
Institute and Faculty of Actuaries

# The Occupational Pension Schemes (Power to Amend Schemes to Reflect Abolition of Contracting-Out) Regulations 2014

Institute and Faculty of Actuaries response to the Department of Work and Pensions

4 July 2014

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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.

Institute and Faculty of Actuaries

Department for Work and Pensions
Contracting-out Policy Team
Level 1 Caxton House,
Tothill St
London SW1H 9NA

4 July 2014

Dear Sirs

**The Occupational Pension Schemes (Power to Amend Schemes to Reflect Abolition of Contracting-Out) Regulations 2014**

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to comment on the draft Regulations. Please note that the comments in this response are only in relation to the draft OPS (Power to Amend Schemes to Reflect Abolition of Contracting-out) Regulations 2014. As well as the answers to the specific questions posed, we have added further supplementary comments which appear at relevant points throughout our consultation response.

**Q1. Is the "principal employer" definition clear in the light of the explanation given above?**

We note that the current wording may provide for two employers to meet the description of "principal employer". We recognise that this is a legal matter about which the DWP should have satisfaction around the outcome.

**Regulation 3**

The IFoA would welcome confirmation that the list of regulations covering the applicable schemes is complete.

**Q2. What issues, if any, do you foresee with the framework?**

**Regulation 4**

With respect to Regulation 4(1), members' contributions may not be fully described in the schedule of contributions. Recourse may be required to the scheme rules.

We anticipate that there may be some ambiguity with respect to the use of the term "relevant members". We expect the intention is that calculations are carried out in respect of the current members of the scheme at the calculation date and that the results would be applied to the survivors of those members and any subsequent new members.

There appears to be a clash between Section 24(3) of the Act, which makes clear the intention to cover future new members, as well as current members, and paragraph 2(1)(a) of Schedule 14 (reflecting the definition of "relevant members" in paragraph 15), which only covers changes for current members. We do not believe that the distinction has been made between "relevant members", as used in Regulation 4(1), to which the actuarial certificate relates, and "relevant

members", as used in the context of Schedule 14 2(1)(a), whom the changes affect. In our view, such a distinction would be useful.

The effect of the Regulations (generally) appears to exclude members who have ceased to be contracted-out prior to the calculation date e.g. members over GMP Age. If schemes are to avoid having to provide different benefits to those already over GMP Age, these members need to be included in the category of members to whom the changes apply if they are not already in the group of members to which the actuarial calculations and certification relate. We would regard the exclusion of these members as an unnecessary complication.

**Regulation 5**

There is a requirement for complete clarity with respect to how relevant earnings are to be calculated after 2016. It is important to avoid any ambiguity, as the limits which define relevant earnings will no longer be published.

**Regulation 6**

Further clarity is needed on how to deal with hybrid arrangements. Regulation 6(3) requires that "money purchase benefits are not taken into account". However, schemes which have a hybrid arrangement will require further consideration. For example, this could arise in a scheme that provides a money purchase arrangement with a defined benefit underpin and; where, perhaps unusually, the defined benefit underpin does not bite. In such a scenario, all relevant members would be deemed to be money purchase members and the employer would not be able to reduce members' benefits, or increase contributions to compensate for the increase in National Insurance Contributions (NICs). In this circumstance, the employer may close the scheme to future accrual, if that option is available. More generally, in any "better of" hybrid, it may be appropriate to reduce the formula on both sides of the comparison and not just on the Defined Benefit (DB) leg.

**Regulation 7**

In Regulation 7, it is not specified how data, if using three years of data, should be used. If it is envisaged that an averaging approach is to be used, we would encourage DWP to make this clear, especially as the choice of data and relevant period could have a material impact on the maximum reductions in benefits that could be certified.

**Regulation 8**

The drafting does not make it clear whether, in 8(4(a)(i), it is the assumptions or the SFP which must be "applicable at the calculation date". It does appear that the intention is to refer to the SFP. This could be made clearer by moving the text "as recorded in the statement of funding principles" into the beginning of (i).

Under 8(4)(a)(ii), it is stated that assumptions should be "updated" if necessary. We would suggest that stronger alternative wording might be "assumptions derived at the calculation date in a manner consistent with the method and assumptions, as recorded in the SFP". Even this wording may be insufficient in situations where the trustees have not clearly disclosed in the SFP how they arrived at their chosen assumptions. Indeed, it is possible that the SFP may be quite widely drawn and a full specification of the assumptions may not be present. Recourse may then be required to other valuation documents.

Under 8(4)(b), the onus is again on the actuary to consider further assumptions which are "necessary and which are consistent with those assumptions". Further clarity is required as to the context of "considers necessary". The SFP is the trustees' document, not the Scheme Actuary's, nor indeed any other actuary's.

Under 8(5), the actuary must (in the circumstances set out in 8(6)) adjust the assumptions to a best estimate basis, subject to the proviso stated. This may be problematic to the extent that the actuary may not reach a satisfactory view for a number of reasons:

- Firstly, in setting assumptions for transfer values, the trustees cannot take credit for options which would reduce a transfer value. For example, a common feature is that commutation rates may be worth less than the value of the pension given up, as calculated on the technical provisions, reserving basis. Consequently, there is a disconnect between what may be included in a Part 3 valuation (e.g. commutation on poor value terms) and in transfer value guidance (commutation not included if it would reduce transfer values). More detail is needed on the extent to which the DWP is satisfied the actuary can exercise professional judgment in such circumstances for certification purposes.

- Secondly, there may not be any evidence for the actuary to form a view as to what the trustees regard as best estimate as there may be no transfer value guidance in place.

  However, we recognise that it has proved difficult to develop a workable approach to these requirements, and it may be thought that the current text is the best that can be achieved.

- Thirdly, the actuary may not be satisfied that the removal of margins for prudence would be consistent with the underlying principles, which would be used by trustees in calculating transfer values. The margins for prudence included in a Part 3 valuation are for the trustees to decide, with agreement in most circumstances from the employer. Unless the actuary has access to all the relevant documented reasoning by which the trustees agreed the margins of prudence, it may be very difficult for the actuary to form a view.

- Finally, we would encourage that the employer should be able to specify the removal of margins from specific assumptions, rather than the regulations requiring an “all or nothing” removal of all margins (which may not be workable in practice).

**Q3. Are there ways in which the draft calculation framework regulations could be clearer as to how calculations are to be performed and the data to be used for this task?**

We have already made specific comments as to how the regulations could be clearer on calculations requirements. It may also help clarity if the Regulations explicitly stated that the employer (and not the trustees) is the client for this exercise.

With respect to Regulation 10, this is a legal matter; therefore, the IFoA does not wish to comment.

**Q4. Is there anything else that would assist in the calculation process if provided for in the regulations?**

As previously mentioned, we would welcome clarity on treatment of hybrid schemes with underpins and also clarity on how to react if information were not available. As outlined above, there may be situations where the actuary is asked to form a view of matters, which have been previously determined by others. This may adversely impact the operation of the regulations.

**Q5. Recorded in the demographic assumptions in the SFP is the assumption concerning when the member is expected to leave pensionable service that the actuary will refer to where needed in making calculations. Does this need to be separated out and more clearly defined?**

We do not see the requirement for such a separation.

**Q6. There are benefits that don't accrue for example ill-health retirement benefits. We would not expect amendments to benefits that don't accrue. Do we need to specify this in regulations?**

Yes, we would welcome the regulations covering such benefits.

**Q7. Do the regulations setting out the calculation requirements work for hybrid schemes?**

No, we have made reference to hybrid schemes in our previous comments (Q2 Regulation 6).

**Q8. The employer may choose any calculation date after 31 December 2011. This is to allow the employer to use the scheme's last triennial valuation as a base for the required calculations. However there is some flexibility because we have not required the employer to use the scheme's last valuation date. Do you foresee any issue with our approach to the calculation date?**

There may be scope for the employer to choose a date, with advice from the actuary appointed for the task, which will have a more beneficial effect for the employer, at the expense of the members. It is noted that the actuary's client is the employer.

**Q9. Is our understanding of how salary sacrifice arrangements work correct? Is there a need to make provision in regulations for this arrangement?**

We believe that this is a legal matter and would not make any specific comment.

**Q10. Our intention is for employers sponsoring shared cost schemes to be able to make use of the override to recoup their increase in NI costs due to abolition of contracting-out. Our expectation is that any amendments made would be proportionate and limited to the minimum needed to recoup the additional costs. For example, it would not be appropriate for sponsors of these schemes to use the override power to make scheme rule changes that, in effect, convert a shared cost scheme into a scheme with a more conventional funding arrangement. Do we need to make further provision in regulations to prevent scheme amendments of this magnitude?**

We would suggest that the DWP takes legal advice on this matter. In order to guard against the type of problem to which DWP alludes (more extensive changes), there may need to be further provision in the regulations.

**Q11. Are there any other funding arrangements that may require specific provision in these regulations to allow employers to use the override as intended?**

The point made in response to question 10 may not be limited to shared cost schemes.

**Q12. It is for the employer to appoint an actuary. The actuary may be employed by the employer already or an independent or, with the approval of the trustee, the scheme actuary. Are regulations clear that it is for the employer to appoint the actuary or do we need to clarify this?**

It would be better if this were made clearer in the regulations; we suggest it could be incorporated in Regulation 2, failing which; Regulation 11 could be made clearer.

**Q13. Is four weeks an achievable and reasonable timeframe for trustees to provide the information or is longer needed – if longer needed, how much longer.**

The IFoA would expect that four weeks would be adequate for scheme-related data. The provision of individual membership data fit for this purpose could present a more significant challenge.

**Q14. By "information" we mean individual membership data as well as scheme data, such as the scheme's benefit structure. Is this clear in draft regulations or do we need to be more specific about the type of data trustees will be obliged to provide? If so, what data should be specified?**

It may be that further background documentation, with respect to the relevant Part 3 actuarial valuation, will be required so that best estimate considerations can be made. In practice, it is likely that the employer may expect to be briefed by the employed actuary with respect to the various aspects to be covered to achieve certification on the most favourable grounds to the employer. e.g. the employer might reasonably expect its actuary to prompt it to remove margins for prudence.

Regulation 8(3) would appear to be suitably enabling.

**Q15. Is there any scheme information that trustees do not have access to and that the employer is likely to need to be able to make amendments to scheme rules?**

We are not aware of any given the scheme is the trustees' scheme.

**Q16. Can you foresee any problems with providing information to the principal employer for associated employer schemes?**

We are not aware of any particular problems.

**Q17. Can you foresee any problems with providing information to the principal employer for non-associated multi-employer schemes?**

We are not aware of any particular problems.

**Q18. Are all the things we require the actuary to certify correct? For example can the actuary certify that the amendments comply with Schedule 14 paragraph 3?**

We are not clear about the use of the word "correct" in the question. We assume that what is meant is that all the matters that should be certified in the context of the exercise have been listed in the regulation. We believe that the list is complete.

However, we believe that the opinion to be given in respect of regulation 12 is for a lawyer to give; not the actuary.

**Q19 to Q24**

There is inconsistency in the meaning of "section" within the certificate and in regulations 14, 15, 16 and 17. In these regulations the meaning of "section" is sometimes a different benefit scale (regulation 17) and sometimes a segregated section.

It may be helpful if a convention were adopted to use "benefits scales" in appropriate circumstance (e.g. in the context of regulation 17) and to use "sections" for segregated sections.

**Q25. Is there any other information that should be included on the actuary's certificate?**

It would be helpful to have a comment on the certificate describing the changes from the SFP. We are also of the view that actuaries would expect to state the assumptions used, potentially in a separate report, rather than on the face of the certificate. The IFoA would recognise there is a public interest in having the assumptions disclosed to the affected members.

**Q26. We would be grateful if respondents could include estimates of costs, by scheme size, including a breakdown of professional fees where possible.**

The IFoA does not have access to this information.

If you wish to discuss our response in any further detail, you should contact Philip Doggart, Policy Manager at the IFoA, in the first instance. You may contact him on 0131 240 1319, or at Philip.Doggart@actuaries.org.uk.

Yours faithfully

Nick Salter
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