TRANSFERS FROM THE UKAEA SUPERANNUATION SCHEMES TO THE AEA TECHNOLOGY PENSION SCHEME

NOTE BY THE GOVERNMENT ACTUARY'S DEPARTMENT ON THE OPTIONS AVAILABLE IN RESPECT OF ACCRUED UKAEA BENEFITS

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Section 1 : Introduction

1.1 Background information

1.1.1 This note has been prepared by the Government Actuary's Department at the request of the UKAEA Superannuation Scheme administrators. The purpose of the note is to explain to those AEA Technology employees who have transferred from either of the UKAEA Superannuation Schemes (PNISS or ISS) to the AEA Technology pension scheme (AEAT Scheme) the options that are available in respect of their accrued UKAEA Scheme benefits which have been earned in the past. The note also outlines the main factors to take into consideration in deciding whether or not to transfer accrued UKAEA Scheme benefits.

1.1.2 The AEAT Scheme has a closed and an open section. The special transfer terms described in this note are available for transfers to the closed section of the Scheme. If you have joined the open section of the AEAT Scheme for future service, this will not affect any pension rights that you may opt to transfer from the UKAEA Schemes to the closed section of the AEAT Scheme.

1.1.3 The note is not intended to suggest that any one course of action is better than any other. This would depend on individual circumstances, and if you are unsure of the most suitable course of action you should seek Independent Financial Advice which would take into account your particular circumstances.

1.1.4 All information contained in this note with regard to the AEAT Scheme has been verified with AEA Technology.

1.2 The options available for accrued UKAEA Scheme benefits

1.2.1 After leaving one of the UKAEA Schemes, there are three alternatives to consider for your accrued UKAEA Scheme pension benefits. They are:

- Preserve the benefits in the UKAEA Scheme;
- Transfer your UKAEA Scheme service to the AEAT Scheme (under the special transfer terms);

or

- Take a transfer value to a personal pension (under ordinary transfer terms).

Section 2 : What the three options mean in practice

2.1 What happens if I choose to preserve my benefits in the UKAEA Scheme?

2.1.1 If you choose to preserve your benefits in one of the UKAEA Schemes, then a member's pension, lump sum and spouse's pension will be calculated as at the date of leaving the UKAEA Scheme, based on your reckonable service in the UKAEA Scheme up to that time and your Pensionable Final Earnings (PFE) at that time.

2.1.2 Unless you die before reaching Normal Retirement Age (NRA), or become unable to continue in employment because of ill-health (or decide before NRA to take a transfer value), the member's pension will come into payment at NRA, at which time the lump sum will also be paid. Both will have been increased by the amount the Retail Price Index has increased between leaving the UKAEA Scheme and reaching NRA.

2.1.3 Thus, if you were to preserve your benefits in the UKAEA Scheme and were to be a member of the AEAT Scheme from now until your retirement, then you would receive two sets of benefits at NRA, one from the UKAEA Scheme and one from the AEAT Scheme. The UKAEA Scheme pension would be based on your UKAEA service and your PFE at the time of leaving the UKAEA Scheme plus inflation increases up to NRA. The pension from the AEAT Scheme would be based on your PFE at the time of retirement and your service with AEA Technology after privatisation.

2.1.4 Should you die before reaching NRA, the preserved lump sum is payable from the UKAEA Scheme to your nominee or estate and, if you are married, a pension becomes payable to your spouse. Both the UKAEA preserved lump sum and spouse's pension will have been increased in line with price inflation between the time of leaving the UKAEA Scheme and the time of death. (If you have joined the AEAT Scheme for future service, your nominated beneficiary will also receive a death-in-service lump sum and dependants' benefits, as appropriate, from the AEAT Scheme.) If you die leaving a surviving spouse after NRA, spouse's pensions will also payable from each scheme.

2.2 What happens if I take a special transfer value to the AEAT Scheme?

2.2.1 If you opt to take advantage of the special transfer terms, which will be available for a limited period until 23 December 1996, a payment will be made from the UKAEA Scheme to the AEAT Scheme. In exchange for this, you will be credited in the AEAT Scheme with one year of service for each year of reckonable service you had in the UKAEA Scheme. You would then no longer have the right to any benefits from the UKAEA Scheme.

2.2.2 The benefits payable by the AEAT Scheme will then be based on your combined service in the UKAEA Scheme and the AEAT Scheme, and on your earnings at the time of retirement (or earlier leaving). There will be no UKAEA Scheme pension.

2.2.3 If you die before reaching NRA, your spouse's benefits will be calculated under the rules of the AEAT Scheme, taking into account the service credits transferred from the UKAEA Scheme. A death-in-service lump sum will also be payable from the AEAT Scheme to your nominated beneficiary.

2.2.4 The overall effect of taking a transfer value is that the whole of your benefits (including that part based on UKAEA Scheme service) will be provided by the AEAT Scheme. The benefit structure of the closed section of the AEAT Scheme is very similar to that of the UKAEA Schemes, so that your <u>transferred</u> benefits will be identical (or very close) to those you would have received if you had been able to continue to contribute to the UKAEA Scheme for future service. If you take advantage of the special transfer terms and also remain in the closed section of the AEAT Scheme, your <u>total</u> benefits will be identical (or very close) to those you would have received if you had been able to continue to contribute to the UKAEA Scheme for future service.

2.2.5 If you do not opt to take advantage of the special transfer terms, but subsequently decide to take an ordinary transfer value from the UKAEA Scheme to the AEAT Scheme, you will not be guaranteed year-for-year transfer terms, and may

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receive fewer years of service than you had actually completed in the UKAEA Schemes.

2.3 What happens if I take a transfer value to a personal pension scheme?

2.3.1 If you decide to take a transfer value to a personal pension scheme, the UKAEA Scheme will not offer the special transfer terms available for transfers to the AEAT Scheme. This is because the special transfer terms are designed, as far as possible, to enable you to reproduce as closely as possible at the end of your career the overall level of benefits that you had expected as a UKAEA Scheme member. The benefits from a personal pension scheme are of a different type from those of either the UKAEA Scheme or the AEAT Scheme, and so are not likely to reproduce the expected level of benefits.

2.3.2 The UKAEA Scheme will, however, offer you an ordinary transfer value to an approved personal pension scheme of your choice. Such a transfer would be possible whatever you decide to do about your future pension provision. Thus, you could transfer your past UKAEA Scheme benefits to a personal pension whilst, for the future, you could either join the AEAT Scheme, opt back into the state scheme, or contribute further to the personal pension.

2.3.3 In a personal pension arrangement, the benefits you receive are not directly related to either your salary or your service. The benefits you actually receive will depend critically on four main factors:

- the amounts and timing of cash paid into the arrangement;
- the investment returns achieved whilst the money is invested;
- investment conditions and annuity rates at the time you retire;

and

- the amount taken out in charges and expenses by the provider.

The money paid in, including the transfer value, is invested until your retirement, when it is used to buy you (and possibly your spouse) a pension. The size of the pension will depend on the accumulated amount of money available, and on what terms insurance companies are offering at that time for the purchase of pensions (these terms can vary quite considerably from time to time).

2.3.4 With a personal pension, therefore, you bear the risk that your pension will be lower than you hoped. If the investment returns and conditions are good, however, you take the reward of a higher pension. You also have some choice as to how the money is invested, and more control over when you take your pension and the form of the benefits taken (although pensions taken early are likely to be considerably smaller than those taken at a later date).

2.3.5 As far as future service is concerned, you should note that AEA Technology will be required to make substantial contributions into the AEAT Scheme; the company will not, however, contribute to a personal pension arrangement.

Section 3 : Factors to consider in making the decision.

3.1. What are the advantages of opting for the special transfer terms?

3.1.1 The main advantage of opting for the special transfer terms is that benefits based on transferred service in the AEAT Scheme are likely to be higher than preserved UKAEA Scheme benefits. This is because the former will be based on your earnings at the time you leave the AEAT Scheme, whilst the preserved UKAEA Scheme benefits will be based on your final earnings in the UKAEA Scheme, plus cost-of-living increases thereafter. There are two reasons why your earnings at retirement are likely to be greater than your current earnings plus cost-of-living increases. Both of these reasons apply more strongly the further away from retirement age you are currently. The first reason is that, over the long term, as standards of living increase, general pay levels increase faster than price levels. The second reason is that your pay level may increase further still as the result of performance and promotional awards.

3.1.2 If you retire from the AEAT Scheme before NRA, it should be borne in mind that preserved UKAEA benefits will not normally be available until NRA, whereas rights transferred to the AEAT Scheme would be likely to be available immediately, although possibly reduced for early payment. (In certain circumstances, if members opt to preserve their UKAEA benefits and subsequently leave AEA Technology on severance terms, compensation may be available for the lack of immediate payment of the UKAEA preserved benefits. However, this note is not intended to cover in detail the potential effects of your decision in relation to your UKAEA pension benefits on your AEA Technology redundancy benefits.)

3.2 What are the advantages of preserving the UKAEA Scheme benefits?

3.2.1 If your pay increases at a lower rate than cost-of-living increases during the period to your retirement then your preserved UKAEA Scheme benefits would be likely to be higher than your benefits based on transferred service in the AEAT Scheme. Thus, if you don't expect your pay to increase significantly before you leave the AEAT Scheme, you may wish to consider preserving your UKAEA Scheme benefits. This consideration is likely to apply more strongly the sooner you expect to leave or retire from the AEAT Scheme, because the long-term tendency for pay increases to outstrip price inflation may not apply to every individual over specific periods of just a few years.

3.2.2 Another advantage of preserving your UKAEA Scheme benefits is that it effectively gives you better "life insurance" cover up to NRA, although, in practice, this advantage would be likely to affect only a small minority of employees. If you die before NRA, your nominee or estate will benefit from the preserved UKAEA Scheme lump sum in addition to the AEAT Scheme lump sum benefit. The preserved UKAEA Scheme lump sum would not be available if you transferred your UKAEA Scheme benefits.

3.2.3 The effect of preserving your UKAEA benefits is that your total benefits will be payable from two independent sources. Whilst it is unlikely that the benefit promise made by either the UKAEA Scheme or the AEAT Scheme would ever be broken, it is still more unlikely that both promises would be broken, and this could be viewed as a reason to opt for preservation. However, this consideration should not normally outweigh those in relation to salary and inflation, although it might be taken into account where the other relevant factors were very finely balanced.

3.3 What about the personal pension option?

3.3.1 Although the personal pension option does have some advantages, for the vast majority of people the disadvantages are likely to outweigh the advantages. This option is likely to attract those who are willing to risk a smaller pension than the UKAEA Scheme or AEAT Scheme pensions, in exchange for the chance that it may be larger. It may also attract those who want more direct involvement in, and control over, the actual investments from which their pensions are derived, and wish for a greater degree of flexibility in the form and the timing of their benefits. Unfortunately, greater flexibility is usually associated with higher cost.

3.3.2 The critical disadvantages of transferring your UKAEA Scheme rights to a personal pension are:

- Special transfer terms are not available, so that the initial sum invested would be insufficient to buy you the benefits obtained by opting for a transfer to the AEAT Scheme (unless the future investment performance of the personal pension was very good indeed);

- Sizeable deductions from your investment will be made to cover the expenses and contribute to the profits of the personal pension provider;

- If you plan to contribute to the personal pension for future service also, you will lose the benefit of the employer's contributions to the AEAT Scheme, and would therefore have to bear the full cost of funding your future pension provision yourself.

- The personal pension option is not generally sensible unless there is a considerable time left until your retirement. This time is needed firstly to ensure that the deductions for expenses and profits are paid whilst still leaving you with a valuable policy, and secondly because the investment returns only build up substantially over long periods of time.

3.3.3 Individuals who have a strong preference for the personal pension route may discount these disadvantages; there are certainly some attractions, although probably only in the case of younger members.

3.3.4 There is one particular case in which the personal pension option may be the desirable one. If you are expecting to leave the AEAT Scheme after only a few years service, and are currently quite young, there may be advantages in leaving with a "portable" personal pension, rather than either preserving your benefits in the AEAT Scheme, or transferring them on to your new employer's scheme. In most cases, however, this advantage would be outweighed by the loss of the employer's contribution to the AEAT Scheme whilst you remained with AEA Technology.

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