

Express Pension Valuation

Technical note and advanced usage

The Express Pension Valuation is a quick valuation of defined benefit pensions for most non-contested cases and to prove need for a full valuation in contested cases.

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Purpose of valuation

The Express Pension Valuation is a simple-to-use valuation of defined benefit (final salary) pension rights for the use in divorce and dissolution proceedings. Valuation assumptions are set to be neutral between the two parties in the divorce or dissolution. The valuation process is designed not to require input from the pension scheme and to return an immediate result.

It can therefore be used to:

- produce an estimate of the value of pension assets;
- validate CETVs and determine whether the cost of a detailed actuarial report would be proportionate to its benefits; or
- calculate pension assets for collaborative law and medication valuations where agreed by both parties.



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The Express Pension Valuation has a number of limitations inherent in its design. In particular

- it is dependent on the information provided by the client, which may differ from the definitive information held by the pension scheme;
- its treatment of the complexities of different pension scheme designs has been simplified to concentrate on significant differences in pension design; and
- it has been necessary to simplify the valuation by ignoring generally second-order effects such as the difference in value on contracted-out rights versus other rights and the specific effect of death in service.

Due to these limitations, Bradshaw Dixon and Moore would not recommend the Express Pension Valuation is used to evidence pension valuations in court during the ancillary relief process, except where the lawyer is confident that the limitations are not significant in the context of the value of the pension rights.

Comparison with other valuations

A pension scheme can be valued in a number of ways, depending on the purpose of the valuation and the level of detail required. A pension scheme will be valued in total normally at least annually to determine whether it is solvent and the future levels of contributions that need to be paid. The high-level results of this valuation will normally be reported to members and be shown in a company's reports and accounts. Such a valuation may simplify the details of a valuation for individual members which are to not significant to the overall result.

A number of valuations of individual member's benefits can also be performed for different purposes and degrees of effort.

The main distinctions are:

What lives are valued? For an accurate valuation it is necessary to use the actual ages and health of the member and spouse, and hence their actual life expectancy. In practice, most valuations make simplifying assumptions of a fixed age difference between spouses and that both are in average health.

Data used? The pension scheme will normally have accurate personal details, will have the definitive details on the pensionable salary, contribution and other related details, and will hold scheme benefit terms. However extracting this data for external valuation can be difficult.

Reason for valuation? The reason for valuing an asset can affect the price put upon it. For example, the value placed upon a house to get a sale within six weeks might be a lot less than that where the buyer can afford to wait for a fair price. Valuing the transfer value of a pension is similar to valuing for an immediate sale. The value for the divorce or dissolution process, where there is no need to upset the pension, is similar to the fair price valuation.



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What is valued? For a divorce or dissolution, it is necessary to value accrued pension rights, ultimately those up to the decree absolute date. In Scotland only those rights accrued during the marriage are valued. For some valuations, the specification of the benefit may be simplified to ease calculation.

Allowance for future salary increases in service? Although only accrued rights are valued, the amount of the accrued right is increased by future salary increases whilst the member is still in service. While it may seem odd that future service affects past rights built up, it should be remembered that defined benefit schemes are designed to reward loyalty and help lock-in staff.

Therefore when valuing past rights on schemes where the member is still employed it is appropriate to allow for future salary increases up to the expected date of leaving employment.

The following table shows how different valuations vary between these points. It shows those produced by pension schemes, including the Cash Equivalent Transfer Value (CETV) quote. It also shows those produced by Bradshaw Dixon and Moore for use in divorces.



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Comparison table of valuations produced by pension schemes
and those produced by Bradshaw Dixon and Moore for use in divorces.

Valuation	Lives valued	Data relied upon	Reason for valuation	What is valued?	Allowance for future salary increases in service?
Funding valuation	All in scheme	Pension scheme data	Current solvency and future funding requirement	Past and future liabilities versus current assets and contributions	Yes
Cash Equivalent Transfer Value (CETV)	Simplified spouse and health details	Pension scheme data	Immediate transfer value	Accrued rights – may be some simplification of benefit specification	No
BDM Express Pension Valuation	Simplified spouse and health details	Client provided data	Current value of accrued rights	Accrued rights – simplified benefit specification	Yes
BDM Bureau Pension Valuation	Actual spouse details and optionally actual health details	Client provided individual data and pension scheme benefit terms data	Current value of accrued rights	Accrued rights – may be some simplification of benefit specification	Yes
BDM Bespoke Pension Valuation	Actual spouse details and optionally actual health details	Pension scheme data	Current value of accrued rights	Accrued rights - accurate benefit specification	Yes

The Bureau Pension Valuation is a full valuation of simple defined benefit pensions and of defined contribution pensions. It is available with full data collection.

The Bespoke Pension Valuation is a full valuation of defined benefit pensions. It is used for pensions that are very large, calculated by multiple benefit definitions or where ill-health retirement is expected.

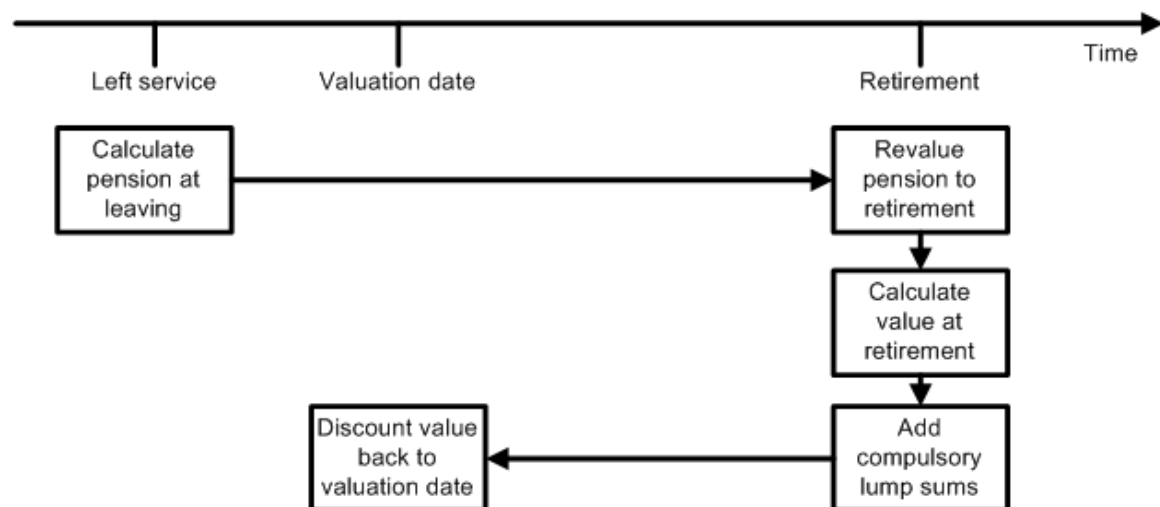
Valuation methodology

The Express Pension Valuation values the accrued pension rights using the following approach.

Pensions for past service

1. Calculate the pension accrued at date of leaving service, using the term of pensionable employment, pensionable salary and scheme benefits for the scheme type chosen.
2. Project the pension to date of retirement using the pension revaluation method appropriate to the scheme type chosen.
3. Calculate the annuity value of the projected pension at date of retirement, allowing for guaranteed pension periods and the spouse's death after retirement pension paid if the spouse outlives the member.
4. Add any compulsory lump sum at retirement benefits determined by the scheme design chosen, to the annuity value of the projected pension at retirement. This gives the projected value of the accrued pension at retirement.
5. Discount the projected value of the accrued pension at retirement to a value at the valuation date allowing for the present value of money now compared to its value on future.

These steps can be summarised graphically.



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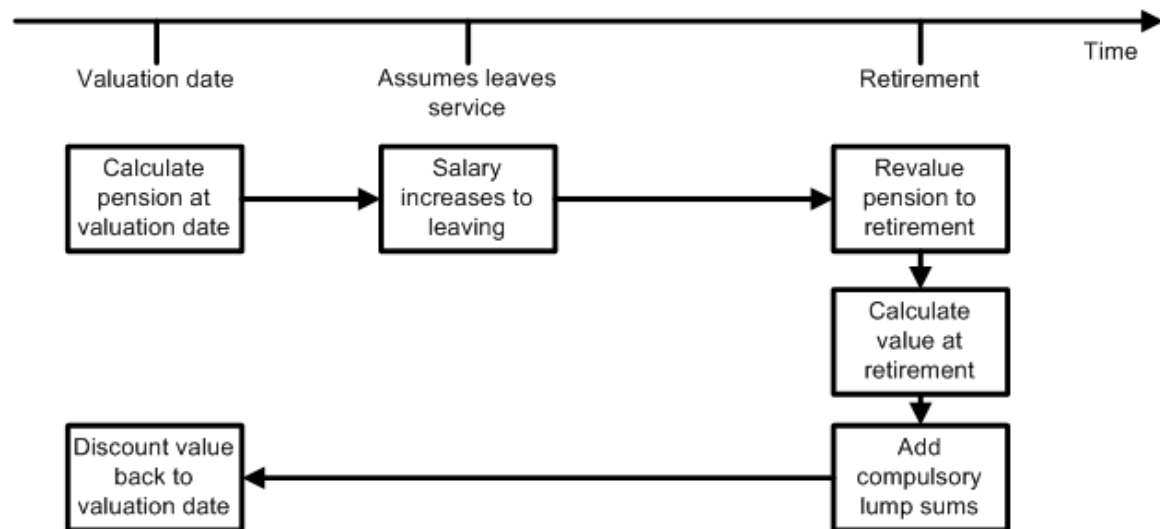
Pensions for current service

Replace steps 1. and 2. above by:

1. Calculate the pension accrued at the valuation date, using the term of pensionable employment, pensionable salary and scheme benefits for the scheme type chosen.
2. Project the pension to an assumed date of leaving the scheme using an assumed future rate of salary increases, and then project from there to the date of retirement using the pension revaluation method appropriate to the scheme type chosen.

Steps 3. to 5. are as above.

Again shown graphically.



The following simplifications to a full pension valuation methodology have been made.

- Contracted-out rights have been valued on the same basis as other rights. Whilst there are minimum revaluation and payment terms for contracted-out rights that might increase their value relative to other pension rights, these are normally second order compared to the effect of other valuation assumptions.
- There is no allowance for additional pension rights accrued through transferring-in existing pension rights, paying AVCs or for other reasons. In some cases the inputs to the valuation can be adjusted to allow for these (see Advanced Usage below). Otherwise, a Bureau or Bespoke Pension Valuation is needed to value these rights.



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- No separate calculation for the effect of death-in-service has been made. The assumption is that the value of death-in-service benefits paid on death will be offset by the reserve built up for paying the pension at retirement.

Valuation assumptions

These may be divided into two parts: those used to round out the data collected, which might be called the “past” assumptions, and those used to project forward to the retirement date and into payment, which might be called the “future” assumptions.

Assumption bias

Each assumption is just a value to be used in a calculation. By the nature of it being an assumption, it is an unknown. There will be a range of possible values which each assumption may actually take, some more likely than others. Therefore, for each assumption there is a range of likely values that someone doing the valuation could reasonably take.

The effect of taking one set of such reasonable assumptions could produce a valuation of the pension rights more in favour of one party or the other in a divorce or dissolution.

Bradshaw Dixon and Moore only produce valuations with the intention that they are neutral between the two parties. That is, without bias to either side. This normally means using the most likely value for any assumption.

It should be recognised that this is a judgement call and someone else also looking to be neutral may produce a different result for the value of the pension rights.

“Past” assumptions

In order to reduce the data required to be collected a number of assumptions have been made to provide the complete information on the pension owner’s current entitlement. The main set of assumptions in this category is the detailed benefit definitions behind the generic scheme types.

“Future” assumptions

Future assumptions are made of economic factors, such as rate of inflation, population factors, such as rate of death, and social factors, such as rate of remarriage. For factors such as dying, the calculation allows for a percentage of deaths each year based on the percentage of deaths expected in a population.

In setting assumptions, the value of assumptions relative to each other can be more important than the actual values of the assumptions, for example the rate of salary increases assumed relative to inflation.

An important assumption is the discount rate, which is used to equate the value of monies being received at different times in the future, with the value of money now.



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Advanced usage

Use in Scottish Law divorces and dissolutions

- Set the date of entering pensionable service as the date of marriage or partnership if later
- Set the Valuation date at the relevant date

Under Scottish Law, only pension rights accrued during the marriage or partnership are included in the value of assets to be divided. The formula to be used in the calculation is specified in the Divorce etc. (Pension) (Scotland) Regulations 2000 [SSI 2000/112] and is:

$(A \times B)$ divided by C

where

A is the benefit accrued up to the relevant date;

B is the period of marriage whilst a member of the scheme which falls before the relevant date; and

C is the period of membership of the scheme before the relevant date.

The relevant date is defined in section 10(3) of the Family Law (Scotland) Act 1985 as being the earlier of:

- a) the date on which the parties finally ceased to cohabit¹; or
- b) the date of service of the summons in the action for divorce or dissolution.

Although seemingly well defined the terms used in the Regulations are open to subjective interpretation, though in general the common sense interpretation that the benefit accrued is proportioned by the time accruing pension whilst married to total time accruing pension is applied.

For defined contribution pension benefits that accrue at a constant rate, which is the assumption for all the generic schemes in the Express Pension Valuation, the same effect may be achieved by setting the date of entering pensionable service at the later of the date of entering pensionable service and the date of marriage.

The Express Pension Valuation accrues pension rights to the later of the date of leaving pensionable service and the valuation date, and therefore it is necessary to set the valuation date to the relevant date.

¹ Section 10(7) of the Family Law (Scotland) Act 1985 states that in determining the date on which the parties to the divorce ceased to cohabit "no account shall be taken of any cessation of cohabitation where the parties thereafter resumed cohabitation, except where the parties ceased to cohabit for a continuous period of 90 days or before resuming cohabitation for a period or periods of less than 90 days in all".

Advanced usage

Transfer values in

Pensions may have been consolidated by transferring in benefits from previous schemes. The receiving scheme normally reflects this by adding additional years of pensionable service to the member's entitlement.

Transfer values in are not specifically allowed for in the Express Pension Valuation. However, in some circumstances the inputs can be adjusted to allow for them.

- Allow for additional years of service by reducing the date of entering pensionable service by the added years
- In Scotland pro-rate the added years by the period in the original pension scheme spent accruing them whilst married, over the total period accruing them
- For transfer values received on other bases consider valuing the original pension accrued as an alternative

Transfers as additional years of service

Where the transfer value in was given as extra years, or years and months, of service then this can be reproduced by reducing the date of entering pensionable service by an equivalent period.

For example say a member started in pensionable employment with a scheme on the 6th July 1999 and a transfer value in was received from another scheme for which the member was granted an additional 3 years and 4 months of service when calculating his pensionable entitlement. The effect of the transfer value can be reproduced by reducing the date of entering pensionable employment, 6th July 1999, by the extra entitlement, 3 years and 4 months. The revised date of entering pensionable employment to be used in the Express Pension Valuation is therefore 6th March 1996.

In Scotland, the reduction must be made pro-rata to the time the member was married whilst in the scheme from which the transfer was made. So if the transfer came from a scheme in which the member got married two-thirds of the way through his employment only one-third of the transfer was accrued during the marriage. Therefore only 1 year and 1 month (rounding to the nearest month) of the additional entitlement can be counted and the revised date of entering pensionable employment to be used is therefore 6th June 1998.



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Transfers on other bases

These cannot easily be valued using the Express Pension Valuation. However, as transfer values have been made using the same actuarial basis for transfers going out as coming in then, an alternative approach is to calculate the value of the pension as if the transfer had not taken place. The accuracy of this method is dependent on:

- whether there were differences in the actuarial bases of the transferring and receiving schemes; and
- whether the form of the transferred in benefits has affected their relative valuation post transfer. For example, the scheme providing the transfer would calculate it assuming certain investments were made up to retirement, normally a mix of equities and Government loans. However if the transfer value in had been invested in a building society fund for a long-time it would probably have underperformed this assumption and be worth less.

No simple rule can be set here, except if in doubt do not rely on the answer. The bureau or bespoke valuations provided by BDM should be used instead.



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Advanced usage

Pension owner expected to leave service

- Enter the expected date of leaving the scheme, instead of leaving the entry blank to show that the pension owner is still employed

Where the pension owner is still in employment then the Express Pension Valuation makes an assumption as to how long they will remain in employment. If it is known that the pension owner is due to, or highly likely to, leave employment at a specific date then this can be used instead.

Instead of leaving blank the date of leaving pensionable employment to show that the person is still in employment, then enter the expected date of leaving the scheme.

The Express Pension Valuation will calculate the pension rights for the period up to the earlier of the date of leaving employment and the valuation date. Where the date of leaving employment is after the valuation date it will allow for salary increases from the valuation date to the date of leaving the scheme, and appropriate statutory revaluation for leavers thereafter.



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Advanced usage

Pension owner beyond Scheme Retirement Age, or definitely expecting to retire after Scheme Retirement Age

- If a definite planned retirement age later than the Scheme Retirement Age is known then this can be entered instead of the Scheme Retirement Age
- If passed Scheme Retirement Age, but without a planned retirement age, then Normal Retirement Age is a suitable assumption if passed NRA the age next birthday can be used
- A number of limitations and warnings apply as detailed below
- Planned retirement ages before the Scheme Retirement Age should be ignored

Pension schemes have two important ages that can determine when a member retires. The first is the Scheme Retirement Age. This is the earliest age at which the scheme allows a member to retire without applying early retirement penalties. This date will be defined by the scheme, and will normally match the current practice of when members usually retire.

The second is the Normal Retirement Age, which is the age at which the employer can, and normally does, ask employees to retire free from legal age discrimination restrictions.

We have made the assumption that most members do not have a specific retirement date in mind, and that they will follow the normal practice of retiring at Scheme Retirement Age, the first opportunity to do so without suffering early retirement penalties.

If the member is already passed the Scheme Retirement Age and has not yet retired then it is necessary to determine at what age they will retire. This age can then be entered in the Scheme Retirement Age input. If a specific age is not known then a suitable assumption might be retirement at Normal Retirement Age, or if passed Normal Retirement Age their next birthday. If a specific age is known this can be entered, though it must be no later than their 75th birthday.

If the member has not yet reached the Scheme Retirement Age, but has definite plans to retire later, then this may be put into the Scheme Retirement Age input. The effect of entering a later Scheme Retirement Age will normally be to reduce the value of the pension asset and therefore this should be used with care.

Remember that the EPV Actuarial Report only reflects the data entered and will show the Scheme Retirement Age as input. In these cases, you may wish to add a covering note to the Report explaining the inputs made.



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The EPV will accrue pension rights for the period up to the end date for pensionable service, or the Valuation Date if sooner. If this period includes time passed the Normal Retirement Age, this may be incorrect for some schemes that cease accruals at Normal Retirement Age.

If the member has definite plans to retire before Scheme Retirement Age then this should be ignored, as the scheme will normally adjust early retirement terms to be actuarially equivalent to those at Scheme Retirement Age.



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