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Private & Confidential
Erhan Kalyon
Pensions Regulator
Napier House
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Dear Sirs

Guidance on Calculation of Cash Equivalent Transfer Values

I am writing on behalf of the Association of Consulting Actuaries (ACA) with our comments on your consultation on Transfer Value Guidance.

Members of the Association are all qualified actuaries and are subject to the code of professional conduct of the Faculty and the Institute of Actuaries. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the vast majority of members of defined benefit pension schemes.

The ACA is the representative body for consulting actuaries, whilst the Faculty and Institute of Actuaries are the professional bodies.

Timing and status of guidance
In general, we found the guidance to be clear and constructive. It carries over many of the helpful elements of the actuarial guidance note of GN11.

This is just as well, as pension schemes will have next to no time to implement the guidance before the 1 October effective date for legislation. When regulations on transfer values were being revised last year, we warned that schemes would need 6 clear months between issuing final rules/guidance and their implementation date, to allow time for scheme-specific advice to be given and system changes implemented. We ask that the Regulator allows schemes to take up to 6 months before fully taking this guidance into account, where it supplements the requirements of transfer value regulations.

It would also help the reader if the guidance included an explanation of the status of the guidance (less prescriptive than a Code of Practice, we assume), and the consequences if trustees do not follow the guidance.

We think it is entirely proper for the Regulator to set out factors to which trustees should give serious consideration when deciding on a transfer basis. We are less happy when the Regulator says that trustees ‘should’ or ‘will normally’ or ‘will usually’ take a particular course of action where the regulations themselves allow them flexibility over their decision.

Transfer value regulations

Our main comments relate to aspects of the transfer value regulations. We appreciate that some of these comments to a greater or lesser extent reflect the wording of the regulations and therefore it may not be possible for you to change these as things stand, but in such cases would be grateful if you would bring this to the attention of the appropriate people at the Department for Work and Pensions. The comments relate to the following:

- We have noticed that the new draft guidance includes an interpretation which goes further than the specific requirements of the regulations. This approach to legislation troubles us. The Regulator has, quite rightly in our view, refused to give interpretations in the past that go further than the legislation in other areas of pension scheme operation. If the legislation is not specific enough, this should be a matter for DWP to make amendment to the legislation, not for the Regulator to issue his own interpretation.
- The interpretation referred to above is in relation to options, where the regulations are not clear as to whether allowance can be made for options that would decrease the value of benefits to the member, but the Regulator has drafted the guidance on the basis that such an allowance is not permissible. Moreover, in paragraph 13 a definitive statement to this effect is made without any comment that this is interpretation by the Regulator (unlike in the preamble to the document). In any event, we do not see why options should only be taken into account if they increase the transfer values. In particular, the tax treatment of cash commutation can mean that it is entirely logical for pension scheme members to take cash, which is tax-free, even if this involves commutation factors at a lower rate than the best estimate of the cost of pension to the scheme. Where there is evidence that a large proportion of members opt for a lower cost option, our view is that the trustees should be permitted to allow for this. Such an allowance will often be made – quite properly – in a ‘prudent’ funding basis and it seems perverse for it not to be allowed in a ‘best estimate’ basis, particularly bearing in mind the Regulator’s view expressed in paragraph 24.
- We are concerned that the Trustees appear to have the power unilaterally to decide to pay transfer values in excess of the normal calculations, as well as to decide what allowance to make for discretionary benefits which are subject to employer consent. (We acknowledge that the regulations contain a rather weak provision to “have regard to any requirement for consent” from the employer first.) There are enough disincentives for employers to run defined benefit pension schemes, without setting up an additional arrangement whereby trustees can impose additional costs on the employer. In our view, the relevant piece of legislation should be removed. If this is not possible, the transfer value guidance should make clear that a unilateral increase is not normally appropriate, and that the trustees would have to have extremely good reasons for granting such an increase if it was opposed by the employer. The preamble to the document suggests that, in relation to

discretionary benefits, the trustees should consult the employer, but the wording in the actual draft guidance (paragraph 16) is much vaguer, merely saying “may wish to consult”.

Areas where the Regulator is seeking views

On pages 3 and 4 of the draft guidance, the Regulator has set out issues on which it welcomes views. With the exception of the interpretive statement on legislation and the approach to valuing options, and subject to the comment above on consulting the employer on discretionary benefits, we are happy with the approach that has been adopted in relation to all the issues listed on pages 3 and 4.

Demographic actuarial assumptions

The descriptions of demographic actuarial assumptions suggest an approach that takes into account the specific circumstances of each individual member to a greater extent than has commonly applied in the past. For example:

- There is a suggestion in paragraph 20 that it may be appropriate to use different mortality assumptions for different groups of members;
- Paragraph 57 suggests that the marital/civil partnership status of the member could be taken into account in transfers-in. (In this case, we cannot see why this would not also be appropriate for transfers out, although the point is not mentioned in paragraph 20.)

In our view, trustees should not be required to go to this level of detail, but should, if they wish, be able to adopt an approach that is appropriate to the membership as a whole, and we would like the guidance to make this clearer.

Along similar lines, we are aware that some trustees have adopted unisex transfer calculations, usually on the grounds of concerns that sex-specific factors may be considered to be illegal in the European Court of Justice at some stage. Again, we suggest that the guidance makes clear that this is permitted.

Public Sector Transfer Club

The guidance does not address the arrangements under the Public Sector Transfer Club. We understand that the Club is continuing to operate. A Club transfer value may be lower than the amount that the trustees consider to the best estimate cost of benefits, and in these circumstances paragraph 8 of Schedule 1 of the transfer value regulations requires the lower Club transfer value to be paid. Alternatively the Club transfer value may be higher than the best estimate cost of benefits, in which case the trustees will be paying the transfer value under the alternative method of calculation and need to go through the appropriate process to satisfy themselves that this is appropriate. It would be helpful for the guidance to document this.

Benefits on transfer in

Paragraph 54 mentions added year and money purchase benefits on transfer in. We suggest extending the wording to mention the third form of benefits typically provided, namely a fixed amount of pension. There are no special considerations needed for these, but it is worth mentioning them for completeness.

Transfer out after transfer in
The guidance mentions the common practice of basing a transfer out after transfer in on the original transfer, adjusted for investment returns. This approach was consistent with GN11 requirements, hence was in effect enshrined in the old legislation. Now however it appears to us that it can only be justified under the regulations that permit the alternative basis for calculating transfer values, and we suggest that this should be mentioned in paragraph 61.

Directors' pensions

We note that there does not seem to have been any move to change the rules for calculating the figures in connection with the disclosure of directors' benefit entitlements, and in particular that they continue to refer to GN11. We ask the Regulator to get in touch with the Department for Business, Enterprise and Regulatory Reform to suggest that they change this. One of our member firms has already done this, but with no effect to date.

Transfer value reductions
Calculating transfer value reductions that explicitly incorporate the PPF priority order is complex, and may be unnecessarily so. We suggest that the last sentence of paragraph 46 is changed to state:

"This should be borne in mind when setting a reduction structure, to reduce the possibility that certain categories of member could take a transfer which significantly exceeds the amount that would be allocated to them on winding up the scheme, to the detriment of other scheme members."

Market-related values
Paragraph 29 states that trustees "may decide to incorporate some form of market yield based adjustment into the calculation" of transfer values. Our view is that this ought to be the norm rather than just a possibility, and the guidance should reflect this. We suggest that the first sentence in the paragraph should read:

"Trustees should normally incorporate some form of reference to current market indices or other indicators into the calculation of the ICE, where this is necessary to maintain the best estimate level in the face of normal market movements."

Evidence base
We feel that paragraph 23 encourages detailed investigation of all actuarial assumptions, even in relation to areas that are unlikely to have a material effect on the resulting values. We suggest two changes to the paragraph:

- The first sentence should be extended to say "…in relation to matters that will have a material effect on transfer values".
- Replace the fourth bullet with "Published statistics on demographic issues"

Finally, we note that the word “insufficiently” in the last line of paragraph 38 should read “insufficiency”.

If you have any queries about this letter please do not hesitate to contact me on 020 7082 6228.

Yours sincerely

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