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sackers extra

DRAFT REGULATIONS – TOUR DE TRANSFERS

1 INTRODUCTION

Like an alpine stage, the road to new law on pension transfers has often seemed like a long climb with no end in sight. But after a two year cycle, the "peloton" is finally freewheeling towards the finish line with the publication of a consultation paper on "Approaches to the Calculation of Pensions Transfer Values" on 6 July 2007.

The wheels of change were initially set in motion back in May 2005 when the Actuarial Profession published Exposure Draft 54. As a direct result of that consultation, the Government decided to reconsider the legislative framework for cash equivalent transfer values (CETVs). This was followed by the Government's initial consultation in June 2006 and the publication of its response in January 2007 (the Response).[1]

This latest consultation paper attaches a set of draft Regulations as well as including a detailed analysis of how the new structure derives from the existing actuarial guidance note on transfer values (GN11). Consultation on the Regulations closes on 17 August 2007.

2 KEY POINTS

- The new law is likely to come into force on 6 April 2008, subject to transitional arrangements.
- Government policy is that CETVs will be dealt with on a scheme specific basis, with assumptions set by the trustees. Trustees can reduce CETVs if there is an "insufficiency report" in place.
- The requirements of GN11 will be transposed into legislation and there are currently no plans for an actuarial guidance note going forward.

[1] See our Sackers Extra Alert: "Transfer News: Trustees to take charge" dated 19 January 2007

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3 GOVERNMENT POLICY

The key message from Government in the Response was that (in line with the majority of the consultation responses) CETVs would be dealt with on a scheme specific basis.

This is because the Government considers that calculating transfer values in a way which reflects the cost to the scheme of the transferring member remaining in the scheme until retirement promotes fairness as between the remaining members and those transferring.

4 A BRIEF TOUR OF THE NEW PROVISIONS

Basic Principles

We expect the Regulations to come into force on 6 April 2008, given a smooth ride. On implementation, the yellow jersey is being transferred to pension scheme trustees who will become responsible for calculating their scheme's CETVs.

The draft Regulations do not set out how the component parts of the CETV are to be calculated, including any allowance for discretionary benefits. This will need to be decided by the trustees, after consulting the actuary. But the draft Regulations are intended to define a minimum level for CETVs (although trustees can always pay a higher amount if appropriate).

The assumptions used must be calculated by reference to a "best estimate" assessment of the cost to the scheme of providing the alternative deferred benefit. There is no requirement for trustees to disclose these assumptions as the Government considers that this would be an extra burden, but "it would be good practice for schemes to provide this information on request".

Some respondents argued that, in order to mirror the scheme funding provisions, the employer ought to be required to agree the assumptions. However, the Government has decided that "the best way forward is to

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allow the trustees to decide the assumptions and, in doing so, to balance the interests of the various groups in the scheme".

Tweaks allowed

The trustees will be required to use a discount rate in the calculation of transfer values which reflects a "best estimate" of future returns, having regard to their scheme's existing asset mix.[2] CETVs may also be reduced to reflect any "reasonable administration cost incurred by the scheme" in relation to the transfer.

5 "INSUFFICIENCY REPORT"

The insufficiency report is the equivalent of the actuary's GN11 report and is the method by which CETVs may be reduced to reflect underfunding. Therefore, trustees can only reduce a CETV if there is an insufficiency report in place. An insufficiency report will normally be obtained at the same time as an actuarial valuation.

But as part of the transitional arrangements the Regulations provide that, in order to "minimise costs to schemes", GN11 reports existing at 6 April 2008 can continue to be used until ("in the normal course of business") new insufficiency reports are prepared.

The requirements of the insufficiency report broadly replicate the current GN11, with certain exceptions. For example:

- Market value – whilst GN11 states that the assets are to be valued on the market basis or such higher amount as the actuary determines, the insufficiency report requires the use of market value only.

- Winding-up expenses – an allowance may be made for winding-up expenses, but only where the scheme is actually in wind-up.

[2] Many public service pension schemes will be required to use the methodology for calculating discount rates set out in Treasury guidance

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6 ADDITIONAL DETAIL

The draft Regulations now include all the detail on calculating CETVs. There are no plans for an actuarial guidance note to ride in tandem with the legislation, as in the past.

Disclosure Requirements

Statements of entitlement are the key disclosure requirement under the Regulations. However, the draft Regulations also introduce new requirements for "greater disclosure" to members considering transferring out. (These seem designed to address mounting concerns over members being offered inducements (or incentives) to transfer.)[3] Trustees will have to:

- inform members that both the Financial Services Authority and the Pensions Regulator "provide information about transfers that may assist [them] in deciding whether to transfer";
- in relation to a scheme which may be eligible for the Pension Protection Fund, notify members of its existence;
- advise members "to consider taking financial advice".

The Department for Work and Pensions' "Deregulatory Review of Private Pensions" is also looking generally at disclosure of information to members.[4] So, watch this space!

Time Trials

The draft Regulations now recognise that there may be reasons other than the failure to obtain information which prevent calculation of a CETV within 3 months. The period can now be extended to 6 months where "for any reason beyond their control" the trustees are unable to complete the calculation.

[3] See our Sackers Extra Alert: "Inducements – TPR Guidance published" dated 25 January 2007
[4] See our Sackers Extra Alert: "The Two Reviews – double trouble from the DWP?" dated 21 March 2007

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Consequential Amendments

The same principles will apply in calculating CETVs in the context of pension sharing on divorce (or the dissolution of civil partnerships). But the Government notes in the Impact Assessment, which accompanies the consultation paper, that "the concerns expressed about the use of the methodology in pension sharing have been noted and will be given separate consideration".

The Early Leavers Regulations[5] (which apply to members who leave a scheme with at least three months' pensionable service, but who have not become entitled to vested benefits) are also in line for changes. Such members have to be given a choice between a cash transfer sum or a contribution refund (and time to make their decision). The Early Leavers Regulations are currently drafted on the basis that the cash transfer sum is calculated at the date the member leaves pensionable service, which can cause problems for defined contribution schemes. The draft Regulations will make changes so that the cash transfer sum is assessed on the date assets are disinvested.

7 TRANSFERS IN?

Bear in mind that the new provisions apply to transfers out only, not transfers in. However, the consultation paper does say that:

> "where there are differences between incoming and outgoing transfers, the Government would expect that these were brought to the attention of any person wanting to transfer into the scheme".

[5] See our Sackers Extra Alert: "New Rights for Early Leavers" dated 22 March 2006

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