



ASSOCIATION OF CONSULTING ACTUARIES

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16 January 2018

Department for Work and Pensions
Contracting-out policy Team
First Floor
Caxton House
Tothill Street
London SW1H 9 NA

Dear Sir / Madam

Draft Contracting-out (Transfer and Transfer Payment) (Amendment) Regulations 2018

I am writing on behalf of the Association of Consulting Actuaries in response to your consultation on the above draft regulations. We welcome the proposed changes in principle but we have some concerns over the detailed proposals. Our comments on the specific questions raised in the consultation are set out in the Appendix.

Our most significant concern is in relation to the requirement that the transfer must “not adversely affect the rights” of the transferring members. This appears to be an onerous additional requirement and it is not immediately clear how it will be assessed and who would be responsible for the assessment.

In our view, it is likely to be difficult to come up with a definition of “adversely affect” which will work well in practice. However, this test is in addition to the “broadly no less favourable” actuarial certification test which is being applied in any case. Our preference would be to rely on this existing and well established protection and not to introduce an additional test which is likely to frustrate the policy objective.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful, in which case please contact me on 020 7432 6635 (david.everett@lcp.uk.com), or my colleague Peter Williams, who prepared this response, on 01372 733763 (peter.williams@aonhewitt.com).

Yours sincerely

A handwritten signature in black ink that reads 'David Everett'.

David Everett

Chairman, Pension Schemes Committee

On behalf of the Association of Consulting Actuaries Limited

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APPENDIX

Draft Contracting-out (Transfer and Transfer Payment) (Amendment) Regulations 2018

1. Do you agree that the draft changes enable transfers of contracted-out pension rights without member consent to be made to schemes that have never been contracted out as mentioned in paragraph 9

We have one significant concern.

The new regulation 8A, that deals with the transfer of section 9(2B) rights, includes a requirement that the transfer will “*not adversely affect the rights*”, with ‘adversely affect’ being defined as altering “*those rights so that the benefits, or future benefits, to which they relate would or might be less generous*”. This appears to be an onerous additional requirement and (unlike the use of this term in Section 67 of the Pensions Act 1995 when modifying accrued rights) it is not immediately clear how it will be assessed and who would be responsible for the assessment. In our view the ‘not adversely affect’ test may be difficult to apply in practice.

As an example, the definition would include consideration of whether the post transfer benefits “*might be less generous*”. Would this need to include assessment of possible future employer insolvencies? Even if the benefits provided are identical post transfer, it is conceivable that the benefits actually delivered might be less generous if, for example, the new sponsoring employer becomes insolvent and the scheme transfers to the PPF. More routinely, cash commutation and early retirement factors might diverge over time, even if the scheme rules were identical at the outset – could this also potentially fall foul of the “*might be less generous*” definition?

In addition, it needs to be clear who is responsible for making the assessment of whether rights would be adversely affected or not, and (as in Section 67 of the Pensions Act 1995), how they would go about it.

In our view, it is likely to be difficult to come up with a definition of ‘adversely affect’ which will work well in practice. We also note that this test is in addition to the ‘broadly no less favourable’ actuarial certification test which is being applied in any case to the section 9(2B) rights being transferred. In the absence of a clear rationale for an ‘adversely affect’ test *and* a workable definition, our preference would be to rely on this existing and well established protection and not to introduce an additional test which is likely to frustrate the policy objective.

If an adversely affected test is to be retained, it would make some sense to base it on an existing structure, which sets out the test to be carried out clearly and defines the respective responsibilities of trustees and the actuary in carrying out the test. We believe the existing protections under regulation 12(3), already included under 8A(1)(b), should be sufficient. If further protection is considered necessary, the structure of the modification provisions under Section 67 of the Pensions Act 1995, which allow certain modifications within a scheme without member consent, would be preferable to the proposed definition, but this would require further exploration given the different context in which it would be used.

As a minimum, if the test is to be retained, it should be made clear that if the new scheme mirrors the rules setting out the benefits of the previous scheme, this will satisfy the requirements.

A separate point is that, in paragraph 8A (draft regulation 2(8)), we would suggest the word "accrued" be removed before the reference to "section 9(2B)" rights. The wording is redundant and its removal would be consistent with the terminology used in the existing definition of "connected employer transfer payment". It would also avoid any suggestion (because of the definition of "accrued rights" in section 20(6) of the Pension Schemes Act 1993) that only prospective entitlements are included (ie that section 9(2B) rights in payment are excluded).

2. Do you think that the proposed changes to the regulations will provide adequate protection for deferred and pensioner members' benefits following transfers without member consent to schemes that have never been contracted out?

Yes, but as noted in our response to question 1, we think the level of protection in the draft regulations should be reduced in order to make the process workable. This will still provide an adequate level of protection for both deferred and pensioner members – and active members.

3. Do the proposed changes to the regulations allow further bulk transfers of contracted-out rights to take place without member consent from schemes which have never been contracted out to other schemes?

Yes, but only with appropriate protections for the contracted-out rights.

4. In your view, before contracting out for salary-related schemes was abolished, how common were bulk transfers of contracted-out rights without member consent to schemes that have never been contracted out, can you give examples of circumstances in which they occur?

It has not previously been possible to make such a transfer to a scheme that has never been contracted out. However, prior to 6 April 2016, it was possible to set up a new scheme and, so long as it then became contracted out for a short period, it could receive a bulk transfer of contracted-out rights. This scenario was relatively rare but did occur from time to time.

Although this occurred relatively infrequently, the removal of this option from April 2016 has caused significant difficulties for clients that are impacted. The scenarios in which clients are likely to want to transfer contracted out liabilities to a new scheme include sales of businesses and scheme consolidation exercises.

5. Can you give an indication of the time/costs of complying with the proposed previous requirements, number of contracted-out right transfers per year that you think might be helpful?

As noted above, prior to April 2016 employers made use of the flexibility to transfer their employees' pension benefits to a new scheme from time to time.

It is not clear to us what the "time/costs of complying with the proposed previous requirements" are. At present it is not possible to make such transfers. The resulting 'costs' are in business sales and scheme consolidations that are frustrated as a result of inflexible legislation.

6. Are there any other areas of transfers of contracted-out rights you believe require further attention and do you have examples of how they are not working?

Yes.

1. Transferring contracted out rights in payment with member consent

As DWP is aware, due to a drafting anomaly, it is not possible to transfer contracted-out rights which are in payment, with member consent, to a scheme that has not been contracted out. It would have been helpful to resolve this issue at the same time as the current consultation (paragraph 7 of the consultation document suggests the draft regulations 'provide for these changes' but this does not appear to be the case). The changes required have previously been highlighted to DWP and are significantly more straightforward than the changes proposed under this consultation for transfers without consent.

2. Continuation of fixed rate GMP revaluation

One further recent example which has become apparent is the GMP revaluation rate for active members involved in a bulk transfer, for schemes which revalue GMPs in line with fixed rate revaluation in deferment (once they have left pensionable service).

Prior to 6 April 2016, in the event of a bulk transfer, contracted out service would not be treated as terminated (see paragraph 3.7 of CA14) and so the fixed rate of revaluation would only apply from a future date of exit in the new scheme (in the same way as if the transfer had not occurred).

From 6 April 2016 there does not appear to be a similar flexibility (under section 16 of Pension Schemes Act 1993 or related regulations). It would now appear that the fixed rate of revaluation would apply from the date service ceased in the old scheme – rather than from the later date that (continuous) service ceases in the new scheme. It would be helpful to address this issue at the next suitable opportunity.

About the Association of Consulting Actuaries (ACA)

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

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