Council, 6 February 2013

HCPC Group Life Assurance Scheme

Executive summary and recommendations

Introduction

In December 2013 the Council considered a paper about pensions auto-enrolment which will apply to the HCPC from 1 April 2014. This paper covered the potential costs of providing a death in service dependent's pension to auto-enrolled employees. The Council requested further information about death in service dependent's pensions before deciding whether or not this benefit should be replaced for new and auto-enrolled employees..

The HCPC's pensions advisers Barnett Waddingham have undertaken this specialised work and have produced the attached report. A representative from Barnett Waddingham will attend the Council meeting to present the paper.

Decision

The report recommends that the HCPC replaces the death in service dependent's pension with an enhanced lump sum. This could be either a generic additional lump sum of 7 x salary (option 1), or a capitalisation calculated additional lump sum of 9 x Salary (option 2).

Both options provide a significant cost saving to the HCPC. Option 2, the lump sum of 9 x annual salary, is slightly more expensive to insure but has the advantage of more closely replicating the value of the dependent's pension. It is likely to be more acceptable both to auto-enrolled employees and to existing pension scheme members in the future if this proposed benefit change needs to be extended to include them.

The Council is requested to:

- approve the recommendation to replace the death in service dependent's pension for new and auto-enrolled employees with a capitalisation calculated additional lump sum of 9 x annual salary

Financial implications

Cost estimates are set out in the attached report

Resource implications

None

Date of paper

28 January 2014

Barnett Waddingham

Considerations for removal of Dependants Pension

prepared for

The Health & Care Professions Council (HCPC)

Carl Chapman
Barnett Waddingham LLP

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Contents

1. Introduction

This report is provided to the Health and Care Professions Council ("the HCPC") by Barnett Waddingham LLP and follows recent discussions surrounding the benefits provided by its Group Life Assurance Scheme ("the GLA Scheme").

Following recent developments in the Group Life Assurance market and, specifically, the rising costs of offering a dependents pension, the HCPC is in the process of reviewing the structure of benefits offered through its GLA Scheme. In particular, the HCPC would like to understand the benefit options available for its auto enrolment population which will be impacted from 1 April 2014.

Within the following report we provide an outline of the current benefits offered by the HCPC, highlight the issues with continuing to offer such benefits and present possible alternatives for the consideration of the HCPC.

Barnet Waddingham LLP

This report has been prepared by Barnett Waddingham LLP, a firm authorised and regulated by the Financial Services Authority and licensed by the Institute and Faculty of Actuaries for a range of investment business activities.

References to "Barnett Waddingham", "us" or "we" throughout this report refer exclusively to Barnett Waddingham LLP.

With reference to the FCA's Conduct of Business Sourcebook, we continue to classify you as a 'Professional Client' as we believe the Company's share capital exceeds £5m; however please let us know if this is incorrect.

2. Background

Current GLA Scheme Structure

Under the current GLA scheme members are provided with a Lump Sum benefit of 3.5 x salary and a Dependents Pension equivalent to of 1/3rd of salary. Salary under both policies is defined as basic annual salary or wages.

The Lump Sum benefit can be paid to any nominated beneficiary whereas the Dependant's Pension can only be paid to a financial dependant of the deceased as detailed in the scheme rules.

Membership of the GLA Scheme is currently only offered to members of the HCPC Group Personal Pension Plan ("the Plan"). There is no provision under the GLA Scheme for employees who have elected not to join the Plan. At the last renewal date (1st April 2013) the GLA Scheme covered 76 employees and the premium was broken down as follows;

- Lump Sum £13,035
- Dependents Pension £19,456

On 1 April 2014 the HCPC will reach its automatic enrolment staging date and as such will be required to automatically enrol its Eligible Jobholders (i.e. employees aged between 22 and State Pension Age, earning over £9,440 in 2013/14 terms) into the Plan. We understand that the majority of the HCPC's non-pensioned employees will be classed as Eligible Jobholders.

Under the current structure of the GLA Scheme the Lump Sum and Dependants Pension cover will extend to the automatic enrolment population and as such will significantly increase the number of employees covered and, as a consequence, the cost.

In addition, these costs will be further impacted by some recent developments in the Group Life Assurance market.

Recent Developments

The use of Dependants and Spouses Pensions has declined significantly over the past 10 years with many companies looking at alternative insurance methods. The main reason for this decline is the cost associated with providing this type of benefit. At present it is common to see increases at rate review of between 50% and 100% and in some cases these increases can exceed 100%.

These increases are a reflection of the insurers reserving capabilities. Unlike lump sum insurance where the potential liabilities are defined, dependants and spouses pensions reserving is volatile and difficult to ascertain because the benefit is paid from the death of the employee to the death of his or her dependant (excluding children who become financially independent).

This volatility and uncertainty is coupled with poor investment returns (particularly as a result of low interest rates) which have been experienced throughout the financial crises. These factors have been so extreme that they have led to one of the biggest insurers, Unum, withdrawing from the market for new business completely.

The premium increases mentioned above are often seen as unsustainable by companies which has led to a contraction in the market and is why many companies have implemented alternative insurance methods.

In the following section of this report we will explore the alternative options available to the HCPC in more detail and also the key considerations of making such a change. Importantly, based on our discussions with the HCPC, at present any proposed changes will apply to the auto enrolment population only, with the benefits for existing Plan and GLA Scheme members being maintained. We would recommend however that any changes introduced should also be considered for existing members in the future.

3. Alternative Insurance Options

When looking at removing a Dependants Pension, there are a few options available, we have detailed these options below under each heading.

Option 1 - Generic Additional Lump Sum

In our experience this option is the most common approach and simply involves removing the dependant's pension and replacing it with an additional Lump Sum. Most companies will simply double their existing Lump Sum offering, rather than using a specific rate of calculation. Therefore under the current 3.5 x salary Lump Sum benefit with a dependant's pension alongside, the latter would be removed and an additional 3.5 x salary would be offered (i.e. a new Lump Sum of 7 x salary). There would be some winners and some losers in value terms especially over time.

This approach does not aim to offer an additional Lump Sum equivalent in value to the dependant's pension rather it is seen more as a form of compensation for the removal of the Dependant's Pension.

Option 2 - Capitalisation Calculated Additional Lump Sum

A much less common option is to use the insurers capitalisation factors to determine what Lump Sum should be offered in an attempt to closely replicate the value of the Dependants Pension.

When determining what reserve they need to satisfy the liabilities of the scheme insurers use a capitalisation figure to multiply the annual pension promise to calculate the total amount required to purchase the required annuity. The capitalisation factor applied to the HCPC scheme is currently 17.

The current pension promise under the scheme is approximately £1,092,000 and applying the capitalisation factor makes a total reserve requirement of £18,564,000. This would result in an additional Lump Sum of approximately 5.5 x salary being required, resulting in a new total lump sum of 9 x salary.

These figures are based upon the current population however the calculations will be valid for the auto enrolled population.

Option 3 - Actuarially Calculated Additional Lump Sum

Some companies have taken the decision to actuarially calculate the Lump Sum requirement so that each employees additional Lump Sum is equivalent to the Dependants Pension and therefore they see no financial loss.

This approach is more complicated, however, because in order to ensure that there is no financial loss a thorough actuarial assessment must be carried out and each individual employee would receive their own unique additional lump sum. The reason for this is the different ages of the population and more importantly the ages of the spouses. Older employees with older spouses will require less lump sum than younger employees with younger spouses.

New calculations will also need to be carried out on a regular basis, normally every two years to ensure the additional lump sum is accurate at all times.

Unfortunately we cannot associate a cost to this option because there are numerous variables and unknowns however in our experience the cost of insurance is similar to the capitalisation option, with however higher consultancy fees as a result of the initial and ongoing actuarial calculations required.

Option 4 - No Alternative Insurance

Some companies simply decide to remove the Dependant's Pension and provide no alternative insurance policy which is of course, the most cost effective option.

Financial Implications of Auto-Enrolment

It is our understanding that at present there are approximately 112 employees who are to be auto-enrolled and therefore become eligible for both Lump Sum and Dependants Pension cover. Until such time as full data is available we cannot quote accurate figures, however, as the auto enrolment membership is similar to the existing membership we will assume a doubling of premiums once these members have been included.

The following tables help explain the financial implications;

Lump Sum	Total premium pre auto-enrolment	Total premium post auto-enrolment
Current Design	£13,035	£32,244*
Option 1	N/A	£54,885
Option 2	N/A	£66,842
Option 3	N/A	£66,842**
Option 4	N/A	£32,244

*additional premium pro-rated 76 lives against 122 lives

**assumed same cost as option 2

Dependants Pension	Total premium pre auto-enrolment	Total premium post auto-enrolment	Total premium assuming 50% inflation in rates
Current Design	£19,456*	£50,688*	£76,032
Option 1	N/A	£19,456	£29,184
Option 2	N/A	£19,456	£29,184
Option 3	N/A	£19,456	£29,184
Option 4	N/A	£19,456	£29,184

* additional premium pro-rated 76 lives against 122 lives

Assuming that the dependant's pension rates do increase by 50%, which is very conservative, the total financial impact of each option is as follows.

Total Costs	Combined premium post auto-enrolment
Current Design	£108,276
Option 1	£84,069
Option 2	£96,026
Option 3	£96,026
Option 4	£61,428

4. Key Considerations

When removing a Dependants or Spouses pension there are a number of issues that must be considered, the following gives a detailed explanation of each alongside any further action that needs to be taken.

Contracts of Employment

Most likely to be the first thing to address is contracts of employment and whether removing the dependants pension requires the involvement of unions or more commonly a consultation period. We understand that this has already been looked into by the HCPC and the advice is that for the auto-enrolment population, who are not currently members of the pension plan, no formal consultation period is required.

Lifetime Allowance

The lifetime allowance is the limit at which proceeds from death from either a lump sum life assurance scheme or pension scheme are tax free, unless protection has been sought. The lifetime allowance is currently £1.5million however this is reducing to £1.25million with effect from 6th April 2014 and the tax charge above this limit is 55%.

Dependants Pensions do not count towards the accumulation of the lifetime allowance however Lump Sum insurance does, therefore insuring higher Lump Sum for employees will increase their lifetime allowance accumulation, not an issue for the majority of employees but something that should be flagged to high earners.

Employee Coverage

Dependants Pensions are designed to provide cover to dependants of a deceased employee, in the event that employees have no financial dependants no cover is in place, however Lump Sum policies cover all employees irrespective of any financial dependants.

As a result all employees will benefit and can ensure other loved ones for example adult children, parents or friends can be cared for in the event the deceased has no financial dependants.

Auto-Enrolment

It is our understanding that HCPC are soon to be auto-enrolling non pension scheme members which will increase the membership of the Dependants Pension scheme, depending on the contracts of employment it may be possible to close the scheme and offer the higher lump sum multiples prior to the influx of members post auto-enrolment.

5. Summary

Of the options set out in section 3 above, we understand that the HCPC does not wish to consider option 4 as this will result in a significant reduction in the benefits offered to employees. Equally, the additional consultancy costs arising from option 3, both initially and on an ongoing basis make this a less viable option and we therefore believe this should be discounted.

The HCPC may therefore wish to consider implementing option 1 or option 2 as both would provide an enhanced Lump Sum benefit to replace the Dependents Pension, whilst allowing for the costs incurred by the HCPC to be controlled. Option 2 (the capitalisation option) would have the added benefit of more closely replicating, as far as reasonably practicable, the value of the Dependents Pension.

We look forward to discussing this report with the HCPC.