



2013 PENSIONS BILL
EVIDENCE FROM THE
ASSOCIATION OF CONSULTING ACTUARIES TO
THE PUBLIC BILL COMMITTEE

1. Introduction

- 1.1 The Association of Consulting Actuaries (ACA) welcomes the key measure in the *2013 Pensions Bill* – the introduction of a single-tier State pension, a measure the ACA has supported for well over a decade. However, as a consequence, the Bill enacts the ending of contracting out of Defined Benefit (DB) pensions (contracting out of Defined Contribution (DC) pensions ended in 2012). Sponsors of contracted-out DB schemes are likely to have approximately two years to plan for this change – as the Government has brought forward the implementation date by a year to 6 April 2016.
- 1.2 The ACA’s 1,750 members provide advice to thousands of sponsors of UK pension schemes, including most of the country’s largest schemes. ACA members are also scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes. The ACA’s evidence below largely concentrates on the impact of the *Pensions Bill* on these DB schemes, their members and employers’ pension strategies as a result of the ending of DB contracting-out and issues raised by the Bill’s content (or absence of content).

2. Executive Summary

- 2.1 **Contracting out and the statutory override for employers:** Changes to State pensions will affect DB schemes – schemes that are already under threat of closure and are being replaced by DC schemes. Under the single-tier State pension DB contracting out of the current additional State pension will end.. *One difficulty is that many schemes had the statutory requirements “baked in” to their rules when they contracted out – so they will not automatically change to reflect the few relaxations proposed in the Bill. Trustees will need to be given overriding modification powers to bring schemes into line (as was given for equivalent problems on the previous abolition of the money purchase contracting-out regime).*
- 2.2 The *Pensions Bill* includes a statutory override to support employers in making changes to their scheme benefits to recover the loss of the NI rebate, in consultation with employees in their schemes. The details of the statutory override will appear in secondary legislation *and it is important that the Government shares these details as soon as possible. The time available for employers and schemes to make the*

necessary changes is already extremely tight and a formal consultation on the draft regulations will be required.

- 2.3 **Conversion of Guaranteed Minimum Pensions (GMPs):** The *Pensions Bill* contains a new power for the Secretary of State to issue “guidance” on GMP conversion, but does not include a regulation-making power to adjust the regime itself. *However, “guidance” as a form of quasi-legislation is apt only to affect the way a statutory authority conducts itself and does not alter the law as it affects scheme trustees or the approach of the judiciary to that duty. Trustees could find themselves still unable to use the regime effectively. A new regulation-making power is essential to allow the DWP to adapt the regime to make it workable.*
- 2.4 **Changing State (and private) pension ages for the future:** The current system of increasing state pension age lacks transparency. In the *Pensions Bill* the Government proposes to review State Pension Age every six years or less, receiving advice from the Government Actuary’s Department and an independent body. *The Government should define the terms, expectations and powers of this independent body in regulations. The regulations should also clearly set out the number of years of advance notice to be provided to those affected by changes in State Pension Age so that they can prepare and make decisions on their pension investments and retirement income accordingly.*
- 2.5 **Auto-enrolment:** The Bill contains provisions that tweak auto-enrolment rules and procedures. *Many of the tweaks are sensible. However, some require further consideration, including the rules around auto-enrolment in hybrid schemes. There is also a missed opportunity to simplify the transition for contracted-out schemes which places unnecessary burdens on these schemes.*
- 2.6 **The Pensions Regulator:** The Pensions Regulator has been given a new objective, adding to its existing five objectives. The new objective is to ‘minimise any adverse impact on the sustainable growth of the employer’. *Though welcome, the Government needs to ensure more transparency on the effects of this objective and how it will be implemented.*
- 2.7 **Single tier State Pension:** A number of DB schemes have within their benefit design an explicit interaction with the current State Pension system. *Such references may deliver perverse results after 2016 unless the DWP puts in place sufficient legislation to allow schemes to react appropriately.*

3. Contracting-out and the Statutory Override

Clause 24 and Schedules 13 and 14

- 3.1 As a necessary consequence of the introduction of the single tier State pension all occupational pension schemes contracted out of the State Second Pension on 5 April 2016 will be immediately contracted back in. The *Pensions Bill* adjusts the current contracting out legislation within the Pension Schemes Act 1993, but with the intention of removing only those few parts that cease to have any relevance (such as provision of contracting out certificates) and ensuring that, for other aspects, the language works

and does not lead to administratively more complex outcomes in the new world of formerly contracted-out schemes.

- 3.2 *One difficulty is that many schemes had the statutory requirements “baked in” to their rules when they contracted out – so they will not automatically change to reflect the few relaxations proposed in the Bill. Trustees will need to be given overriding modification powers to bring schemes into line (as was given for equivalent problems on the previous abolition of the money purchase contracting-out regime).*
- 3.3 There appear to be two potential drafting flaws which ought to be examined closely given their potential impact on private sector schemes. The first concerns the amended revaluation rule (in paragraph 16 of Schedule 13). It seems that when this provision is commenced on 6 April 2016 the law will change not only for schemes that are forced to contract back in on this date, but also for all schemes that contracted back in before then. The second concerns the proposed change to the definition of “cessation date” (in paragraph 38 of Schedule 13). As with revaluation the change of definition seems to apply to all schemes that were contracted out before 6 April 2016 which if true would mean that schemes that ceased to contract out prior to 6 April 2016 but remained open to accrual would have their members’ cessation dates redefined as when the individual subsequently left pensionable service. *This will mean that all anti-franking calculations carried out in respect of such individuals will need to be revisited which we assume cannot be intended, especially for those whose benefits have since commenced. In both cases we were expecting to see drafting that limited the change to schemes that were forced to contract back in on 6 April 2016.*
- 3.4 Since the beginning of the discussion on reforming the State pension, we have recognised that the introduction of a single-tier State pension would result in the end of contracting out of the State Second Pension and the NIC rebate. The statutory override for employers in the *Pensions Bill* seeks to ensure that employers and schemes are able to administer these changes and the transition to a new system in the most cost effective manner, avoiding where possible placing additional burdens on those employers still offering a DB scheme to their workers.
- 3.5 The employer override is a unique power which enables employers to amend scheme rules to offset their increase in NICs, regardless of any restrictions imposed by scheme rules. **The provision is welcome and there is ample regulation-making power included to provide member protection** but potential issues exist including:
 - 3.5.1 **The timetable for making the changes:** taking into account the number of affected schemes, the availability of actuarial advice, the large number of key details which are being left to regulations, the usual timetable for regulations, the member consultation process and the need, in practice, for employers to work closely with trustees and their advisers, we had originally concluded that formal consultation on full draft regulations would need to start in October 2013 for a 2017 start date. *With now a 2016 start date, the timetable is very tight to achieve the policy objective of allowing employers to avoid a net increase in costs. Smaller employers, less able to command immediate attention from the limited pool of advisers, are likely to be affected most, unable to make changes for the*

start date, but only later after NIC costs have already risen. The DWP's preparation of the regulations needs to be prioritised.

- 3.5.2 The conditions in which employers can access the provision and the limited flexibility given to employers who wish to make rule changes.
- 3.5.3 The override does not apply when restrictions to rule changes are provided for in regulations (specifically, this could include protected persons).
- 3.5.4 Some scheme structures make it difficult for employers to take advantage, or get the intended relief, from the override – for example, large multi-employer schemes, where employers are all associated and shared cost schemes.
- 3.5.5 Restricting the change to individuals who are already members of the scheme at the date of change, meaning that employers cannot use the power to change the rules in the same way for future members. *To deliver on the policy to allow employers to reshape their offering so that it is not dependent on NIC savings the drafting needs to extend to individuals admitted to membership in the future.*

4. Solving the GMP inequality conundrum through conversion

Paragraph 20 of Schedule 13

- 4.1 Guaranteed Minimum Pensions (GMPs), the product of DB contracting-out up to 1997, are required by statute to be unequal as between the sexes, despite sex equality requirements applying from 1990. Whether and, if so, how that statutory inequality should be corrected by schemes paying compensatory uplifts to scheme benefits is a hotly debated topic. The DWP plans simply to impose scheme equalisation by regulation shortly, but recognises the administrative complexity entailed. The policy hope now is that an existing statutory facility for conversion of GMPs into conventional benefit entitlements could provide a partial simplification of the new obligation. However, this Pensions Act 2007 regime has rarely (if ever) been used, primarily due to the sex equality question, but also because of flaws in its construction which are now becoming apparent through dialogue with the DWP.
- 4.2 The *Pensions Bill* contains a new power for the Secretary of State to issue “guidance” on GMP conversion, but does not include a regulation-making power to adjust the regime itself. *However, “guidance” as a form of quasi-legislation is apt only to affect the way a statutory authority conducts itself and does not alter the law as it affects scheme trustees or the approach of the judiciary to that duty. Trustees could find themselves still unable to use the regime effectively. A new regulation-making power is essential to allow the DWP to adapt the regime to make it workable.*
- 4.3 Before a scheme can address the GMP inequality issue it will need to reconcile its records of GMPs with those held by HMRC. At the current time there is insufficient resource made available by HMRC for this purpose and the processes employed are cumbersome. A far more efficient way of working along with resourcing up will be necessary, not only so that schemes can address the GMP inequality issue, but also for

the step change in HMRC's workload that will accompany DB schemes contracting back in on 2016, when they all will have to carry out a GMP reconciliation exercise.

5. Starting to put State Pension Age increases on a firmer footing

Clauses 25-26

- 5.1 The life expectancy of future pensioners continues to increase, with latest figures suggesting that men who turn 65 in 2013 can expect to live to 86 while women of the same age can expect to live to 89 years of age on average.
- 5.2 The current system of increasing State Pension Age lacks transparency. In the *Pensions Bill*, the Government proposes to review State Pension Age every six years or less, receiving advice from the Government Actuary's Department and an independent body. *The Government should define the terms, expectations and powers of this independent body in regulations. The regulations should also clearly set out the number of years of advance notice to be provided to those affected by changes in State Pension Age so that they can prepare and make decisions on their pension investments and retirement income accordingly.*

6. Tweaking automatic enrolment

Clauses 33-38

- 6.1 A significant loophole in the Pensions Act 2008 allows employers to put off auto-enrolment until 1 October 2017 by offering membership of the DC only section of an otherwise mixed (ie hybrid) scheme. *The Bill limits this "transitional period" so that for hybrid schemes it does not apply to "money purchase members". But this exclusion might not be wide enough to save individuals whose primary benefit is DC but with some minor defined benefit such as life cover. The DWP needs to rethink the definitions.*
- 6.2 *A related issue is that it seems that DC sections of hybrid schemes cannot phase in minimum contributions, unlike pure DC schemes. If so, this will need to be fixed.*
- 6.3 There are a number of outstanding technical issues in relation to auto-enrolment that need to be addressed to assist scheme sponsors. *The July 2012 DWP guidance designed to enable employers and actuaries carry out their certification duties needs urgent revision. And since the Pensions Bill removes the automatic qualification of contracted-out schemes for auto-enrolment, employers will suddenly have to test schemes which currently are considered perfectly apt for auto-enrolment against the alternative test scheme standard, regardless of whether they have changed or not. This is an unnecessary burden and needs to be revisited by the DWP.*
- 6.4 Some contracted-in schemes with risk-sharing aspects are finding it difficult to meet the conditions laid down to be treated as a qualifying scheme for auto-enrolment, despite their being of good quality. This is because there may not be a "test scheme" that closely mirrors their risk-sharing design. An example is a scheme that operates on a with-profit deferred annuity basis. *The DWP may need to introduce further*

adjustments to the auto-enrolment legislation to facilitate the admission of risk-sharing schemes.

7. The Pension Regulator's new objective

Clause 42

- 7.1 The Pensions Regulator has five statutory objectives under the Pensions Act 2004 and the *Pensions Bill* will impose another.. The proposed wording of this new objective, which has been included in the *Pensions Bill*, is for the Regulator to 'minimise any adverse impact on the sustainable growth of the employer'.
- 7.2 For this new objective to materially influence the Regulator's behaviour, in a way that meets the Government's intentions, there needs to be more clarity over how the Regulator's existing statutory objectives affect its regulatory actions, and what changes it is expected to make due to the new objective. *For example, this could include consideration of whether the Regulator's objectives require it to consider only accrued rights, which appears to drive its current behaviour, or whether they include an obligation to promote ongoing, good quality, employer sponsored pension saving, which the Government stated (for example, in its recent Green Paper) was one of its objectives.*
- 7.3 *There is also uncertainty about how, as currently drafted, it will apply to employers (such as charities and other not-for-profit organisations) who are not pursuing a growth or profit objective but for whom the on-going viability of the employer is critical to the future prospects of the DB scheme.*

8. Interaction with State Pensions

No provision in the Bill

- 8.1. Occupational pension schemes quite often make references to a 'state retirement pension' (or similar wording) in their rules (typically meaning the Basic State Pension) – for example, when providing a temporary pension to bridge the period from retirement until State Pension Age or defining an offset to pensionable salary or benefits. Such references may no longer be appropriate in 2016 and could, unless altered, have quite perverse results, including reducing the scheme benefits that have accrued. *It will be most important for the DWP to ensure that sufficient legislation is in place in order that schemes can react appropriately to this fundamental change in state pension provision.*

9 The Pensions Bill and 'Defined Ambition'

For a future Bill?

- 9.1 As vital as the new single-tier pension is in ensuring everyone has a solid State pension, it is even more important that private pensions are in a position to deliver an increasing overall proportion of retirement income for millions of pensioners in the coming years. *More needs to be done alongside the changes to State pension and auto-enrolment to secure this.*

- 9.2 The Pensions Minister has made it clear that he sees new **‘Defined Ambition’** pensions which share risks as a game changer. Defined Ambition pensions will seek to give greater certainty for members about the emerging retirement income than a current DC pension provides, and much less cost volatility for employers than a current DB pension.
- 9.3 *Ending DB contracting-out in 2016 means most of those remaining employers with open DB schemes will have to review their schemes.* Some will utilise the employer override and will continue to meet the cost of running such a scheme. However, without new pension design choices that fall within the law, research by both the ACA and NAPF suggests many other employers will feel driven to take the opportunity to close their DB schemes. As the shift towards DC schemes continues, many more employees than at present will have to rely on pension arrangements where pension risks are met predominantly by those employees themselves. Research suggests the vast majority of employees do not want this outcome, nor do substantial numbers of employers.
- 9.4 **There may be a number of different types of Defined Ambition schemes that emerge from the current DWP discussions with industry, employers and consumers, but, given the 2016 reforms, it is essential that the Government paper due later this summer flags up the need to act quickly, with provisions included in legislation, to make sure new pension design options are available for employers to use no later than 2015.**

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About the Association of Consulting Actuaries (ACA)

The **Association of Consulting Actuaries (ACA)** is the representative body for consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body. The ACA has 1,750 members working in around 75 firms. ACA Members are all qualified actuaries and all actuarial advice given by members is subject to the Actuaries’ Code. The ACA forms the largest national grouping of consulting actuaries in the world.

27 June 2013