The Actuarial Profession
making financial sense of the future

consultation response

Department of Work and Pensions

Workplace Pension Reform - Completing the Picture

November 2009

About The Actuarial Profession

The Actuarial Profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London, the two professional bodies for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuing 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's 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 advise 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.

The Profession also has an obligation to serve the public interest and one method by which it seeks to do so is by making informed contributions to debates on matters of public interest.

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Jason Yianni
Department for Work and Pensions
Enabling Retirement Savings Programme
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20 November 2009

Dear Jason

Workplace Pensions Reform: Completing the Picture

We are writing in response to the above named consultation document that was issued on 24th September 2009. We regret that in the limited time that has been made available, we have not been in a position to undertake a thorough analysis of the proposals within this lengthy consultation document.

We have examined the document as a whole, but rather than responding directly to your questions we have concentrated on those aspects that are of direct interest to actuaries. We set out our observations in three appendices to this letter. We also have the following observations:

- The consultation document reveals a very prescriptive approach to the auto-enrolment aspects which seems to be built on a premise that all employers are reluctant to offer pension arrangements. Good workplace pension schemes will have their own tried and tested approaches to enrolling members. There is a danger that unless your proposals can be made to work within the grain of existing good practice, the additional administrative burdens will be a further disincentive to the continuation of existing workplace pension provision.

- We have some concerns about the employer compliance regime. It does appear to be incredibly detailed and burdensome. You should seek out ways in which it can be streamlined.

It seems that much more work needs to be done at both the regulatory and the guidance level and to this end close co-operation with interested parties is essential. As it currently stands, it is not clear to us that it is safe to seek to finalise all this material by the spring of 2010.

If you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us. Should you wish to do so, please contact Martin Hewitt, Pensions Practice Manager on 0207 632 2185 or via Martin.Hewitt@actuaries.org.uk.

Yours sincerely

Robert Hails
Chairman, Consultations Group of the Pensions Practice Executive Committee

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Appendix 1

Money purchase schemes – certification and reconciliation

The certification and reconciliation requirements for the purpose of assessing the quality of money purchase schemes are so detailed that we fear that many sponsors of good quality money purchase schemes will shy away from them. Far from addressing the levelling down concern, these requirements may encourage abandonment of such provision. The difficulty as we see it is reluctance by Government to depart from a minimum percentage of "qualifying earnings" – a measure of reward that is rarely used as a basis upon which contributions to workplace money purchase schemes are determined.

We do not understand why there is so much prescription for the certification of money purchase schemes, including the reconciliation requirement, compared to the test scheme standard for contracted-in defined benefit schemes.

We have the following specific points:

- Although neither the certification nor the reconciliation requirements need actuarial skills, their complexity is such that actuaries are likely to be needed, as numerate and knowledgeable pensions professionals, in order to assist many scheme sponsors meet the requirements. This surely cannot be the policy intention.
- We do not see the need for the reconciliation requirement, especially when the certification has to be carried out annually.
- Reconciliation is incredibly detailed, with the prospect of having to carry out checks for each member.
- It is not clear, if reconciliation is carried out on a sample basis, how any shortfalls identified get translated into the need to make up shortfalls since the draft regulations are expressed as if a member-by-member reconciliation has been carried out.
- Two aspects of the reconciliation have no parallel within the test scheme standard – the proscription of large shortfalls (more than 5%) and consecutive shortfalls (more than once in a consecutive 24 month period).
- Restricting the testing to a comparison of contribution amounts is very narrow. The scheme being tested may have desirable features in relation to expenses, investment choice and selection of default fund. We are not suggesting that you seek to extend the test to allow for these factors, but the existence of important factors other than contributions suggests that the test on contributions should not be too prescriptive.

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Appendix 1 (cont)

- The requirement for shortfalls to be met within three months of the end of the certification period is impractical, especially as this is the same period within which the reconciliation must be carried out.

We believe that you need to rethink your proposals, focussing on the need to ensure that good quality money purchase provision can have a similar easy passage to passing the quality test as you are offering contracted out defined benefit schemes.

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Appendix 2

Hybrid schemes

The exceptionally narrow definition of “defined benefit scheme” within the Pensions Act 2008 and the standard definition of “money purchase scheme” has resulted in nearly all salary-related schemes and some money purchase schemes being treated as hybrid schemes for the purposes of meeting the quality requirements. Clarity is needed as to how typical scheme designs are treated.

We have the following specific points:

- The “cash balance hybrid scheme”, as described, seems to be a defined benefit rather than a hybrid (ie mixture of defined benefit and money purchase) scheme. If this is intentional we suggest that it should fall outside the Hybrid Schemes Quality Requirement Rules and be built into the test scheme standard.

  The 16% lump sum accrual is expressed as if the scheme is of a final salary nature. This will make certification difficult. It would seem more appropriate to develop a separate test scheme that utilises the principal features of a cash balance scheme. It is also not clear to us why you have settled on 16%. Presumably it is intended to be broadly equivalent to the final salary based test scheme of 1/120ths pension accrual.

  The merit of offering an alternative 8% lump sum accrual but with revaluation set at 3.5% pa plus RPI capped at 2.5% is not clear to us. Again, the 8% formula suffers from being final salary in nature.

- The “final salary lump sum hybrid scheme”, as described, seems to be a defined benefit rather than a hybrid (ie mixture of defined benefit and money purchase) scheme. If this is intentional we suggest that it should fall outside the Hybrid Schemes Quality Requirement Rules and be built into the test scheme standard.

- The “self-annuitising hybrid scheme”, as described, does not feel like a hybrid scheme. We suggest that it should fall outside the Hybrid Schemes Quality Requirement Rules and be built into the money purchase quality test.

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Appendix 3

Test scheme standard

We have the following specific points:

- The test scheme standard is devoid of provision for widow/ widower / surviving civil partner's pensions. It is not clear why this should be so, as it is a clear inconsistency with the reference scheme test and it prevents contracted in schemes from being able to demonstrate value in an important area.

- We think that you should develop an alternative form of test scheme standard that can reflect career average revalued earnings designs so that the ability for such schemes to meet the quality requirements is not driven through an accident of the manner in which the actuarial test is carried out (as is currently the case for the reference scheme test).

- It is not clear how the rise in the age 65 starting date for benefit is to be handled. We suggest that the starting age should be defined as the higher of 65 and State Pension Age and that you make analogous changes to the reference scheme test for contracted-out salary-related schemes.

- Setting the "final salary method" as the sole acceptable means of revaluation for members who leave pensionable service before attaining normal pension age is unnecessarily restrictive.

- The guidance to employers lacks clarity on when they do and do not need to refer to an actuary.

- There is a lack of clarity on what historic earnings data is needed for the test. The actuarial guidance in part 2 does not refer to three years' worth of data. The guidance to employers (pages 182 and 183) suggests that for final salary schemes only one year's worth of historic data is needed. However, for career average schemes three years' worth of data is needed and should be averaged for the test. Since a final salary scheme could base benefits on an average of the last 3 years' pensionable earnings, it would surely make more sense for the test to be based on three years' worth of historic earnings data in both cases.

- There is a strong argument that the guidance for actuaries should be as close as possible to Guidance Note 28 (updated where necessary) which is used in relation to the reference scheme test. Indeed, we would go further. Since GN28 is likely to be rescinded by the Board for Actuarial Standards when TAS P is introduced (currently anticipated to be in April 2011), there is sense in the same parties developing guidance for both the reference scheme and the test scheme tests.

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Appendix 3 (cont)

- While it is possible we have missed it somewhere in the 200 page document, although we could find a pro forma certificate for the employer, we could not find a pro forma for the actuary. Should there be such a statutory certificate?

- The balance between self-certification by the employer and certification by the actuary can be shifted further in favour of the employer. The employer guidance could provide tables to adjust benefits with a normal retirement age other than 65 and separate tables containing conversion factors to apply to schemes that accrue lump sum rather than pension.

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