# KNOWLEDGE BASE

PENSION SOLUTIONS

## General Information

**Transvas Report: Yields and Pension Projection Graphs**

**Date Logged: 7 March 2014**

## How are Yields and Graphs related?

It is a common misconception that the graphs showing the pension benefits are directly linked to the Critical Yields. However, this is not the case.

## Pension Projection Graphs

### Existing Scheme

The projected pension for the existing scheme is calculated by revaluing the scheme benefits up to retirement using the scheme's revaluation rates. The assumptions used for any future projected revaluation will be those laid out in the FCA Conduct of Business Sourcebook (COBS) Section 13, Annex 2. Different assumptions will apply at the low, mid and high rates of return.

### Personal Pension and Section 32

The Personal Pension and Section 32 projected pensions will be based on the future rate of return assumed for the funds used for comparison. These can be fund specific, but cannot be more than those stipulated in COBS 13 Annex 2. From 6th April 2014 the maximum rates at low, mid and high will be 2%, 5% and 8% respectively.

The PP and S32 future projection will also allow for the charges on both the product and the fund, as well as any adviser charges included.

This fund value is then converted into an annuity using the rules and guidance in COBS 13 Annex 2.

To make a meaningful comparison with the existing scheme, the escalation rate used to generate the annuity rate, and project the ongoing pension for the PP and S32, is set to be as close as possible to the overall escalation experienced in the existing scheme.

This annuity rate is applied to the projected fund for the PP and S32 to provide the starting pension amount. For the S32, if there is GMP, the cost of providing the GMP is allowed for first.

## Critical Yields

For the purposes of calculating the Critical Yield, the scheme pension at retirement is converted into a capitalised value (again using annuity rates based on the FSA Guidance but this time from COBS 19.1.4). The PP/S32 yields represent the amount of growth required in a PP/S32 (taking into account charges) in order to meet the capitalised value of the scheme pension at retirement. It has no direct link to the PP/S32 pension shown in the graphs.

When calculating the critical yield, the annuity shape for the PP and S32 is irrelevant because the critical yield is based on the fund required in the PP or S32 to match the capital value of the existing scheme benefits at retirement. How this fund is used to purchase benefits is immaterial.

## Or put another way…

The two calculations are similar, but are seeking to find a different value.

For the critical yield, we know the PP maturity value we want (the capitalised value of the existing scheme) and we want to find the growth rate that will get us there (the critical yield).

For the Pension Projection graphs, we know the growth rate (the assumed growth assumption) and we want to find the maturity value.