Spotlight

Hewitt

A retirement and investment update from Hewitt Ireland

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Change in transfer values and funding standard liabilities

The Minister for Social and Family Affairs has approved a change in the actuarial standard of practice relating to the calculation of transfer values with effect from 1 September 2009. This will lead to a slight reduction in transfer values at younger ages, and a modest increase for those closer to retirement. It will also impact on the liabilities for active and deferred members under the funding standard and related funding proposals.

Legislative Background

The Pensions Act provides (Section 34(2)) that transfer payments in respect of preserved benefits shall be calculated in accordance with professional guidance issued by the Society of Actuaries in Ireland and specified in Regulations. The applicable guidance is actuarial standard of practice ASP Pen - 2, Retirement Benefit Schemes Transfer Values which is reviewed on a regular basis by the Society of Actuaries in Ireland. Any changes to the guidance must be approved by the Minister for Social and Family Affairs.

Updated Mortality Assumptions

In 2008, the Society published a report into the mortality experience of pensioners of self administered pension schemes which showed significant reductions in mortality rates from previous investigations, reflecting the rate of improvement in population mortality of the order of 3-4% per annum. A further investigation into rates of mortality improvement was published in October 2008, and this considered in particular the allowance which would be appropriate for future improvements in mortality in the context of the calculation of pension liabilities. The recommendation in this report was that future rates of mortality improvement incorporated in the Society's actuarial standards of practice should be the same as the rates of improvement assumed by the Central Statistics Office in its population projections. In broad terms, these projections assumed a long term rate of improvement of 1.5% per annum for both males and females (i.e. the probability of death at each age would reduce by 1.5% each year), with future improvements in the shorter term reflecting recent experience i.e. 5% for males and 3.5% for females, declining to the long term rate by 2031, and with some adjustments at the oldest ages. This recommendation was incorporated in a revised ASP Pen - 2 submitted to the Minister for approval in December 2008.

The table below sets out the increase in the life expectancy of males and females adopting the revised mortality table and future improvements, relative to the table incorporated in the existing version of ASP Pen – 2. It can be seen that there is a big increase in post retirement life expectancy for younger males and, to a lesser extent, younger females and this would have the effect of significantly increasing transfer values at those ages. For example, for a male aged 30 the effect of the change would have been an increase of 14.5% in the transfer value, and for a female of the same age the corresponding increase would be 12.9% (level pensions, assuming 50% spouse's pension). In practice, of course, this would have had little if any impact on the transfer value available from the majority of schemes, as the increase in transfer value would be offset by a corresponding reduction in the coverage percentage under the Funding Standard, and in the amount available for transfer.

Increase in Life Expectancy		
	Males	Females
Age 65 in 2008	2.2 years	0.8 years
Age 65 in 2028	4.2 years	2.3 years
Age 65 in 2048	5.3 years	3.3 years

Financial Assumptions

The underlying financial assumptions in ASP Pen – 2 are reviewed on a quarterly basis by the Society of Actuaries in Ireland taking into account current market conditions. In the most recent review, the Society considered that it would be appropriate to reduce the allowance for inflation pre-retirement from 2.5% per annum to 2% per annum to take into account the recent falls in the expected rate of inflation as derived from market bond yields. A further recommendation was made to the Minister in this regard.

The Minister has recently announced her approval of both changes, and the revised ASP Pen – 2 comes into effect on 1 September 2009. It will apply for transfer value requests received on or after that date, and for funding standard calculations with an effective date on or after 1 September 2009.

Effect of Changes

The table below sets out the change in the standard transfer value for level pensions, assuming 50% spouse's pensions, under the new ASP Pen – 2 when compared with the version which has been in effect since 1 July 2008. It can be seen that there are reductions in the transfer value at younger ages (particularly for females) and for those closer to retirement the transfer value will increase slightly. This reflects the interaction of the allowance for improved mortality, which has most impact at younger ages, and the reduction in pre-retirement inflation, which again is greater for the longer terms to retirement. If there are guaranteed pension increases, the impact of the allowance for future mortality improvements is more pronounced.

	Change in Transfer Value	
Age	**Males**	**Females**
30	-3.2%	-4.6%
35	-2.1%	-3.5%
40	-1.0%	-2.4%
45	+0.1%	-1.3%
50	+1.3%	-0.2%
55	+2.4%	+0.9%
60	+3.6%	+2.1%

Funding Certificates and Funding Proposals

The impact of the change on the funding standard calculations for a Scheme will depend on the balance between young and old active and deferred members, and between males and females, whether there are guaranteed pension increases, and the proportion of pensioner liabilities which are not affected by the change in ASP Pen – 2. For an immature scheme, particularly if there are significant numbers of female members, there should be some reduction in the funding standard liability.

For funding proposal calculations, Hewitt actuaries were already anticipating the introduction of the revised mortality assumptions, and hence the impact on these calculations will reflect only the introduction of the reduced pre-retirement inflation allowance. This could have a material positive effect on the funding proposal calculations for schemes with a relatively young active work force. Combined with recent positive investment returns, this may make it slightly easier to reach agreement on a funding proposal to address current funding standard shortfalls.

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