Institute and Faculty of Actuaries

Technical changes to Auto Enrolment

Consultation response to the Department for Work and Pensions

9 January 2014

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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Alison Evans
Department for Work and Pensions
Automatic Enrolment Programme
1st Floor, Caxton House
6-12 Tothill Street
London
SW1H 9NA

Dear Ms Evans

IFoA response to Technical Changes to Automatic Enrolment (AE)

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to DWP's consultation 'Technical Changes to Automatic Enrolment'. This response has been drafted by IFoA members who work in Defined Benefit (DB) pension schemes. We have limited our response to areas where the IFoA can offer specific comment.

Question 1: Does the level of the alternative test deliver broad equivalence with the Test Scheme?

2. The assessment of whether the alternative test would deliver broad equivalence with the Test Scheme will depend on the assumptions used to value the benefits accruing. Our response to question 5 answers this point in more detail.

Question 3: Does this definition meet the needs of schemes? Are there scenarios where this definition would create additional work for schemes/employers? Is the default period of 12 months an appropriate period for schemes which may not have an actuarial valuation or control period? Does the definition at regulation 1(2) capture those schemes described as master trusts in chapter 2?

3. The reference in the new 32L(4)(b)(i) appears to define a specific date, rather than a period of time. It is unclear whether this date would be the effective date of the valuation. If the definition does refer to a period of time, the IFoA would welcome clarity in the definition.

4. As drafted, the definition would appear to include the annual actuarial report, any informal funding updates, or any report on the assets and liabilities for the sponsor's accounting disclosures. These may place a value on the assets and liabilities, but additional relevant information may not be in that report. It does not necessarily require any update on the cost of accrual. Consequently, our preferred interpretation of the definition would limit it to the triennial valuation report. If this interpretation were not the policy intention, we would welcome clarity in the definition.

Question 4: Does this definition fit with existing practice? Are there any circumstances in which it would cause problems or additional work?

5. In preparing the triennial valuation report, actuaries will generally calculate the cost of benefit by accrual scale, prior to aggregating the results for the scheme as a whole. However, the actuary will often only show the aggregate result for the scheme in the formal report, with no split shown for any separate benefit scales. The actuary will not generally calculate a separate cost for each employer (as well as by benefit scale), so the calculation of these costs by employer would generally require additional calculations undertaken specifically for this purpose. It is possible that practice may change over time to meet employers' future requirements.

Question 5: Are there any risks in not prescribing methods and assumptions? Does this provide an incentive to select methods or assumptions which enable a scheme to meet the test where it otherwise might not?

6. Actuaries' work is subject to ethical and technical standards. The use of very prudent assumptions is likely to meet the standards required of actuaries, but could still result in placing a value in excess of the proposed thresholds on benefits that are lower than those provided by the Test Scheme. Therefore, there may be merit in placing some constraint on the method and assumptions adopted for this specific purpose. One alternative approach would be to require use of the assumptions adopted to value Technical Provisions for the latest triennial valuation. While this would not achieve consistency between employers, it would constrain the assumptions to a reasonable range for the purpose of the valuation.

Question 50: Do you think this exception provides a useful easement for employers as well as a sensible protection from unwanted tax charges for the employee?

7. We would agree with the assertion above.

Question 52: Can this exception be communicated to employees within existing material?

8. While the IFoA accepts this can be done, there should also be a requirement to communicate the implications on AE of taking a Winding-Up Lump Sum (WULS) within the communication of the WULS option.

Question 53: Does the benefit of having this exception for both the employer and employee outweigh the risk of some people being left outside of pension saving for a period of what could be 3 years?

9. The IFoA agrees with this, provided members are properly informed within the communication of the WULS option.

Question 55: To what extent are WULSs being paid out by employers to employees who continue to be employed by them? If they are why, having regard to the tax rules on paying WULSs?

10. If an employer is winding up a DB scheme and offering a DC scheme to current employees, there would be no reason for trustees of the occupational scheme to distinguish between deferred pensioners, who are current employees of an employer linked to the scheme, or other deferred pensioners, when offering those deferred members the opportunity to take a WULS. The same would apply for the winding up of a trust based DC scheme and offering a contract based DC scheme to current employees.

11. Indeed, trustees will often not know whether those deferred pensioners are current employees of any of the related employers, or not. Trustees would have to establish new processes to ensure that such a scenario did not arise. The scheme for current employees may, or may not, be able to accept transfers (e.g. NEST will not). If employer A sells employer B, and then winds up the scheme in which employers A and B both participated,

employer B would not be involved in the wind–up process. However, employer B would be caught within the proposed provisions, with tax implications for the scheme members concerned (who have no control at all over the wind-up).

If you wish to discuss any of the points raised please contact Philip Doggart, Policy Manager (philip.doggart@actuaries.org.uk/ 01312401319) in the first instance.

Yours sincerely

Nick Salter
President, Institute and Faculty of Actuaries