



The Actuarial Profession

making financial sense of the future

consultation response

The Pensions Regulator

**Guidance on calculation of
cash equivalent transfer values**

September 2008



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Dear Mr Kalyon

Guidance on calculation of cash equivalent transfer values: TPR

Thank you for offering The Actuarial Profession the opportunity to comment on this discussion paper. Our comments on the paper and on the specific consultation questions are attached to this letter.

If you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us. Should you wish to do so, please contact Martin Hewitt, Pensions Practice Manager on 0207 632 2185 or via martin.hewitt@actuaries.org.uk.

Yours sincerely,

Robert Hails

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Response from the Actuarial Profession

Guidance on calculation of cash equivalent transfer values – TPR

We have a number of comments, suggestions and questions on the draft guidance, as follows:

1. Timing of the draft guidance

The timing of the draft guidance is, at best, unhelpful and thus TPR may wish to consider formally stating its views on materiality of late transfer values in the months after 1 October. Trustees needed to have made the necessary decisions well in advance of the deadline in order to implement them, so even if the guidance is finalised by 1 October this will be too late.

2. What to do when the guidance is finalised

Does TPR expect trustees to immediately review their transfer value bases and methods again when the final guidance is issued (assuming they have already reviewed their basis in advance of 1 October, and perhaps even before the draft guidance was available)? It would be helpful to know TPR's views on whether it is reasonable to delay any such additional review until an appropriate time.

3. Existing quotes at 1 October 2008

Can TPR comment on whether the legislation and guidance could have any impact on existing cash equivalent quotations that are within the three month guarantee period at 1 October but have not yet been accepted? Views were attributed to TPR at a recent 'Webinar' hosted by the Actuarial Profession that quotations issued prior to 1 October do not need to be reissued and can continue to be processed after 1 October as if the new regime had not come into force (whether or not they had been accepted by 1 October). Although DWP also suggested this in the April 2008 response to its consultation on the draft regulations, we are not convinced that the legislation is completely clear on this point and would welcome a clear interpretive statement from TPR supporting the legislative intention.

4. Options (paragraph 13)

We must question whether TPR has the power to 'clarify the legislative intention' with regard to the allowance for options. It is also noted that DWP, in its response to its consultation on the draft regulations, made comments on options but failed to categorically rule out the allowance of options that are favourable to the scheme. The legislation itself appears to be silent on the matter.

5. Best estimate (paragraph 19)

The guidance should refer to the best estimate being the amount of money needed *on average*, since the allowance for mortality means that the cash equivalent will not be the actual amount required for each individual.

6. Reconciliation of cash equivalent and funding bases (paragraph 24)

TPR says it expects a rational reconciliation of the funding and cash equivalent bases to be possible, although we question whether this is really necessary and also note that it is not a legislative requirement.

If a reconciliation is necessary, it will presumably require advice from the scheme actuary and so it would be useful to know whether TPR expects evidence of the reconciliation to be automatically available. We would also point out that it will not necessarily be the case that the prudent funding assumptions will give a higher cash equivalent than the best estimate cash equivalent basis. This is mainly because options that are favourable to the scheme may have been allowed for in the funding basis. Thus there must be some question over whether the best estimate assumptions will actually be able to demonstrate the *prudence* of the funding assumptions, even if the two can be reconciled.

7. Reviewing assumptions (paragraph 27)

The draft guidance says “Trustees should instruct their actuary to alert them when [the ICE is no longer within a reasonable margin of materiality of a best estimate]”.

We are concerned that this appears to expect constant proactive monitoring of the cash equivalent basis by the actuary which, in our opinion, would be neither cost-effective nor proportionate in some cases. It also potentially places a responsibility on the trustees and actuary which is beyond that required by the legislation.

In our view, TPR should instead suggest that trustees *could* consider instructing their actuary to alert them or that they *could* review the basis with their scheme actuary at appropriate, regular intervals and also in response to certain events (such as those set out in paragraph 28).

Similar comments apply to the final sentence of paragraph 29, which implies constant monitoring by the trustees in the light of changing market conditions.

8. The alternative method (paragraph 33)

In the final sentence of paragraph 33, we believe that you mean to say that the reduced cash equivalent on the alternative basis must be at least as high as the reduced cash equivalent on the best estimate basis. However, the guidance could possibly be read as saying that the reduced alternative cash equivalent must be higher than the unreduced best estimate cash equivalent.

9. Priority allowance in reducing cash equivalents (paragraph 46)

Paragraph 46 suggests that best practice is to take into account the priority order on wind-up when preparing an insufficiency report. However, in some cases, the theoretical correctness of such an approach is outweighed by the significant additional administrative complexity (since all transfer values need to be split into PPF and non-PPF benefits, a non-trivial additional procedure for an administrator). It would be helpful if TPR acknowledged this complexity and commented on the use of a more approximate approach.

10. GN11 reports where there is no SFO valuation (paragraph 39)

The regulations (schedule 1A, paragraph 2(b)) require the insufficiency report used to support reductions to have an effective date no earlier than the effective date of the most recently received SFO valuation. Therefore, where the trustees have yet to receive an SFO valuation, it appears that cash equivalents may not be reduced from 1 October 2008. However, DWP has confirmed in writing to the Actuarial Profession that this is not the intention.

Paragraph 39 does not mention this problem, but does say that trustees of a scheme with no SFO

valuation must obtain an insufficiency report (or GN11 report) if reductions are being considered. We suggest that TPR could be more helpful in acknowledging the problem and clearly stating its view that reductions are possible. We have seen evidence of confusion on this point among lawyers and scheme actuaries and note that at a recent 'Webinar' hosted by the Actuarial Profession, TPR's Fraser Low did not dispute a statement that cash equivalents could not be reduced from 1 October for a scheme with no SFO valuation.

11. Partial cash equivalents

As you will be aware, scheme members have a statutory right to a partial cash equivalent of the excess over contracted out rights in certain circumstances. GN11 provided guidance on how to calculate such a partial cash equivalent in paragraph 5.1. Of course GN11 ceases to have effect from 1 October and leaves a gap in this area. Does TPR wish to consider providing guidance?

12. Transfers in (paragraphs 55 and 56)

The draft guidance suggests that a best estimate basis will usually be appropriate, but it also suggests that the transfer-in should not prejudice security of existing benefits nor be such as to require additional employer funding. Putting aside whether the impact of the transfer-in is material to the scheme as a whole, which is irrelevant to the principles set out in paragraph 55, it seems to us that these requirements may be conflicting, because transferred-in benefits granted on a best estimate basis will still have to be funded on a prudent basis. Thus, on the general assumption that the funding basis will produce higher liabilities than the best estimate basis, additional funding (or weaker security) *will* result (in the longer term, all other things being equal). The draft guidance perhaps needs to be a little less definitive on this point and could steer trustees towards using a more prudent (or even an economic) basis for transfers-in.

Paragraph 59 says that divorce transfer credits should be calculated on the same basis as transfers-in, but we would suggest that a best estimate remains appropriate for these calculations (i.e. consistent with the calculation of the member's cash equivalent).

13. Disclosure (paragraph 69)

It is not clear why it would only be appropriate to disclose the inclusion of options and discretionary benefits where the best estimate basis has been used (and not where the alternative basis has been used).

14. Former spouse's or civil partners' pensions (paragraph 71)

Paragraph 71 currently contains a statement of fact, rather than any guidance.

Transfer values for 'divorce' cases may be a particular problem in the months after 1 October as often these are required within short timescales and cannot simply be delayed because the trustees have not completed a review of their transfer value basis. Some guidance from TPR on what would be a reasonable course of action for these cases would be helpful. For example, could it be reasonable in certain circumstances to issue a (non-guaranteed) transfer value which is not a best estimate or which does not follow the guidance?