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COUNTDOWN TO THE NEW TRANSFER VALUE REGULATIONS

1 INTRODUCTION

Time is ticking! As many trustees are already keenly aware, there are now only two months to go before revised transfer value legislation finally becomes law on 1 October 2008. The lengthy consultation process started as long ago as May 2005 when the Actuarial Profession first published proposals for a major revision of their guidance note on transfers (GN11).¹

Amendments to The Occupational Pension Schemes (Transfer Values) Regulations 1996² provide for cash equivalent transfer values (CETVs) to continue to be based on the expected cost to the scheme of providing members' benefits. However, calculations will need to be done on a scheme specific basis, with trustees required to determine the assumptions.

The amendments affect both defined benefit and defined contribution arrangements, but the greatest impact is on the former.

2 KEY POINTS

- The most significant change is that the responsibility for calculating and verifying CETVs is transferred to trustees.
- Trustees (on actuarial advice) will need to determine the economic, financial and demographic assumptions to be used.
- There are no transitional provisions, so trustees need to decide in advance what to do about applications for CETVs received in the run-up to 1 October 2008.
- The revised requirements do not apply to non-statutory transfers or to incoming transfers.

¹ See our Sackers Extra Alerts: "Transfer News – Trustees to take charge" (19 January 2007) and "Draft Regulations – Tour de Transfers" (12 July 2007)

² As amended by The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008 ("the Amendment Regulations")

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3 THE TRANSFER PROCESS

Early leavers with at least two years' qualifying service³ have a right to a deferred pension in the scheme ("vesting") or to take a CETV. Those with at least three months' qualifying service (up to two years) are entitled to a cash transfer sum (calculated in a similar way to a CETV⁴) or to a contribution refund.

The CETV process remains broadly unchanged by the Amendment Regulations, with strict time limits for the provision of a statement of entitlement and application of the CETV.

Following a member's request⁵, trustees must provide a statement of entitlement to a CETV within three months. Trustees will be able to extend this period to six months where they are unable to provide the statement of entitlement for any reasons beyond their control (currently, an extension is only permitted in circumstances connected with obtaining information).

The statement of entitlement will include a "guarantee date" which is within three months (or up to six months if the period is extended) of the member's application. Members then have three months from the guarantee date to inform the trustees how they would like their CETV to be used. Having received such a request, if the CETV is then not applied within six months of the guarantee date, the trustees will need to recalculate it or add interest.

³ And also someone who has transferred benefits from a personal pension scheme

⁴ The rules for calculating and verifying cash transfer sums are also set to change to ensure consistency with the new rules for calculating and verifying CETVs

⁵ Members are generally limited to one request in a 12 month period

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4 THE INITIAL CASH EQUIVALENT (ICE)

Calculating the CETV starts with the ICE. This is a new concept and effectively requires trustees to calculate the minimum CETV before any permitted deductions are made (see section 6 below). ICE calculations for salary related benefits⁶ need to be done on a scheme specific basis, based on a best estimate of the anticipated cost to the scheme of providing the alternative deferred pension benefits.

Having taken actuarial advice, trustees will need to determine the economic, financial and demographic assumptions. The individual assumptions do not each need to be best estimates, but should be determined in such a way that they lead to an overall best estimate of the ICE.

In deciding the demographic assumptions, trustees must take into account the main characteristics of the members of the scheme. If the scheme's membership is too small to allow demographic assumptions to be made, the trustees must consider "the characteristics of a wider population sharing similar characteristics to the members". Trustees will also need to have regard to the scheme's investment strategy when deciding what assumptions will be included in calculating the discount rates⁷ in respect of the member.

Subject to possible consent requirements, as an alternative, trustees may provide higher CETVs than the required minimum. If this route is chosen, the trustees will determine the method for calculation and verification.

⁶ The ICE for money purchase benefits is the realisable value of the member's benefits

⁷ The interest rates "used to discount future payments of benefit for the purposes of placing a current value on them"

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5 OPTIONS AND DISCRETIONARY BENEFITS

In determining the ICE, trustees must factor in:

- any options that members have which would increase the value of their benefits (options which would reduce benefits are not included);
- any adjustments to be made to reflect the proportion of members likely to exercise those options; and
- the extent to which “any discretionary benefits should be taken into account, having regard to any established custom for awarding them and any requirement for consent before they are awarded”.

6 REDUCING AN ICE

An ICE may be reduced⁸, for example, if the scheme is underfunded or begins to wind-up.

To do this, trustees will need to obtain an “insufficiency report” with an effective date not earlier than the effective date of the most recent actuarial valuation. For schemes which have not yet completed a scheme funding valuation but which have a relevant GN11 report, this can be used as an insufficiency report until the first scheme funding valuation has been carried out and an insufficiency report prepared.

⁸ For schemes which are subject to the scheme funding requirements of the Pensions Act 2004

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The Insufficiency Report

The insufficiency report is the equivalent of the actuary's GN11 report and must contain:

- a comparison at the effective date of the "insufficiency report liabilities" of all members (for active members with vested rights, these are essentially their ICEs) and the market value of the assets of the scheme; and
- a statement of the amount deducted from the assets (if any) to allow for winding-up expenses.

Where the scheme funding requirements apply separately to segregated sections of a scheme, an insufficiency report will be required for each section.

7 DISCLOSURE

The disclosure requirements under the Amendment Regulations remain broadly as before. However, a member who is given a statement of entitlement also needs to be informed:

- that further information is available from the Financial Services Authority, the Pensions Regulator and the Pensions Advisory Service; and
- if applicable, of the existence of the Pension Protection Fund and that the scheme is an eligible scheme.

Trustees should also recommend that members take financial advice before transferring their benefits. The Pensions Regulator plans to publish guidance for scheme members to help them compare the key risks with any potential advantages associated with taking a transfer.

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8 WHAT SHOULD TRUSTEES BE DOING NOW?

Trustees need to consider their CETVs and discuss them with the scheme actuary so that they are ready for the changes when they come in. It is important that trustees start this process now (if they have not already done so) as the DWP decided not to introduce transitional provisions on the basis that these would, of necessity, be very complicated.

The DWP, in its April 2008 response to the consultation on the Amendment Regulations, suggested that in respect of applications received in August or September 2008, if trustees are confident that the statement of entitlement can be issued before 1 October 2008, the current GN11 methodology can be used (although trustees choosing this route should consider telling members that the transfer basis is under review). Trustees who do not consider this to be a viable option may wish to select a guarantee date in October, once the Amendment Regulations are in force (the DWP's response to consultation hinted at the possibility of trustees using their powers of extension in these circumstances).

Given the lack of transitional provisions, it is perhaps disappointing that intended guidance by the Pensions Regulator to assist trustees in understanding the different considerations and new requirements in relation to transfers has still not been published.