

New Transfer Value Regulations

Barnett Waddingham

New regulations governing the calculation of 'cash equivalent' transfer values come into effect on 1 October 2008. From this date, pension scheme trustees will be responsible for setting the assumptions used to calculate transfer values.

Background

Under current legislation, transfer values must be calculated in accordance with actuarial guidance ('GN11'). It is the responsibility of the Scheme Actuary to determine the assumptions underlying transfer calculations.

From 1 October 2008, GN11 will no longer apply and the framework for transfer value calculations will instead be set out in regulations (as amended by the *Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008*). Although the main principles of GN11 have been transposed into the regulations, it will now be the responsibility of trustees to set the assumptions.

The Pensions Regulator has issued draft guidance for Trustees, available on their website (www.thepensionsregulator.gov.uk). We expect the guidance to be finalised before 1 October 2008.

Transfer Value Calculations

Trustees must set a calculation basis according to the following principles:

- actuarial advice should be sought when choosing assumptions
- demographic assumptions (eg in relation to members' longevity) should be chosen based on scheme experience or published tables, whichever is appropriate
- discount rates should take into account the scheme's investment strategy and expected returns
- the assumptions as a whole (not necessarily individually) should lead to at least the "best estimate" of the cash equivalent of the member's accrued benefits

- trustees must consider the extent to which allowance should be made for any options exercisable by the members where these increase the value of the benefits (eg early retirements if there are favourable terms) and any discretionary increases in benefits

Reviewing Assumptions

The assumptions should be kept under review. It would normally be reasonable to review the assumptions at the same time as making any changes to the scheme's Statement of Funding Principles, usually as part of the triennial actuarial valuation.

However, an earlier review should be carried out if the assumptions are no longer regarded as 'best estimate'. The trustees should instruct their actuary to alert them when this appears likely to be the case.

Reducing transfer values

Trustees will still be able to reduce transfer values if the scheme does not have sufficient assets to pay all transfer values in full. Under the new regime, this will only be possible if an 'insufficiency report' has been prepared by the Scheme Actuary. The report would normally (but not necessarily) be prepared alongside a scheme funding valuation.

The Regulator expects trustees to take the sponsoring company's financial strength ("covenant") and length of any Recovery Plan into account when deciding whether to reduce transfer values.

Disclosure requirements

When issuing transfer quotations, trustees must tell members that help is available from the Financial Services Authority and the Pensions Advisory Service. Members will also be able to read guidance prepared by the Pensions Regulator (expected shortly) which will help them compare the potential risks and advantages in transferring.

Trustees must also recommend that the member seeks independent financial advice.

The Regulator's guidance suggests that it would be 'good practice' to disclose the assumptions underlying the calculations to the member.

Other considerations

The chosen assumptions for 'cash-equivalent' transfer values will also have an impact on the award of transfer-in credits (where a scheme accepts transfers in) and values for divorce proceedings.

Schemes which regularly receive transfer requests from members should start preparing to take over responsibility for setting transfer value assumptions now. As well as deciding on a best estimate transfer basis, trustees should check that all the required disclosures are covered by their transfer quote documents.

When choosing their 'best estimate' assumptions, trustees might find it useful to consider their scheme funding basis. Under scheme funding legislation the assumptions used in calculating Technical Provisions must be 'prudent'. Where quantifiable margins for prudence have been included in scheme funding, stripping these out might be a good starting point in deciding what determines a 'best estimate'.

The Regulator's guidance states that there should be consistency between the transfer value assumptions and scheme funding assumptions.

If you have any questions or need advice in relation to the new regulations, please speak to your usual Barnett Waddingham consultant.

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