

Briefing

# Covid-19

## Cash equivalent transfer values: trustee considerations

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In this paper we address key considerations for trustees of defined benefit (DB) pension schemes, given the current pandemic, when dealing with member requests to transfer away their pension benefits. We assess:

- Whether to (temporarily) suspend transfer quotations
- Whether to amend the assumptions for calculating cash equivalent transfer values
- Administration issues, including increased risk of pension scams and capacity / cashflow restraints

Recent market volatility has had a significant effect on many schemes' funding positions – caused by combinations of falling asset values alongside rising risk and liability measures. As members consider their personal financial situations, many may be tempted to transfer DB pension entitlements to alternative arrangements in order to gain earlier access to cash. However, as [the Pensions Regulator \(TPR\) has warned](#), such decisions could be damaging to their long-term interests.

For schemes that are not fully funded, the quotation and payment of Cash Equivalent Transfer Values (CETVs) in the current economic climate poses a number of risks to the security of benefits for those members who choose not to transfer. In particular, volatile conditions and reduced liquidity mean that a significant level of transfer activity could materially damage scheme funding positions, at a time when scheme funding and the availability of support from sponsors may already be challenging.

### Actions by Barnett Waddingham clients so far

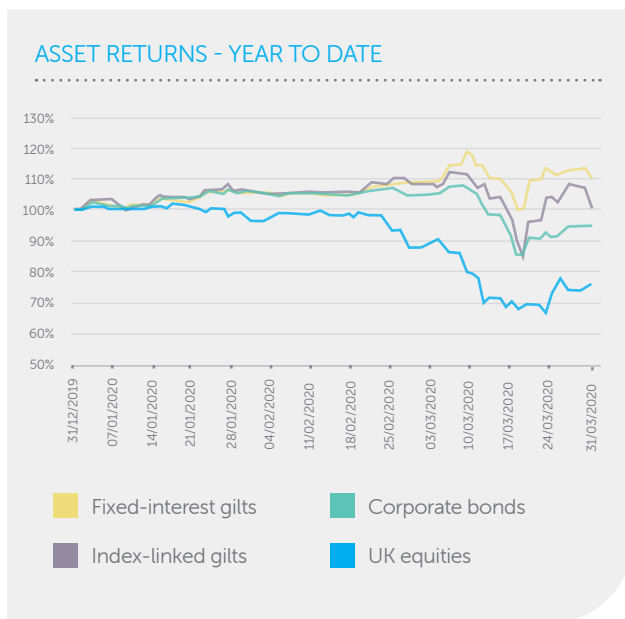
Our survey of occupational DB schemes suggests:

- Around three in ten trustee boards who have 'live' CETV requests have taken the decision to suspend transfer values – at least on a temporary basis – though many intend to reinstate CETVs pending a review of the funding position.
- Around two in ten schemes with CETV requests pending have already taken action to update the assumptions used in transfer calculations, to reflect material market movements and continuing volatility.
- In total, about half of all schemes with a live CETV quote have decided to make changes to usual CETV procedures in light of current circumstances.

This briefing note has been prepared to assist trustees with the key CETV related decisions that DB schemes are currently facing. Every scheme will be different and so the required course of action will depend on the specific circumstances, and obtaining professional advice from your Scheme Actuary and investment consultants for example will be important.

You should also consider whether there have been any material changes to the sponsor covenant, and liaise with your scheme administrators to understand, for example, expected volumes of CETV requests and any capacity / prioritisation constraints that may have arisen in the current working situation.

## Background



There has been significant market volatility in recent weeks following the spread of Covid-19. The chart (above) illustrates how the value of equities, Government bonds (gilts) and corporate bonds have changed between the start of the year and the end of March 2020.

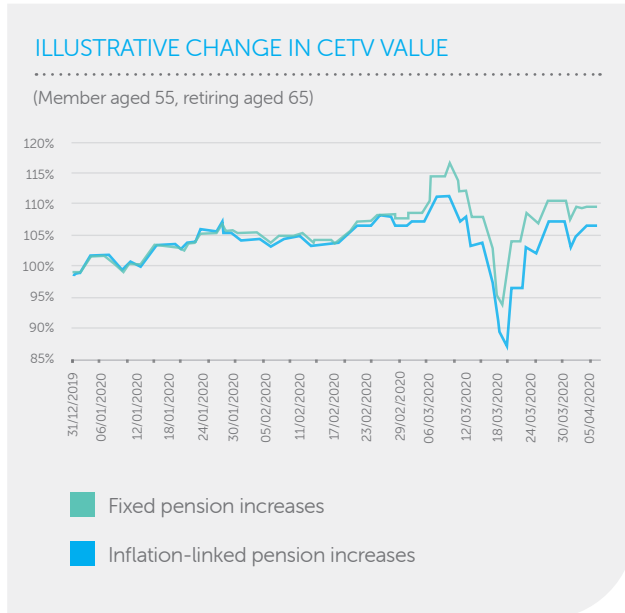
*Note: Gilt returns are based on FTSE over 15 year fixed- and index-linked total return indices. Corporate bond returns based on iBovx non-Gilt all stocks 'over 15 year' total return. Equity returns based on FTSE 100 Total Return Index.*

*Source: FTSE and IHSMarkit.*

### Over the quarter:

- Gilt yields have fallen significantly, pushing fixed-interest gilt and schemes' liability valuations up. Specifically, while there was lots of volatility during the month of March, at the end of the quarter, the 20 year gilt yield was around 0.5% pa lower than it was at the start of the year.
- Market-implied RPI inflation has also fallen significantly since the start of the year – by the end of March it was around 0.4% pa lower at 20 years. In part, this may reflect the UK Statistics Authority's plans to change RPI and the related ongoing Government consultation, as well as possible deflationary fears as the economy enters recession. This will have reduced RPI-linked liability valuations.
- Changes in corporate bond yields largely mirrored those in gilt yields at the start of the year. However, in recent weeks, the 'credit spread' (i.e. the difference between corporate bond and gilt yields) has increased by around 0.7% pa at longer terms. Therefore, in contrast to fixed-interest gilts, corporate bond valuations have fallen over the year. This could reflect the market's view that the creditworthiness of the companies issuing debt has decreased. The change in credit spreads has been even greater at shorter-terms – for example, the increase at a term of two years has been 1.5% pa.
- The impact on 'growth' asset classes has been significant. For example, the FTSE 100 equity index fell by around 25% over the quarter to 31 March 2020 – a movement associated with the deepest recessions of the past century.

## Amending the CETV basis



Source: Barnett Waddingham calculations

In light of market volatility trustees should, taking guidance from their Scheme Actuary, consider whether the assumptions used to calculate CETVs remain robust to recent developments. The chart (above) gives an illustration of how a typical CETV amount may have changed over the year for a member who is ten years away from retirement.

However, recent market movements will have impacted quoted CETV amounts differently – possibly materially so – depending on both the underlying methodology used to set the assumptions and the benefits payable from the scheme.

In light of changes in asset valuations, the assumed returns on different asset classes are likely to be the key assumptions to review. For example, where schemes invest in corporate bonds, trustees should check whether the asset return assumptions are set with reference to market yields, or whether a fixed addition to gilt yields has previously been agreed and whether these returns should be adjusted to reflect widening credit spreads.

## Reducing CETVs to allow for underfunding

Pension schemes that are not fully funded on their CETV basis are able to reduce the transfer values quoted to members, if they first obtain an “insufficiency report” from the Scheme Actuary.

Given investment market falls, some schemes will have become underfunded for the first time and those that have an insufficiency report may now discover that an even larger reduction to CETVs is possible. For schemes in these circumstances, trustees should review whether it is necessary or desirable to reduce transfer values to protect the security of remaining members’ benefits.

TPR’s guidance states that before deciding to reduce CETVs trustees should consider their assessment of the strength of the employer’s covenant and the structure of any recovery plan in place. The stronger the covenant and/or the faster a funding deficiency is being addressed, the less the trustees may feel it necessary to reduce transfers. This may mean that it is not appropriate to reduce CETVs at all, even where the scheme is underfunded.

Even trustees who remain comfortable with the current CETV assumptions may still wish to consider the issue further and revisit any previous decisions about reducing CETVs.

## Suspending transfer values

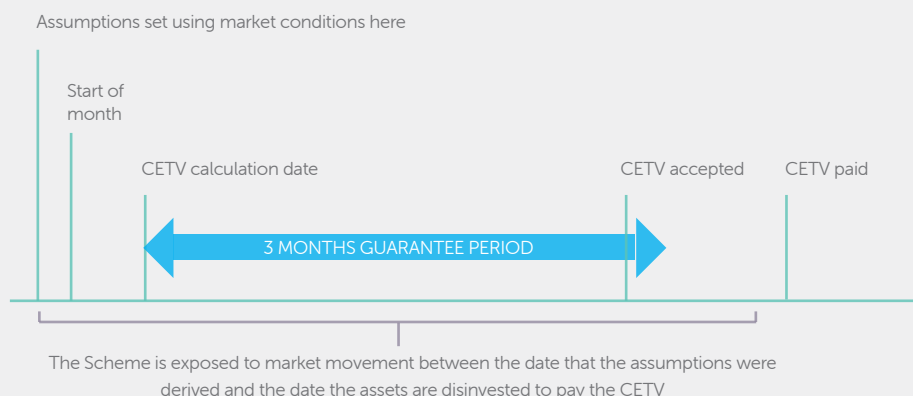
[TPR has said](#) that in light of the ongoing Covid-19 pandemic, it may be appropriate for trustees to decide to suspend CETV quotations for up to three months. Whilst this may mean breaching statutory disclosure timescales, TPR goes on to say it will take a pragmatic approach and won't take action against trustees who breach deadlines during this period. Nevertheless, trustees should ensure they properly document decisions and obtain appropriate advice.

There are a number reasons why trustees might decide that suspending transfer values could be appropriate at this time. These include:

- To allow trustees and advisers time to review whether assumptions used in calculating CETVs remain appropriate.
- Alternatively, trustees and advisers may conclude that the current conditions are too volatile to derive reliable assumptions (ie assumptions that do not pose an unacceptable risk to scheme funding). That is, if investment market volatility continues, then schemes are exposed to a greater risk of loss due to changes in market conditions between the date transfer values are calculated and when they are actually paid. This risk is heightened by the possibility of members 'selecting' against the scheme and requesting transfers when transfer values are highest relative to scheme assets.
- If there are concerns over the strength of the employer covenant and trustees need to consider whether to reduce CETVs.
- If the trustees have concerns about cashflow requirements. For example, if a scheme has to pay out a large number of transfer values, they could then be forced to sell assets at depressed values, or may find that liquidity constraints limit the amount of free cash available for paying transfers.
- If a high volume of CETV work would cause capacity issues for administrators, particularly where this could impact the highest priority administrative functions such as pension payroll.

However, suspending CETV payments and quotations is a decision not to be taken lightly, and will potentially not be in the interest of members wanting to transfer and those who wish to remain in the scheme. Whilst suspending CETVs for a three month period is likely to be the right decision for some, many schemes will want to ensure CETV activity continues as normal to the extent possible (recognising that an initial delay while trustees consider the issues and potentially review assumptions may be unavoidable).

### ILLUSTRATIVE CETV TIMELINE



## Administration matters

[The Pensions Regulator has been warning](#) savers not to rush into making decisions about their pension in response to the Covid-19 pandemic, as fears over the impact on personal finances may make members more vulnerable to scams and / or making decisions that damage their long-term interests.

Where they haven't already, companies and trustees [may want to consider](#) putting a support framework in place for members who wish to investigate transferring, ensuring they're offered independent and trusted advice which supports their short and long-term financial needs. Trustees should also consider the impact of the virus on their scheme administrator's capacity to process transfer values – and what contingency plans they have in place. Reduced capacity may be a reason for suspending or delaying transfer quotations (see above).

Trustees should also consider how transfers will be impacted by any cashflow or liquidity constraints – especially if employer contributions have been reduced or temporarily suspended and these would otherwise have been relied on to meet material cash outflows from the scheme.

## Actions

Transfer value requests are fairly infrequent in many schemes and so urgent action may not be necessary. Nevertheless trustees should establish a plan of action for when / if a request is received.

If the trustees have any particular concerns with the strength of the employer covenant, CETVs could be temporarily suspended and a review of the CETV funding position conducted. In any case, delaying issuing more recent transfer quote requests until the latter part of the associated three-month statutory disclosure timeframe may give the trustees enough time to obtain appropriate professional advice.

Trustees may wish to give special consideration to offering non-statutory CETVs where there is an established practice to do so – it may be appropriate to treat these differently to statutory CETVs in current times.

### Need to know more?

The Pensions Regulator's updated statements on the issues pensions schemes need to consider can be found on [TPR's website](#).

For further information, or to discuss any of the issues raised in this briefing note, please speak with your usual Barnett Waddingham consultant, or contact us via [our website](#).

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch via the following:

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