Liability management exercises

Liability management exercises enable schemes to offer their members additional choice and flexibility and can reduce pension risk.

Recent liability management exercises run by LCP have helped companies to reduce their pension risks in a cost effective and responsible manner.

We can help you identify whether these exercises could benefit your company and members. We have recent experience of implementing large scale liability management exercises which have met the company’s objectives and followed industry best practice for such exercises. This best practice has now been formalised in the recently published Code of Good Practice (June 2012).

What are liability management exercises?
Liability management exercises generally fall into one of three categories:

- Incentives to deferred members to transfer out of a pension scheme such as an Enhanced Transfer Value (ETV) exercise.
- Incentives to deferred members aged over 55 to transfer out and purchase an immediate annuity providing additional flexibility, sometimes referred to as a Total Pension Exchange (TPE). In addition these members can be given a reminder or an incentive to receive their pension early from the scheme.
- Offers to pensioner members or future retirees to surrender future pension increases in return for a higher initial pension, commonly known as a Pension Increase Exchange (PIE).

Whilst most exercises fall into one or more of these general headings, there are many different options that can be incorporated, each with differing impacts on likely member take up rates, and differing risks. Increasingly, these exercises are targeted to focus resources on the members for whom the options are most relevant, so-called “selective offers”.

LCP has recent wide-ranging experience of implementing exercises in line with industry best practice.

Thank you to the whole team for your advice, support and commitment to the successful project, which enabled us to reduce our pension risk.

Tony Bickerstaff
Group Finance Director
Costain Group plc
Why carry out such an exercise?
There are many benefits that can be obtained from undertaking a liability management exercise and these include:

- The potential for reductions in pension liabilities or risks.
- The reduction in buy-out or other insurance costs.
- The reduction in uncertain future cash costs.
- The opportunity to provide flexibility and choice to members.
- The reduction of future administration costs.

What solutions have we implemented?
We have hands-on recent experience of implementing these exercises at all stages of the process. The case studies below are just two examples of how we have helped our clients achieve a successful outcome.

**LCP case study A**
**Household name makes buy-in affordable**

**Background**
- Highly complex pension increases promised historically
- Insurers are reluctant to take on pensions that are difficult to match and so prices were high, if available at all

**Solution**
- Members offered same value of benefit, in a more simple form and 30% higher pension initially (on average)
- Over 80% of pensioners now on simplified structure

![](chart.png)

**LCP case study B**
**International engineering and construction group reduces pension risks**

**Background**
- £600m of pension liabilities
- Company seeking to achieve more certainty about future pension liabilities

**Solution**
- All members provided additional choice and flexibility
- Deferred members offered ETVs and, if over 55, TPE
- Current pensioners offered PIE
- To manage reputational risks and help appropriate member decisions, no cash enhancements were offered
- Over £30m of pension liabilities were removed
What makes LCP’s approach different?

- **Feasibility - is this exercise right for your company?**
  Our starting point is to identify and fully understand the objectives of the company. Based on this we will carry out a feasibility study which presents a balanced and clear recommendation of whether or not to proceed with a liability management exercise. Our report will highlight the risks to the company, trustees and members and suggest actions to mitigate these risks.

- **Trustee engagement**
  If the company decides to proceed, we will engage with the trustees from an early stage. Our experience is that engagement levels from members have been highest where both the company and trustees have had significant involvement and input in the exercise throughout all the stages.

- **Bespoke design and implementation**
  Based on our thorough understanding of the company and trustees’ objectives we will help design a bespoke offer with tailored communications to satisfy the new industry Code of Good Practice. We have also designed “selective” offers, for example to target the concentration of risk common in most schemes due to a small number of members with the largest pensions.

- **Multi-channel communications designed for your members**
  We will help design and implement a communication strategy that best engages your members. We have practical experience in delivering multi-channel communications, including videos and interactive websites, to help maximise member engagement.

- **A balanced view from LCP**
  We take a balanced view to these exercises as we appreciate that they are not suitable for every pension scheme. For example, we have carried out several feasibility studies in 2011 and 2012 where, after considering the company’s objectives, we recommended that they did not carry out a member incentive exercise at that time.

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**Code of Good Practice**

A new Code of Good Practice on Incentive Exercises (the Code) was issued by an industry working party in June 2012. LCP’s representation on the working party allowed for a significant contribution to the shape and content of the Code. The Code sets out seven good practice principles. The most significant of these is to prohibit the use of cash incentives due to concerns that they may distort member decision-making. In addition member communications should be fair, clear, unbiased and straightforward. The Pensions Regulator supports this Code. We recommend clients adhere to the Code, which is closely aligned with LCP’s own internal guidance that we have applied in previous exercises.

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*Alex Waite*
Partner
LCP

*There are real opportunities to reduce risk with a bespoke and carefully targeted exercise. Added to which, the Code provides a clear framework on which to proceed.*

We recommend clients adhere to the Code. The Code is closely aligned with LCP’s own internal guidance that we have applied in previous exercises.
LCP is a firm of financial, actuarial and business consultants, specialising in the areas of pensions, investment, insurance and business analytics.