



The Actuarial Profession

making financial sense of the future

consultation response

DWP consultation

***Approaches to the calculation of pensions
transfer values***

Comments from the Actuarial Profession

August 2007

Mr M Rochford
Department for Work and Pensions
3rd Floor, The Adelphi
1-11 John Adam Street
London
WC2N 6HT

17 August 2007

Dear Mike

DWP consultation on approaches to the calculation of pensions transfer values

I refer to the DWP's recent consultation paper and draft regulations on the calculation of pensions transfer values. The Actuarial Profession has reviewed these documents and this letter sets out our main comments on the regulations as currently drafted. Our detailed comments are set out in the enclosed appendix. All our comments are made in the context of what we understand to be the policy objective – a system based on a high level of flexibility for trustees to determine what they consider to be appropriate bases for the calculation of transfer values from their own schemes. In particular, we understand that in moving to a cost of scheme approach Government is not looking to apply any overlay of a range of assumptions that is acceptable.

Cash equivalents and transfer values

As currently drafted, the Regulations do not appear to provide for the calculation of certain transfer values covered by the existing requirements. This is of particular concern given that there are currently no plans for the Board for Actuarial Standards (BAS) to produce a GN11-equivalent to support the Regulations. It is our view that cash equivalents paid under s94 of the Pension Scheme Act 1993 and transfer values paid under s73 (2) of the same Act should be treated in the same way (it is illogical to do otherwise). This should be made clear preferably in the Regulations, or at least in any supporting Code of Practice or guidance issued by the Pensions Regulator.

There is also a problem where trustees decide to make transfer values available that are higher than the minimum required level – this results from the use of “cash equivalent” in the new Regulation 7(2). The current drafting could be taken as requiring the quotation of an initial cash equivalent that is the minimum level regardless. This aspect could be dealt with by requiring the trustees’ “initial cash equivalent” to be no less than the minimum level.

Please reply to Staple Inn

Faculty of Actuaries
Maclaurin House
18 Dublin Street
Edinburgh EH1 3PP
Tel: +44 (0)131 240 1300
Fax: +44 (0)131 240 1313
e-mail: faculty@actuaries.org.uk
www.actuaries.org.uk

Institute of Actuaries
Staple Inn Hall
High Holborn
London WC1V 7QJ
Tel: +44 (0)20 7632 2100
Fax: +44 (0)20 7632 2111
e-mail: institute@actuaries.org.uk
www.actuaries.org.uk

Institute of Actuaries
Napier House
4 Worcester Street
Oxford OX1 2AW
Tel: +44 (0)1865 268200
Fax: +44 (0)1865 268211
e-mail: institute@actuaries.org.uk
www.actuaries.org.uk

Insufficiency reports

We are concerned about the implications of paragraph 7 of schedule 1B to the draft Regulations, as this could cause significant practical problems for schemes. Of particular concern is how the percentages shown for each priority category would be taken into account in the calculation of actual transfer values. Accurate calculations would be required of each member's "corresponding PPF liabilities" and those with a lower priority class, so that appropriate percentage adjustments could apply to each. To implement this would require a major change to the transfer value calculations and procedures adopted by most schemes. GN11 permits aggregation of priority classes where appropriate, and it would be essential for this to be carried through to the new regulations to avoid extra costs.

Also, as background, the requirements in GN11 to take into account priority orders for insufficiency reports were introduced at a time when the priority order was significantly different; in particular, pensioner benefits had highest priority and there was therefore a need to ensure that reductions to transfer values for deferred pensioners and members in service took into account the higher protection given to pensioners. This no longer applies.

A scheme's transfer value basis is likely to differ significantly from a Section 179 valuation basis. Requiring the split of the transfer value into the priority orders therefore does not protect the PPF position particularly, and therefore does not achieve much in practice.

Disclosure of assumptions

We note that there is no requirement in the regulations for the trustees to disclose the assumptions they have used to calculate a transfer value as this would be "an extra burden for firms". We consider that, in practice, this burden would be very small and suggest that, rather than it being good practice for schemes to provide this on request, members should have a right to access the assumptions used on request. In our experience, this is what generally happens in practice and should not prove burdensome for schemes. However, it should not be a requirement on schemes to provide these automatically, as this may be considered information overload from the member's perspective.

Timetable and transitional issues

While the principles behind the calculation of transfer values will not be changing significantly, the Regulations do introduce a change in responsibility for the calculation of transfer values from the Actuary to the Trustees. In practice therefore each Trustee Board will need to consider and decide on a transfer basis, and any change in the procedures and calculations will need to be made and implemented prior to the regulations taking effect. We note that the regulations are expected to take effect on 6 April 2008 and recall that it had been hoped that there would be a period of six months between the regulations being laid before Parliament and their coming into effect. This would point to the regulations being laid by no later than 6 October which is a very challenging timetable. If the regulations are not laid by 6 October, we are concerned that there will be insufficient time for the trustees to consider and agree the assumptions to be used and for any necessary changes to procedures and methodologies to be made in time for 6 April. Consideration should therefore be given to some form of transitional arrangement covering perhaps six months from 6 April 2008.

Supporting guidance

We consider that there are a number of areas where supporting guidance from the Pensions Regulator would be beneficial to scheme trustees.

Some further detailed comments are set out in the enclosed appendix.

We hope that these comments are helpful and would be happy to discuss them or offer clarity if that would be of use.

Yours sincerely

A handwritten signature in black ink, appearing to be 'G Sharp', written in a cursive style.

Gordon Sharp
Chairman, Pensions Board

cc: C Massey, The Pensions Regulator

Detailed comments on draft Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2007

Regulation 7A (2)

This regulation states that, for schemes in wind-up, the trustees should assume (for the purposes of calculating the initial cash equivalent value) that the scheme is not in wind-up. This seems odd, since investment policy is likely to change when a scheme goes into wind-up. It is not clear what the intention is here and greater clarity about the policy intention would be welcomed.

Regulation 7A (3)

It is not clear to us why actuarial advice is needed in respect of the accrued benefits. This should be a matter of fact but, if unclear, it should be the responsibility of the trustees to confirm the accrued benefits – perhaps with legal advice. As currently drafted, the regulation imposes an inappropriate legal responsibility on the actuary. In many cases, schemes (particularly small schemes) might endeavour to minimise costs by avoiding formal legal advice. In such cases, the actuary is often pressed for a view although it is not his or her role to offer one. It would therefore be helpful if the regulation was amended to make clear that this is not a matter for the actuary. In particular, as currently drafted, the regulations would in effect require scheme actuaries to tell trustees how benefits should be equalised under sex discrimination legislation. **This is not appropriate.**

Paragraph (b) of this regulation refers to options that would increase the member's cash equivalent value. It is not clear why options that would decrease the value cannot be taken into account in a best estimate calculation which is meant to reflect the cost to the scheme of providing benefits. The regulation could be amended to allow for trustees to take account of options, having received actuarial advice, and having considered the likelihood of the option being exercised or amended in future. An alternative approach would be for the regulations to be silent on the matter and for a Regulator's Code of Practice to address how options should be dealt with. In either case, disclosure of the approach taken should be required.

Regulation 7A(4)

The draft Regulations provide for different normal pension ages for different types of benefit and we consider that this flexibility is important. However, we are concerned about potential difficulties relating to interaction with how normal pension age is defined elsewhere in legislation e.g. the Pensions Scheme Act 1993 implies that there is a single normal pension age.

Schedule 1B paragraph 3

This paragraph suggests that, where cash equivalents have been reduced, trustees are obliged to obtain a new insufficiency report. We do not consider this appropriate; trustees should be able to consider whether or not they require such a report in the light of any revised financial position.

The problem arises at least partly because the wording in the draft regulations has been taken, broadly, from GN11 para 4.2. A similar problem already exists, in that GN11 requires that a new GN11 report is issued with a s224 valuation if any cash equivalents have been reduced following the previous GN11 report. This applies even if cash equivalents have since reverted to unreduced levels or if there is no intention to reduce them after production of the s224 report or if no cash equivalents will be quoted for some time after the s224 report is signed.

GN11 (and the new draft regulations) requires that the new GN11/insufficiency report must also be provided with, and have the same effective date as, the s224 report. This could be seen as unnecessary.

It would be more helpful if the regulation provided that, where an initial cash equivalent is to be reduced following the signing of a section 224 valuation, it must be based on a new insufficiency report prepared with an effective date on or after the effective date of the most recently published s224 valuation.

Comments relating to possible supporting guidance

Guidance on matters to be raised with the trustees/disclosure to members

We note that the regulations, as currently drafted, offer no guidance on the extent of the advice to be provided by actuaries to trustees when setting the transfer value basis. Further, there is no requirement on Trustees to act on such advice. In order to facilitate the establishment of an appropriate framework of operation between actuaries and trustees, a Code of Practice or other guidance from the Pensions Regulator would assist trustees in this area, similar to that provided in respect of funding.

We are also concerned that in the absence of any certification or disclosure of the transfer value method, transfer values would be “given in a vacuum”. It would be more meaningful for members to know how the figure related to the scheme specific funding and buy-out positions. Accordingly, disclosure to members to enable them to understand the transfer value in relation the funding position is crucial. We recognise that this would have cost implications but are of the view that it should be possible to provide information on a scheme wide basis, leading to generic disclosure, that would not be too costly but would be of benefit to the member.

More detailed points:

We consider that a review of assumptions should take place where required by external events (and guidance could be prepared to offer a non-exhaustive list of such events), but in any event at least annually.

We also note that GN11 would cease to apply after 6 April 2008 and that transitional arrangements in respect of reviewing assumptions after this date may be required.

It would be useful for trustees to have guidance on splitting transfer values (for contracting-out benefits etc.) and on the inclusion of winding up and other expenses.

Unintended consequences

We also note that the consultation paper accompanying the draft regulations included a number of statements, which were in effect “quasi guidance” as they raised expectations to how a matter should be dealt with. For example, where there are differences between incoming and outgoing transfers it stated the expectation that these would be brought to the attention of any person wanting to transfer into the scheme. However such matters are not covered in the draft regulations and it is not clear how trustees should deal with them. Again guidance may be useful in these areas.