



# GAD

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## Pensions Newsletter

### **Cash Equivalent Transfer Values New Proposals from the Actuarial Profession**

The Actuarial profession have issued for consultation proposals for a revised basis for calculating cash equivalent transfer values (CETVs). The new proposals would lead to a significantly different basis being adopted for most schemes. In many cases, at least over the longer term, this will lead to increased CETVs being paid. In our view, in addition to imposing additional costs on schemes, this gives an unfair advantage to leavers opting to transfer from a funded scheme over those members who remain.

The current principle is that the CETV should reflect the cost of providing the benefits within the scheme. Under the existing approach the discount rate is derived from the return expected from the scheme's underlying assets. For a typical funded scheme this means the return expected from a mix of equities, bonds and gilts. Corresponding CETVs in the public sector schemes are calculated using a premium over the return on gilts.

The new proposals ignore the scheme's underlying investments and derive the discount rate from bond or gilt yields having regard, amongst other things, to the financial strength of the employer. The greater the financial strength of an employer the lower the discount rate which could be used and so the higher the CETV. For the public service schemes this would imply a purely gilt-based discount rate which would result in higher CETVs than are currently payable.

At present most private sector schemes have insufficient assets to cover their liabilities. The existing legislation allows CETVs to be cut back to reflect that underfunding. A strengthening of the underlying basis could, for these schemes, be argued to be cost neutral. However in the longer term the funding position of schemes should improve and not all funded schemes are in deficit. It follows that CETVs will be increased if the new proposals are introduced. The cut-back provisions have no effect for the public service schemes and so the increase in cost would be immediate.

We understand the actuarial profession have made their proposals in light of the June 2003 legislation which required solvent employers to fund schemes to full buy out level if they chose to wind up the scheme. This legislation was not intended to influence investment strategies of ongoing schemes. Although there has been much discussion of the issue, there is little evidence to show schemes have made a substantial shift from equities towards bonds. Gilt-based CETVs would give leavers too large a share of scheme assets; and will increase contribution rates for employers. We consider these to be good arguments against strengthening the CETV basis in the way proposed.