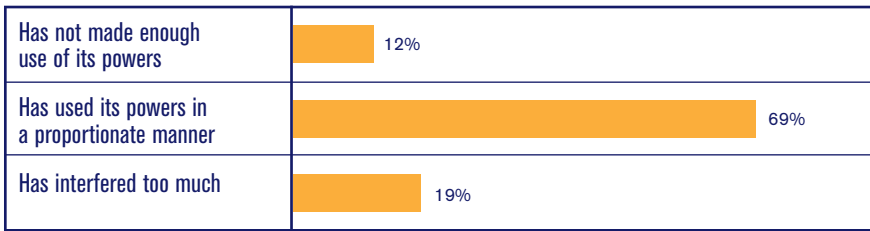
enough to ensure prudence. The range of results reflects the huge uncertainty over how future longevity increases will play out, with research and arguments reaching to both extremes of the mortality 'funnel of doubt'. See [Figure 1](#).

A similar number of respondents, 69 per cent, felt that the regulator's new mortality trigger was not the right way to ensure funding assumptions are sufficiently prudent. Of those 69 per cent, around half felt that focus should not be specifically on the level of prudence inherent in a set of mortality projections, but rather prudence should be considered in the round, taking account of the other valuation

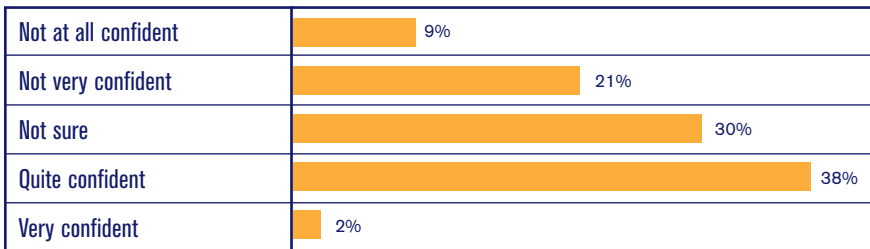
assumptions and the length of the recovery plan. The other half felt that the regulator's focus should be on education of trustees and sponsors to help them understand the risk and uncertainty inherent in any assumption for future longevity improvements. See [Figure 2](#).

We also asked our audience to play the actuary and estimate what proportion of men aged 50 today would reach the age of 95. Results varied widely, with 32 per cent believing that 10 per cent or less of 50 year old males would reach 95, and 14 per cent believing that more than 40 per cent would reach 95. In projecting how the UK population will grow, the ONS assumes that

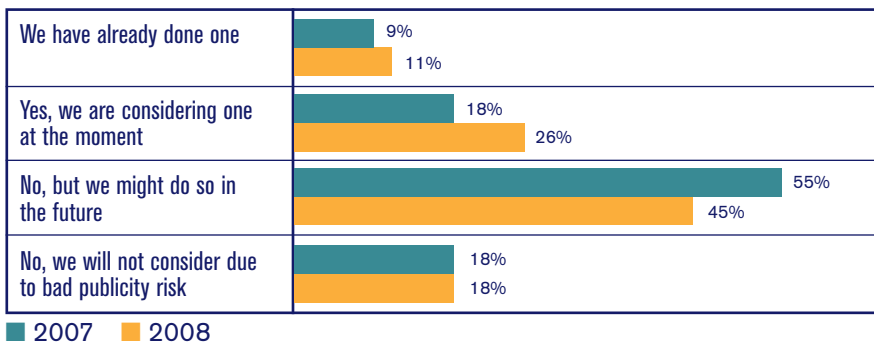
**Figure 4 | Has TPR made enough use of its powers since 2005?**



**Figure 5 | How confident are you that TPR will use its new powers in a proportionate manner**



**Figure 6 | Considering an ETV exercise or similar liability management**



23 per cent of males aged 50 today will live to at least 95. On average, respondents gave almost precisely this answer, which may come as no surprise to those who believe in the wisdom of crowds. However, this was in part because a small number of participants expect very high survival rates. Fifty-nine per cent of delegates gave a lower figure than the ONS. See [Figure 3](#).

### Section 75 and revised clearance guidance

Whilst the audience had reservations about TPR's proposal of a new mortality trigger, they were more confident about its use of its powers to prevent companies abandoning

their DB pension obligations. 69 per cent of delegates felt that since its creation in 2005, TPR had used its anti-avoidance powers in a proportionate manner, intervening where necessary but not interfering with legitimate transactions. Perhaps unsurprisingly none of the corporate sponsors in the audience felt that TPR had 'not made enough use' of its powers, and nearly a quarter thought that already TPR had interfered too much, see [Figure 4](#).

For the future, and despite a recent increase to the powers available to the regulator to carry out its objectives on anti-avoidance, many delegates continue to expect the regulator to use its powers in

64%

...felt that the regulator's new mortality trigger has gone too far in terms of prudence, given the difficulty in returning surplus funds to the employer.

40%

...were confident that the regulator would continue to use its new powers in a proportionate manner.

37%

...of schemes have already completed an enhanced transfer value exercise, or other similar liability mitigation, or are considering one at the moment.

a proportionate manner, with 40 per cent confident this would be the case. However, there are clearly high levels of uncertainty as the pensions industry waits to see how the new powers would be applied in practice.

Contribution Notices can be issued up to six years after the event, so people's expectations about how the regulator will behave in future may determine whether they apply for clearance today. The regulator may need to provide further reassurance if its belief that new powers will not lead to more clearance applications is to be vindicated. See [Figure 5](#).

## Enhanced transfer values

This is the second time we have asked our audience at a Corporate Pensions Briefing whether they are considering, or have considered, undertaking an enhanced transfer value (ETV) exercise. The results from our survey a year ago are shown alongside this year's results, see [Figure 6](#).

While the same proportion of respondents remained firm in that they did not intend to undertake an ETV exercise or other similar form of liability management, the proportions who had already completed an exercise or are currently considering one have increased from 9 per cent to 11 per cent, and 18 per cent to 26 per cent respectively.

This suggests that as time has gone on, and transfer incentives have become more common, they have gained an air of respectability. However, this comes with a warning: TPR fully expects members to be given sufficient information and advice to be able to make informed decisions over whether to accept such an incentive. It expects lessons to have been learned from mis-selling scandals of the past.

## Conclusions

The survey results suggest three key points:

- corporates and trustees alike have concerns over the regulator's proposed new mortality trigger
- although there is some uncertainty, many expect the regulator to use its new powers on funding and anti-avoidance in a proportionate manner
- we have seen an increase in the numbers of schemes considering undertaking an enhanced transfer value exercise, with the potential for more in the future as they become more common.

## Watson Wyatt's Corporate Consulting Group

Watson Wyatt's Corporate Consulting Group helps companies optimise the risk and reward management of their pension and employee benefit arrangements.

Companies are faced with increasing costs and risks, decreasing control over their obligations and full settlement of the problem can be (at least in the short-term) unaffordable.

The issues that need to be addressed lie on a spectrum between managing the legacy (dealing with past obligations efficiently and effectively) and strategy for future business (implementing solutions to drive the business forward).

We offer practical, business focused advice to clients across this spectrum of issues.

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