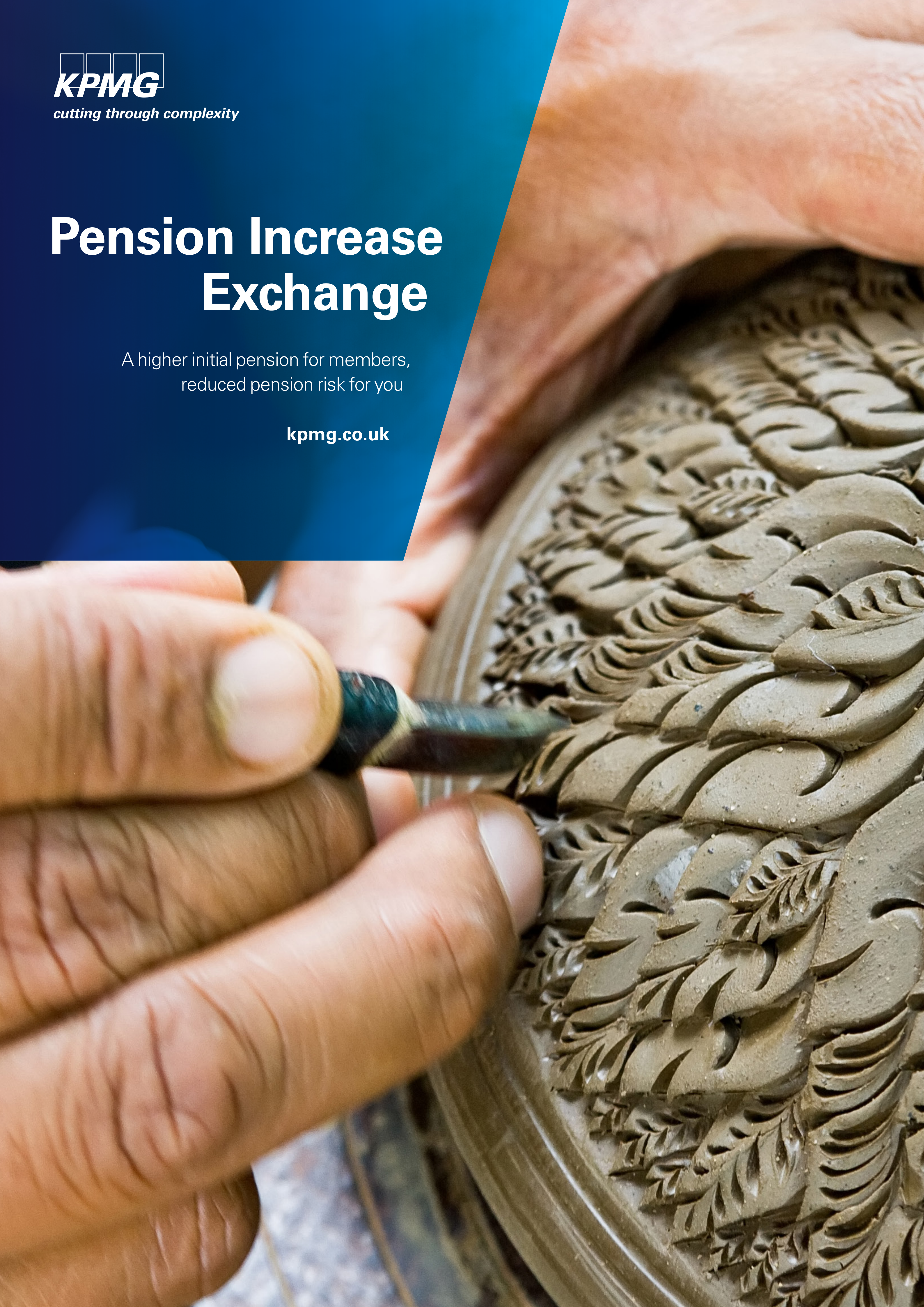


KPMG
cutting through complexity

Pension Increase Exchange

A higher initial pension for members,
reduced pension risk for you

kpmg.co.uk

PENSION INCREASE EXCHANGE

An exercise designed to reduce pensions risk and give members a **higher initial pension in exchange for lower future pension increases**.

01 **WHO** IS COVERED?

Members who are currently receiving their pension, including spouses of deceased former members.

Many schemes provide pension increases in excess of the statutory minimum. A Pension Increase Exchange offer allows members to exchange future non-statutory increases in return for an additional non-increasing pension.

02 **WHY** IS IT GOOD FOR MEMBERS?

Pensioners are provided additional benefit flexibility through a Pension Increase Exchange. For many, a higher non-increasing pension may better meet their lifestyle needs, providing a greater income when they are younger and have more commitments. Others may not expect inflation to be as high as predicted by the scheme.

For younger pensioners, state benefits may not become payable for a number of years, and Pension Increase Exchange can allow members to re-shape their benefits so that they receive a more stable income during retirement.

An example of how this might work is shown in the diagram below.

03 WHAT ARE OTHER **COMPANIES** DOING?

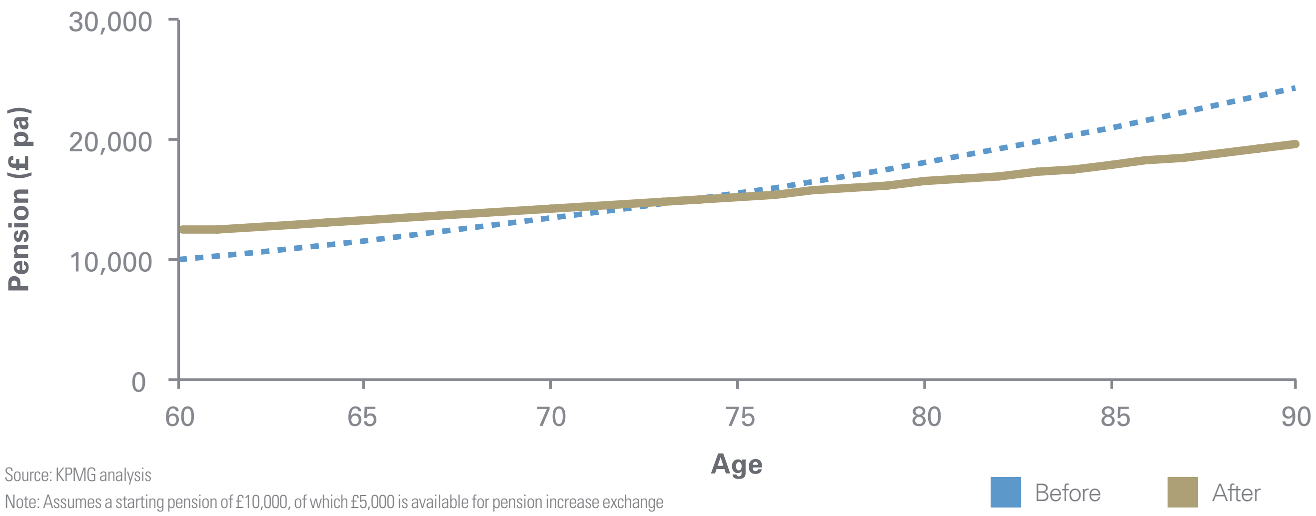
KPMG has implemented over 30 Pension Increase Exchange exercises for large and small companies alike, covering over 180,000 members.

Our 2012 member option survey showed two-thirds of exercises offered between 60% and 79% of value to members. Since the Code of Good Practice was introduced some exercises have had a Balanced Deal Percentage of 100%, although our experience is that non-balanced deals remain the norm.

04 WHAT WILL THIS **COST** ME?

The overall cost will usually comprise advisor fees, communication costs, administration costs and the costs of providing independent financial advice or guidance. Our experience is that a Pension Increase Exchange exercise typically offers a deficit reduction, although this will depend on the value of the option offered to members. The lower deficit should in turn lead to a reduction in ongoing cash contributions. to the scheme, and we have seen trustees agree to offset the costs of running the exercise against these ongoing savings.

PENSION INCREASE EXCHANGE EXAMPLE



Source: KPMG analysis

Note: Assumes a starting pension of £10,000, of which £5,000 is available for pension increase exchange

05 WHAT MAKES A SUCCESSFUL **EXERCISE?**

Our experience in this area allows us to understand the drivers behind achieving a successful exercise:

Understanding the detail is key for designing the offer and our annual member options survey gives us unique insight into members' behaviours and preferences.

Communications are critical to success; KPMG has a specialist team who are experts at designing communications strategies to encourage member engagement

In depth knowledge of the market is vital to manage risk and our involvement in developing the industry Code of Good Practice and working with IFAs on exercises completed to date gives us excellent insight in this area.

Proactive management of the process ensures smooth execution and up front identification of potential pinch points.

CODE OF GOOD PRACTICE

The Code of Good Practice for incentive exercises was introduced in 2012. It provides a clear framework for the operation of Pension Increase Exchange exercises.

Under the Code members must be provided with either guidance or full advice (at no cost to the member) from an independent financial advisor, to enable them to make a fully informed decision on whether or not to accept the offer. Whether guidance or advice needs to be provided depends on what proportion of the value of increases being given up is passed onto the member (the "Balanced Deal Percentage") in the form of additional pension.

- If the Balanced Deal Percentage is under 100%, then full advice must be made available to the member (i.e. a recommendation on whether or not to accept the offer)
- If the resulting Balanced Deal Percentage is 100% or more, then it is sufficient to provide guidance from an independent financial advisor.

A Balanced Deal Percentage of 100% means that the value of the pension before and after the option is taken up is unchanged.

WHAT ARE THE POTENTIAL BENEFITS FOR ME?

Our experience suggests that for a typical Pension Increase Exchange exercise around 50% of the target population will engage with the offer, and a well run exercise with a good communications strategy might expect to see higher engagement levels. Typically around 50% of members who engage will accept the offer.

A successful exercise will typically reduce:

- pension risk by removing inflation link on the exchanged pension
- funding and accounting deficits, particularly where the Balanced Deal Percentage is less than 100%
- pension costs in the accounts, as the reduction in accounting deficit leads to a P&L credit
- buyout costs due to the lower cost of hedging fixed (as opposed to inflation-linked) benefits

A Pension Increase Exchange option can also be made available to members as they retire over time (just like the option to take tax free cash), further reducing risks in the pension scheme over time.

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Oliver Marketing for KPMG I OM 009008A I January 2014