

**APPROACHES TO  
THE CALCULATION OF PENSIONS TRANSFER  
VALUES**

**RESPONSE TO THE CONSULTATION**

**JANUARY 2007**

**DWP** Department for  
Work and Pensions

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## Preface

On 27 June 2006, the Department issued the consultation document ***Approaches to the Calculation of Pensions Transfer Values***. The consultation ended on 11 August.

Sixty-nine responses were received. A list of the respondents is at **Annex A**. **The Government is very grateful to all who gave their time to take part in the consultation.**

This document has been sent to all who responded to the consultation, either in the form of a weblink or a paper copy.

This document is available on the Department's website at

<http://www.dwp.gov.uk/consultations/2006>

A paper copy of this document can be obtained from:

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# 1. GOVERNMENT PROPOSALS

1. This section of the response sets out the Government's proposals on the calculation of pensions transfer values and the arrangements for bringing them into effect. The next section reports back on the responses made in the consultation.

## **Announcement**

2. Having carefully considered all of the responses, the Government announced its decisions on 18 January, in a Written Statement to Parliament by James Purnell MP, Minister of State for Pensions Reform. The text of the Statement is as follows:

The Minister for Pensions Reform (Mr James Purnell): Last year we consulted on approaches to the calculation of pensions transfer values.

Members of defined benefit occupational pension schemes are usually best served by leaving their pension rights in the scheme when they change employment. Transfers are an option that members can exercise. But transfers should not jeopardise the success or sustainability of the pension scheme.

The great majority of respondents to the consultation favoured an approach to the calculation of pensions transfer values based on the expected cost to the scheme of providing the alternative deferred pension benefits. This approach is consistent with what happens now. It is also an approach which does not affect the ongoing viability of the scheme. The Government therefore intends to regulate on this basis.

The regulations will also provide that:

- the trustees of the pension scheme will be responsible for the determination of the actuarial assumptions used to calculate transfer values. They will be required to seek the advice of the actuary. This is consistent with the framework of responsibilities under the rules on scheme funding;
- the trustees will be required to determine the assumptions in the calculation of transfer values on a "best estimate" basis;

- 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 the existing asset mix of their scheme;
- the trustees will continue to be able to reduce transfer values where the scheme is underfunded;
- the trustees will be allowed to deduct any reasonable administrative costs incurred from the transfer value;
- the trustees will have to provide members considering whether to transfer with more information.

These arrangements will apply to private sector pension schemes.

Public service pension schemes are different in a number of ways to funded private sector schemes. The Government is still considering arrangements for these schemes and hopes to make an announcement soon.

The Government’s formal response to the consultation is being published today.

We intend to bring all of these new arrangements into effect in April 2008.

A press release has also been issued<sup>1</sup>.

### **Policy proposals**

3. The consultation elicited a range of views about the way that cash equivalent transfer values should be calculated. On the one hand, some respondents addressed the issue from the point of view of the person involved in the transfer. For these respondents the issue was primarily whether members would be able to replicate their scheme benefits in a defined contribution scheme. Other respondents, the majority, were primarily concerned about the pension scheme itself and the effect on the scheme – the remaining members and the sponsoring employer – of any change in the transfer arrangements.

4. In coming to a view on these matters, the Government has been guided by a need for a solution which focuses primarily on maintaining and sustaining the

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<sup>1</sup> Web reference: <http://www.dwp.gov.uk/mediacentre/pressreleases/2007/jan/>

viability of defined benefit occupational pension schemes. As the consultation document made clear, the key issue is that the provision of pensions should be supported and encouraged.

5. The Government has also been mindful that for most people there is now much less reason for them to want to transfer out of a defined benefit scheme. The new scheme funding arrangements will improve the way that schemes are funded; and in the event of the employer failing, the Pension Protection Fund now provides an improved level of security for most people's benefits.

6. Having considered all the arguments, the Government has decided that transfers policy should be looked at from the scheme perspective, on a scheme specific basis - on what has been termed a "cost to the scheme" basis. Fairness as between the transferring member and the other remaining members is therefore best achieved by transfer values which reflect the current expected cost to the scheme if the transferring member had actually remained in the scheme to retirement.

## **Next steps**

### ***(i) Regulations***

7. The Government will now proceed to prepare amending regulations for consultation. As a starting point, a number of the requirements in GN11 will be transposed into regulations. There will be some minor changes to existing arrangements, but for the most part, in the Government's view, pension schemes will need to make very little change to accommodate the new arrangements.

### ***(ii) Guidance – Board for Actuarial Standards***

8. The Board for Actuarial Standards will consider whether any technical actuarial standard will be needed for actuaries under the new arrangements. It is

anticipated that any such standard would be available at the same time as the new regulations come into effect.

***(iii) Cost***

9. A Regulatory Impact Assessment is being prepared and will be issued with the draft regulations. In this context an estimate has been made of the possible cost of these new arrangements. It is estimated that the scheme specific approach would lead to a total one-off administrative cost for private sector defined benefit occupational pension schemes of around £8 million. The effect on the aggregate level of transfer values across all such schemes is expected to be broadly neutral.

***(iv) Timing***

10. The consultation document said that it was the Government's aspiration to bring the regulations into force in April 2007. However a number of respondents to the consultation emphasised that pension schemes would need time to prepare for any new arrangements, suggesting that a period of between six months and a year would be needed. If the Board for Actuarial Standards decides that a technical standard is needed, time would also be needed so that it could be developed alongside the regulations. The Government has therefore decided that it would be appropriate to allow more time for the introduction of these new arrangements.

11. It is the Government's intention to issue the draft amending regulations in the early part of 2007 for consultation. Following the consultation, the Government's aim is to make and lay the regulations in the middle part of 2007 and to bring them into effect on 6 April 2008. It is expected that any technical standard from the Board for Actuarial Standards would also come into effect on that date, after a due process of consultation.

## **2. RESPONSES TO THE CONSULTATION**

### **Introduction**

1. This section reports on the consultation and sets out the Government's response on substantive issues. Broadly this section groups material by reference to the questions raised in the consultation document, the proposed objectives for the policy and the three possible approaches to the calculation of pensions cash equivalent transfer values. But inevitably, as can be seen in the first "General" section, comments were made which did not fit neatly into these categories.

### **General**

#### *Statutory right to a transfer*

2. A number of respondents commented that there was no longer a need for members to have a statutory right to transfer out of a defined benefit occupational pension scheme and that it should be left to pension schemes to offer transfers if they wanted to. Arguments in support of this position focussed on the greater security for scheme benefits that now existed, including the new scheme funding arrangements and the existence of the Pension Protection Fund as a safeguard for schemes of insolvent employers. Respondents also argued that this could be a major de-regulatory measure.

3. Restricting the right of members to transfer out of their pension scheme would provide some administrative savings, but this would not be a straightforward de-regulatory measure. Some transfers would probably have to continue, for example transfers in and out of defined contribution schemes; a methodology for calculating the value of pension rights would still have to be maintained for purposes other than transfers; and there would be a variety of legal /ECHR issues around taking away a longstanding right from scheme members.

4. The Government has considered carefully the arguments that have been made but is not convinced that they are strong enough to support a major change such as this.

*Pension sharing on divorce*

5. Many respondents said that the existing rules on the calculation of cash equivalent transfer values were unsuitable for use in pension sharing on divorce. They argued that the resulting cash equivalent transfer values did not reflect the value of the promised benefits to the member. The position was compounded by the fact that former spouses were very often not allowed to become a member of the scheme but were required to move their pension rights to another pension arrangement, usually defined contribution in nature. Some respondents suggested that there needed to be a separate means of valuing pensions for divorce purposes. Other respondents suggested that the rules should be changed so that the trustees of the member's scheme could no longer prevent the former spouse from becoming a member of the scheme.

6. The Government's view is that the primary purpose of this exercise is to determine how best to regulate the process for calculating cash equivalent transfer values generally. But the concerns expressed about the use of the process in pension sharing are noted and will be given separate consideration.

*"Early leavers"*

7. "Early leavers" in this context are people who leave a pension scheme with between three months and two years pensionable service. A recent change in legislation provided that early leavers could either have a refund of their contributions or a cash transfer sum in respect of their accrued pension rights to another scheme.

8. One respondent suggested that the opportunity should be taken to revisit the rules on early leavers in order to make them entirely consistent with the rules on other transfers.

9. The rules on early leavers only came into effect in April 2006 and it would not be appropriate to make any changes to the rules so soon after introduction (other than those required by the overall change to the way transfer values are to be calculated). The Government will of course take note of any specific points made about the operation of these rules.

#### *Directors' pensions*

10. Directors' pensions are stated in company accounts by reference to their cash equivalent transfer value. Several respondents said that this was no longer appropriate.

11. This is not a matter for this consultation but the comments will be drawn to the attention of the appropriate authorities.

#### *Other legislative changes*

12. Respondents made a number of comments about other areas of legislation.

- Consideration should be given to removing the condition that no transfers are allowed within one year of the normal retirement date. Many people only start to consider their pension around this time.
- The requirements in the Pension Schemes Act 1993 should be changed to allow partial transfers of rights in order to provide consistency with the Finance Act 2004.

- Any new arrangements should not prevent inducements whereby cash equivalent transfer values are enhanced by employers to encourage members to transfer out.

These issues are outwith this consultation but the points made have been noted.

#### *General features of new arrangements*

13. Respondents made a number of suggestions about the general features of any new arrangements for the calculation of cash equivalent transfer values.

- Any new arrangements should be simple and easy to understand, communicate and implement. Arrangements should be suitable for small schemes. Regulatory oversight should be kept to a minimum.
- Arrangements should remain appropriate through changing market conditions and whether pension schemes were in surplus or deficit.

The Government does not disagree with any of these representations and will aim to make the new arrangements consistent with them.

#### **QUESTION 1. ARE THERE ANY OTHER KEY STAKEHOLDERS WHOSE INTERESTS NEED TO BE ADDRESSED?**

14. Respondents suggested a wide range of other stakeholders including:

**pension schemes** Scheme administrators who will have to operate the new arrangements. Spouses, partners and dependants of members who may be affected by a decision to transfer.

**pension sharing** People and bodies involved in pension sharing on divorce, including former spouses; former civil partners; and family courts.

**sponsoring company** Shareholders in the company and its employees.

**third party advisers** Including independent financial advisers; the legal profession and actuaries who will have to advise on the new arrangements.

**public service schemes** The Government and taxpayer because they stand behind these schemes.

**QUESTION 2.      *WHAT IS YOUR VIEW ABOUT THE LEGAL RIGHTS OF A MEMBER WANTING TO TRANSFER OUT OF A PENSION SCHEME?***

15. Respondents tended to focus on the issue of “fair” transfer values. Some respondents saw the issue of fairness in terms of whether the transferring member would be able to secure equivalent benefits in the new scheme. Other respondents considered fairness had to be assessed in terms of the interests of a wider range of parties.

16. Arguments in support of the position that cash equivalent transfer values should be fair primarily to the transferring member included:

- pensions are deferred pay and transfer values must therefore start from the position that the member is entitled to a full and fair substitute for the employer’s defined benefit promise;

- members have entered into a contract with the employer for the provision of pensions. That should be honoured in full whether at retirement or on transfer. The employer covenant is not used to determine the amount of pension and should not determine the amount of the transfer value;

- transferring members do have rights in law and any action by the Government to diminish those rights could be contrary to the Human Rights Act.

Respondents who put forward this view generally seemed to support the EXD54 approach to the calculation of transfer values or the use of a bond or gilts based discount rate.

17. Respondents who took a more holistic approach to the issue of fairness argued that a transfer should not be to the detriment of other members remaining in the scheme and nor should it lead to the employer having to make additional contributions. Amongst these respondents there was a view that the current arrangements for the calculation of cash equivalent transfer values produced a fair result.

18. This question also prompted some discussion about the Human Rights Act. Whilst some respondents considered that cash equivalent transfer values were possessions to which the Human Rights Act could apply, other respondents argued that the transfer value was simply an option and that the possession was the pension itself. The possession would therefore be the promised cash flow of the benefit rather than any cash value put on that pension for transfer purposes.

19. Other respondents commented on the draft Portability Directive, currently being considered by the European Council and Parliament. One view shared by a number of respondents was that the Directive should not require that members should have the right to transfer. They viewed the Directive as being about labour mobility and argued that the existing requirements in legislation on preservation and revaluation etc meant that those objectives would be met. (Some of these respondents also argued against there being a statutory right to a transfer.)

20. The Government's view is that transfers should be fair to all stakeholders and should not particularly favour the transferring member at the expense of other parties. In most cases, a transfer is an option that members can exercise if they want to. The primary purpose of a pension scheme is the provision of pensions, not the provision of transfers. A transfer payment should not therefore be to the detriment of other members of the scheme and should not lead to the payment of additional contributions by the employer.

21. The Government believes that this position is consistent with the Human Rights Act and it will conduct negotiations on the Portability Directive in line with this view.

**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**

22. The great majority of respondents favoured an approach whereby cash equivalent transfer values were calculated on a scheme specific basis. And within that, many respondents suggested that schemes should determine the assumptions to be used by reference to a "best estimate" assessment of the cost to the scheme of providing the alternative deferred benefit.

23. This is the approach that the Government intends to follow, as described in the section on "Government proposals".

24. Although there was strong support for a scheme specific framework using a "best estimate" approach to determine assumptions, the consultation did give rise to wide-ranging discussion about other options. These are summarised in the

following paragraphs.

25. **Some prescribed assumptions** Some respondents, whilst agreeing broadly with the scheme specific approach, suggested that some of the assumptions should be prescribed, for example a prescribed requirement about mortality assumptions. However this was qualified in responses by a comment that very large schemes should be able to set their own assumptions based on their own experience if they wanted to. In the Government's view it would not be practical to prescribe assumptions in the level of detail such that they would be suitable for all schemes. But, in addition, prescribing exceptions to the rules would add extra layers of complication. The Government therefore believes that decisions about assumptions rests properly with trustees.

26. **Scheme funding** A number of responses discussed whether cash equivalent transfer values could be calculated using the assumptions determined by the trustees for the purposes of the Pensions Act 2004 scheme funding arrangements. But almost all of these came to the same conclusion that it would not be appropriate to require transfer values to be determined using the prudent approach required for scheme funding. This is also the Government's conclusion. Other respondents pointed up a number of other differences of principle and practice as between scheme funding and the calculation of transfer values which meant that one did not readily read into the other. For example, the strategies and targets a scheme might adopt in scheme funding might lead to unintended consequences in the calculation of transfer values.

27. **FRS17** There was some interest in an approach to transfers based on an FRS17 approach. The advantages of this approach were said to include a clarity of approach; the regular updating of assumptions; and the belief that on this basis, transfers would be attractive to both the member and the scheme. Other respondents did not favour an FRS17 approach, arguing that it would not be appropriate for Government to hang the calculation of transfer values on a

methodology that was itself currently under review, and that if features of FRS17 were changed, that could require consequential changes to the calculation of transfer values. The Government's view is that the calculation of transfer values will draw on certain aspects of the principles governing FRS17 calculations, in particular that assumptions should be on a "best estimate" basis.

28. **Full buy out** There was some support for transfer values to be calculated on a full buy out basis. However, these submissions did not fully address the practical issue of how the extra costs of such an approach would be met. In the Government's view, it would not be helpful in the current climate to load additional costs on employers in this way.

**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?**

29. The great majority of respondents agreed that trustees should be able to continue to choose whether or not to reduce transfer values where the scheme was underfunded. There was also general agreement that the payment of a reduced transfer value should discharge the scheme of all further liability for the transferring member. Supporting arguments included the following:

- not allowing reductions could jeopardise the viability of the scheme for remaining members;
- members could remain in the scheme until the deficit under the new scheme funding rules had been addressed;

- members considering a transfer should always take independent financial advice if the scheme is underfunded.

30. A number of these respondents also put forward suggestions about changing the basis of the reduction. Proposals included:

- reductions related to the strength of the employer covenant and future funding plans;
- reductions only permitted if the scheme was funded below a level calculated on a “best estimate” basis.

31. Some respondents suggested reductions by reference to Pension Protection Fund arrangements:

- reductions by reference to the statutory priority order which reflects the level of Pension Protection Fund compensation payments;
- reductions limited to the level required to provide the same level of benefits as would be provided by the Pension Protection Fund.

32. Other respondents argued for various mechanisms whereby reduced transfer values could be enhanced in some way. Suggestions included:

- any shortfall in the transfer value should be made good by the employer;
- shortfalls should be made good by the scheme once it was fully funded; or an additional sum should be added to the transfer value itself, calculated to reflect the risk that the employer might default;

- the reduced transfer value should be enhanced by reference to the amount by which the employer would benefit from the reduction in the Pension Protection Fund levy because the member had left the scheme.

33. On the other hand, a small group of respondents disagreed in principle that transfer values could be reduced. Points made included the following:

- allowing the reduction of transfer values amounted to a moral hazard. The employer was effectively rewarded for a scheme which was not properly funded;
- it was inconsistent with the rules on winding up solvent schemes, where employers have to meet the cost of full buy out to extinguish their pension promises;
- the employer covenant needed to be considered before a reduction could be considered. An AAA rated scheme sponsor with an underfunded scheme should not be allowed to cut back transfer values.

The Government takes the view that it is still appropriate to allow trustees the option of reducing transfer values but that the scale of these reductions should fall as scheme funding improves. An improvement in scheme funding will also address moral hazard issues. The Government has considered whether the basis of reductions should be changed. However the current arrangements for reductions provide an approach which is appropriate for all funded schemes. The Government is not attracted by proposals to enhance transfer values in some retrospective manner. Such a change would add another level of complication and would increase administrative and other costs.

**QUESTION 5. TO WHAT EXTENT DO YOU THINK THAT ANY NEW RULES SHOULD DEFINE THE RIGHTS OF ALL THOSE INVOLVED IN THE SCHEME?**

34. There was a mixed response to this question. A few respondents said that the rights of all stakeholders in the transfer process ought to be defined as comprehensively as possible. Others said that defining rights would be a means of assisting transparency in the transfer process.

35. On the other hand, other respondents suggested that the rights of stakeholders would be better safeguarded in other ways. Points made included:

- instead of defining rights, it would be better to provide the transferring member with more information;
- the rights of stakeholders should be considered in setting the rules for the transfer process. The balance of rights would then be reflected in the way the transfer value was to be calculated;
- the rights of the various parties were already defined in a number of ways, for example in legislation, including trust law, scheme rules and codes of practice. Another layer of definition was not needed.

The regulations setting out the requirements for the calculation of transfer values will not specifically define the rights of those involved in the transfer process.

The Government agrees with those respondents who say that the balance between the various parties is best achieved by carefully defining how transfer values are to be calculated.

**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?**

36. Most respondents were of the view that members considering whether to transfer needed to be made aware of the Pension Protection Fund and the protection for most people's pension benefits that it now offered.

37. But, apart from that, most respondents were against factoring the Pension Protection Fund into the calculation of transfer values. The point most usually made was that "PPF benefits" could only be determined if the employer actually became insolvent and the scheme was accepted by the Pension Protection Fund. The payments of such benefits could not therefore be assumed in advance.

38. Some respondents did however see a need for the Pension Protection Fund to be taken into consideration. One concern raised was that a large transfer payment could lead to a reduction of assets in the scheme immediately before it became insolvent. In turn this could lead to a greater call on the resources of the Pension Protection Fund. However the Pensions Regulator already has arrangements in place for monitoring transactions like this – although there is no power to reverse a lawfully made transfer. In addition, liaison arrangements provide that the Regulator will notify the Department of any unusual activity in this area.

39. More specifically, respondents suggested that the protection offered by the Pension Protection Fund should be taken into account in relation to reductions where there was underfunding. This issue is discussed in the section on Question 4.

40. In terms of the discount rate, some respondents said that “PPF benefits” had a greater degree of security attaching to them and that this might reasonably be allowed for in the transfer calculation by use of a lower discount rate.

41. The Government’s proposals are based on the fact that the transfer payment should reflect the “cost to the scheme”. Whilst the Pension Protection Fund is now an important factor in the safeguarding of pensions, it is expected that only a very few schemes will actually enter the Fund. It would not therefore be appropriate to include in the requirements on transfers features based on “PPF benefits” which in practice will not apply to most schemes.

***QUESTION 7. VIEWS ARE SOUGHT ON HOW BEST TO PROVIDE INFORMATION TO INDIVIDUALS AND ON THE POSSIBILITY OF RESTRICTING CETV VALUATIONS TO A THREE YEAR CYCLE.***

42. Comments on this Question fell into three categories – advice, information and restricting valuations.

43. **Advice** There was general agreement that members ought to consider taking financial advice before transferring. But there was only limited support for the proposal that a member should be required to take financial advice before a transfer could be made. Most respondents argued that financial advice should not be a legal requirement on the grounds that it would be too onerous and, for some individuals with comparatively small pension rights, the costs might outweigh the benefits. One respondent did however suggest that the cost of financial advice could be deducted from the transfer value. Other respondents were concerned about the burden that might be placed on schemes who would have to check that financial advice had been obtained. One respondent suggested that the member should be required to sign a disclaimer stating either that they had taken advice or had been advised to take advice but had not done

so.

44. The Government agrees that people thinking about a transfer from a defined benefit scheme to a defined contribution scheme ought to consider taking financial advice. But to make it into a legal requirement would be too prescriptive.

45. **Information** There was wide ranging agreement amongst respondents about the importance of information for members considering whether to transfer, so that they could make informed decisions. Some respondents set out in detail the information they considered needed to be provided, both by the transferring scheme and the receiving scheme. This included details of benefits in the “home” scheme they would be foregoing and from the receiving scheme an illustration of the benefits they might get at retirement. There was general agreement that members also needed to be reminded about the protections now afforded by the Pension Protection Fund and about the information on scheme funding contained in the Summary Funding Statement.

46. Respondents suggested other information items which could be provided to the member:

- an explanation that the transfer value would not necessarily allow the member to replicate his benefits in the new scheme;
- a benchmark against which the member could compare the transfer value for example full buy out cost. Another suggested benchmark was a critical yield illustration.

47. In putting forward these suggestions, respondents acknowledged that this could increase the administrative burden on schemes. Some respondents suggested that generic information could be provided in a leaflet produced either

by Government or the Pensions Regulator.

48. The Government accepts that members need more information but fully accepts that any new arrangements should not overburden schemes with new disclosure requirements. The Government will look carefully at the suggestion that generic information, produced by regulators, should be provided to members considering whether to transfer.

49. **Restrictions on valuations** The consultation document sought views on whether the requirement to provide CETV valuations should be restricted to one every three years. There was limited support for this proposal. Most respondents were of the view that the requirement to provide, on request, annual valuations was still appropriate even though so few requests actually led to transfers. The main point made by these respondents was that the circumstances of the scheme could change significantly over three years. There was also a view that valuations were usually sought for good reason, for example changes in personal circumstances. As a halfway house, some respondents suggested that schemes should be allowed to charge for valuations in certain circumstances, for example one free valuation in any three year period but other requests in that period could be charged for. But specimen charges quoted were of the order of £50 to £100, which could be prohibitive for many members.

50. The Government has been convinced of the need to retain the requirement for annual valuations and no changes are planned for this area of the policy.

## **POSSIBLE OBJECTIVES OF THE POLICY ON TRANSFERS**

51. The consultation document set out three possible objectives for the policy on transfers. There was no specific question on these possible objectives. In summary form, the possible objectives were:

- (a) Any new arrangements should be broadly fair to the transferring member.
- (b) Any new arrangements should not weaken or impact on the scheme's funding position.
- (c) Any new arrangements should be broadly neutral in their impact on transfer values.

52. There was a clear division amongst respondents about objective **(a)**. Some respondents considered that “fair” should be judged only or primarily in relation to the transferring member. For these respondents, the transfer payment should be sufficiently large to give a high probability that members would be able to replicate their existing benefits in their new scheme. Other respondents considered that “fair” had to be assessed by whether the interests of all stakeholders were balanced. These respondents tended to favour a “cost to the scheme” approach.

53. Respondents generally seemed content with objective **(b)** but there was some discussion around objective **(c)**. Some respondents suggested that this objective would effectively stifle any discussion about new approaches because it would effectively mean no change to the current rules. Other respondents commented that existing levels of transfer values were unrealistically low and that there was no reason why current transfer levels were uniquely correct.

54. Respondents suggested some new objectives. One proposed objective was that the new arrangements for calculating transfer values should reduce the complexity of the process and hence reduce scheme costs. Additionally the new arrangements should be easily communicable to members. Other proposed objectives were more specific: any new arrangements should not encourage members to transfer from defined benefit to defined contribution schemes; and they should not act as a disincentive to employers to provide defined benefit

schemes.

55. In terms of the proposed new objectives, the Government is not convinced that objectives which focus on process - the methodology of the transfer calculation – are appropriate. Objectives for public policy usually focus on outcomes for people. The Government intends to retain the objectives proposed in the consultation document but to broaden objective **(a)** so that it refers to fairness as between all key stakeholders, not just to the transferring member.

## **APPROACHES TO THE CALCULATION OF TRANSFER VALUES**

56. The consultation document set out three different potential approaches to the calculation of pensions transfer values. In the consultation, respondents commented on these approaches and in addition several other approaches were suggested.

### ***Prescribed assumptions***

57. There was very little support for this approach. One respondent said that this approach would be useful for unfunded public service schemes where all of these schemes would be required to use the same assumptions. Another respondent suggested that this approach might be suitable for use in pension sharing.

58. Most respondents however disagreed with this approach:

- it would not reflect the different circumstances of schemes;
- there would be problems in setting the assumptions in the first place;

- it would not be simple to operate – systems would still need to be altered on a regular basis to reflect revised assumptions;
- this approach had already been tried with the minimum funding requirement.

### ***Scheme specific basis***

59. Comments made about this approach have been addressed in the commentary on Question 3.

### ***“EXD54” basis***

60. There was limited support for this approach. Some respondents said that if the policy was that transfer values should equal the actuarial value of benefits, the “marked to market” approach was the correct approach. They also commented that assessing the strength of the employer covenant was not an insurmountable difficulty. Given time it would have been possible to simplify EXD54 which would have made it easier to use. Other respondents supported this approach because it would give a better outcome to former spouses where a pension was shared on divorce.

61. A much larger number of respondents disagreed with this approach. Some of the disadvantages cited included:

- it would be complicated and expensive;
- it would increase employer costs but not increase pension provision;
- it would be particularly difficult for small schemes. It would be difficult for these schemes to make an assessment of the employer covenant. As such they would have to adopt a gilts basis for discounting which

would produce transfer values higher than would be produced using technical provisions;

- it would be negated if transfer values could be cut back because of underfunding. This would also make it difficult to explain to members;
- it would increase costs for the public sector.

### ***Other approaches***

62. A number of respondents proposed other approaches to the calculation of transfer values. One approach would have given schemes complete freedom to set their own transfer values. Other approaches were more prescriptive, proposing new rules for the various parts of the transfer calculation.

63. The Government has considered these approaches very carefully. However, making significant changes to the current way that transfer values are calculated would have a cost for pension schemes. The test therefore has to be whether any of the suggested approaches would deliver the objectives set out earlier in a more efficient and effective way. Although some of the approaches could deliver the objectives, it is not clear that they would provide sufficient administrative savings or efficiencies to warrant wholesale changes to the existing arrangements.

## **ANNEX A**

### **Responses to the consultation**

Association of British Insurers  
Association of Consulting Actuaries  
The Actuarial Profession  
AEGON  
Alexander Forbes Financial Services  
Aon  
AstraZenica  
AXA  
Baker & McKenzie  
Balfour Beatty  
Barnett Waddingham  
S. Bridges  
British Airways Pensions  
J. Burman  
CPRM  
CS Pension Consultants Ltd  
Cape Pension Trustees Ltd  
L. Churchill  
Collins Actuaries  
Compact Analysis  
Confederation of British Industry  
Co-operative Group  
C. Cowling  
H. Davies-Williams  
P. Davis  
Deloitte  
R. Dennis  
EB Consultants Ltd  
First Actuarial  
Fraser Glass and Co  
Guinness Peat Group plc  
HBOS  
HBOS Pension Scheme  
Hargreaves Lansdowne  
Haven Partnership  
Hewitt  
Higham Dunnett Shaw  
HSBC  
Hymans Robertson LLP  
Imperial Tobacco Pension Trustees Ltd  
Jardine Lloyd Thompson  
T. Keville

Lane Clark & Peacock  
Law Debenture  
Legal & General (scheme actuaries)  
Lloyds TSB  
Mercer  
National Grid  
National Association of Pension Funds  
Norwich Union  
Occupational Pensioners' Alliance  
Paul Weaver and Co  
Pensions Management Institute  
Pensions Ombudsman  
Pension Protection Fund  
Pensions Regulator  
PricewaterhouseCoopers  
Punter Southall  
Resolution  
Rolls-Royce  
Royal Bank of Scotland  
Scottish Life  
Scottish Widows (scheme actuaries)  
R. Simmons  
Society of Pension Consultants  
Standard Life  
Tesco  
E. Topper  
Watson Wyatt