

## Six reasons why CETV's are an inappropriate valuation method

***There are six general reasons why CETVs for defined benefit (final salary) schemes may not be appropriate for divorce cases.***

### 1. CETVs can ignore discretionary benefits

- A scheme can ignore discretionary benefits in calculating CETVs, even if the scheme intends to provide such benefits whenever possible. Examples of discretionary benefits include pension increases when in payment, generous early retirement terms or ill-health benefits.

### 2. Schemes can offer different benefits for active members and leavers

- Some schemes offer worse benefits for leavers than active members. The assumption of leaving the scheme used by the CETV triggers a step-down to the worse benefits.

For example, most uniformed service schemes offer immediate pensions subject to minimum length of service requirements. However earlier leavers only get their deferred pension at a later age between 55 and 65 depending on the scheme.

### 3. Active members lose the loyalty benefit of future salary increases

- Active members are assumed to leave at the date of the CETV. This loses them the loyalty benefit of future salary increases.

The pension accrued to date is based on a multiple of the years of service times the final pensionable salary of the member. The CETV assumes the member leaves service at the valuation date and calculates the final pensionable salary at retirement based on the current salary increased at the statutory valuation rate.

However, the reality is that for as long as the member remains in service his salary will increase at a rate expected to be higher than the statutory valuation rate. Therefore, the final pensionable salary is lower for the CETV than that actually expected and so the pension accrued is lower.

**4. Under-funded schemes** - The CETV can allow for the funding state of the scheme and can depress the value payable on transfer by the proportion of the scheme's full value that is not funded. As the CETV is for calculating assets to be taken from a scheme this is reasonable. However, schemes now need to have plans to eliminate under-funding and a divorcee need not reduce their pension by taking a transfer and so it is inappropriate to adjust for scheme underfunding in a valuation for a divorce.

### 5. CETV assumptions need only be reasonable, not best-estimate

- Currently, the assumptions of future experience used in CETV calculations need only be reasonable and consistent with those for setting benefits on transfers in. It is not unreasonable within this range for schemes to veer towards lower valuations for CETVs, which are for members leaving the scheme.

For example, we have found that scheme CETVs tend to ignore the improvement in mortality in retirement that has been allowed for in even the best rates available in the market (for example, from the FSA website).

Regulations have been laid before Parliament such that from 1<sup>st</sup> October 2008 transfers must be on a "best estimate" basis. The practical interpretation of these regulations remains to be seen.

### 6. CETVs normally ignore the health of the individuals

- CETVs are normally calculated assuming the member and their partner are in good health. However, the pension value should be reduced if either of the partners is in ill health and their life expectancies are reduced, as the length of time pensions will be paid will be reduced.

If the member is in such ill health that an ill health early retirement pension is likely to be triggered then this will increase the value again as the pension might be paid earlier and on more generous terms.

