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TRANSFER VALUES REVISITED

SEMINAR, 25 JUNE 1993

THE Transfer Values Revisited seminar, organised jointly by the Institute and the Faculty of Actuaries, was held at Staple Inn on 25 June 1993. Approximately 180 actuaries attended.

Mr Roy Brimblecombe, Chairman of the Pensions Joint Committee, opened the meeting by providing a historical perspective on transfer values and discussing the timeliness of a comprehensive review of GN11 and related issues. The Pensions Joint Committee intends to prepare a proposal on a Minimum Solvency Standard for submission to the Goode Committee in October, and this seminar was part of a consultative process with the profession. Discussion at the seminar focused on the re-examination of GN11 and the relationship GN11 should bear to other guidance notes.

Mr Paul Thornton presented the case for an investment-led approach to the determination of the discount rate for GN11. He pointed out that the preservation legislation refers to 'benefits otherwise available on withdrawal'. The intention of the legislation is to leave the scheme in a financially neutral position, so that equity between transfers and the remaining members of the scheme is maintained. He stressed the serious economic consequences if the solvency of schemes was assessed by reference to a more costly basis.

Mr Michael Pomery presented the case for a liability-led approach. The deferred pensioner has a right to be risk averse, and preserved benefits should thus be discounted at a rate based on the gilt yield, which represents the risk-free rate of return that can be achieved on the fund. Otherwise, the member is in the inequitable position of bearing the risk of investing in equities, while the employer reaps the reward of the risk premium (as assessed by the efficient United Kingdom equity market) through the lower cost of providing the guaranteed benefit. The actuary has a duty to the pension scheme member as well as to the employer, and should not be led by the employer to reduce the costs of the scheme at the member's expense. An actuary who attempts to pay out less than the value of the preserved benefit upon transfer, on the ground that a transfer value is only an option, is attempting to thwart the preservation legislation.

THE WORKSHOP SESSIONS

After the case presentations, the actuaries attended workshops to consider the GN11 issues. The seminar concluded with reports from those sessions.

The majority of actuaries favoured the liability-led approach to GN11. The disadvantages of using equity-based yields cited were: less uniformity; anomalies, i.e. lower transfer values for strongly-funded schemes which were justifiably assuming more risk by investing more heavily in equities; volatility effects on one to three month transfer value guarantees; and the adverse effect on the profession's image if actuaries advocated a change from gilts to equity returns now only to reduce transfer values.

The considerable number of actuaries that did favour the investment-led approach to GN11 recommended the use of a discount rate that reflects the scheme's investment policy excluding short-term investment tactics. These actuaries disputed the role of the actuary as watchdog for the member. A market level adjustment that moved more in sympathy with the scheme's overall funding was welcomed, as opposed to the current gilt approach.

Actuaries agreed that the credibility of the profession may be at risk with different definitions of cash equivalent for transfer values (GN11), a minimum solvency standard, debt on the employer (GN19), the actuary's report (GN9, paragraph 3.1.9) and spouse benefits upon divorce.

Approximately half of the workshop groups supported only one measure of cash equivalent for all purposes as in the best interests of the public image of the profession. Opinion was evenly divided on whether or not to adjust cash equivalents for underfunding and the investment position of the scheme. Actuaries supporting the use of unreduced cash equivalents argued that a scheme should not be underfunded and that deficiencies could be rectified over a number of years. If the minimum solvency standard reflected the asset mix of the scheme, the minimum solvency level could increase when an ongoing scheme is wound up and the asset mix is changed from equities to gilts. This could impugn public opinion. One beneficial side effect to this approach is support for the view that the employer is entitled to surplus. Most actuaries felt that the minimum solvency standard should reflect the size and circumstances of the scheme on discontinuance.

The rest of the workshops supported the position that the GN11 basis was appropriate for transfer values and spouse's benefits on divorce, but that a different basis was required for valuations on a collective basis. Affordability was the major concern if minimum solvency levels are determined on a more costly gilt basis. Since funding margins are tight on a cash-equivalent basis, investment decisions could also be affected with the resultant impact on asset mix. Efforts to match assets and liabilities would result in distortions to the gilt market. The diversion of more assets to pension schemes was considered undesirable. Scope for variation in GN11 was considered unacceptable for a minimum solvency standard. The collective approach to GN19 discourages trustees from shopping for the highest solvency quote.

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