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TRANSFER VALUES

A DEBATE

This House Believes that there should be a Statutory Minimum to Cash Equivalent Transfer Values payable from Defined Benefit Pension Schemes

[A Debate on the above Motion held by the Institute of Actuaries, 24 September 2001]

Background

With effect from 1997, transfer values paid from most occupational schemes have been subject to a statutory minimum amount, calculated by reference to the Minimum Funding Requirement (MFR). Before then, the amount of transfer values was left solely to the discretion of trustees and actuaries, in the latter case guided by the profession's GN11. Back in 1997, critics of the statutory minimum transfer value requirement argued that it was arbitrary, complex and often unsuitable for their particular schemes. Proponents countered that it did, at least, limit the range of transfer values paid by different schemes in respect of the same benefits and did something to ensure that deferred pensioners transferring could expect fair value.

Cash equivalent transfer values are used in a wide variety of circumstances other than on transfer. Examples of such uses include:

— the valuation of pension rights on divorce;
— the assessment of any 'debt on the employer' for schemes which wind up; and
— the assessment of directors' pension costs for company accounts (Greenbury disclosure).

The Myners Report on institutional investment, the recommendations of which have been accepted, in principle, by the Government, recommended the abolition of the MFR. At the time of writing, it remains a moot point whether any statutory minimum value will exist for transfers from final salary schemes.

The following references and extracts from GN11 are given for background information.

Statute and Regulations

The right to a cash equivalent is set out in Chapter IV, Part IV, of the Pensions Schemes Act 1993. The principal regulations giving effect to this right are the Occupational Pension Schemes (Transfer Values) Regulations 1996 (SI 1996/1847) (as amended). The detail of calculation methods is, however, set out in GN11, which has statutory recognition for this purpose.

GN11 Requirement

2.1 The purposes of the guidelines are (a) to ensure that members of retirement benefit schemes exercising a right to a cash equivalent can be assured that it fairly reflects the benefits otherwise available following withdrawal with entitlement to a deferred pension, (b) to ensure that incoming transfers are dealt with consistently with outgoing cash equivalents, ...

3.1 It is a fundamental requirement, stemming from the legislation, that a cash equivalent should represent the actuarial value of the benefits which would otherwise have been preserved. Such actuarial value should represent the expected cost within the scheme of providing such benefits and should be assessed having regard to market rates of return on equities, gilts or other assets as appropriate.

4.1 In the case of a scheme to which Section 56 of the Pensions Act 1995 applies (the Minimum Funding Requirement (MFR)), the cash equivalent calculated in accordance with Section 3 above shall be increased, where necessary, to the liability which would be calculated in accordance with GN27, as at the effective date of the calculation.

ABSTRACT OF THE DEBATE

The President (Mr P. N. S. Clark, F.I.A.): I should like to remind you that all the views which will be expressed are those of the individuals concerned. They are not necessarily those of their employers. In addition, the views that they express may not even be their own!

Mr J. M. Lowes, F.I.A. (proposing the motion)**:** In looking at why there should be a statutory minimum for transfer values, I want to deal first with the forms that regulation can take. There are two main approaches: regulation by principles, as in the guidance set out in GN11; or regulation by rules, with a fixed minimum amount set out in the detailed rules.

The main advantages of principles are the flexibility that these afford and that they can be applied successfully to varying situations. However, while there are problems with the Minimum Funding Requirement (MFR) — and I think that we can all agree that there are many problems with MFR as it stands — I think one problem that we have not found is with the ability to apply the MFR to different pension schemes. What we have found is that the pension schemes we deal with have benefits that are similar enough to be dealt with under a set of fixed rules. So, we have not needed the flexibility that would come from using principles rather than rules.

The disadvantage of using principles rather than rules is, again, flexibility — but, in this case, the flexibility that principles afford to different actuaries, or even to a single actuary working for different pension schemes, is to apply the principles differently, and to get different answers in identical circumstances.

In general, rules-based approaches are preferred — I do not mean just in actuarial circumstances, but in general — where you can get a succinct set of rules that apply successfully to all the circumstances that you come across. On the other hand, principles-based approaches are preferred where rules would not work, where it would be too difficult to frame a set of rules that worked for all circumstances, or else where the set of rules had to be so long and complicated that it became unworkable.

There is a third approach, widely referred to as freedom with disclosure. I had not even intended to mention this approach, on the grounds that it was self-evidently not workable nor applicable in the circumstances. However, I was reminded of it last week by the Department for Work and Pensions consultation paper on interim changes to the MFR. This approach, freedom with disclosure, relies on two things. It relies on the buyer or the decision maker having the freedom to choose between different products, based on the disclosure given, and it also relies on the buyer being able to understand the disclosure given. I do not think that any of us would argue that either of these applies to transfer values. Employees are only eligible to join the pension scheme of their own employer; they cannot choose to join pension schemes of other employers that might provide more generous transfer values. I think that we would also agree that the average member of a pension scheme would not understand the disclosures given about how transfer values might be calculated. So, it is quite evident that freedom with disclosure is just not applicable to pension scheme transfer values. In other words, scheme specific funding targets and pension scheme transfer values based on scheme specific funding targets are just not workable.

Therefore, if we are going to have regulation of transfer values at all, we need to choose between the first two approaches — rules or principles — but we do have to look quickly as to whether there needs to be regulation at all, or whether there can be just a free for all. This is essentially a political question rather than an actuarial one. However, it is an old political question. The Pension Schemes Act 1993 requires there to be cash equivalent transfer values available to all leavers from pension schemes. That cannot be interpreted sensibly as meaning: "You must make a transfer value available, but we do not care how you calculate it.'' That is just nonsense. It must mean: "You must make a transfer value available, and it must be calculated on a sensible basis.'' So, we do need regulation.

We need to choose between the two approaches. We do not need the flexibility afforded by a principles-based approach, so there is no advantage in a principles-based approach; so, we might as well go for the rules-based approach, which does have the advantage of giving similar answers from different people in the same situation. Many people have argued against this, and have said that the introduction of the MFR, rather than improving the position for members, actually makes things worse, with pension schemes bringing down transfer values to hit the new minimum. I do not accept this argument.

First, I think that it is a misleading view of what happened in 1997. Yes, there were some pension schemes that reduced transfer values, but there were many others which were forced to increase them by the new MFR and cash equivalent legislation. There was a survey of transfer values in the early 1990s, looking at the range of transfer values that were being quoted by pension schemes. I was a recipient of two different letters from the Institute in respect of that survey in respect of two of my clients, telling me that my transfer values for those two clients were out of line with the majority, and would I not like to review them and increase them? Needless to say, I did not. The guidance was flexible; I could justify the transfer values that I was quoting within the guidance; my clients did not want to increase the transfer values; my duty to my clients overrode the letters from the Institute; and I stuck exactly where I was. Exactly the same would happen now if we removed the minimum that applies to cash equivalents. We would have clients pushing us down to levels at which we might be uncomfortable, but, as long as we could justify them within the guidance that was given, we would be forced to go down that route.

Secondly, we cannot turn the clock back. Even the pension schemes that reduced their transfer values back in 1997 would not increase them again now if we removed the minimum. Companies are much more aware of the financial impact of pension schemes on their businesses, and there are many fewer paternalistic employers around now. The removal of the minimum would not be an opportunity to increase transfer values; it would be a chance to push them down further.

I believe that there are particular reasons now why it would be a bad time to remove the minimum. The cost of pensions has increased enormously over recent years, due to increased life expectancy and lower real interest rates, but pension scheme trustees and the companies that sponsor pension schemes have really not woken up to the magnitude of the increasing cost of pension schemes. They are still living in the old world, where pensions were much cheaper. If we remove the minimum transfer value, the level of transfer values that those companies, those trustees, would expect, would be much lower than they ought to be. It would put us, as a profession, in a very difficult place. We would be having to deal with clients who firmly believe that the right answer is a very small answer, and one that we are not happy with. By keeping an appropriate minimum transfer value, it can protect us as individuals, and the profession as a whole, against that pressure from clients.

Keeping that minimum will also protect the pension scheme trustees themselves. They have a very difficult conflict of interest. Many of them are managers in the company as well as being pension scheme trustees. As managers of the company, they want to drive down transfer values. As trustees, they should be looking after the interests of the members. Keeping a minimum transfer value will, at least, mitigate that conflict of interest.

The most dangerous aspect, I think, of removing the minimum transfer value would be in relation to actuaries themselves. Unfortunately, I think that all too many actuaries have not appreciated just how much the cost of pensions has increased. They have not accepted the idea that the pension promised has cash flows that look like a bond, can be hedged with bonds, and should be valued as an equivalent portfolio of bonds. They still have this odd idea that, by investing in equities, you can change the value of the pension promise. As long as we have actuaries out there who believe these odd ideas, we have a problem. Removing the minimum transfer value, and relying, instead, on guidance, would give those actuaries the freedom to calculate inappropriate transfer values, and that would weaken the reputation of the profession. Indeed, this is illustrated by recent public comments made by many actuaries that the MFR test should be weakened. Everybody will agree that the value of MFR liabilities has increased. However, the value of MFR liabilities has increased, in general, by far less than the increase in

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the underlying cost of pensions. If we want to maintain the level of protection to members — and it is a good question whether we do want to maintain that level — we would have to increase or strengthen the MFR, not reduce it. That question illustrates the problem that we have in relation to transfer values. As long as we have people out there who think that the MFR is too strong, we have a problem with removing minimum transfer values.

Reaching a consensus as to how that minimum transfer value basis should be set will not be easy, but avoiding that problem of reaching a consensus by removing the minimum altogether is not a solution. It will just leave some pension scheme members to suffer inappropriately low transfer values.

Finally, I want to illustrate the weakness of guidance by referring to a letter from the then Chairman of the Pensions Board of the Institute, issued on 28 April 1999. This reminded actuaries that life expectancy had increased and that limited price indexation (LPI) had become almost as costly as a full price indexation, given the current low inflation. Actuaries were asked to consider increasing their transfer values accordingly.

I should like to ask anybody here who increased his or her transfer values accordingly to indicate. I am not surprised that nobody indicated. So, that illustrates the power — or should I say the weakness — of guidance, and shows why we need a minimum transfer value.

Mr C. G. Singer, F.I.A. (opposing the motion)**:** There is one key word in the motion which I should like you to bear in mind as I summarise the case against the motion. That word is 'statutory'. We are not debating whether, for example, the profession might wish, in its wisdom, to discuss the merits and demerits of a minimum cash equivalent, and specify one such for members of the profession; we are debating whether there should be a statutory minimum, with all the inflexibility and regulation that that entails.

Do you remember a time when actuaries were trusted professionals? Do you remember a time when the sole requirement upon you was to think carefully about the issues, discuss them with your clients, and reach conclusions without unnecessary statutory interference? Amazingly, this was not really very long ago. Probably the worst pensions legislative mistake in recent years was the introduction of the ill-fated MFR. It now seems to me, at least, slightly ludicrous to think that a test designed for pension schemes, which last many decades, has, itself, lasted only a few months.

Why has it failed? It has failed because neither actuaries nor legislators can predict the future with 100% certainty. If only we had known, in 1995, that a new Labour Government was going to remove the tax credit on United Kingdom dividends and blow our dividend discount model out of the water, maybe we would have come up with a different test, but we did not.

We pride ourselves in being an intelligent profession. Would it be intelligent to ignore the lessons learnt from this experience of an inflexible calculation routine imposed by statute?

One might reasonably ask oneself why it was necessary for there to be such an animal as the MFR cash equivalent in framing a new solvency test. Even if we were all agreed that there should be a statutory calculation of asset cover on some agreed basis, and that that basis should include evaluation of deferred pensions, why should that necessarily flow through into the calculation of the transfer value payable for the member when he or she leaves a scheme? There remains, to my mind, considerable confusion in this area, and we need to be clear thinking, as our rigorous training has taught us to be, about the different purposes of the valuations that we make — in particular, what applies for an asset cover calculation does not need to apply for a member's option.

This brings me to the consideration of the different situations in which a cash equivalent is now used. There are four: transfer on leaving service; divorce calculations; GN19, employer debt; 'Greenbury', directors' disclosures. I now consider these in turn.

The normal cash equivalent for a member leaving service and choosing to transfer his or her benefits to a new scheme is an option. The member can always choose to leave his pension in the scheme. As such, it would be reasonable for this option to be priced by reference to the views of the interested parties after considering actuarial advice. Indeed, on a reasonable interpretation of paragraph 3.1 of GN11, that is exactly what we are expected to do. I quote: "Such actuarial value [i.e. of the cash equivalent] should represent the expected cost within the scheme of providing such benefits [i.e. the alternative deferred pension] and should be assessed having regard to market rates of return on equities, gilts or other assets as appropriate."

This seems to me to require the actuary to take into account scheme specific circumstances, particularly investment policy, in framing the cash equivalent basis. How can a statutory minimum take into account the differences between thousands of schemes? Further, why should, for example, a set of trustees or a plan sponsor be artificially constrained in their choice of the price of the transfer option when sufficient constraint is surely imposed by the need to ensure, as in GN11, paragraph 2.1 (a), that the cash equivalent fairly reflects the benefits otherwise available?

There is a further requirement for consistency between transfers out and transfers in — paragraph 3.6 of GN11 — and this also constrains the position for schemes offering added years on transfers in. Different actuaries with different clients may well reach different conclusions on the basis to use, depending upon, perhaps, whether they are seeking to encourage transfers in or, possibly, because they follow different funding strategies. (It would be interesting to hear from the proposer the reasons why his particular clients had low transfer values and were encouraged by the Institute to have slightly higher ones. I think that he was slightly arguing against himself, as this flexibility for the actuary to choose the basis, with his client, is precisely why the basis should not be prescribed by statute.) Maybe the client has a scheme with very few active members, but many deferred pensioners. Such a scheme has a risk of a large outflow of assets by cash equivalents, especially if overgenerous terms are set. If the actuary, acting in good faith, together with his client, decides that lower transfer values may have applied if the fund had less risk of a large outflow, then should they not be able to take such a decision free from arbitrary state interference?

Turning now to cash equivalents on divorce, provided that the same basis is used to assess the effect on the member's entitlement as is used to price the amount payable to the ex-spouse, then the effect on the member's benefits on the divorce is independent of the choice of basis for the cash equivalent. The issue is one of the amount payable to the ex-spouse from the pension scheme, for whom, objectively, the trustee, the plan sponsor and the actuary have no fiduciary responsibility. Perhaps, therefore, one might be able to argue that unscrupulous actuaries and trustees would disadvantage the ex-spouse by placing an artificially low value on the member's deferred benefits.

Of course, I hardly need remind an audience as august as this one that this could not happen if a requirement is imposed that the cash equivalent for divorce purposes is the same as that used for ordinary cash equivalents. This is the present position under GN11 (see paragraph 1.6). So, I see no value for any party in having a statutory minimum cash equivalent for divorce calculations.

The MFR cash equivalent also forms a part of the debt on employer regulations, referred to in GN19. Perhaps the thought of a statutory underpin to define the pensions debt on an employer, should an insolvent employer have the money, sounds appealing. However, of course, we are entering the post-Myners world, where there will be no MFR. If we have no statutory defined solvency requirement — and this seems inevitable now — how could we then impose a statutory defined minimum of the MFR, or otherwise cash equivalent, for deferred pensioners? This would be an MFR, by another name, for only part of the pension liabilities, and would ignore that most significant group, pensioners. I cannot believe that this is Myners' vision, nor that the Government will allow such a fragmented, backdoor minimum statutory solvency requirement. I recognise the different position of a solvent employer, as referred to in last week's Department of Work and Pensions consultative paper. However, it looks as if such employers may be required to finance buyout terms on a wind up, and so, again, a statutory cash equivalent basis is not required. Therefore, I do not see how, in a post-MFR world, there could be such a thing as a statutory defined minimum cash equivalent for the employer debt requirement. Therefore, in my view, this is not worth debating any more.

Another use for the cash equivalent is in directors' disclosures under Greenbury. These, as you know, are just that — disclosures. They serve the interests of shareholders and close examiners of accounts by placing a reasonable value on the accrual of pension over a given year by a director of a U.K. company. I can see no reason why the Stock Exchange would not accept such a cash equivalent to be calculated on the normal scheme cash equivalent basis. If there is then a required further disclosure of the main elements of that basis, then so be it.

So, does a statutory minimum cash equivalent achieve anything? Some may argue, like the proposer seemed to, that, in the absence of a statutory minimum, you cannot trust actuaries and their clients to put a fair value on the cash equivalent. Some actuaries may not have read about trends to longevity, and they may be bullied by their clients to put unfair, low values on the alternative deferred benefits. Shame on such actuaries! Do we really need the force of statute to avoid an aggressive client inappropriately requiring a mean cash equivalent basis? With GN11 requirements for a fair value, and the observation that the possible loser from such a policy might be the plan sponsor himself, who ends up with a long tail of possibly rising liabilities, because most will not transfer, surely the actuary has armoury enough!

Does it add anything more? Yes, it adds to the complexity of schemes, it increases administration costs, and, possibly, in a scheme with a large portion of deferred pensioners, active members may impose additional costs and constrain investment strategy. In addition, it stops us thinking and taking responsibility. I know that there is always a downside to responsibility in these litigious days, but I would much prefer all actuaries to have the responsibility of thinking about these things for themselves, and, with their clients, to reach a conclusion, than half a dozen actuaries, albeit hugely talented, experts in their fields, intelligent and well trusted, doing so on our behalf in a closed-door fashion with the authorities.

I have been unfair. Of course there will be consultation about such matters, but consultation, as we have seen with the MFR, is a highly imperfect way of reaching a consensus in a world as challenging, difficult, but fun, as the world of pensions for actuaries. Why? Because different actuaries have different clients in different circumstances with different preferences. A statutory minimum one-size-fits-all cash equivalent is nearly as foolish as a statutory standard shoe size for all shoe manufacturers. Unsurprisingly, people have different sizes of feet, and a standard shoe size would be too big for some and too small for others. Our consumers, pension schemes, their sponsors and members, are more complex, but the absurdity of the principle is the same.

So, where are we? In summary, a statutory minimum cash equivalent is inappropriate for valuing a deferred pension option, and irrelevant for divorce, GN19 and Greenbury purposes. With the backing of the Government, Paul Myners has opened the door to a freer regime with transparency. We would be uncharacteristically foolish if we did not learn from the recent MFR experience. We do not need a statutory minimum transfer value. Indeed, I rather doubt whether we even need to agree one within the profession. I am unashamedly delighted that the Myners Report has given us the opportunity to reclaim some of the job satisfaction which always was ours, and could still be. Indeed, it is more than just job satisfaction. Statutory valuations teach the majority of actuaries not to think for themselves. This is why we are starting to hear words of nervousness from our opponents, such as the proposer, and defendants of the MFR. They have forgotten how to think through the issues, and give real, valuable and tailored advice to their clients.

I end with a quotation from John Milton — even though he was not an actuary — who, in 1644, wrote: "Where there is much desire to learn, there of necessity will be much arguing, much writing, many opinions; for opinion in good men is but knowledge in the making.''

If you wish to continue to be a trusted professional adviser and you wish your successors to be so, and if you wish our profession to build on its enviable reputation for thoroughness and putting knowledge into practice, do not stifle debate in the development of knowledge by the imposition of a statutory minimum cash equivalent. Use your vote intelligently, and vote against the motion.

Mr P. D. G. Tompkins, F.I.A. (Chairman of the Pensions Board)**:** I warmed very much to the proposer's arguments that bonds are the best match for liabilities that people have when they leave benefits in a pension scheme and then wish to transfer them elsewhere. This means that the value of liabilities should be addressed, as we have come to realise, by reference to the matching assets which are appropriate to cover those liabilities. This implies that the cash equivalent of a benefit given up does not depend on the scheme from which those benefits are to be transferred, as the opposer has suggested that it should. However, where I differ from the proposer, and side with the opposer, is in the ability of the state or the Pensions Board to specify a 'statutory basis'. Demographic values do need to depend on an assessment of a scheme, or even circumstances, as to life expectancy, retirement decrements, and so on. Valuation assumptions are better drawn from market assessments made by actuaries individually.

What I think that the profession needs to do in this period of reflection, as we look to the way in which we, as actuaries, seek to gather the enjoyment that the opposer referred to in assessing the way in which our valuations are done, is to think about the way in which we prescribe the methods that we employ, rather than about the basis that we are to use. So, perhaps, we need to look at GN11, and the clarity with which that specifies the way in which the actuarial value of benefits should be determined.

I take on paragraph 3.1 of GN11, which is the one which appears in the introductory note, which states that an "actuarial value should represent the expected cost within the scheme of providing such benefits ... having regard to market rates of return on equities, gilts or other assets as appropriate."

I suggest that the wording in that paragraph is somewhat unhelpful, particularly those wonderful words 'as appropriate', and that it should be consideration of what we mean by 'appropriate' that we take as the cue to our discussions over the next year or two. I think that we need to think about the way in which we pay reference to corporate bonds and the returns which they give to those who are seeking to back the liabilities that they take on when they take transfers, for example, to insured schemes, and we ought to consider the appropriateness of having references to equities there when, in fact, the backing liabilities for other purposes, generally, these days, are seen to be corporate bonds, with their greater margin over gilt edged stocks, in the endeavour to achieve the appropriate backing of the liabilities with an asset which matches the payouts that those liabilities deliver.

So, I oppose the motion, though, perhaps, for slightly different reasons than those given by the proposer and the opposer.

Mr B. H. Davies, F.I.A.: About 12 years ago I produced a pamphlet, based on some research, called *What Is Wrong with Transfer Values?* There are all sorts of things wrong with transfer values, particularly from the perspective of the plan member. I am sure that most pensions actuaries are aware of the concern and lack of understanding on the part of scheme members as to what happens to their rights when they transfer from one scheme to another. I think that we should listen to, and try to respond to, those concerns.

One of the major problems is that the early-leaver benefit is wrong. We are not debating that here, so we can leave that, but, if even we accept the early-leaver benefit, the next major problem which I identified in the pamphlet was that different bases were being used by different actuaries. Going back 12 years, the range of bases being used by actuaries for transfer values in a world where each actuary was left to make up his or her own mind was astonishing, and led to considerable concern on the part of the profession at that time. So, do not let anyone go away with the idea that freedom will arrive at a satisfactory situation. The Institute was then very concerned about what was happening, and letters were written to people like the proposer, asking for greater consideration to be given to narrowing the range of bases that were being used.

At that time there was some protection against the range of bases, because, for many schemes, transfers in and transfers out balanced. That is becoming less and less true. Many schemes now refuse to accept transfers in. Those that do are only prepared to accept them on the basis of a money purchase credit. So, this element of protection for members has gone. There is a greater risk of too many schemes setting their transfer values on an inadequate basis. This is an unacceptable and unsustainable position for the profession and the pensions industry to place themselves.

I can quite understand, and fully accept, the concept of scheme specific transfer values. There is a range of different circumstances in which schemes find themselves, but I think that the proposer is right; the experience of the MFR has shown that the scheme specific circumstances can be dealt with within a standard basis. What concerns me more is the idea of 'actuary specific transfer values', where the actuary's view is driven by the needs, probably all too often, of the plan sponsor. Essentially, what those opposing this motion are seeking is the right for schemes to shortchange early-leavers when this is considered to be in the plan sponsor's interests. That is the danger that we face. The only way of avoiding that is for the Institute to draw up a standard basis, which has statutory backing, that we can all, then, apply.

Mr L. Edmans (a visitor)**:** Following on from what Mr Davies has just said, a survey was conducted in 1993, which enumerated the ranges in the amounts of transfer values when they were calculated on many different bases. I think that it might be useful to have some of the ranges that Mr Davies has described enumerated, so that those people who are considering this issue can think about them.

From that 1993 survey, the range for a male aged 30 for a paid-up pension of £1,000 at 65, with statutory revaluation and LPI pension increases, was a transfer value of between £1,500 and £6,000. The range for a man at age 45 was between £3,000 and £6,250, and the range for a man at age 60 was between £6,300 and £11,000. I think that this underlines the point that both Mr Davies and the proposer have made very clearly, and argues for the presence of some form of minimum basis in the interests of the members.

There were some equally interesting statistics as to the transfer values which, at that point, were granted by pension schemes advised by consultancy firms as opposed to those by insurance companies. On average, the transfer values calculated by consultants were approximately 15% less than those that were quoted by insurance companies. I leave you to draw your conclusions from that. I think that the evidence supports what Mr Davies said very clearly indeed. Were I allowed to vote, I think you know where I would be.

Mr T. J Gordon, F.I.A.: If we believe that the actuarial profession has some spine and some understanding of long-dated liabilities, then we do not need a statutory minimum. The proposer argues that it does not, and therefore we need statutory backing. I think that he has demonstrated here, by example, that the profession has problems without statutory backing, and that really clinches it for me, provided that we listen to what he said, and get the statutory minimum correct — that is, base it on bonds.

This leads me to some of the opposer's comments. He referred to the MFR being based on the dividend discount model, which apparently worked until the Government interfered. I think that that is contentious. I suggest that it did not work anyway. It is very sad that it took such a traumatic event to blow away this myth from actuarial dogma. I am sympathetic to the fact that transfer values, in the day-to-day running of an ongoing scheme, are options for the members, but then it does seem that, unfortunately, many other important matters hang from them. The key point is when the member has no option.

As a profession, we still seem to fail to understand the impact of investment policy on the valuation of deferred benefits. A good reference is paragraph 3.1 of GN11. The first sentence is great. It says: "It is a fundamental requirement ... that a cash equivalent should represent the actuarial" (I am not sure what the word 'actuarial' means) "value of the benefits which would otherwise have been preserved." The second sentence was presumably drafted by those actuaries with odd ideas, to whom the proposer was referring. In particular, it refers to the rates of return on equities. No sensible model to price defined payments — that is payments of £x in n years — that I have come across would actually refer to the expected rate of return on equities. This is very fundamental to corporate finance and financial economics. It is absolutely key. You might have equity volatility in there; you might have a credit risk or all sorts of other things, but expected returns on equities would not make it.

I also recall the scandal of wildly varying transfer values. I think that it does our profession no credit, especially when the problem of pricing deferred pensions is not actually that difficult. The fact that something is not in the Myners' Report nor in the Government's vision does not make it wrong.

Finally, I should just like to revisit the comment about shoe sizes. Having only one size of shoe is obviously a silly thing, but that is not what a statutory minimum is. It means that you have a standard shoe size scale, which is rather a useful thing, I think.

Ms W. M. Beaver, F.I.A.: I add my voice, on a personal basis, against the motion, but it will be with some caveats, which I now explain.

As we know, cash equivalents or individual transfer values represent the cost of providing the preserved benefits to which the member would otherwise have been entitled. That is, and always has been, a fundamental principle of GN11. The GN11 requirement is that, as we have heard, the transfer value should represent the expected cost within the scheme of providing such preserved benefits. As the opposer has mentioned, after the introduction of MFR, GN11 was clarified in this respect, to state that the value: "should be assessed having regard to market rates of return on equities, gilts or other assets as appropriate".

However, while I agree with the comments of the Chairman of the Pensions Board that the inclusion of the words 'as appropriate' is probably inappropriate, I am comfortable that the choice of basis is left to the professional judgement of the Scheme Actuary. All of this is, of course, subject, at the moment, to a statutory minimum floor provided by the current MFR underpin. However, that statutory underpin will presumably fall away when the MFR is abolished, unless it is replaced by another, which, of course, is why we are having this debate.

It is interesting, at this point, to look back at the conclusions of the Goode Committee, which reported on the issue of pension law reform to the then Secretary of State for the Department of Social Security, and whose recommendations informed the Pensions Act 1995. That Committee pointed out that different schemes have different experiences, different membership profiles, and different investment strategies. The Goode Committee concluded, therefore, that it would be quite wrong to impose standardised bases for the calculation of the transfer value for all schemes. However, the Committee's conclusion was caveated. The Committee believed that the bases under GN11 were too wide, and recommended that the actuarial profession should be charged with the responsibility for tightening them, so that the possible range of transfer values, of which we have heard some figures in this discussion, would become narrower. In fact, anecdotal evidence suggests, particularly in most recent conditions, that the range of transfer values has narrowed considerably, but more as a consequence of values being calculated at, or close to, the statutory minimum MFR basis.

There is a sense that, if the underpin were removed, unless there were no statutory minimum basis, we might go back to square one, and an unhealthy range of values across the profession could become applicable to the transfer value amount. While I am in favour of there being no statutory minimum basis, because I am in favour of professional judgement being applied, I should not like to see the re-emergence of disparate values for cash equivalents across the profession.

If there were to be no statutory minimum cash equivalent transfer value, then clearly, we in the profession should look to ways of maintaining a reasonable uniformity of approach to the calculation, but that should not get in the way of individual professional judgement. I should like to look for some sort of norm from which the actuary was entirely free to depart where the circumstances justified it.

I would also suggest, if this met with the Government's policy intentions, that there should be, in any case, a standard document for disclosure to the members, which set out clearly what the policy of the trustees was for calculating transfer values, after consultation and advice from the Scheme Actuary. This document should clearly be framed in as clear English as possible, and should set out to members the basic principles for calculating the transfer value, the trustees' policy on allowing for discretionary increases, and whether or not there was any non-standard feature of the calculation, perhaps peculiar to the type of scheme or to the circumstances of that

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scheme, that was worthy of note. Obviously, this statement for the transfer value calculation should link to other disclosure documents of the scheme, as presently proposed by the Government — for example, on funding and investment policy. Such a disclosure statement to members would go beyond the statutory measures already in place, but would, I think, be in keeping with announced Government policy on making the trustees' intended policy on funding and investment strategies transparent to members.

I now refer to the comments of the proposer, where he said that he was firmly against freedom with disclosure, which is what I am arguing for. He said that it was self-evident that freedom with disclosure is not applicable to transfer values, but I would respectfully put that it is not self-evident to me. The first ground on which freedom with disclosure was argued to be not applicable to transfer values was that the buyer should be free to choose. Well, the potential occupational pension scheme member does have a choice. He or she can choose not to join the pension scheme, and to make personal investments elsewhere. Arguably, that might be particularly appropriate if the potential member is contemplating, at some point, that he or she might be an early leaver at some time in the future. The member should be able to make that choice, in my view, on a fully informed basis. The member should also be free to contact the trustees and to ask them questions about their policy, and he or she should be able to do that from a fully informed standpoint.

The second ground argued that freedom with disclosure would not work is that the member would not understand transfer values. That is merely a challenge for some actuaries, not an insoluble obstacle, as the President has encouraged all of us to overcome, in terms of improving our communication skills.

I add my own voice to those who argue against the motion. However, that is with the caveat that the actuary's professional judgement for setting the calculation of transfer values should be formed after careful consultation with the trustees, and with a view to setting out the framework clearly and understandably in a trustee policy statement for members. I believe that actuaries are up to that challenge, and I would encourage all of them to try.

Mr P. M. Greenwood, F.I.A.: I return you to the motion, because there have been many comments that are not relevant to it. The motion does not mention the current wording of GN11, so that is irrelevant. The motion does not say: "If you vote for this motion you wish to restrict funding freedom." So that is irrelevant.

Much of what I was originally going to say replicated what the proposer said, but I was very taken by the opposer's eloquence. Again, it was so eloquent that many of you might have not spotted its irrelevance. Quoting rules on transfer in and transfer out is not relevant to the motion. The current wording of GN11, as I have said, is irrelevant.

Many in the profession, when asked what a transfer value should be, would say that that was a political decision. If they believe that a transfer value is a political decision, they have to vote in favour of this motion, as it is drafted. Fundamentally, Mr Gordon and I have similar views on financial economics, but we are probably going to vote on opposite sides of this debate. I would ask him to consider one thing; voting for a statutory minimum transfer value does not depend on whether you support equities or bonds as the basis of the valuation. Again, it is irrelevant. First of all, society — and that is why it is a political decision — has to decide what degree of risk is attached to the pension promise. Do we want that degree of risk to have an underpin, or do we want it to vary substantially from scheme to scheme without underpin? In a world where the supply of adequate independent financial advice, capable of operating in a freedom and disclosure regime at economic cost to the membership in this country, is just not there, then society, I would say politically, is bound to produce some simple definition, understandable by members, of what the pension promise risk is. Regarding anything which depends on freedom and disclosure via an actuary's funding statement, I have seen attempts at drawing up a Myners' transparency and disclosure statement four or five pages long. An actuary understands it; a lay member has no chance whatsoever. Therefore, I believe that transfer values should be a political decision.

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Also, we still live in a market economy. If we live in a market economy, any transfer value which is more than the market assessed value, that is alternative benefit, would be too high, and the scheme sponsor would object to it. Any that is too low, if the member had proper advice available to him, he would not accept. Therefore, I will be voting in favour of the motion, on the grounds that I believe it represents and permits a political decision about the level of pension risk, with the statutory setting of a basis, advised by the profession, that is a market assessed basis of that risk. To blame things like the MFR, which did not satisfy that rule and assessment, as supporting failure of this motion will be very false.

Mr J. G. Spain, F.I.A.: For the avoidance of any doubt, these are really my own views. I am not sure about previous speakers.

We are a numerate profession, yet I look at this motion and I think: "Where are the numbers?" "This house believes that there should be a statutory minimum ..." — what does that mean? Does that mean that a particular statutory minimum will be okay, but another would not, or do we not want any statutory minimum, or do we want it to be very high? Picking up on what was said by Mr Davies and Mr Edmans about the variations of transfer values some years ago, is the problem that they were too low? Is the problem that there was too much variation? Is the problem that they were too high? Probably, it is all three. What is it that we will be voting for? If we vote for the proposition, I am not sure what it is we are going to be saying, either to the profession, or to the Government, or to society as a whole. Frankly, society, as a whole, does not really understand what is going on, and that is the root problem of defined benefit pension schemes. They do have a very valuable role, but no members really understand them. Mr Greenwood is quite right. Trying to set up a transparency statement along the lines of 'Myners' is going to be great work for consulting actuaries who are experts in communications, trying to explain these to members of pension schemes who, after three minutes, will nod off and later ask the chap next door: "Did you understand what was going on?"

I think that the only honest thing that we can do, because this motion is so badly worded for a numerate profession, is to vote against, not necessarily because of the arguments, but because we do not know what it is that we will be voting for.

Mr A. Evans (a visitor)**:** I am an auditor — someone from the profession where judgement is right at the cornerstone of what we do, and where even 'true and fair', as many of you know, is not defined. So you would imagine that I would be in a camp for supporting a judgemental basis.

However, auditors do not calculate anything. In fact, some wag in the *FIASCO* magazine once commented that auditors do not do a great deal; they just watch others, and then pass an opinion.

I feel strongly, however, that when it comes to something that directly affects members' entitlements, it is fundamentally different from what I am used to, and therefore we should examine the circumstances quite closely. I believe that we are in a world of transparency — a very important word — and therefore, if we are in that world, I am supportive of the views from Ms Beaver about disclosure of information and the disclosure statement. It seems to me, irrespective of whether it is statutory or non-statutory, actuaries and others have an obligation to communicate with the members just what basis is to be adopted. I feel that this is within the capability of the actuarial profession, and others like myself. Therefore, were I able to vote, I would be voting against the motion, and therefore cancelling out the vote of the other guest who has spoken.

Mr W. Law, F.I.A.: I am an actuary employed by Opra. My comments, as with others in this debate, are very much my own, and not those of my employer. However, they have been formed as result of working for the Pensions Regulator.

The original intention of the much maligned MFR was, I understand, to ensure that all

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pension schemes would be in a position, at all times, to meet their minimum obligations, whether that scheme was ongoing or winding up. By 'minimum obligations', the DSS (at that time) meant that the pension scheme had sufficient assets to be able to buy out all pensions in payment with an insurance company, and that all other members had a 50-50 chance of matching their accrued benefit entitlements elsewhere, by payment of the minimum cash equivalent transfer value, whatever else might be happening to the scheme.

As a former member of five different pension schemes, I believe that the original concept of the MFR would have been as welcome to all other pension scheme members as it was to me. What has happened in practice? We now have hundreds, if not thousands, of small schemes in wind up, and some bigger ones as well, many with MFR deficits, and many deferred members with much reduced pension expectations, where payments for transfer values have been delayed by months, if not years. In addition, we have many schemes which are closed, but the employer may not be able to afford to wind them up at the present time, and voluntary wind up is going to cost them more in the future.

Many commentators have welcomed the proposed abolition of the MFR, on the grounds that it means that employers will not have to pay as much as a minimum as their current schedule of contributions requires. I wonder if they have considered the impact that this will have on the security of members' benefits, let alone how future contribution requirements, certified by a Scheme Actuary (with a duty of care to the members), can be anything less than those which would be required, say, under FSR 17, unless a scheme already has a healthy surplus.

We all accept that the MFR is far from perfect. Indeed, a year ago the profession recommended that it should be strengthened, as an interim measure, to take account of falling yields and improving mortality. Should we not be pressing Ministers for those interim measures to be the new minimum transfer standard in the future?

There are various uses to which MFR transfer values can apply. In my experience, it is rare for two actuaries to come up with very different MFR funding levels for the same scheme and membership, unless they have different views of interpretation over, say, MFR pension age.

If transfer values have to be reduced because a scheme has an MFR deficit, at least the membership, the member-nominated trustees and other interested parties should be able to know what is going on. Trying to hide bad news or obfuscate the issue is not in anybody's interests.

As you will appreciate from my comments, I am in favour of retaining some form of minimum funding requirement, and hence a minimum transfer value basis. To go back to the free-for-all pre-1997 era would not be, in my view, acceptable or in the public interest. We have an established MFR basis in place. It may be far from perfect. It is better than what went before. Ideally, we should be trying to persuade the powers that be to improve it. I suspect that that would be politically unacceptable. Perhaps it will be up to us, as a profession, as part of our guidance to the dwindling band of those still willing to be Scheme Actuaries, and having sufficient indemnity insurance cover to meet their duty of care to scheme members, to ensure that, in future, transfer values will be no lower than those determined under current guidance.

Mr K. G. Smith, F.I.A.: I am a voice from the past. Transfer values provide a classic case of conflict of interest. On the one hand are the employers, and sometimes, I am afraid, the older and more settled employees, whose interests are to keep the cost of promised benefits to early leavers to a minimum. On the other hand are those employees who may not continue, or may not be allowed to continue, in employment, who wish to maintain their reasonable expectation of pension benefit.

In my view, all members of a pension scheme should be entitled to a fair assessment of their pension expectations, whether they stay or leave. It is often argued that the solution is a defined contribution scheme. I am old enough to remember the fiasco created by such schemes for the universities and nurses in the 1950s, which led to hastily contrived supplements.

In the public sector the Government Actuary's Department devised the Public Sector Transfer Club, which facilitated movement throughout the public sector without prejudice to final salary pension entitlement. It was a great disappointment to me that neither the actuarial

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profession nor the National Association of Pension Funds had the wit, or the courage, to devise and recommend something similar for the private sector. I would hate to think that that was in any way influenced by a desire not to upset employers.

It was left to the Government to provide gradually improving protection for early leavers — as the French so succinctly put it, *plus ça change, plus c'est la même chose*.

Mr J. Quarrell (a visitor)**:** I could not resist the comments made by Mr Law from Opra concerning the MFR. The MFR is a false hope — it always has been — because it is based, essentially, on the fact that any debt on the employer is an unsecured debt.

There is a fascinating case called Blagden. I am the independent trustee of Blagden. If it was not for the fact that I have an MFR surplus by 1% or 2%, I would be lost, because all I could claim was the MFR. Because I have an MFR surplus, I can claim the full amount; such is the appalling state of the legislation when it comes to the MFR. The fact of the matter is that we will not bite the bullet, and allow pension schemes to be preferential creditors in an insolvent liquidation. We now have the interesting situation where we have VAT, which is a preferential debt (which props up French farmers), and, as a consequence, prefer these French farmers to our own pensioners. There has been much talk about this. I have been speaking about this since long before the MFR came into effect. I shall vote against the motion, because, as soon as the legislature and Parliament get involved in statutory calculations, things go very badly wrong.

There was nothing wrong with pension funds relying on actuaries before the Pensions Act. It was nothing to do with a failure by actuaries that 'Maxwell' happened. It was not the actuaries who stole the money. Why do we suddenly think that we have to have some statutory control over what decent consulting actuaries used to do before? I would rather that Parliament kept out of it.

Mr G. R. Hibbard, F.I.A.: The proposer argued that a statutory basis follows logically for an employee having a right to a cash equivalent. Mr Greenwood concurred with that, saying, essentially, that this is a political, not an economic nor an actuarial, issue.

Let us explore the political dimension a step further. It is difficult to compare political dimensions in one country, so let us look around the world to see how other countries face the same problem.

First of all, relatively few countries actually grant a right to a cash equivalent. There are some notable exceptions: the Netherlands, Switzerland, the U.K., and, to a lesser extent, South Africa, and of these only South Africa does not have a statutory minimum transfer value calculation. All the others do. Also, South Africa has suffered somewhat politically in recent years by not having one, and is about to introduce one. I should stress that in no way am I actually saying that any of these statutory calculations are right, that they are fair, that they are proper, but that they are statutory minimum calculations.

Interestingly, just to complete the circle, the United States of America does not have a right to a cash equivalent. Cash equivalent transfer values are rare. Canada, by comparison, does grant a right to a cash equivalent, and does have a statutory minimum calculation.

Mr C. M. Stewart, C.B., F.I.A. (in a written contribution that was read to the meeting)**:** I suggest that we now have to consider two types of defined benefit scheme: the traditional final salary scheme; and the new cash balance scheme.

In the former, the member's accrued right is to the cash equivalent of the pension accrued to date, for which I favour a statutory basis. In the latter, the accrued right is to a cash sum calculated by accumulating a fixed contribution rate, typically by reference to the yield on government bonds. In both schemes, the actuarial liability is calculated by estimating what the benefits might be at the time of retirement, and valuing a proportionate part of that benefit by the projected unit method on an equity-yield basis. With a final salary scheme, this actuarial liability is higher than the value of the member's accrued rights. With a cash balance scheme, the actuarial liability is lower than the member's cash balance.

In both cases, I believe that any apportionment, for example on divorce, should be by reference to the member's present entitlement, rather than to what, on certain assumptions, it might become in future. In the case of the cash balance scheme, it seems to me to be obvious that it is the present cash balance which must be apportioned, rather than a notional lower figure, arrived at by what actuaries refer to as an ongoing valuation method. The principle is the same in the case of the final salary scheme, even if the actuarial liability is greater than the value of the member's accrued rights.

Mr P. N. Thornton, F.I.A.: There is no doubt at all that we cannot possibly go back to a situation where there is such a wide variation of transfer values as we had ten or more years ago. Therefore, one way or another, we do need some kind of floor to ensure that, from a consumer viewpoint, members of pension schemes think that they are being dealt with fairly.

I think that we have a general consensus that the transfer value should represent the fair value of the benefits given up. Where the thinking has moved on enormously since GN11 was first drafted is in how we arrive at that fair value, and the methodologies that we might use to do that.

Mr Pomery, as Chairman of the working party which produced the report on how the MFR might be revised, is the person who knows that, if the profession were to be given the challenge of defining a basis for minimum transfer values, we would now rise to the occasion! We would set up a substantial working party that would spend much time thrashing out some of the principles, many of which have already been thrashed out in arriving at our proposal for a revised MFR, and the profession itself would take on the responsibility, I believe, of setting the minimum. Therefore, it is extremely safe to vote against this motion.

Mr C. G. Lewin, F.I.A.: I think that the problem with a statutory basis is that, if circumstances alter, so that it needs to be changed, undoubtedly there will be political considerations, which come in at that point, as to whether it should be changed or not. These will not necessarily reflect fairness, but might reflect totally different factors, which may not be appropriate. A statutory basis always suffers from these problems, as we have been witnessing with the MFR basis. The difficulty is so often the sluggishness with which a statutory basis can be changed in response to changing conditions. Therefore, given the assurances from various people that the profession is capable of establishing appropriate guidance, which can obviously respond much quicker to changing circumstances, I shall be voting against the motion.

Mr D. O. Cule, F.I.A.: I am more of a pragmatic actuary, and believe that a statutory minimum makes it administratively easy for everyone to calculate the values, particularly for the smaller schemes. One can think about running insured schemes; one can think about the administrative systems that are in place. We can all do statutory calculations very easily. This is a pragmatic solution. It may well be wrong, but so may the basis that one chooses by our professional methodology. However, it will be a reasonable estimate. If we think, professionally, that the cash equivalent should be greater than a minimum, then we could always go up.

A criticism is that a statutory basis is slow to change. When does that make it dangerous? It is possibly dangerous when it gets too high, because, if we were sluggish to change it when it was too low, our strong professional guidance would make us make it higher, so we would be able to advise clients appropriately. If it goes too high, as is possible in today's circumstances, we will probably find that our schemes are underfunded. We would then have to write down the values anyway, so there is a self-correcting mechanism built into the system. It is not perfect; it is not intellectually solid all the way through; it is driven by government; it is a political decision; but it is a pragmatic one. I think that, if we impose extra costs by each of us giving ourselves our own professional advice, we impose costs on running it, we create the wide ranges which clearly the users of our services do not appreciate at all, and do not understand the subtleties of it. While it is not perfect, I am on the side of the statutory basis.

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Mr Greenwood: Mr Thornton's comments were very impressive, but there is one thing that he has forgotten. Mr Pomery's working party thought that it had its criteria specified by Government. Every time in the early years of the transfer value debate, when they met to discuss the issue, so far as I remember, the Council and the Pensions Board had said: "These elements require political guidance. As soon as you have political guidance in there, you have some form of statutory minimum."

Mr Spain: The following point is crucial to the sponsors of pension schemes: they can pay their staff whatever they want if they can get away with it; they can provide different levels of pension: 80ths accrual; 50ths accrual; or somewhere in between; they can provide half rates for spouses, two-thirds rates for spouses; so why should transfer values per pound of pension necessarily be the same? Employees take what they get, if they can get it. Ms Beaver is quite right about disclosure, but, in fact, there is a disclosure statement to trustees of a pension scheme on what the actuary has decided to assume for transfer values. Unfortunately, that is not available, as of right, to members of pension schemes. Employers do not have to set up defined benefit pension schemes. At the beginning of October 2001 they will have to set up a stakeholder pension scheme, or, as somebody else put it, a: 'stay colder pension scheme', because you are going to be on your own. Why do we insist on total uniformity on just this one part of an employee's pay package, and not on everything else?

Mr Thornton: I am provoked by Mr Greenwood to reply. I think that there is a difference here. First of all, going back to when the MFR was brought in, and before that the winding up regulations, there was some logic in linking all these things together. If a member is entitled to a statutory minimum amount on leaving a scheme and cashing in his preserved pension, why should that not be a reasonable basis for the protection that he gets in a wind up? Why should that not be a reasonable basis for a minimum funding standard?

If we are now approaching this in a completely different light, and de-linking all these things, and there is something quite separate that defines how well funded schemes are, then the political angle is quite different. When we were talking about the MFR, the profession, quite rightly, said that this was a hugely delicate issue, which could have the impact, either of deterring employers from providing defined benefit schemes altogether, or, alternatively, of doing very little to address the security of members. So, quite wisely in my view, we placed that question firmly on the political table to obtain a political steer, and then we worked from that point into the technicalities of what we could do to devise a MFR.

In the case of transfer values, we have established, quite clearly, the principle that the transfer value would be the fair value of the benefit given up, and I think that it is entirely an actuarial matter, and not a political matter, what that fair value is.

Mr Tompkins: I challenge Mr Spain's argument, which is the argument that pensions are a voluntary act of the employer, and therefore we should set no standards against them. I think that that argument went a very long time ago. It went when preservation was accepted as a reasonable and rational obligation to place on somebody who had made a promise of a benefit, and that benefit should be provided either on leaving or at retirement.

I think that the issue that we are talking about here is that the voluntary act is the creation of the defined benefit pension plan, in the first place. Having created that, and given a right to a benefit, then the exchange of that benefit for a sum of money to be passed on to another employer's scheme or into a personal pension is something which does need a degree of regulation.

Ironically, in these debates, one ends up by arguing with somebody who is on the same side. I think that I will put my hand up to the same case as Mr Spain, but one is ultimately talking about having a framework which, I would argue, does not need to be so statutory, and we wish to retain some of our professionalism in judgeing the exchange of the deferred benefit value which is being given up for a sum of equivalent value which is to be transferred to another vehicle.

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Mr Gordon: I am glad to see that the Chairman of the Pensions Board is arguing in favour of the motion now. The other point that I make relates to Mr Spain's point, that, as a worker, when I have my contract of employment, and somebody tells me that they are going to pay me a salary of £*x*, I can work out that its value is £*x*. It is not a very complicated thing. When I leave, there may be 20 or 30 years between now and when I get to retirement, during which time companies can wind up schemes. If there is no statutory minimum to cash equivalents, they can walk away from that promise and I lose a lot of value, then I think that that is an altogether different scenario. I think that this is one of the reasons why there needs to be some statutory underpin.

Mr M. R. Slack, F.I.A. (closing the debate against the motion)**:** I remind you that the motion in front of you is: "This house believes that there should be a statutory minimum to cash equivalent transfer values payable from defined benefit pension schemes." I intend to persuade you to vote against that motion when it comes to the vote.

We have had 16 contributions from the floor. My straw poll gives a slight favour in defeating the motion, although I have to say that, with one or two of the contributors, it was not at all clear which case they were making! You might say the same about some of the proposer's and opposer's remarks as well!

I think that we should remind ourselves exactly what a cash equivalent is. It is a cash payment to be paid now in lieu of a series of benefits that a member is entitled to receive at some future date. We all know — at least, we should know, as actuaries — that there is no absolute right value for that series of future payments. The accountants are beginning to think that there is in the way that FRS 17 is going, but we have to realise that a very small difference in the assumed rate of discount makes quite a big difference to the cash equivalent now. Taking the cases that Mr Edmans quoted, 0.5% p.a. for 35 years is going to mean that he is looking at something like 20% - 35% difference in the current value. How many of us here can say that 5% p.a. discount is right and that 5.5% p.a. discount is not? We just do not have that amount of foresight to know exactly what is going to happen in future.

I have been quoted in the press as saying that all actuarial assumptions are wrong. That is exactly the point. We are only making assumptions about what we think is going to happen. Yes, we can appeal to statistics that exist in the financial markets, but there are still many other assumptions that we have to make. We just do not know. We can make what we hope is a sensible and educated guess.

What we must also not forget is that the cash equivalent is only an option. Members do not have to take it if they do not think that it is sufficient. That, again, is a crucial part of our argument that we do not need to have a statutory minimum basis.

Ms Beaver discussed options. She started by saying that the member does not have to join the pension scheme, which I think is a rather earlier decision. We are looking at the situation where the member has left. He or she has benefits that are going to be paid from that scheme in the future, and has been given an option to take a cash equivalent instead of those now. Why should the amount of that option be prescribed? Surely, it is something that members who leave are going to decide about. They are going to take advice and form a view as to whether the sum on offer represents a sensible option and enables them to get better benefits, if that is what they are looking for, from some other source. So, again, do not forget that we are looking at the exercise of an option. I might have been interested in participating in a different debate, as to whether members should even have that option. In some situations, the introduction of the right to a cash equivalent has caused quite a lot of the difficulties that defined benefit schemes are now facing, because it has suddenly created this expectation that there is a right value that people should have. We can look back at all the mis-selling exercise that went on once people had rights to cash equivalents, and wonder whether that would have happened in other circumstances.

Also, we must remember — and this is picking up on Mr Spain's points — that defined benefit occupational schemes are established as voluntary acts by employers, or, perhaps, in today's environment, they are continued as voluntary acts by employers. We can have much debate as to whether defined benefit or defined contribution is the best form of benefit or whether we should be moving more to cash balance plans, but the key feature of defined benefit is that it is the employers which take all the financial risk. If we believe that that is something to be encouraged, then we have to find as many ways as we can of giving the employers the flexibility to keep the scheme going and to continue to take that risk. I would argue that imposing a statutory minimum cash equivalent is, by definition, restricting the freedom of the employer, and therefore becomes another reason why employers will think about looking for other forms of pension provision.

Clearly, no actuary here, I am sure, is looking to cheat members by offering them unreasonably low cash equivalents. There has to be a professional requirement to make sure that the basis is fair, but I do not think that that requires a minimum basis. I will argue later that what would happen if we try to impose some sort of minimum or floor is that everybody would drop down to it. The number of cases in other environments where that happens is countless. If you set a minimum, people say: "If that is the minimum, why do I have to pay any more?" We have to be very careful about even trying to define what the floor is.

There is also a danger, if we do set a minimum statutory basis, and that becomes the basis that most schemes choose to pay, that there will become an acceptance that it is correct, and that members will say: "If that is the cash equivalent that I am offered, then I must take it." That, again, is denying the individual member the process of thinking through and asking: "What am I giving up; what am I being offered instead of this?" There is a great danger that some people who are offered a statutory cash equivalent may take it without thinking whether it is going to replicate the benefit that they would have had from the occupational pension scheme. They are fooled into thinking that it will, because it is a prescribed minimum, whether that prescription is coming from the profession or from legislation.

The next point about having a statutory basis, which Mr Lewin referred to, is the complication and expense. We have a scenario, at the moment, where we, in theory, have to do a double calculation. We have to calculate what we, as individual actuaries, think is an appropriate transfer value under Section 3 of the Guidance Note, and then we have to apply a statutory minimum, which happens to be the MFR.

Reference was made to the letter from the Pensions Board that went out in 1999. I confess to having been involved in the initiation of that process. What that letter was saying was: "When you are looking at your Section 3 transfer value, in other words, the one that is subject to actuarial judgement, do not forget that some of these things are changing, and it may have had the effect of putting what you think is an appropriate transfer value in excess of the statutory minimum."

The fact that many schemes did not change their cash equivalents should be suggesting that the statutory minimum was still higher than they really wanted to pay, and that all that these new circumstances were doing was bringing the two a little bit closer together, but not necessarily putting their own value on top of the minimum.

How many of you are now looking at your transfer value basis, your non-statutory basis, and are asking: "Has it actually gone above the statutory minimum? Have parts of it gone beyond the statutory minimum?" In certain circumstances, you have to split that transfer value between different parts of the benefit. Have you thought through what the value of a fixed-rate revaluation guaranteed minimum pension is compared to the MFR? If you have not, I suggest that you go back and do so.

These are issues that are creating enormous complications, as we look at the interaction between a professional requirement to give an adequate minimum transfer value and the statutory basis.

Another feature of having a statutory basis is that it makes us all just a little bit more reluctant to set our own basis above it. We are hiding behind it, and we are saying: "Here is the statutory basis; that must be all right." This was very much the line of Mr Lewin's argument; having a statutory basis is stopping us all deciding what we really think is appropriate. Any statutory basis is going to be inflexible. We have had the clear example of how the MFR fails to respond to changes in circumstances. One argument for a statutory minimum basis is that it links to the MFR. The Government decided to have a statutory minimum funding requirement; the Government also decided to have a statutory minimum transfer value; and, given those two requirements, I think that it was inevitable that they would be the same. It would clearly be illogical to have a minimum funding requirement based on discontinuance, but a different minimum cash equivalent, because that would be undermining what the minimum funding requirement was intended to do. The reason that we are where we are is because we have both requirements in place. Maybe, without MFR, cash equivalents would be on a totally different basis to where they are today, and, possibly, without minimum cash equivalents, we might have found that the minimum funding requirement would have been different.

If the MFR is abolished, but we still have a statutory minimum cash equivalent basis, is that not going to become a replacement MFR? How are you going to justify, if you have the requirement to pay minimum cash equivalents, not having sufficient money in the fund to be able to do that? The danger is that we may be waving goodbye to the MFR with great enthusiasm, but, if we support this motion and say that we should retain a statutory basis of cash equivalents, we will see another minimum funding requirement coming in behind us. I do not suppose that that is really what we are all hoping for.

Running through some of individual comments in the debate, there is clearly an issue which Mr Spain has picked up, and it arose when we were debating the MFR, that we can get two actuaries who both say: "Yes, there ought to be a statutory basis, provided that it is the one that I like''. That is going to be the great difficulty. Mr Gordon is clearly very keen on a particular basis for cash equivalents. I might ask him whether that is the basis that he uses at the moment. He might say that this should be a statutory basis. Somebody else is going to stand up and say: "I support a statutory basis, but it should be this different one.'' That exposes the great difficulty of any statutory basis; we cannot agree what it is going to be. We have seen the experience with the MFR. Within my own firm we have debates about the MFR: one half says that it is too high; and the other half says that it is too low. I say: "Fine, that is why we have ended up somewhere in the middle'', but we are going to get the same process with statutory bases of cash equivalents, if they are not linked in to the MFR.

Mr Tompkins talked about the basis for transfer values. There was reference to a matching asset, which is coming back to a bond basis. It is fairly straightforward defining matching assets to current pensioner liabilities, because the terms are reasonably short. We do not have matching assets for the terms of some of our deferred pensions. So, there is not a basis out there that we can use, and we are back into some form of actuarial judgement. The difficulty then, as Mr Lewin said, is that it may be some closed group of people who decide what the long-term discount is for liabilities payable 30 or more years in the future, and who are they to decide that that is the right basis compared to what other actuaries might think?

I would also put in a little note of caution. Mr Tompkins referred to corporate bonds. I have a worry that corporate bonds are on a bandwagon. When there were high premiums and no apparent risk, we all thought that corporate bonds were the answer to everything. We should now be asking whether some of that risk was there for a reason, and maybe we should be careful about leaping onto that bandwagon.

Mr Davies went back many years into the history of transfer values. I think, again, that there was some confusion between defining the benefit rather than the cash equivalent, which is intended to be a value that is available in lieu of the benefit. The interaction between transfers in and transfers out again is also part of the benefit issue. We know that, within the defined benefit structure, if you leave one scheme with ten years' service, you will not get ten years' credit in an otherwise identical scheme that you transfer into, because you have lost the final salary link in the process. This is a benefit design issue, not a cash equivalent issue.

Mr Edmans gave us a full recollection of the survey that was done back in the early 1990s. The issue that is quite interesting is to know where the current statutory minimum actually lies. I suspect that, on the ranges that Mr Edmans was quoting, the current statutory minimum is very much towards the bottom end. That illustrates the principle that, as soon as you impose a statutory minimum, cash equivalents will tend to fall down to that. I can see that the proposer is disagreeing with me, but he does not have an opportunity to come back! He said that he did not think that they would bounce back above the current level if the statutory minimum was removed. To some extent I would agree with that. They would not go back to the levels that they were before the statutory requirement was introduced, but the whole general thrust, when the statutory basis came in, was to level down.

I recall discussions with the DSS (as it then was), who said: "We want to have a more consistent level of cash equivalents.'' We said: "Fine, just tell people not to pay so much.'' It is very easy; we can get more equal transfer values by just not being as generous, but the effect of bringing in the minimum was to make those who were paying more than that come down to that minimum, and those few who might have been paying less to increase up to the minimum.

There are many points that have come through in this debate. I hope that the balance of the opposer's arguments and my own, and what I thought was the majority of those from the floor, will persuade you to vote against this motion. You need to think through the various interests: the interests of the profession; the interests of individual actuaries; the interests of the plan sponsors; the interests of members; and the interests of the Government and regulators. It is not at all clear that all of these are consistent with a statutory basis.

In summary, the experience has shown that statutory bases do not stand the test of time. They introduce much more complication, and hence expense; and, on the whole, they do not result in larger cash equivalents. I therefore urge that you vote against the motion.

Mr M. W. Duke, F.I.A. (closing the debate for the motion)**:** My basic argument in favour of the motion is a very simple one; and is that we should be making a decision on the basis of public interest. It struck me, from the opposer's opening remarks, that, rather than having the interests of the public in mind, it was largely about providing him with an interesting job. While spending time and money debating the rights and wrongs of transfer bases may be interesting and remunerative, I am not sure that it really serves the public terribly well.

Again, I take a very simple view, I think that two people in two different schemes with the same benefits should get the same transfer value. I have just heard that the closer against the motion seems to revel in being wrong. Well, try explaining that to the general public. I think that, if we really take our duty to explain and communicate well, we have no option other than to home in on a fairly prescriptive, but robust, basis.

There has been much talk about the MFR. I can understand that, because people point to that as a statutory form of measurement that has failed. I would put it to you that that is a rather unsatisfactory and, in many ways, sad argument, because the MFR failed because it was based on unsound principles — unsound economic principles — it did not fail, as the opposer suggested, because it was overtaken by events. I think that the challenge for the profession is to come up with robust approaches to these kinds of questions that do stand the test of time. I do not feel that we need the flexibility to sway in the wind.

I return to some of the basic points that have been made about the motion. We went through some of the reasons why cash equivalents are used. I think that they are very instructive. They are an option. People do not have to take their cash equivalents. I cannot see why that, in itself, should change the way in which they are valued. I think that there are very good grounds for saying that it does not matter what kind of option it is. I do not see why it should be subject to subjective actuarial judgement in its valuation; and I come back my point: same benefits; same value.

We also had mention of the fact that, if we do lock ourselves into a statutory basis for cash equivalents, and, remembering the debt calculations, as the opposer was pointing out, we are flying in the face of the Myners' Review and scheme specific funding principles. Wonderful! I think that this is the big opportunity for the profession; it is to demonstrate how unsound many of the principles underlying the Myners' Review have been, and to demonstrate what we can really bring to the debate.

So, in answer to the question which was posed: "Can we trust the actuary?", I am afraid that his track record is not very good, and we do need to go back to the drawing board and define some robust principles that we can put into statute. Statute does not mean totally prescriptive. There seems to be an assumption that every 'i' has to be dotted and 't' crossed. I do not think that it does, but there do have to be some principles which we, as a profession, are prepared to stand behind.

Now, considering some of the observations made by other speakers, I too found the world of *laissez-faire* extremely embarrassing. I would not want to return to that. I am not confident, if we move away from some prescribed statutory basis, that we would end up with robust and consistent calculations. Perhaps, like Mr Gordon, I am saddened that we need it, but we do. There is no consensus about some of the basic principles that underlie the valuation of options within the profession, and I would find it acutely embarrassing if that continues to be displayed to the general public.

Ms Beaver made some interesting points. To me, the summary seemed to be that Ms Beaver wants freedom to do the same thing as everybody else, but I do not buy that. I have no interest in following the herd; I have an interest in getting it right.

I entirely agree with Mr Greenward's point about the basic principle that, underpinning all this, there is a political decision about the level of risk that people have to accept in defined benefit schemes. This was, and is, a question that continues to be ducked.

There was mention of the 50-50 risk principle that was meant to underpin the MFR, albeit introduced at the last minute, and little discussed since. That, in essence, is the nub of the problem. We need to define how much risk people are accepting within those schemes.

There has been some debate about the nature of the motion. I tend to regard arguments about the semantics of the motion as the refuge of scoundrels. I think that you need to vote on conscience, but, in answer to a particular question: "What are we voting for?", which was Mr Spain's point, I think that we are voting about whether we and the politicians have to find an answer to this question. It is not something that we can sweep under the carpet, and leave it to the profession, generally, to come up with the right or average answer.

I also believe that conflicts of interest are a real issue here. We are in a world where there will be increasing pressure and increasing conflict between trustees and employers. I can see one of us here advising, say, one of the opposer's clients to go for low transfer values, while the opposer talks to the trustees about high transfer values. Whose interests does that serve? Surely, we need to align ourselves behind some robust and sensible basis of calculation.

The only other argument that I have heard advanced against the statutory basis is its inflexibility. I see no reason why it needs to be inflexible. Indeed, when you look at the profession's failure to respond speedily to change, I cannot see much value in inflexibility.

If given the job, I think that we could come up with a statutory underpinning basis of cash equivalents which is robust, long-term and will serve the public interest. Vote for the motion!

The President (Mr P. N. S. Clark, F.I.A.): You have heard the various proponents. The motion before you is: "This house believes that there should be a statutory minimum to cash equivalent transfer values payable from defined benefit pension schemes".

The votes are: 38 in favour of the motion, and 29 against. I declare that the motion is carried.

I express my own thanks to those who have proposed and opposed the motion, and to all who have spoken in the debate. It has been a good debate. A number of the issues have been explored and re-explored by some speakers. I, as a life office actuary, see now this world of fun, as the opposer described it — the actuary in pensions, but I also see this obligation to communicate is definitely as strong in the pensions world as it is in the life assurance world. I am rather depressed that some should say that, even with the best communication, the readers will fall asleep in three or four minutes. I think that there is a significant challenge to us as a profession and as communicators; but also there are many who spoke in favour of discretion and in favour of professional judgement. I think that we, as a profession, have to face up to that

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challenge if we want discretion, if we want professional judgement, and if we want the right to use it. We have to demonstrate very effectively — not to ourselves, but to the world outside — that we can, indeed, use that effectively and wisely and rightly. Some of the figures that Mr Edmans quoted suggest that we have a hard fight to do that. I do not say that we should not use discretion; I do not say that we should not use judgement; I certainly believe, as a profession, that we should; but we need to demonstrate that we can do that effectively, and be held up to public gaze. This world of openness and transparency is very definitely upon us.

I ask you to join me in showing your appreciation to those who have led this debate for us.

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