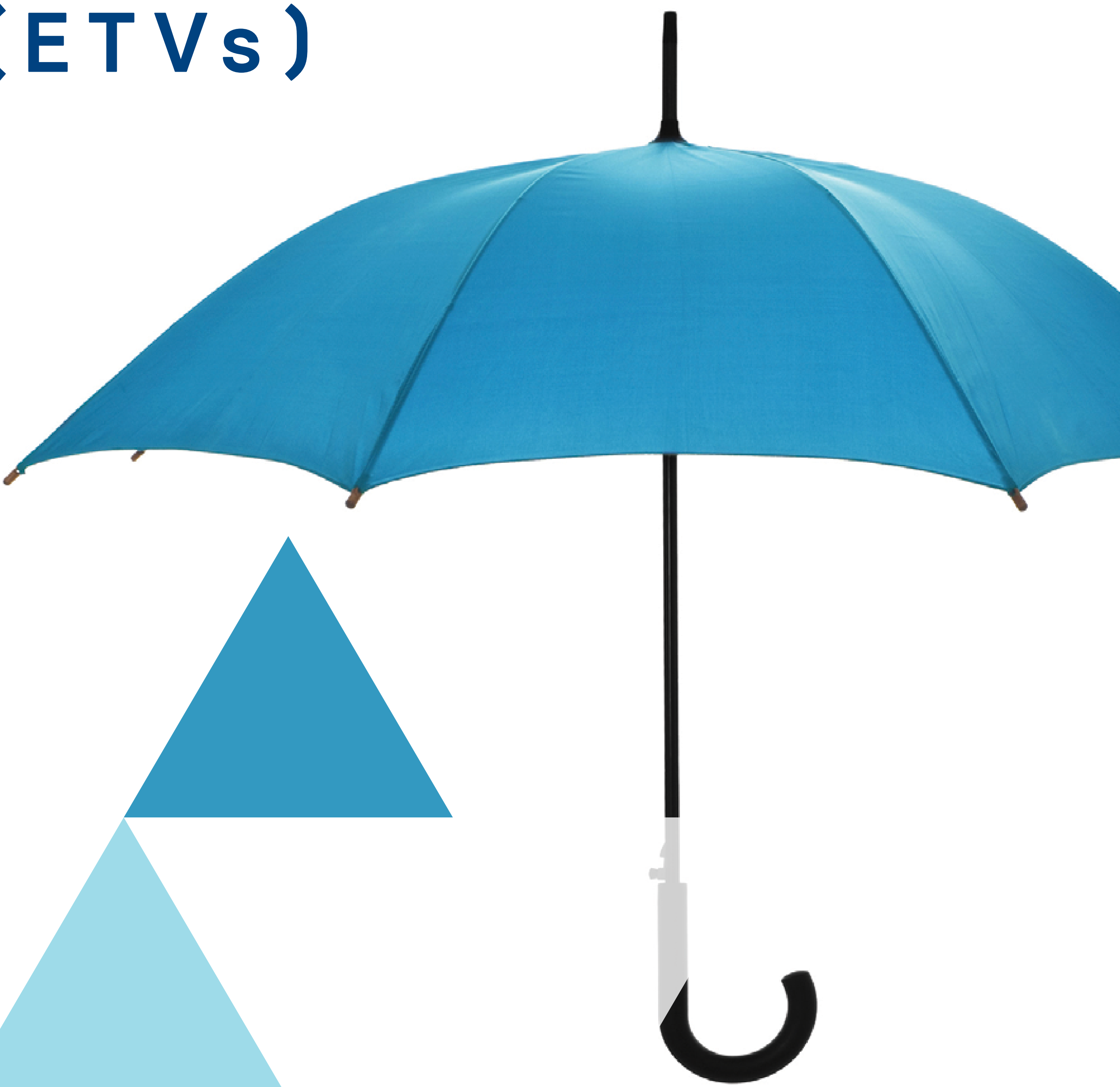
HEALTH WEALTH CAREER

ENHANCED TRANSFER VALUES (ETVs)



There are many cost-effective liability management options available to help companies reduce the volatility of their defined benefit (DB) scheme and move schemes towards self-sufficiency or buyout.

One such option increasingly being used by Irish DB sponsors is an **Enhanced Transfer Value (ETV) exercise**. ETVs give sponsors a cost-effective means of materially reducing pension risk and potentially improving their scheme's funding position. They also give members additional flexibility and choice.

HOW ETVS WORK

DB pension schemes can allow members to take a transfer from their scheme. This applies to:

- current employees where schemes have ceased to accrue future service benefits, and
- deferred members (former employees not yet in receipt of their benefits).

Current employees may be offered the option to transfer to their employer's defined contribution scheme while deferred members may be able to transfer to another approved pension arrangement.

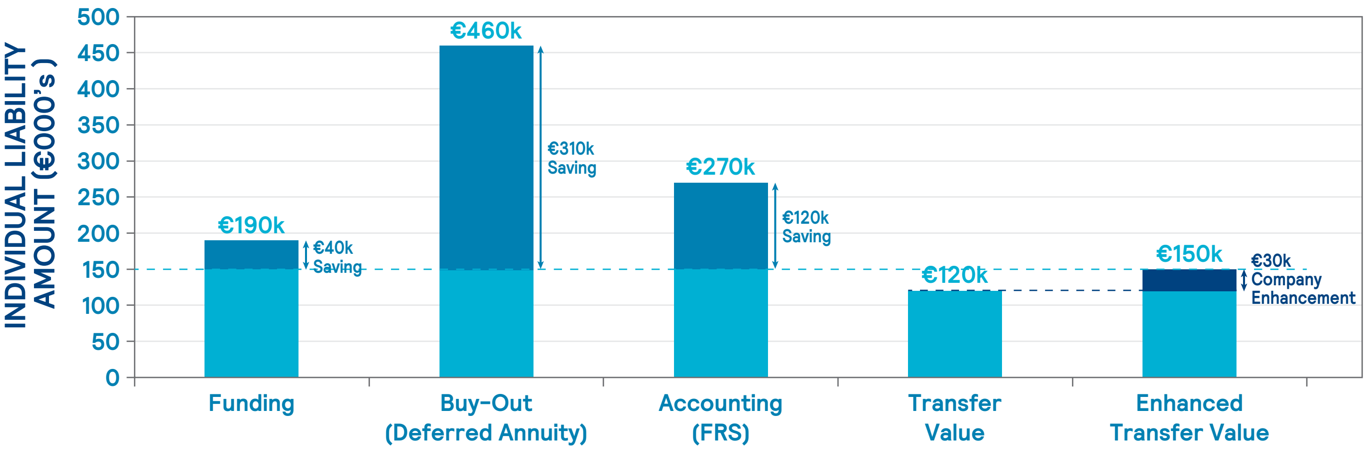
Transfer values are normally calculated on the basis underlying the Funding Standard (FS) and this basis is not considered to offer members, especially younger members, good value. To make the transfer option attractive to members, it may be necessary to offer them an Enhanced Transfer Value (ETV).

ETV EXERCISE EXAMPLE

BENEFITS TO THE COMPANY AND SCHEME

If a member accepts an ETV, their liabilities are removed from the DB scheme. This in turn reduces both the size of the scheme liabilities and the associated risk. ETVs can offer a significant saving against company accounting reserves, scheme funding and ultimate buyout costs, even after the enhancement, as shown in the following graph:

ESTIMATED LIABILITY VALUES FOR A MEMBER



In the ETV exercise, if the member accepts the ETV, savings after allowing for the €30,000 cash cost to the employer are as follows:

- Company accounting saving of €120,000 (€270,000 - €150,000).
- Scheme funding saving of €40,000 (€190,000 - €150,000).
- Notional cost of buying a deferred annuity of €310,000 (€460,000 - €150,000).

The ETV also:

- Extinguishes all future scheme pension risk associated with the member once they transfer from the scheme.
- Eliminates the need for the liability "step-up" under the FS as members are transferred before they become pensioners.
- Reduces accounting funding volatility.
- Reduces the scheme's long-term operating cost.
- Has a potentially positive impact on financial institutions from a regulatory capital perspective.
- Demonstrates to key stakeholders that pension risk is being managed.
- Reduces future regulatory risk.

BENEFIT TO MEMBERS

ETVs have numerous potential benefits for members:

- They enable deferred members aged over 50 to access their pension immediately
- A member may receive a higher tax-free lump sum
- They enable flexibility in benefit provision and ownership of investment decisions
- The member receives a higher transfer value than normal
- Ring-fence members' assets and removes any risk caused by the scheme or employer e.g. that the scheme winds up in deficit or benefits are reduced
- An ETV may be considered to offer good value
- An ETV may suit the member's personal circumstances in terms of health, marital status and financial status

An ETV will not be appropriate for all members and it is important that member communications are clear and transparent. We recommend providing members with advice from an independent qualified financial advisor (QFA), who is not remunerated by commission, to ensure that they make the right choice for their own circumstances.

CASE STUDIES

Recent ETV exercises that we have completed have been very successful, with companies reducing their liabilities significantly.

A number of factors can influence the success of an ETV exercise, such as enhancement level, scheme demographics and member circumstances. The case studies below outline some recent exercises covering a range of different scheme sizes and employers.

	CASE 1	CASE 2	CASE 3
Number of Actives/Deferreds	1,000+	800+	50+
Enhancement Level (% uplift on MFS)	Up to 80%	Up to 200%	Up to 100%
Approximate Take Up Rate (Liabilities)	40+	50+	65+

WHY MERCER?

Mercer has been involved with a significant number of ETV exercises, for both sponsors and trustees. For the sponsor, it is critical that they engage the help of trustees in facilitating the exercise. We can apply our experience to help clients run well-executed, low-risk ETV exercises that deliver good outcomes for sponsors, trustees and members.

We model initial financial impact assessments to our client's objectives and base them on a realistic assessment of the likely outcome. This enables us to determine whether or not an ETV exercise is the best option for the client.

FURTHER INFORMATION

To find out more about how Mercer can help you reduce pension risk through the use of ETVs, please contact your usual consultant or our ETV expert:

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