

EXPLANATORY MEMORANDUM TO
THE OCCUPATIONAL PENSION SCHEMES (TRANSFER VALUES)
(AMENDMENT) REGULATIONS 2008

2008 No. 1050

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 When a member of a pension scheme wants to transfer to another pension scheme, a cash value is put on their pension rights (the cash equivalent transfer value – “cash equivalent”) and that amount is paid from the transferring scheme to the receiving scheme. It is then converted into pension rights in the receiving scheme. These Regulations set out the methodology for the calculation and verification of cash equivalents. The methodology is also used for other purposes, for example pension sharing on divorce; and this is reflected in the consequential amendments included in the Regulations.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Background

4.1 Since 1986, members of pension schemes have had a statutory right to have the cash equivalent transferred to another pension scheme. The current provisions are in Chapter IV of Part IV of the Pension Schemes Act 1993. Under regulation 7 of the Occupational Pension Scheme (Transfer Values) Regulations 1996 (“the 1996 Regulations”), the Government delegated to the Faculty and Institute of Actuaries (“the Actuarial Profession”) the responsibility for determining the policy on the calculation framework for cash equivalents. The Actuarial Profession fulfilled its obligations by issuing a mandatory guidance note to actuaries, usually known as “GN11”. (From April 2007, responsibility for GN11 passed to the Board for Actuarial Standards.)

4.2 In May 2005 the Actuarial Profession consulted on proposals for a major revision of GN11. The effect of the proposals would have been to increase the values of cash equivalents significantly. But this would have increased costs to schemes. The proposals might have led to perverse incentives to transfer out of pension schemes. Ultimately the increased costs of transfers might have affected the viability of some schemes.

4.3 The Government discussed the results of the consultation with the Actuarial Profession. It was agreed that the time was right for the Government to resume direct responsibility for setting the rules in this area. These Regulations amend the 1996 Regulations to prescribe the new way of calculating cash equivalents.

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 **Valuing pension rights** Members of pension schemes accrue pension rights in their scheme. Broadly there are two kinds of pension rights, salary related and money purchase rights. A cash value may need to be put on pension rights for a number of reasons. The main reason is when a member wants to transfer to another pension scheme. In such a case, a cash value is put on the member's pension rights in their current scheme, and that cash amount is then passed to the member's new scheme. In the new scheme, the cash sum is converted into pension rights for the member. Pension rights may also need to be valued for other purposes, particularly where a pension is taken into account for divorce purposes.

7.2 With money purchase pension rights, the value of the member's pension rights is generally simply the cash value of those rights at any particular point in time. However putting a cash value on salary related pension rights is much more difficult. Salary related rights are generally based on length of service and the member's salary. A special methodology has to be used to put a cash value on salary related pension rights based on assumptions on matters such as future investment returns, life expectancy etc. These Regulations explain how these cash values (i.e. the cash equivalents) are calculated and verified for both money purchase and salary related schemes.

7.3 **Policy objectives** In coming to a view about the objectives of the policy, the Government has been mindful of a number of issues. Transfer payments can be very large and potentially could have an impact on the level of funding in the transferring scheme. On the other hand, the amount of the cash equivalent is important to the member: the larger it is, the greater will be the pension rights the member will be awarded in the new scheme. A balance therefore needs to be struck between the interests of the member who wants to transfer out and, on the other hand, the interests of the transferring scheme, the scheme's sponsoring employer and the members remaining in the scheme.

7.4 The Government also decided that detailed rules for calculating cash equivalents are still necessary because transfers can be quite large and both members and pension schemes need to have some certainty in the way they are calculated.

7.5 **Consultation on general approach** In June 2006, the Government consulted on three approaches to the calculation of pensions transfer values¹. Following the consultation the Government decided to regulate on the basis of one of these approaches - the "scheme specific" approach. The scheme specific approach an approach based on the

¹ Approaches to the calculation of pensions transfer values June 2006
<http://www.dwp.gov.uk/publications/dwp/2006/calc-ptv.pdf>

expected cost to the scheme if the member had decided to remain in the scheme rather than transfer to another scheme. This is also the approach that underpins GN11. There were 69 responses to the consultation, most of whom favoured the scheme specific approach. A full report on the consultation has been published².

7.6 Draft regulations The draft regulations were issued for consultation on 6 July 2007³. The consultation ended on 17 August and covered a period of six weeks. The key policy points contained in the draft regulations issued for consultation are set out below.

- Trustees (where this Memorandum refers to trustees, it also includes managers) of pension schemes will be responsible for calculating cash equivalents.
- The method of calculation in the Regulations sets a minimum amount for cash equivalents (but trustees can pay higher amounts if they want).
- Trustees will be required to determine the assumptions to be used in calculations on a “best estimate” basis.
- Trustees will be able, as now, to reduce the amount of the cash equivalent where the scheme is underfunded.
- Trustees will be able to recover any reasonable administrative costs from the cash equivalent which are incurred in carrying out the transfer.
- Members considering whether to transfer will be told where more information is available to help them make their decision.

7.7 Consequential amendments Other sets of regulations also provide for the valuation of pension rights, for example in the context of the sharing of pension rights on divorce. Consequential amendments are being made to those regulations so that there is consistency about the way that pension rights are valued. The consequential amendments are contained in Schedule 2 to these Regulations.

7.8 “Early Leavers” One amendment in particular in Schedule 2 should be noted. Paragraph 8 amends the Occupational Pension Schemes (Early Leavers: Cash Transfer Sums and Contribution Refunds) Regulations 2006 (SI 2006/33) (the “Early Leavers regulations”). The Early Leavers regulations make provision for members with between three and twenty-four months service who have unvested pension rights. On leaving service they are entitled either to a refund of contributions or a transfer to another pension scheme (termed a “cash transfer sum”). The Early Leavers regulations currently provide that cash transfer sums have to be calculated by reference to the date that the member’s pensionable service terminates. In money purchase schemes, the value of members’ pension rights is their cash value at any particular point in time. Because of fluctuations in the value of investments, the value of the cash transfer sum will vary between the date the member’s pensionable service terminates and the actual date the

² Approaches to the calculation of pensions transfer values - Response to the Consultation
<http://www.dwp.gov.uk/publications/dwp/2006/response-calc-ptv.pdf>

³ Approaches to the calculation of pensions transfer values - Consultation on Draft Regulations
<http://www.dwp.gov.uk/consultations/2007/approaches-to-pensions-calculations.pdf>

investments are realised. Representations were made to Government that this caused problems for schemes and additionally that the method of calculation of cash transfer sums for early leavers was at odds with the way that ordinary money purchase transfer amounts were calculated. In order to address these concerns, paragraph 8 of Schedule 2 provides that the cash transfer sum is to be the realisable value of any benefits to which the member is entitled.

7.9 Results of consultation on draft regulations There were thirty-nine responses to the consultation. A full report on the consultation including information on the changes made to the Regulations is being published⁴. The Regulations were broadly well received because they maintain the status quo in terms of amounts of transfer values. The main changes made to the Regulations as a result of the consultation are set out below.

Timetable Respondents wanted more time to prepare for the new Regulations. The coming-into-force date has been deferred until 1 October 2008.

Guidance Some respondents said there was a need for guidance about the new arrangements. The Pensions Regulator will be issuing guidance.

Discretionary benefits There was concern that the Regulations might give too much say to trustees about the extent to which discretionary benefits were included in the calculation. The Regulations now reflect the fact that consent (of the employer) is usually involved.

Discount rates Respondents commented that schemes did not usually have an explicit investment strategy for particular classes of member. They commented that instead the strategy would have regard to the nature of the membership. The discount rates now have to reflect the long-term investment strategy the scheme has adopted in the light of the nature of its membership.

“Best estimate” The point was made that it could be difficult and costly to establish a “best estimate” for every assumption in the cash equivalent calculation. The Regulations have been changed so that some of the individual assumptions need not be on a “best estimate” basis, provided that a “best estimate” is the overall result.

Reduction for underfunding Respondents commented that the existing flexibility in GN11 for calculating the assets and liabilities of a scheme was not reflected in the draft regulations. The Regulations have been amended to retain this flexibility.

7.10 Other issues Other points relevant to the background to the policy are set out in the following paragraphs.

7.11 Public service pension schemes The discount rates to be used for public service pension schemes will not be calculated under these Regulations. They will be calculated in accordance with guidance prepared by the Treasury or the Secretary of State. The

⁴ Approaches to the calculation of pensions transfer values - Response to the Consultation on Draft Regulations. <http://www.dwp.gov.uk/consultations/2007/>

guidance is being prepared now. When it is published a further instrument will be made to refer to it. The guidance will be made available to the Committee when they are considering the instrument. The intention is to make the instrument before October 2008.

7.12 *Scope* The amendments in these Regulations will be of relevance to all occupational pension schemes, particularly salary related schemes. They will also be relevant to members wanting to transfer.

7.13 *Consolidation* The Government accepts the need for consolidation of some pensions legislation in due course. However most users of pensions legislation are pensions professionals who will have access to their own online resource materials. In addition the Department for Work and Pensions publishes the “Blue Volumes”, which can be accessed by members of the public. The Blue Volumes contain the legislation for which the Department is responsible. The legislation is presented in a consolidated format and is updated regularly. The weblink is http://www.dwp.gov.uk/advisers/docs/lawvols/bluevol/pdf/c_0031.pdf

8. Impact

8.1 An Impact Assessment is attached to this Memorandum.

8.2 The impact on the public sector is a total one-off cost of between £250,000 and £450,000 across all public service pension schemes.

9. Contact

Mike Rochford at the Department for Work and Pensions Tel: 020 7962 8126 or e-mail: mike.rochford@dwp.gsi.gov.uk can answer any queries regarding the instrument.

SUMMARY: INTERVENTION & OPTIONS

Department for Work and Pensions	Impact Assessment of the calculation of pensions transfer values
----------------------------------	--

Stage Final	Version April 2008	Related Publications
----------------	-----------------------	----------------------

Available to view or download at: <http://www.dwp.gov.uk/resourcecentre/ria.asp>

Contact name for enquiries: **Mike Rochford**

Telephone number: **020 7962 8126**

What is the problem under consideration? Why is government intervention necessary?
Policy on the calculation of pensions transfer values was delegated to the Actuarial Profession. The Profession fulfilled its responsibilities by issuing mandatory guidance to actuaries. However the Actuarial Profession decided that it was no longer appropriate for it to have the responsibility for setting policy on cash equivalent transfer values.
The Government has therefore had to resume the responsibility for setting policy in this area. The Government cannot itself issue a mandatory guidance note and there is no other appropriate body who could issue the guidance note. The only way that policy can be articulated is by regulations.

What are the policy objectives and the intended effects?
The policy objective is to maintain the existing framework for the calculation of the value of pension rights and to do so at a minimal cost to pension schemes.

The **intended effect** is that across all pension schemes, pensions transfer values should remain broadly at the same level as they would have done had the current actuarial guidance remained in force.

What policy options have been considered? Please justify any preferred option.
Prescribed assumptions The Government would prescribe all the assumptions for calculating transfer values.
“EXD54” basis Transfer values would be calculated by reference to the likelihood that pension benefits would be paid.
Scheme specific Transfer value would be based on the expected cost within the scheme of providing the pension benefits. This is the **preferred option** because it mirrors current arrangements and will allow transfer values to remain broadly at the same level as they would have done had the current actuarial guidance remained in force, and meets the objectives.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? October 2011.

Ministerial Sign-off For final stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: **Mike O'Brien**

Date: 3rd April 2008

Policy Option 1		Description	Prescribed assumptions		
<p>ANNUAL COSTS</p> <p>One off (Transition) £ 6.75-12.75m Yrs 1</p> <p>Average Annual Cost (excluding one-off)</p> <p>£ None</p>		<p>Description and scale of key monetised costs by 'main affected groups'</p> <p>Pension schemes £6.75-12.75 million</p>	<p>Total Cost (PV) £ 6.75-12.75m</p>		
<p>Other key non-monetised costs by 'main affected groups'</p> <p>None.</p>					
<p>ANNUAL BENEFITS</p> <p>One off £ None Yrs</p> <p>Average Annual Benefit (excluding one-off)</p> <p>£ None</p>		<p>Description and scale of key monetised benefits by 'main affected groups'</p>	<p>Total Benefit (PV) £ None</p>		
<p>Other key non-monetised benefits by 'main affected groups'</p> <p>Increased certainty for scheme members about amounts of transfer values. Less need for trustees to factor the scheme's circumstances into the transfer calculation.</p>					
<p>Key Assumption/Sensitivities/Risks A key assumption is that the Government would be able to set out in regulations all of the assumptions necessary for the calculation of transfer values. The risk is that this approach is relatively inflexible, applying to all schemes large and small, and it would be difficult to make changes quickly.</p>					
Price Base Year 2007	Time Period Years 1	Net Benefit Range (NPV) £ (-6.75m) – (- 12.75m)	NET BENEFIT (NPV Best estimate) £ -9.75m		
What is the geographic coverage of the policy/option?			Great Britain		
On what date will the policy be implemented?			1 October 2008		
Which organisation(s) will enforce the policy?			Pensions Regulator		
What is the total annual cost of enforcement for these organisations?			£ Negligible		
Does enforcement comply with Hampton principles?			Yes		
Will implementation go beyond minimum EU requirements?			N / A		
What is the value of the proposed offsetting measure per year?			£ Nil		
What is the value of changes in greenhouse gas emissions?			Negligible		
Will the proposal have a significant impact on competition?			No		
Annual cost (£-£) per organisation (excluding one-off)		Micro N / A	Small N / A	Med N / A	Large N / A
Are any of these organisations exempt?		No	No	N/A	N/A
<p>Impact on Admin Burdens Baseline (2005 Prices)</p> <p>Increase of £ 0 Decrease of £ 0 Net Impact</p>				<p>£ (Increase - Decrease)</p> <p>0</p>	
Annual Cost: Constant Prices			(Net) Present Value		

Policy Option 2		Description "EXD54"			
ANNUAL COSTS One off (Transition) <input type="text" value="£ 13.4-- 25.5m"/> Yrs <input type="text" value="1"/> Average Annual Cost (excluding one-off) <input type="text" value="£ 300m"/>		Description and scale of key monetised costs by 'main affected groups' Pension schemes (and their sponsoring employers) would be the groups affected by these costs. Total Cost (PV) <input type="text" value="£ 2.17bn"/>			
Other key non-monetised costs by 'main affected groups' None.					
ANNUAL BENEFITS One off <input type="text" value="£ None"/> Yrs <input type="text"/> Average Annual Benefit (excluding one-off) <input type="text" value="£ 300m"/>		Description and scale of key monetised benefits by 'main affected groups' Members of salary related pension schemes who opted to transfer out of their scheme to another scheme would benefit under this option. Total Benefit (PV) <input type="text" value="£ 2.15bn"/>			
Other key non-monetised benefits by 'main affected groups' None.					
Key Assumption/Sensitivities/Risks The effect on transfer values of scheme underfunding has been assumed to be generally eliminated over a period of 10 years.					
Price Base Year 2007	Time Period Years 10	Net Benefit Range (NPV) £ (-13.4m) – (-25.5m)		NET BENEFIT (NPV Best estimate) £ -19.5 m	
What is the geographic coverage of the policy/option?					Great Britain
On what date will the policy be implemented?					1 October 2008
Which organisation(s) will enforce the policy?					Pensions Regulator
What is the total annual cost of enforcement for these organisations?					£ Negligible
Does enforcement comply with Hampton principles?					Yes
Will implementation go beyond minimum EU requirements?					N / A
What is the value of the proposed offsetting measure per year?					£ Nil
What is the value of changes in greenhouse gas emissions?					Negligible
Will the proposal have a significant impact on competition?					No
Annual cost (£-£) per organisation (excluding one-off)			Micro N / A	Small N / A	Med N / A
			Large N / A		
Are any of these organisations exempt?			No	No	N/A
			N/A	N/A	
Impact on Admin Burdens Baseline (2005 Prices)					£ (Increase - Decrease)
Increase of <input type="text" value="£ 0"/>		Decrease of <input type="text" value="£ 0"/>		Net Impact	<input type="text" value="0"/>
Annual Cost: Constant Prices					(Net) Present Value

Policy Option 3		Description Scheme specific			
ANNUAL COSTS One off (Transition) <input type="text" value="£6.75-12.75m"/> Yrs <input type="text" value="1"/> Average Annual Cost (excluding one-off) <input type="text" value="£ None"/>		Description and scale of key monetised costs by 'main affected groups' Pension schemes £6.75-12.75m Total Cost (PV) <input type="text" value="£6.75-12.75m"/>			
Other key non-monetised costs by 'main affected groups' None.					
ANNUAL BENEFITS One off <input type="text" value="£ None"/> Yrs <input type="text"/> Average Annual Benefit (excluding one-off) <input type="text" value="£ None"/>		Description and scale of key monetised benefits by 'main affected groups' No ongoing benefits. Total Benefit (PV) <input type="text" value="£ None"/>			
Other key non-monetised benefits by 'main affected groups' This approach will provide the trustees with greater flexibility; assumptions can be quickly amended to reflect changes eg in mortality. The approach will be very much consistent with current arrangements for transfers and with the way that the scheme funds benefits for individual members.					
Key Assumption/Sensitivities/Risks In order for transfer values to remain broadly unchanged, a key assumption is that schemes already use a "best estimate" to determine the assumptions used in the calculation. A risk is that if schemes use some other basis, amounts of transfer values will change.					
Price Base Year 2007	Time Period Years 1	Net Benefit Range (NPV) £ (-6.75m) – (-12.75m)		NET BENEFIT (NPV Best estimate) £ -9.75m	
What is the geographic coverage of the policy/option?			Great Britain		
On what date will the policy be implemented?			1 October 2008		
Which organisation(s) will enforce the policy?			Pensions Regulator		
What is the total annual cost of enforcement for these organisations?			£ Negligible		
Does enforcement comply with Hampton principles?			Yes		
Will implementation go beyond minimum EU requirements?			N / A		
What is the value of the proposed offsetting measure per year?			£ Nil		
What is the value of changes in greenhouse gas emissions?			Negligible		
Will the proposal have a significant impact on competition?			No		
Annual cost (£-£) per organisation (excluding one-off)		Micro N / A	Small N / A	Med N / A	Large N / A
Are any of these organisations exempt?		No	No	N/A	N/A
Impact on Admin Burdens Baseline (2005 Prices) Increase of <input type="text" value="£ 0"/> Decrease of <input type="text" value="£ 0"/> Net Impact				<input type="text" value="£ (Increase - Decrease)"/>	
Annual Cost: Constant Prices				(Net) Present Value	

Evidence Base for Summary Sheets

Introduction

1. This Impact Assessment (IA) considers changes to the way that pensions transfer values are to be calculated. It is accompanied by a set of regulations: the Occupational Pension Schemes (Transfers Values) (Amendment) Regulations 2008.

Problem under consideration

2. **Pension rights** Members of pension schemes accrue pension rights in their scheme. Where a person transfers from one pension scheme to another a cash value is put on their accrued pension rights and that cash sum is paid from the transferring scheme to the receiving scheme. The cash sum is then converted into pension rights in the receiving scheme. Pension rights may also need to be valued for other purposes, including circumstances where the pension is taken into account in divorce proceedings and the disclosure of the value of directors' pensions in annual reports.

3. There are broadly two kinds of pension rights, salary related rights and money purchase rights. Salary related rights are generally based on length of service and remuneration. Money purchase pension rights are represented by the monetary value of the individual's account within the scheme (the contributions paid by and in respect of the employee and the investment returns on those contributions).

4. In a money purchase arrangement, the value of the member's pension rights is, straightforwardly, the cash value of his or her individual account at any particular point in time. However the conversion of salary related pension rights into a cash amount is much more complicated. A special methodology has to be used for the calculation. It is the methodology for the calculation of the value of salary related pension rights which is the subject of this IA.

5. **Actuarial Profession** The Social Security Act 1985 gave members whose pensionable service had ended a statutory right to have the "cash equivalent" of their pension rights transferred to another pension arrangement. The Government delegated to the Faculty and Institute of Actuaries ("the Actuarial Profession") the responsibility for determining the policy on the calculation framework for cash equivalent transfer values. The Actuarial Profession fulfilled its obligations by issuing a mandatory guidance note for actuaries, GN11⁵. (From April 2007, responsibility for GN11 passed to the Board for Actuarial Standards.)

6. **Policy review** In May 2005, the Actuarial Profession issued proposals for a major revision of GN11. The proposals were contained in a document called *Exposure Draft 54* ("EXD54").

7. **EXD54 proposals** The existing GN11 bases the value of the cash equivalent on the expected cost of the members' benefits to the scheme. However EXD54 proposed the pension benefits should be valued by reference to their security, in other words the likelihood that they would be paid. Benefits considered to be secure would have a higher transfer value; conversely benefits considered to have a larger degree of risk, and therefore less secure, would have a lower transfer value. A strong employer, able to support the scheme, would mean that pension benefits

⁵ GN11 Retirement Benefit Schemes – Transfer Values. Originally issued by the Actuarial Profession, but since April 2007 adopted by the Board for Actuarial Standards, to provide guidance to actuaries on the calculation of pensions transfer values. The guidance has been in place since 1985.

should be treated as secure and hence should have a high transfer value. On the other hand, an employer perceived to lack financial strength would mean that pension benefits should be treated as less secure and therefore should have a lower transfer value.

8. The Actuarial Profession issued EXD54 because their perception of the nature of transfer values has changed. The expected cost to the scheme approach has generally been accepted as the appropriate method for calculating transfer values, and this approach is contained in GN11. However the Actuarial Profession has now moved to the position that an approach based on value to the member ie the EXD54 approach is the better actuarial view. In the arguments put forward by the Profession to support this change, the point was made that their primary concern was the calculation of what they regarded as fair transfer values for members and not wider social policy issues.

Rationale for Government intervention

9. The effect of the EXD54 proposals would have been to increase transfer values significantly and thus increase costs to schemes. Whilst it would have increased the amount of the transfer payment and given the transferring member the opportunity of securing a higher level of benefits in the new scheme, it might also have led to perverse incentives to transfer out of schemes. Ultimately the increased costs of transfers might have affected the viability of some schemes. The EXD54 proposals would also have had a negative effect on public service pension schemes, where unplanned-for increased costs would have had to have been met by the taxpayer.

10. For the Government, the starting point in considering this issue has been the ongoing sustainability of pension schemes. The EXD54 proposals, if put into effect, would have weakened private sector schemes and added costs to the public service. The Government discussed the results of their consultation with the Actuarial Profession. It was agreed that the time was right for the Government to resume direct responsibility for setting policy in this area.

11. As part of this change in responsibility, GN11 will be withdrawn. The Government, in considering how best to discharge its responsibility for policy on this issue, has had to weigh up a number of factors:

- the Actuarial Profession wanted to withdraw from the existing arrangements;
- it would not be appropriate for the new Board for Actuarial Standards, which has taken over some of the responsibilities of the Actuarial Profession, to take on this policy responsibility long-term; and there was no other appropriate body to whom the responsibility for issuing mandatory guidance could be given;
- complete deregulation was not an option because amounts of transfer values can be quite large and this is therefore an important issue for both members and schemes. There needed to be some certainty about the way that transfer values were calculated;
- the Government could not itself issue a new mandatory guidance note to replace GN11 because of the nature of the primary power in section 97 of the Pension Schemes Act 1993.

12. In the light of these factors the Government decided that the most appropriate way forward was to set out in legislation the principles that should underpin the calculation of transfer values. On 21 March 2006 the Government announced that it intended to regulate in this area.

Objectives

13. The Government's objective is to maintain the existing framework for the calculation of the value of pension rights and to do so at a minimal cost to pension schemes. In more detail, the objectives are as follows:

- (a) Any new arrangements should be fair to the transferring member, to members remaining in the scheme and to the sponsoring employer.
- (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 across all schemes.

Intended effect

14. The intended effect is that across all schemes, transfer values should remain at broadly the same level as they would have done had the current actuarial guidance (ie GN11) remained in force.

Common features

15. There are a number of features which are common across all the options and these are described below.

(i) Main affected groups

16. The main groups affected by the proposals are as follows:

- **the transferring member** The higher the transfer value the better it is for the transferring member. He or she is better able to replicate or improve their benefits in the new scheme.
- **members remaining in the scheme** The greater the amounts of money that are taken out of the scheme in the form of transfer values, the greater the risk to the funding of the scheme and therefore the greater the risk to their pension benefits.
- **sponsoring company and its shareholders** If transfer values for individuals leaving the scheme are above the levels at which the scheme is funded for those individuals, the company may be forced to make additional contributions to the scheme, to make good the shortfall in funding. Higher levels of transfer values may therefore be detrimental to the sponsoring company and its shareholders.
- **Government** The Government and the taxpayer stand behind public service pension schemes. Unplanned-for increases in transfer values would have to be met by redirecting expenditure from elsewhere in Government. The Government has overarching responsibility for all schemes for determining the transfers regime.
- **administrators and advisers** Pension scheme administrators and advisers, such as actuaries and independent financial advisers, would be particularly concerned that the new arrangements should be straightforward, simple to operate and easily explainable to members.
- **other users** The methodology for the calculation of pensions transfer values is used for other purposes including divorce and the disclosure of the value of directors' pensions in annual reports. Other users may therefore be concerned about significant changes in the methodology.

(ii) Geographical extent

17. Whilst all of the options would apply to the United Kingdom, Northern Ireland will make separate, corresponding legislation.

(iii) Implementation

18. It was originally intended that the new arrangements should come into effect on 6 April 2008. However in order to give schemes more time to prepare, the Government announced in October 2007 that the new regulations would come into force on 1 October 2008.

OPTIONS

19. In June 2006, the Government consulted on three possible approaches to the calculation of pensions transfer values⁶. (The Response to the Consultation was published in January 2007⁷.) The three approaches were:

(i) **Prescribed assumptions**

(ii) **“EXD54” basis**

(iii) **Scheme specific basis**

Counterfactual

20. The counterfactual is the position that would prevail if a new policy change was not introduced (ie the position if nothing were done). For this Impact Assessment the counterfactual is not straightforward. As previously described, the Actuarial Profession had decided to withdraw GN11 because it was no longer content that the framework for the calculation of transfer values which it prescribed was appropriate. (GN11 will be withdrawn once the new regulations come into effect.) Clearly therefore the GN11 requirements cannot strictly be described as the position if nothing were done. However in order to demonstrate the effects of the options in this Impact Assessment, and in the absence of any other suitable comparator, they have been measured against the position that would have applied if GN11 had remained in force in its current form.

Option 1 - Prescribed assumptions

21. Under the **prescribed assumptions** approach, the Government would set out in regulations the detail of how transfer payments were to be calculated. Regulations would set out in detail the assumptions to be used in the calculation and would limit the extent of any actuarial discretion. For example the regulations would define the mortality tables, the rate of inflation and the rates of investment return to be used in calculating the transfer value. The rules would apply to all schemes, funded and unfunded, in the public and private sectors.

22. The **prescribed assumptions** approach would be a “one size fits all” approach and it could be used in all kinds of pension schemes. It would be a transparent methodology and members could see how their transfer values were calculated. On the other hand, there would be difficulties in determining assumptions which were suitable for all schemes and thereafter ensuring that they remained appropriate.

23. This approach could be structured to meet the objectives, so that, for example, individual transfer values remained at broadly the same level after the new regulations took effect. However this would mean setting the assumptions, which would apply to all schemes, towards

⁶ Approaches to the calculation of pensions transfer values – Consultation document June 2006

⁷ Approaches to the calculation of pensions transfer values – Response to the consultation January 2007

[Both documents are to be found at: <http://www.dwp.gov.uk/consultations/2006/>]

the lowest common denominator. The regulations would need to be amended frequently to reflect changing circumstances for example in relation to the markets.

24. In the June 2006 consultation, this was the least popular option. The main concern that respondents had about this approach was that it would not take into account the circumstances of individual schemes.

Cost

25. **Numbers of schemes affected** The schemes primarily affected by these proposals are salary related schemes. It is not possible to estimate the cost impact on smaller schemes. Therefore for the purposes of this costing it has been assumed there will be no additional costs for all schemes with fewer than 12 members and for half the schemes with between 12 and 99 members. On the other hand, it has been assumed that all larger schemes will incur additional costs.

26. Since the consultation on the draft Impact Assessment, new figures on the numbers of occupational pension schemes have become available⁸. These new figures are used in the section below.

27. The estimates of numbers of schemes affected are as follows:

Private sector

Schemes with 100+ members: 3,340

Half of all schemes with 12-99 members: 1,345

Public service

All public service pension schemes: 310

28. **One off costs** Under this option, trustees and managers of the scheme would be responsible for the calculation of transfer values. Some one off costs would be triggered by this change.

29. In the consultation on the draft Impact Assessment, the only comments made about costs were in relation to the **scheme specific** option. The **scheme specific** option has therefore been revised in the light of those comments and those changes are discussed in detail later on. However for the purposes of costing the options, the costs of the **prescribed assumptions** and **scheme specific** options have always been assumed to be the same. The costs in this section have therefore been amended so that they continue to be consistent with the costs of the **scheme specific** option. Costs have now been presented in ranges and the figures below have been amended to reflect this change.

- administrators would need to become familiar with the new arrangements – estimated £130 per scheme;

- some actuarial input would be needed to review the scheme's processes – estimated £1,250 - £2,500 per private sector scheme. (Cost expected to be lower for public service schemes.)

In total a typical private sector scheme might face one off costs in a range from £1,400 to £2,600 under this option.

30. **Total one off costs** For private sector schemes, the total one off cost is expected to fall in the range between £6.5 – 12.3 million. For public service schemes the one off cost would range

⁸ *Occupational Pension Schemes 2006* published by the Office for National Statistics.

between £250,000 and £450,000.

31. **Annual ongoing costs** Schemes already have in place systems for the calculation of pensions transfer values and for reviewing the arrangements. The only new ongoing requirement is that more information has to be provided to members considering whether to transfer. However this new information is quite limited and once it is added to standard documentation, ongoing costs would be negligible.
32. **Non-monetised costs** None.
33. **Annual costs per organisation** This approach has no annual costs.
34. **Exemptions** All salary related pension schemes would be covered by this approach.

Benefits

35. “Benefits” effectively means benefit to the transferring member. However overall under the **prescribed assumptions** option, transfer values would be expected to remain at broadly the same level as they would have done had the current actuarial guidance remained in force. There would be no benefit to any particular group.

36. **Non-monetised benefits** Members would have greater certainty about the amounts of transfer values. There would also be less need for trustees to have to factor the scheme’s circumstances into the transfer calculation than is the case at present.

Key assumptions / Sensitivities / Risks

37. The key feature of this approach is that the Government would determine and set out in regulations all of the assumptions to be used in calculating transfer values. A key assumption is therefore that the Government would, in the first instance, be able to establish an appropriate and detailed framework for the calculation of transfer values which would be suitable for all types of scheme; and, thereafter keep it up to date.

38. The main risks arise from the fact that assumptions prescribed by the Government would be relatively inflexible. They would have to apply to all schemes large and small and such an approach might not be able to respond quickly enough to reflect changes, for example in the market.

Option 2 - “EXD54” basis

39. The June 2006 consultation included the “EXD54” approach, originally put forward by the Actuarial Profession in May 2005. This approach would lead to higher transfer values and hence would favour the member wanting to transfer out. It could also be used in unfunded public service pension schemes. On the other hand, this approach would be a more complicated and expensive way of calculating transfer values. It would increase the likelihood that employers would have to make extra contributions to the scheme. There could also be difficulties in trustees having to routinely and regularly assess the strength of the “employer covenant”, that is, the employer’s ability and willingness to support the pension scheme.

40. This approach would not meet any of the Government’s objectives. It would benefit the transferring member at the expense of members remaining in the scheme. It would not be consistent with the scheme’s funding arrangements. And it would increase the level of transfer values.

41. In the June 2006 consultation, only a handful of respondents favoured this approach. Most of these respondents favoured this approach because it would benefit former spouses – usually

women – where a pension is shared on divorce. The majority of respondents, including all the sponsoring employers who responded, were against the approach, many quite strongly.

Cost

42. **Numbers of schemes affected** It has been assumed that numbers of schemes affected would be the same as under the **prescribed assumptions** approach.

43. **One off costs** Administrative costs would be much higher under the **EXD54** approach and in fact they have been assumed to double. For private sector schemes costs would therefore range from £12.9 – 24.6 million; and from £500,000 to £850,000 for public service schemes.

44. **Annual ongoing costs** In terms of a cost benefit analysis, increases in the amounts of transfer values could be counted as a transfer insofar as the cost to the employer is balanced out as a gain to the member. However the perception by employers and others is that increased transfer values may well mean increased contributions into their pension scheme, which in turn would be a cost on their business. For the purposes of this Impact Assessment, increased amounts of transfer values have therefore been treated as a cost to the scheme and the sponsoring employer, but a benefit to the member. Under the **EXD54** approach, amounts of transfer values payable would increase significantly.

45. Where a private sector scheme is underfunded, transfer values can be cut back to reflect that underfunding. Where an actuarial valuation reveals a funding deficit, trustees must prepare a recovery plan for eliminating that deficit and must send a copy to the Pensions Regulator. There is no prescribed time limit for the length of the recovery plan, but for the purposes of this IA it has been assumed that funding deficits will generally be eliminated within a period of 10 years. Over time, there would be a significant increase in costs because of increases in the amounts of transfer values payable. When schemes as a whole had moved to a position where it was not necessary to reduce transfer values because of underfunding, the annual additional costs for private sector schemes could be of the order of £400 million a year. A progressive increase to this amount over the 10 years has been assumed. Because the underfunding provisions do not affect public service pension schemes, these schemes could see an immediate increase in costs of up to around £80 million a year.

46. **Non-monetised costs** Increases in transfer values of this amount would impact on a number of other groups. The sponsoring company and shareholders might be required to put additional funds into the pension scheme to make good amounts paid out as transfer values. Similarly in the public sector, unplanned for increased costs would have to be met by the taxpayer. There would be training costs for administrators and advisers, who would have to become familiar with the new approach.

47. **Annual cost per scheme** This cost would arise from increases in the amounts of transfer values. However a transfer value is determined by a member's salary and length of service. Amounts of transfer values are not related to scheme size. It would not therefore be appropriate to apportion annual costs in terms of the size of the pension scheme.

48. **Exemptions** All salary related pension schemes would be affected by this approach.

Benefits

49. The people benefiting from this change would be scheme members who transferred out of their schemes. The costs for schemes and employers under the **EXD54** approach would become the benefit for this group. For example for private sector schemes, the **EXD54** approach could lead to an average uplift in transfer values of the order of 35 - 45%. These increases in transfer values would give the transferring member a greater chance of replicating his or her benefits in

the new scheme.

50. **Non-monetised benefits** None.

Key assumptions / Sensitivities / Risks

51. Because transfer values can be cut back to reflect underfunding, a key assumption is the length of time that it is assumed that schemes, broadly, remain underfunded. This IA assumes a ten year horizon but if schemes generally become fully funded before then, that would lead to increases in costs above the levels assumed.

52. Another important assumption is that it is possible for the trustees to regularly and routinely come to an accurate view about the strength of the employer covenant. This is also one of the main areas of sensitivity. Differences in estimates of the strength of the employer covenant could lead to significant variations in transfer values.

53. There are a number of risks with this approach. The first is that it is not directly related to the way that the scheme is funded. The provision that the scheme is making for the members' benefits is not directly reflected in the amount of the transfer value, other than by the proxy measure of the strength of the employer covenant. Increases in transfer values could well result in increasing numbers of transfers out of the scheme. This in turn could lead to a weakening of scheme funding and a risk of scheme failure for those members remaining in the scheme. Finally there is a risk that the trustees may not be able to properly evaluate, routinely and regularly, the strength of the employer covenant. For example full up-to-date information about the employer's business may not be available to the trustees. Without full information about the employer covenant, there is the risk of transfer values being distorted.

Option 3 - Scheme specific basis

54. This approach is based on the expected cost within the scheme of providing the member's benefits. It is the approach currently contained in GN11. The approach is based on what the scheme estimates it would need at the time of the transfer to provide benefits for the transferring member if he or she had actually remained in the scheme. Under this approach, schemes would calculate transfer values by reference to assumptions and values consistent with – but distinct from – those used to assess the funding position of the scheme.

55. Most public service pension schemes are unfunded and on that basis would not therefore be able to fully adopt this approach. However guidance to be issued by HM Treasury would set out how key parts of the calculation of the transfer value are to be performed. The intention is that transfer values should remain at much the same levels as under the approach set out in GN11.

56. Taking the **scheme specific** approach forward into regulations would mean that schemes should only have to make a few technical changes to their arrangements.

57. In terms of the objectives, this approach would appropriately balance the interests of the outgoing member, the members remaining in the scheme and the sponsoring employer. The arrangements would be broadly consistent in approach, but distinct from, scheme funding arrangements. It would also mean that across all pension schemes, transfer values would remain broadly at the same level as they would have done had the current actuarial guidance remained in force.

58. In the June 2006 consultation there was overwhelming support for this approach.

Costs

59. **Numbers of schemes affected** The numbers affected are assumed to be the same as under the **prescribed assumptions** approach. For ease of reference the numbers are set out here again.

Private sector

Schemes with more than 100 members: 3,340
Half of all schemes with 12-99 members: 1,345

Public service

All public service pension schemes: 310

60. **One off costs** In the consultation on the Impact Assessment comment was made that the estimates of costs were too low and that for example some manual calculations might need to be done before computer systems had been updated. Comment was also made that the estimates of the actuarial input required needed to be revised upwards.

61. In October 2007, the Government announced that the coming-into-force date for the new regulations would be deferred until October 2008. From the date the regulations are published, schemes will have five months to prepare. The Government remains of the view that some of the costs of preparing for the new regulations can be contained within the normal cycles that schemes have for reviewing their arrangements. Nonetheless the Government accepts that it would be better to present costs as falling into a range, and the figures below have been amended to reflect this change.

- administrators would need to become familiar with the new arrangements – estimated £130 per scheme;

- some actuarial input would be needed to review the scheme's processes – estimated £1,250 – £2,500 per private sector scheme. (Cost expected to be lower for public service schemes.)

In total a typical private sector scheme might face one off costs of between £1,400 and £2,600 under this option.

62. **Total one off costs** For private sector schemes, the total one off cost is expected to fall in the range between £6.5 – 12.3 million. For public service schemes the one off cost would range between £250,000 and £450,000.

63. **Annual costs** As with the prescribed assumptions approach, these would be negligible. Transfer values would remain at broadly the same level as they would have done had the current actuarial guidance remained in force.

64. **Non-monetised costs** None. This approach rolls forward the current arrangements with which all parties are familiar.

65. **Exemptions** All salary related pension schemes would be affected by this approach.

Benefits

66. Under the **scheme specific** option, transfer values would remain at broadly the same level as they would have done had the current actuarial guidance remained in force. There would be no new benefit to any particular group.

67. **Non-monetised benefits** This approach would provide the trustees with greater flexibility; assumptions could be quickly amended to reflect changes eg in mortality. The approach would

also be much more consistent with the way that the scheme funds benefits for individual members.

Key assumptions / Sensitivities / Risks

68. The intended effect of these proposals is that transfer values would remain broadly at the same level as they would have done had the current actuarial guidance remained in force. A key assumption for the **scheme specific** approach is that schemes already calculate transfer values using a “best estimate” to determine assumptions. If a large number of schemes use some other methodology, the new regulations may alter the level of transfer values.

69. Because this is a **scheme specific** approach, transfer values would vary from scheme to scheme. If it becomes apparent that there are wide variations between schemes that may give rise to pressure from members and their representatives for a more prescriptive approach.

Admin burdens baseline

70. Under the **scheme specific** approach, schemes will be required to give more information to members considering whether to transfer. This information consists of (i) advice that the Financial Services Authority, the Pensions Regulator and the Pensions Advisory Service can provide more information on the advisability of transfers; (ii) the existence of the Pension Protection Fund; and (iii) that the member may wish to consider taking financial advice.

71. It is expected that schemes will meet this new obligation by adding some additional paragraphs to the standard documentation they already provide to members considering whether to transfer. There will be some minor one off costs in drafting these paragraphs but ongoing costs will be negligible. These changes would therefore have no effect on the admin burdens baseline.

Other issues

(i) Enforcement

72. The draft regulations do not provide for any new sanctions. The existing regulatory and enforcement regime that applies to occupational pension schemes would also apply in respect of these regulations.

73. Enforcement would be carried out by the Pensions Regulator. The Pensions Regulator has a number of sanctions at its disposal including the power to issue improvement notices and third party notices where necessary (sections 13 and 14 of the Pensions Act 2004). If these notices are ignored, the Regulator has powers, under section 10 of the Pensions Act 1995 to apply financial penalties.

74. There are also specific penalties attached to breaches of requirements in relation to transfer values. Section 93A(4) of the Pension Schemes Act 1993 provides for a sanction where a statement of entitlement has not been issued. Section 99(7) of that Act provides that where trustees or managers have failed to give effect to the member’s wishes in respect of the transfer, they can be sanctioned. Regulation 11(6) of the Occupational Pension Schemes (Transfer Values) Regulations 1996 (SI 1996/ 1847) provides that where any person has failed to disclose information in accordance with regulation 11, they may be sanctioned by the Pensions Regulator.

75. There will be no additional enforcement costs attached to any of the options. Any enforcement action would be counted in the Pensions Regulator’s existing regulatory regime.

Monitoring and evaluation

76. Trustees would need to review their arrangements to make sure they are fully aligned with the new regulations, but this should not be a major task. If however a scheme fails to take any action and there is reason to believe that the arrangements are not consistent with the regulations, the Government would expect the scheme advisers to make a report to the Pensions Regulator, as required by section 70 of the Pensions Act 2004.

77. If a member of a scheme has a complaint about the way that a transfer value has been calculated, and that complaint cannot be resolved within the scheme, that complaint can be taken either to the Pensions Ombudsman or the Pensions Regulator, depending on the nature of the complaint.

78. The Government intend to review and evaluate the policy in October 2011, three years after the regulations come into force.

SPECIFIC IMPACT TESTS

1. The other specific impact tests which have been considered are described in this section.

Competition assessment

2. The new regulations would not affect any particular market sector. Nor would they have any effect on suppliers. Instead they would affect any company which has a salary related occupational pension scheme.
3. The proposals contained in **EXD54** would have significantly increased the costs of transfers for these companies. Some of these companies could have been required to make extra contributions into their pension schemes. That would clearly have had a detrimental impact on their competitiveness.
4. The Government's preferred option, the **scheme specific** approach, would entail some minor, one-off costs in the change over to a system based fully on regulations, but those costs should not have any effect on competitiveness.

Small firms impact test

5. These proposals would impact on employers who have salary related occupational pension schemes. The three options would impact in different ways on small businesses.
6. The **EXD54** approach would lead to significant increases in transfer values, which in turn could lead to the sponsoring employer having to make increased contributions to the scheme. This approach would also add to the administration costs of smaller schemes. These costs would be higher than for the other two approaches.
7. The **EXD54** approach would also bring with it a particular difficulty for smaller pension schemes. A key point of the **EXD54** approach is that the trustees must make estimates, regularly and routinely, of the strength of the employer's covenant. In a small scheme where some of the trustees would also be part of the employer's management team, having to make such judgments on a regular basis could be difficult because there may possibly be conflicts of interest.
8. The **EXD54** approach would therefore be the least favourable to small businesses.
9. The other two approaches would be more straightforward for schemes to operate and hence would be better options for small employers. Both approaches would leave transfer values broadly as they are now; both approaches would involve some one-off administration costs but these would be lower than the **EXD54** approach. However the **scheme specific** approach would be more attractive to employers because it would mean that transfer values were set by reference to the features of that scheme, for example the scheme's investment strategy and its chosen reference point for mortality rates. Moreover the **scheme specific** approach would roll forward the existing arrangements as far as possible and so this would make the transition to the new regulation-based system much more straightforward.

Legal aid

10. There will be no impact on legal aid.

Sustainable Development, Carbon Assessment, Other Environment

11. It is not expected that these proposals will have any impacts in these areas.

Health Impact Assessment

12. The options have been considered against the screening questions for health impact assessments and such an assessment will not be necessary.

Race Equality, Disability Equality

13. The proposals do not have any consequences for race equality or disability equality.

Gender Equality

14. This issue is addressed in terms of the transfer values produced by the three approaches and whether the amounts so calculated are unfair or disadvantageous to men or women.

15. In terms of the amounts of cash equivalent transfer values, none of the options in the Impact Assessment would produce amounts which were unfair to women or men.

16. However in the June 2006 consultation, divorcing women were particularly mentioned by respondents as being unfairly treated by the current (GN11) arrangements. Where a couple divorce, the court must consider the value of any pensions the couple have in making the financial settlement. In practice, when the court orders that the pension be shared, this usually means that part of the man's pension is discharged into a pension credit for his former spouse. Many respondents said that the current (GN11) rules on the calculation of cash equivalents 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 members of the scheme but were required to move their pension rights to another pension arrangement, usually defined contribution in nature. Some respondents suggested 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.

17. The Government's view is that the primary purpose of the Impact Assessment is to determine the best approach for the calculation of cash equivalent transfer values generally. But the concerns expressed about the use of the methodology in pension sharing have been noted and will be given separate consideration.

Human Rights

18. The proposals are compatible with the Human Rights Act 1998.

Rural Proofing

19. The proposals have no specific impact on rural communities.

“EARLY LEAVERS”**Introduction**

1. The draft regulations which accompany this Impact Assessment also make a minor change to the Occupational Pension Schemes (Early Leavers: Cash Transfer Sums and Contribution Refunds) Regulations 2006 (SI 2006/33) (the “Early Leavers regulations”).

Background

2. From April 2006, people who have left an occupational pension scheme:
- a. whose rights have not vested and
 - b. have at least 3 months pensionable service in the scheme

have to be given the option of either a cash transfer sum to be sent to a pension scheme of their choice, or a refund of contributions. The cash transfer sum is calculated in the same way as a normal cash equivalent transfer value.

3. The legislation as currently drafted provides that the amount of the cash transfer sum is the amount at the date the member leaves pensionable service. However in money purchase schemes, administrative systems for paying cash equivalents transfer values are geared to the amount on the date of disinvestment, that is, the realisable value of the member's benefits. With early leavers, a period of several months can elapse between the date they leave service and the date of disinvestment. This is because early leavers have to be given a period to decide whether they want a cash transfer sum or a contribution refund. The amount of the cash transfer sum at the date of leaving service could well have changed by the date at which disinvestment takes place.

4. For cash transfer sums, schemes have not so far changed their administrative procedures so that they match the date the member leaves pensionable service. However if the regulations are not changed, schemes will have to change their administrative systems to make special arrangements for calculating cash transfer sums.

Amending regulation

5. The amending regulation will provide that the cash transfer sum is the realisable value of the member's benefits.

Consultation

6. The draft Impact Assessment issued for consultation proposed that this change would save schemes a one off amount of £500,000 on the basis that new systems etc would not have to be introduced.

7. However in the consultation on the draft regulations and the Impact Assessment one respondent pointed out that the primary legislation still required the notification to the member to contain the value of the money purchase rights at the date of leaving service⁹. The Department's legal advisers have confirmed that this is indeed the case. To change the notification requirements, an amendment to the primary legislation will be required, but this cannot be achieved by these regulations.

8. Clearly for members, the most important information is the amount of the cash transfer sum they might get, not the amount at some particular point in the past. Trustees will have to consider the content of the notification. The Pensions Regulator has been informed of this issue.

⁹ Section 101AC(3) of the Pension Schemes Act 1993.

Specific Impact Tests - Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	Results in Evidence Base? (Y/N)	Results annexed? (Y/N)
Competition Assessment	Y	N
Small Firms Impact Test	Y	N
Legal Aid	Y	N
Sustainable Development	Y	N
Carbon Assessment	Y	N
Other Environment	Y	N
Health Impact Assessment	Y	N
Race Equality	Y	N
Disability Equality	Y	N
Gender Equality	Y	N
Human Rights	Y	N
Rural Proofing	Y	N