

## **Policy principles underlying proposed GN11 (EXD54)**

The Pensions Board has been considering the principles that underlie GN11 for a considerable time. It has followed a rigorous process involving consultation with interested bodies and identification of possible options, filtering to a short-list and a final decision on the appropriate methodology for the calculation of cash equivalents.

The end result of this process was a decision that a "marked-to-market" basis (as defined in the draft Exposure Draft) was the appropriate methodology since it placed a value on the member's benefits which could reflect all relevant factors affecting that value. The Board considered the possibility of requiring cash equivalents to be calculated on the basis of a risk-free rate, but rejected this option since it would treat all pension benefits as guaranteed when in practice they are not. Indeed, the profession has been at pains to point out publicly to the Government that benefits promised from the new Pension Protection Fund are not guaranteed; it would appear inconsistent if the profession were now to require actuaries to assume that all pension benefits were guaranteed when calculating cash equivalents.

The Board is conscious of the difficulties inherent in the marked-to-market basis. The Exposure Draft therefore makes it clear that actuaries are required to use their judgement and are expected to take a broad brush approach in order to agree pragmatic solutions with the trustees or managers of each scheme. Furthermore, it makes it clear that trustees are not precluded from agreeing a more generous cash equivalent basis than that implied by the marked-to-market basis, although the actuary would be expected to explain the implications of this to the trustees (without necessarily quantifying the effect).

The Board took the view that it should determine the principles to be adopted by reference to cash equivalents' use in transfer values. It would then be for the Government to decide on policy in relation to reductions to reflect schemes' funding levels and whether it wished to continue to use cash equivalents in other areas, such as disclosure of directors' remuneration. Nonetheless, it is the Board's view that the 'marked-to-market' basis successfully copes with the other uses to which cash equivalents are put (directors' benefits and divorce) in contrast to a gilts-based basis. .

The minimum basis would use the actuary's 'best estimate' for demographic assumptions and, in particular, an allowance for future changes to mortality which he or she considers reasonable. The Board considered to what extent it might prescribe a mortality basis and/or an allowance for future changes to mortality or make reference to the latest reports from the CMI. It concluded that this was not appropriate in view of the clear evidence that mortality varies significantly between pension schemes and the speculative nature of any allowance for future changes in mortality.

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