

Technical Briefing

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New transfer value legislation

A transfer value (CETV) in respect of defined benefits is calculated on actuarial principles as the capital sum which, if invested appropriately in the scheme, is expected to provide the relevant member's benefits as they fall due. The calculation requires assumptions to be made about many factors including future investment returns, mortality rates, inflation rates and the relative age of any dependant(s).

With effect from 1 October 2008, it becomes the responsibility of trustees, rather than the Scheme Actuary, to determine the method and assumptions used to calculate CETVs. This new legislation was issued in the second half of 2007 for consultation and has recently been finalised. The Pensions Regulator issued draft guidance for consultation with the consultation period ending on 19 September 2008, such that formal guidance is expected around the time of the effective date of the legislation.

The main principle behind the change in the new legislation is that the CETV should be the best estimate of the cash required to be invested in the scheme to reproduce the relevant member's benefits.

Trustees must confirm the basis to be used by their actuary before any CETVs can be quoted after 1 October 2008.

The key policy points contained in the regulations are:

- Trustees of pension schemes will be responsible for calculating CETVs. This approach is consistent with the government's general trend of placing responsibility for bases on the trustees directly.
- The method of calculation in the regulations sets a minimum amount for CETVs – trustees can choose to pay more than this minimum.
- The assumptions to be used in calculations should be on a "best estimate" basis.

- The amount of CETV can still be reduced where the scheme is underfunded.
- Reasonable administrative costs which are incurred in carrying out the transfer can be recovered by the trustees.
- Members considering whether to transfer will be told where more information is available to help them make their decision.

Regulatory guidance

The draft guidance from the Pensions Regulator (which is currently still in the consultation phase) is summarised below.

"Best estimate" basis

- Benefit options (e.g. cash commutation at retirement or early retirement without consent) can be allowed for in calculating the CETV only if it increases the value.
- Discretionary benefits (e.g. pension increases above the minimum required by the trust deed and rules) can be allowed for in calculating the CETV. In deciding on whether to allow for discretionary benefits, the trustees must have regard to any established custom for granting such benefits and any consent required (particularly employer consent).
- Trustees must seek advice from an actuary when deciding on the assumptions to use and discuss:
 1. Whether a particular assumption is likely to be influenced by specific scheme factors (e.g. the industry the members are employed in).
 2. Whether the scheme membership should be subdivided into different groups with separate assumptions.
 3. External data and observed trends – e.g. observed improvements in mortality and how this will develop in the future.
 4. Whether the scheme's past experience should have an impact on the assumptions.





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Investment strategy – when setting the discount rate, the trustees must have regard to how the assets are invested and discuss with the actuary the relevance of the funding plan (as set out in the Statement of Funding Principles).

Evidence base – decisions made in respect of assumptions should be objective and based on facts about the past and opinions by recognised experts on the future.

Technical provisions – the CETV basis should be consistent with the ongoing valuation basis, but with margins for prudence stripped out. The ongoing basis is required to err on the side of caution whereas the CETV basis should be realistic.

Reviewing assumptions – the basis should be reviewed on a regular basis (e.g. when an actuarial valuation is done) or if there are significant changes to the scheme. These changes would include a change to the scheme's investment strategy.

Alternative CETV – The trustees are allowed by legislation to pay CETVs greater than the realistic value.

Reducing CETV

- As before, a CETV can be reduced to reflect the scheme's funding position. An "insufficiency report" must be prepared by the Scheme Actuary before any reductions can be applied. This report doesn't oblige the trustees to reduce CETVs, but allows them to do so.
- If the sponsor covenant is strong and the recovery period is short, the trustees may take the view that CETVs should not be reduced. Trustees should ask their actuary about the implications of not reducing CETVs.
- In certain circumstance, the trustees can adopt the current GN11 report as an insufficiency report.
- In setting the priority order, the scheme actuary can choose an appropriate method after discussions with the trustees.

cprm Commentary

In essence, the new legislation for calculating CETVs has not changed significantly. Different terminology is used, but the basis will be determined in a similar manner to the previous CETV basis. The biggest change is where the responsibility lies for determining the basis and consequently where guidance for determining the basis comes from. This used to be the Scheme Actuary and the actuarial profession, but has changed to the trustees and the Pensions Regulator respectively.

GN11 reports and transfer value bases determined historically by cprm have been on a scheme specific basis and are linked to current market yields. This ties in with the new legislation and guidance and we therefore do not expect major changes to our current approach. For some schemes, trustees may be able to adopt their current basis under the new legislation. Where a basis is due for review, a report can be prepared following the issue of the finalised guidance.

Where the trustees believe it is appropriate to reduce CETVs, an insufficiency report is required. In some circumstances the latest GN11 report can be adopted as an insufficiency report. Trustees should discuss the most suitable approach for their scheme with their Scheme Actuary.

Trustees for each individual scheme will need to consider their CETV basis and implement a strategy prior to 1 October 2008. In effect however there is a 3 month period within which bases need to be agreed, the statutory period for quoting a member a CETV request being 3 months. Complete regulatory guidance (currently in draft) can be found on the Pensions Regulator's website at <http://www.thepensionsregulator.gov.uk/>.