Institute
and Faculty
of Actuaries

Automatic enrolment: defined benefit alternative quality requirements and provisions for seafarers and offshore workers

IFoA response to Department for Work and Pensions

30 August 2017

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

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Automatic Enrolment Policy
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30 August 2017

Dear Ms Beyene

IFoA response to DWP Consultation: Automatic enrolment: defined benefit alternative quality requirements and provisions for seafarers and offshore workers

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this consultation. The IFoA's Pensions Board has provided the detail in this response. We have provided comments on only Chapter 1 as we are happy to leave responses on Chapter 2 to those who have specific experience of those situations.

2. We believe the alternative quality requirements are very useful and are beneficial to schemes. Consequently, we support their retention, although there are a few minor amendments that would prove beneficial to schemes.

3. It is our understanding that many schemes are using the temporary easement of looking at the cost of accrual for the whole scheme. In many cases, the cost of accrual is quoted as an overall figure and is not broken down by benefit scale. To carry out the test at benefit scale level would often require additional work and potentially cost.

4. There are certain scenarios where the salary definition cannot be used under the cost of accruals test. Examples include:
   - Pensionable salary is subject to a cap; or
   - Some earnings are within basic pay but are not included in pensionable earnings.

5. Although the test could be met in many, if not most, of these scenarios, as the cost of accrual exceeds 13%, the current regulations do not support a simple understanding that the test is met. We would support the possibility of introducing an easement in this area.

6. Some of our main concerns relate to who has responsibility for whether a scheme satisfies the Auto-Enrolment requirements (the employer) and who is most likely to provide the information efficiently (the actuary who does not report to the employer).

Q1: Do the alternative quality requirements for DB schemes broadly deliver the intended simplifications and flexibility in contrast to the test scheme standard?

7. Yes, broadly. The alternative "cost of accruals" quality requirements are in most cases significantly easier to satisfy than the test scheme standard. In most cases, the involvement of the actuary has been to explain how the system works rather than to complete any actuarial calculations.

Q3: To what extent are the different forms of earnings which a scheme can use to determine pensionable earnings meeting the needs of employers? Are employers taking advantage of these variations?
Are there any circumstances in which a scheme is unable to satisfy any of the different forms of earnings used?

8. We believe that the different definitions of earnings used within the cost of accruals test work for the majority of pension schemes. However, we believe that there is a significant minority of cases where the scheme's definition does not match any of the definitions in the test.

9. In general, this does not cause a problem because one of the definitions is sufficiently similar and/or because the contribution requirements are significantly higher than 13% of earnings.

10. The biggest difficulties probably arise in cases where a scheme's pensionable earnings are subject to some form of cap. However, it is likely that the more-complex calculations required under the "test scheme standard" method should indeed be followed in these cases in order to satisfy the overall quality requirements for qualifying as an Auto-Enrolment scheme.

Q4: Does this definition fit with existing practice? Are there any circumstances in which it is causing problems or additional work?
When applying the test at benefit scale level what difficulties, if any, has the actuary encountered in determining whether there is a material difference in the cost of providing benefits between different groups of relevant members?

11. We believe that the definition of relevant members generally works.

12. Identifying whether there is a material difference in the cost of providing the same benefits to different groups of members would be complex. Completion of full calculations to analyse this are probably very rare. Such calculations would typically conclude that the main variant relates to the member's current age. In most cases it will be assumed that the cost of providing the benefits is uniform across the group.

Q5: What actuarial reports have schemes been relying on for applying the tests under the alternative quality requirements?
To what extent are employers commissioning separate reports?

13. Schemes have not been relying on any information for this purpose. The Auto-Enrolment responsibility falls on the employer, not on the scheme.

14. It is very rare for an employer to commission full actuarial calculations based on full membership data. It is more common for the employer to use information produced by the Scheme Actuary for the scheme's trustees, but this introduces separate issues.

15. The Scheme Actuary's responsibility is primarily to the scheme's trustees. Indeed professional guidance prohibits the Scheme Actuary from advising the employer on the funding of the scheme. A Scheme Actuary's reports will normally include standard wording

explaining that only the scheme trustees may rely on the advice and that the Scheme Actuary accepts no responsibility for anyone other than the scheme trustees relying on the report. Certain funding information must, however, be shared between the trustees and the employer.

16. This puts the employer in a challenging position in the context of needing comfort that the cost of accrual for benefits in the scheme is higher than the relevant percentage without going to the expense of commissioning further actuarial work. This is especially true in the majority of cases where everyone is fairly confident that the cost exceeds the relevant percentage.

Q6: Where employers are choosing to commission reports, are they using TSS or alternative requirements?

17. In the cases where an employer does commission a report, it is most commonly to explain the requirements, the reliances and the process, rather than to complete additional actuarial calculations based on full membership data. It most commonly uses the alternative requirements rather than the TSS.

Q7: The legislation is not prescriptive on who should apply the test. In practice, who is applying the alternative quality requirement?

18. The legislation is clear that it is the employer's responsibility to satisfy the Auto-Enrolment requirements. The employer may complete the work itself, with help from the scheme trustees or with help from an actuary.

19. The contributions required for scheme funding are routinely far in excess of the percentages set for the purposes of the cost of accruals test. The main element of work in such situations becomes the analysis of the pensionable earnings definition and/or whether there are different benefit categories. Satisfying the Auto-Enrolments is a relatively specialist matter and so employers often ask their own actuaries, if appointed, for some form of advice. Typically this advice relates to the requirements and the processes, rather than involving actuarial calculations.

Q8: Are multi-employer schemes making use of simplifications provided for under this part of the legislation?

20. Yes, we believe that the assessment is not carried out separately for each employer within a group unless obviously necessary, or unless this is already a routine feature of the scheme's operation.

Q9: Are these transitional arrangements being utilised?
What action will be taken by schemes in order to be ready to apply the test at scheme-level once the flexibilities have ended on 5 April 2019?

21. We suspect that the transitional arrangements are being utilised but we have not surveyed the situation. The new cost of accruals test is relatively straightforward and so we do not anticipate a problem at the end of the transitional period. Requiring the tests to be completed at a more granular level will provide the Government with a higher level of confidence that all employees are being provided with a satisfactory level of benefits. We expect that most

employers would in any event wish to understand the value of pension benefits being provided to various groups of employees.

Should you wish to discuss any of the points raised in further detail please contact Philip Doggart, Technical Policy Manager (Philip.doggart@actuaries.org.uk / 0131 240 1319) in the first instance.

Yours sincerely

Colin Wilson
Immediate Past President, Institute and Faculty of Actuaries