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Mr Mike Rochford  
Department for Work and Pensions  
3rd Floor  
Adelphi  
1-11 John Adam Street  
London WC2N 6HT

15th August 2006

Dear Mr Rochford

### **Consultation on Approaches to the Calculation of Pensions Transfer Values**

I am writing on behalf of the Association of Consulting Actuaries in response to the consultation document issued by the Department for Work and Pensions dated June 2006. I apologise for missing the deadline by a few days.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. 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 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.

Our key comments are as follows:

- We are pleased that the Government has recognised that what a transfer value is supposed to represent is a matter for public policy.
- Particularly given all the protections now available to members compared to in 1986, we do not believe that members of defined benefit schemes need to have a statutory right to transfer values. We are yet to be convinced of the arguments set out in the document in relation to the Human Rights Act 1998, and the Government may be able to ensure that the prospective EU Portability Directive does not inhibit its options in this area.

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- Assuming that the statutory right remains, we have obtained the opinions of ACA members through our own survey about the approach that should be taken in relation to the calculation of statutory transfer values. A significant majority of members believes Government policy should be based on the expected cost of benefits to the scheme and is in favour of a scheme-specific approach to the calculation of statutory minimum transfer values, with most of these advocating best estimate assumptions without additions for prudence as required in technical provisions. It is fair to say that there is a sizeable minority who are split in favour of various other approaches.
- Reductions for under funding should be permitted whichever approach is selected.
- The information regime to members should be strengthened.
- Legislation should set out the principles clearly. Technical guidance can then build on this.
- The regime for divorce calculations should be reviewed separately.

Further comments and answers to the specific questions in the consultation document are set out in Appendix 1 to this letter.

We summarise in Appendix 2 the results of the survey of the ACA's membership, carried out over the last two weeks, referred to above. You may find this helpful.

The consultation document lists those bodies that are being consulted. We believe this should be exposed to wider consultation still, particular among employers, and consumer and trustee representatives before adoption.

Yours sincerely



**David Everett**  
**Acting Chairman**  
**Pension Scheme Committee of the Association of Consulting Actuaries**

### Appendix 1

We have set out in this Appendix our comments on the specific questions set out in the consultation document.

*Question 1 – Are there any other key stakeholders whose interests need to be addressed?*

Users of company accounts (in respect of disclosure of directors' remuneration) and ex-spouses on divorce (in relation to pension sharing on divorce).

*Question 2 – What is your view about the legal rights of a member wanting to transfer out of a pension scheme?*

We are unable to comment on this point, except to say that we do not find the arguments relating to the impact of the Human Rights Act 1998 on legal rights to transfer benefits to be convincing. In our view and bearing in mind the Government's stated wish to de-regulate, we do not believe that members of defined benefit schemes should have a statutory right to a transfer. That is not to say that schemes would not offer transfers if they so wish. Where they do they should be able to benefit from the statutory discharge where they follow the existing specified processes.

The statutory right to transfer should continue for defined contribution schemes (to prevent members from being locked in to investment vehicles they feel are inappropriate to their circumstances) and be extended so that an individual with benefits from a mixed arrangement is able to take a partial transfer – e.g. of his defined contribution benefits whilst not being forced to also transfer his defined benefits.

*Question 3 – Your views are sought on whether it would be reasonable to have a separate set of assumptions for the calculation of transfer values, and if so, the principles underpinning the choice of those assumptions.*

Assuming that the legislation sets out a basis for minimum transfer values, we believe that this minimum should be determined on the expected cost to the scheme of providing the deferred benefits. This would mean that the basis would reflect the scheme's likely investment policy to meet the benefits for the member, the mortality expected to be experienced and would need to vary with investment market conditions. It is then for individual schemes to decide whether to pay a higher level of transfer values, such as that calculated using the scheme funding basis or another basis.

We believe that the principles should be set out clearly in the legislation. Technical guidance can then build on this platform.

We believe that the position on divorce needs separate review. We do not believe that the use of the cash equivalent basis has necessarily worked as was desired, whether or not an actual transfer payment is made in relation to an ex-spouse.

*Question 4 – Do you consider it right that private sector schemes should continue to be able to reduce transfer values because of underfunding and that the payment of a transfer value should discharge the scheme of all further liabilities for the transferring member?*

Yes and Yes.

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*Question 5 – To what extent do you think that any new rules should define the rights of all those involved in the scheme?*

We are not sure what this question means in this context. Does it mean for example that employers or trustees might have the right to block transfers in certain circumstances?

*Question 6 – Do you consider that the existence of the PPF should be factored into the calculation of transfer values and, if so, in what circumstances?*

The PPF is compensation payable from outside the scheme to members, conditional on company insolvency and scheme underfunding. The transfer value should take account only of benefits that are payable from the transferring scheme.

The PPF is an important consideration for the member when considering the risks of retaining his benefits in the scheme. The member should be provided with sufficient information about the PPF to enable him to make an informed decision as to whether to transfer.

*Question 7 – Views are sought on how best to provide information to individuals and on the possibility of restricting valuations to a three year cycle.*

We agree this area needs to be strengthened. Information should be sufficient for the member to understand the benefits he is likely to receive from the transferring scheme if he retains benefits there, and risks to them, including:

- statement of amount of and description of benefits to member and contingently to dependants;
- an explanation that, in the event of company insolvency, members should receive at least the benefits provided by the PPF and brief details of what these are;
- if the company remains solvent, members may expect to receive their benefit entitlement in full; and
- a reminder that information on the scheme's position is included in the summary funding statement.

Much of this would be provided in the leaver's statement and so need not be repeated at the time of transfer.

On the receiving side, information should be sufficient for the member to understand the benefits he is likely to receive from the receiving arrangement if he transfers benefits there, and risks attaching to them, including:

- transfer credits provided on a defined benefit basis – statement of amount of and description of benefits to member and contingently to dependants
- transfers credits on a defined contribution basis – provide an illustration using the scheme's most recent Statutory Money Purchase Illustration basis (SMPI) to illustrate the possible level of benefits that the member might receive at retirement, or FSA basis for a personal pension/stakeholder.

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It should be borne in mind that the member might have reasons to transfer benefits other than purely financial, for example to tidy up benefits in different arrangements; or there might be different investment options (for example a Self Invested Personal Pension); he might have no need for dependant's benefits or pension increases; and so on. It might be helpful if the Regulator could put together a leaflet for individuals setting out the issues a member should consider.

We would welcome any change to the legislation which would reduce the number of transfer value quotations which are produced unnecessarily by schemes. However, we do not agree with restricting the provision of transfer values to every three years.

### *Other matters*

The consultation document states that the same principles will have to apply to public sector schemes as those used in private sector schemes. The principle of 'expected cost to the scheme' will need to be interpreted differently in unfunded schemes.

The Government should take the opportunity to simplify and clarify related legislation, including the legislation on partial transfers and on GMP equalisation.

## **Appendix 2 – Summary of a survey of the ACA’s membership**

There were 281 responses collected to a survey between 26 July 2006 and 4 August 2006 of individual members of the ACA. 96% of respondents work in pensions.

### **Government policy on statutory transfer values**

Government policy should be based on:

- expected cost of the benefits to the scheme - 211 (77% of those voting)
- the value of the benefits to the member - 62 (23%)

### **Approach to calculation of transfer values**

<b>Approach</b>	<b>First preferences</b>	<b>All preferences</b>
Prescribed assumptions (on expected cost of the benefits as proposed by the DWP)	10%	13%
Scheme-specific basis - best estimate assumptions	59%	43%
Scheme-specific basis - technical provisions	11%	19%
EXD54 approach - bond discount rate, taking into account strength of employer covenant and PPF compensation	4%	4%
EXD54 - gilt discount rate	3%	3%
FRS17 (which is broadly equivalent to EXD54 using a AA corporate bond discount rate)	6%	11%
Section 179 valuation of PPF element plus AA corporate bond discount rate on excess benefits	2%	3%
Other	5%	4%

Members were invited to give second and third preferences. The “All preferences” results above have been determined by giving 3 points to preference 1, 2 points to preference 2 and 1 point to preference 3.