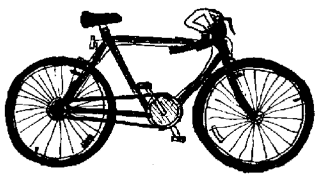
Pension Notes

Windsor Actuarial Consultants Ltd

Jan/Feb 2007

Issue 4

DWP bows to pressure on CETV issue



In a statement issued last week, the Department of Work and Pensions confirmed its expected decision to allow final salary pension schemes to continue to calculate transfer payments using assumptions ‘appropriate to the scheme and current market conditions’, rather than moving to a fixed interest related basis.

While on the face of it this sounds reasonable, it ignores the fact that the cost of securing a pension share in the market is likely to be substantially higher than the money made available, ie, for a 50/50 CETV share, the spouse is likely to still be significantly worse off.

It is thought that, after the other recent trials and tribulations that have beset pension schemes, including the higher PPF levy, and tougher reporting standards from the pensions regulator, pension schemes could not withstand more strains on their finances.

All of this could be avoided, with one simple piece of legislation. It would require schemes to offer spouses an internal transfer to the scheme, on similar terms to those offered to someone leaving the scheme.

The scheme would, almost certainly, already offer a spouses benefit to that same spouse, on

CONTINUED ON PAGE 2

Contents

Offsetting—how to negotiate?

Offsetting, or exchanging pension value for other assets, is a valuable method of settlement. There need to be adequate non-pension assets, of course, and enough to ensure each party has adequate liquidity after the settlement- per the Martin-Dye decision.

The starting point is to value the pension. This can be done via an objective valuation, or by using the CETV. Using a CETV alone is always risky, as it often understates the value of the pension. However, if

?

CONTINUED ON PAGE 2

Offsetting—how to negotiate? - Continued from Page 1

you are representing the pension holder, you may wish to start here. I am aware of some firms making quite trivial offers – for example, 20% of the cash lump sum on retirement – for a Police pension, in exchange for a 'quick settlement'. Divorce in haste – repent at leisure….

The same principles apply as for a pension share, but it is always best if there is agreement as to what the pension is worth as pension, (ie, in illiquid form, not being convertible to cash).

If the pension is in payment, the process is made simpler by the fact that there is a ready market in retirement, and non retirement, annuities for sale. Holders of maturing personal pension plans, and the Trustees of group schemes purchase millions of pounds of annuities from insurers each year, and the market is very competitive, prices sometimes varying by only a few pence.

Unfortunately, the annuity cannot be sold on by the annuitant, that being part of the conditions of its purchase. It is not, therefore, possible to estimate more closely a 'mid market price' which would be fair to buyers and sellers.

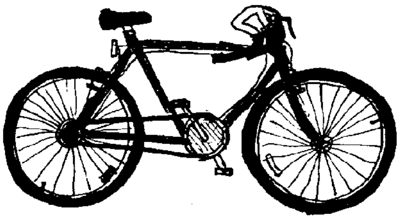
CONTINUED ON PAGE 3

DWP bows to pressure on CETV issue - Continued from Page 1

the death of their partner, so it can't be argued that the risk or cost is unacceptable.

Some schemes (notably, the Local Government Pension Scheme) already offer the choice of an internal or external transfer. Where a scheme does not offer a choice, there will always be a greater tendency to effectively penalise the spouse, with a lower benefit or CETV, citing the protection of the remaining members as justification. The Armed Forces Scheme insists that the spouse wait to age 65, perhaps thirty years after the original pension commences!

As it is, if your client is the one with the lower (or no) pension benefits, you need to continue treat offers based on a share of the CETV with extreme care, as your client is likely to lose out.



"greater tendency to penalize the spouse "

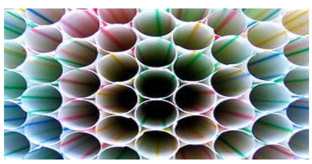
"Choose your pension carefully"

Where more than one pension is involved in a pension share, (ie, the member has past service in more than one scheme) it is important to choose the correct pension to share.

Apart from different retirement ages, additional benefits, and options, the value offered by the CETV may vary significantly between different schemes.

We were involved recently in a case where one scheme converted pension to CETV at 7:1, and the other scheme at 11:1.

So by sharing the correct pension, an improvement of nearly 60% was obtained! This was shared between both parties—rare good news in a divorce!



Offsetting—how to negotiate? - Continued from Page 2

For a deferred pension, which is some years away from coming into payment, there is no convenient market measure. It's a question of combining an annuity rate with a factor to allow for investment returns, and inflation before the pension comes into payment. This is the standard method of calculating a value, and also the method used to calculate the CETV, (although the latter uses far more optimistic assumptions!)

Once the value is calculated, we need to adjust it for the disadvantage that the pension is illiquid.

This can be looked at in a number of ways. It could be argued that there should be no adjustment for liquidity. If a pension share is used to buy the spouse a pension in the market, it can be argued that it has achieved its purpose, and the spouse has received full value. Hence no premium.

However, liquidity can be very attractive, especially after a divorce where overall assets may be in short supply. If we look at the behaviour of retirees from a pension scheme, where they have the option of converting their pension to cash at an unfavourable rate, they still take the option, e.g., some schemes pay them only £9 for every £1 of pension, where the fair rate would be £16 to £18, you could then say that the liquidity premium they are being charged is 50%. However, in these circumstances, the pensioner is being subjected to a 'forced rate', ie he or she cannot choose an alternative, and is probably not aware of the price they are paying for liquidity.

If we look at a contribution into a pension scheme, this attracts tax relief at the taxpayer's marginal rate, up to 40%. It can then be argued that £1 of newly contributed cash within the pension fund would be worth 60p to the member otherwise. However, the tax relief is based on political, as well as financial issues, in that governments are keen to persuade people to become financially independent in retirement. There are two other factors to take into account – not everyone pays tax at 40%, and the tax enhanced rollup within the pension fund (although an ISA can achieve this without the lock in). I therefore usually suggest that half of this incentive is taken into account, meaning that £1 in the pension fund is worth 80p outside it. More precise calculations can be carried out if the case requires it, but 80% is a good rule of thumb.

Services we offer

We offer the following benefits:

Quick, free of charge telephone or email assessment of your case

Estimate of amount, and value of benefits, if information is sparse

Advice on whether to commission a report, a letter (or nothing!)

How to counter the usual arguments on pensions

Clearing the jargon and cutting through to the key issues

Clear and concise reports and supporting documents

Immediate telephone support for discussions with Counsel

A rapid response at a very competitive price

Handling large or unusual cases

Uncooperative spouses Overseas Pensions

Also valuation of reversions and share options

Contact us for a free discussion and quotation – details overleaf.

Windsor Actuarial Consultants Ltd

Windsor Actuarial Consultants provide consultancy services for solicitors and other professionals. We have a particular expertise in advising on fair divisions of pensions assets, and clear communication of the issues involved.

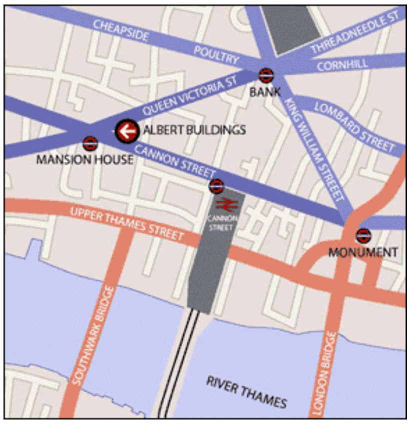
We have over 25 years of experience in pension scheme, life assurance and related areas involving complex financial matters.

Peter Crowley is also an Individual Member of the Expert Witness Institute, and an Affiliate Member of Resolution.

We offer a service where we will express an initial view on your clients pension and financial issues totally free of charge, so you can decide whether additional work and expense are justified for any particular case.

Suite 46
Albert Buildings,
49 Queen Victoria Street,
LONDON EC4N 8SA

Phone: 020 7653 1908
Fax: 08707 875873
mail@windsorac.com
mail@windsorac.co.uk
www.windsorac.com



Reduced CETVs and Internal Transfers

One thing to be watchful for is if the scheme offers a reduced CETV. This is where the scheme cannot currently afford to pay the 'full' CETV, as calculated by the actuary, because the assets within the fund are not sufficient to meet it. In these circumstances, the scheme has to offer an internal transfer, as the spouse may refuse an external one.

This syndrome may not be restricted to cases where the transfer value is reduced. If the spouses chooses not to 'co-operate' with the Trustees (wording taken from a recent letter), the Trustees may have difficulty in persuading an IFA that setting up an insurance arrangement for him/her without a full client 'fact-find' is justifiable. In these circumstances, the Trustees only option is to offer an internal transfer – they cannot just leave the money 'sitting there'!

It will be interesting to see how this issue develops, as I have seen a few cases where scheme Trustees are becoming more flexible in their attitudes!

SEMINARS—NEGOTIATING PENSIONS ON DIVORCE

We will be shortly announcing the venues for our 2007 CPD – accredited seminars—

'Negotiating Pensions

on Divorce'.

Contact us for details and dates of seminars in your area!