



Mr Ian Hook
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Scrutiny Unit
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Dear Mr Hook

IFoA Written Evidence – Pension Schemes Bill 2014-15

1. The Institute and Faculty of Actuaries (IFoA) is the chartered professional body for actuaries in the United Kingdom. Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment. 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.
2. The IFoA welcomes the opportunity to provide written evidence to the Scrutiny Unit on the Pension Schemes Bill 2014-15. Some of our members who design and advise on both defined benefit (DB) and defined contribution (DC) schemes have provided input to this response. We have focused our evidence on those aspects of the Bill where we have relevant expertise and we would be delighted to discuss our response in more detail if it would be helpful.

Summary

3. The IFoA welcomes the policy intention to increase participation in pension schemes across the UK. However, there are a number of areas in which the draft Bill may make a complex subject even more difficult to comprehend. While we understand the desire to provide a wider scope for scheme design, we would request clarification that the more open approach to defining shared risk schemes should not result in classifying certain types of schemes in a way that was not the original intention of the sponsors.
4. The IFoA would also encourage further research into a possible default decumulation strategy. While there is a need to develop understanding of, and participation in, the accumulation stage, the outcome in retirement is what will ultimately matter to scheme members.
5. The IFoA has also offered a number of comments about the drafting where we would welcome additional clarification. While the exact legislative requirements could be considered in regulations, we would welcome an early indication of what those regulations may contain.
6. The IFoA has a clear obligation with regard to ensuring that its members are equipped to carry out specific functions. An opportunity to comment on the draft regulations will also

allow a focus on practical implementation and in particular detail about the duties set out in the Bill that an actuary will be required to perform.

General comments

7. The IFoA welcomes the Government's aim of encouraging private pension provision. Complexity in the current pensions system is a significant barrier to saving¹, but the IFoA suggests the Bill, as drafted, could add further complexity for both new and existing schemes. We would encourage Government to explore ways to avoid any unintended consequences for existing schemes that could undermine private pension provision.
8. In our view, there would be merit if existing schemes could continue in their present form under existing legislation. Then, the proposed legislative framework could focus solely on the new arrangements and reduce the risk of unintended consequences. Employers could, under such an approach, resolve to change their schemes to reflect the new legislative regime.
9. As automatic enrolment (AE) increases, the number of schemes and individual participants - providers, employers and trustees - will have an increased responsibility to provide new scheme members with the best explanation of what they may expect to receive in retirement. For many employees joining pension schemes for the first time, or indeed participating in any long-term savings plan for the first time, there might be merit in offering some degree of certainty. The IFoA recognises that shared risk schemes can offer more certainty than traditional DC arrangements (although generally there is a cost to doing so); however, there are a number of challenges that may prevent the establishment of such schemes:
 - a. The mechanisms for providing increased certainty also have the potential to create more complexity that could deter members from saving.
 - b. Many members are likely to desire certainty without realising that there is an associated cost.
 - c. Unless employers are able and willing to meet the additional cost of providing certainty, scheme members will have to bear that cost, which is likely to affect the level of future retirement income.
 - d. Managing a pension fund that offers intergenerational savings and provides for cross subsidy between each cohort requires substantial technical expertise and strong governance. This is to help ensure that members are treated as equally as it is reasonable to expect. The increased complexity and the inherent opaqueness of collective schemes will also require strong governance and strong fiduciary oversight. This increased governance and the necessary expertise come with a price. It is important that any additional costs in governance provide scheme members with value for money.
10. There is a broad range of scheme designs that could be established within the proposed framework. The IFoA's Sleepwalking into Retirement Working Party² considered starting points of either purely DB or DC structures and then sought to demonstrate how to adapt those starting points to provide shared risk schemes. The following table indicates the range of possible scheme designs.

¹ Sinclair, D. (2010) *Where next for pensions reform? How can we encourage people to save?* International Longevity Centre - UK

² IFoA's Sleepwalking into retirement Working Party (2013) *Why DC desperately needs actuaries* (<http://www.actuaries.org.uk/research-and-resources/documents/d05-sleepwalking-retirement-%E2%80%93-why-dc-desperately-needs-actuaries>)

From a DC starting point	From a DB starting point
DC in with profits fund	Career Average Revalued Earnings
Deferred annuities	Cash balance schemes
Managed DC	Flexible retirement age
DC with insured capital guarantees	Risk management tools: buy-outs, buy-ins, longevity swaps and re-insurance
DC with mutualised capital guarantees	Core DB + bonus
Split retirement into term annuity plus (mutualised) later life annuity	CETV on leaving employer
CDC	Fluctuating pensions
Employer smoothing fund	
Risk sharing between multiple employers	

11. While we understand the approach taken in the legislation to defining Collective DC, the range of possible outcomes, as shown in the table, may cause uncertainty among providers, employers and members about the exact definition of the schemes they offer. If the definitions do not provide the required certainty, the courts, as in other cases, may step in to make an interpretation that differs from the original policy intent and which imposes additional costs on many schemes.
12. Under current proposals there will be no default decumulation option meaning all members will have to make a choice about how they should draw their benefits. The IFoA suggested in its response to the HM Treasury consultation 'Freedom and choice in pensions' that consideration should be given to developing a default decumulation strategy at retirement.³ The IFoA recognises that developing such an approach may not lead to the best outcome for all scheme members; however, it may reduce the risk of poor outcomes.
13. Under the proposed framework, the least complicated route for many scheme members may be to take DC pots as lump sums at one particular date, which may not be the date of retirement. This provides members with an opportunity to avoid making a more complex decision. While this may be the best outcome for members with small funds, it might not be the best decision for those who would incur large tax charges.
14. We would recommend that the Government conducts research into what arrangements might be put in place to ensure that inertia nudges savers in a direction that would be more appropriate for a majority of retiring scheme members. Consequently, we would also encourage schemes to establish default frameworks that would support good outcomes. The exact form that these might take is beyond the scope of this response, but the significant changes occurring in the legislative environment provide an opportunity to put in place an appropriate default decumulation vehicle, particularly one that meets the needs of the newly auto-enrolled population.

³ <http://www.actuaries.org.uk/research-and-resources/documents/foa-response-hmt-freedom-and-choice-pensions>

Detailed comments on drafting

15. Clauses 20, 26 and 27 refer to specific advice which must be obtained from "an actuary". Clause 32 says that regulations may require specific actuarial advice to be obtained from "the scheme actuary", where "the scheme actuary" is as defined by regulations. This is a very different approach from the Pensions Act 1995 (PA 95) which sets out the provisions for the appointment of "the actuary" and specifies the advice that must be provided by "the actuary". More widely, the only reference in primary legislation to "the scheme actuary" (rather than to "the actuary" appointed under PA 95) is in the Pensions Act 2008. The responsibilities of a DB scheme actuary would not necessarily be the same as those of the primary actuary responsible for a collective DC scheme. The IFoA has responsibility for ensuring actuaries fulfilling specific roles have the appropriate skills and experience to carry out their responsibilities. Consequently, we would welcome the opportunity to work closely with Government towards clarification within the Bill of the roles which are to be reserved to "the actuary" or, failing this, in drafting the regulations to ensure there is clarity in what is required. We would also welcome consistency in legislation between usages of the terms "the actuary" and "the scheme actuary".
16. The IFoA notes that there is inconsistency in definitions of "money purchase" and "defined contribution" between tax legislation (both existing and new, including the Taxation of Pensions Bill) on the one hand, and DWP legislation (including the Pension Schemes Bill) on the other hand. Given the extent of current regulatory change, the IFoA would encourage Government to implement as much consistency as possible across legislation (without introducing retrospective effects). If (as seems likely) it is not possible to have that consistency, we would suggest using distinct terms between the tax legislation and DWP legislation, rather than using the same terms with different meanings. In particular, including DC benefits as a subset of money purchase benefits under the tax legislation is not helpful given money purchase schemes are a subset of DC schemes under the DWP legislation.
17. There are a number of areas where we suggest the lines between DB, DC and Defined Ambition (DA) are not adequately drawn:
 - a. As already indicated in paragraph 3 above, the definition of 'shared risk scheme' in Clause 3 is very broad and, indeed, may be too broad in practice.
 - b. The provision outlined in Clause 6 may not work as intended; schemes can share risk by virtue of some scheme members having a 'pensions promise' and other having a 'full pensions promise' (or any discretionary benefit). Once a scheme is classified as a shared risk scheme it cannot satisfy clause 6(1) and so regulations would need to address such a scheme under clause 6(2). It would be helpful to have greater clarity about what may be in the regulations mentioned in 6(2).
 - c. If DB schemes with money purchase additional voluntary contributions (AVCs) are to be categorised as shared risk, it is likely that a majority of schemes will be reclassified. Even if the practical effects of re-categorisation are not significant, the costs of advice are likely to increase without any necessary benefit for scheme members.
 - d. The use of 'each member' in 3(a) of the Bill appears to be interpreted by Government as 'each and every member', but this is not a unique interpretation.
 - e. It is possible for schemes to offer one or more investment options within a range of options, some of which may be categorised as 'shared risk'. However, as the choice of option is for members, if no members select one of the 'shared risk' options, it seems the scheme should be regarded as DC. However, a subsequent decision to select a 'shared risk' option could alter the scheme classification. We would welcome clarity on this matter.
18. 'Full pension promise' as set out in 5(1)(a) does not recognise the nature of many, if not most, DB schemes that are able to provide discretionary benefits. Consequently, it could be

possible to argue that such DB schemes would fall into the 'shared risk' regime. Again, we would welcome an explanation if this were to be the case (although, as commented in paragraph 8, our preference would be for existing DB schemes to be outside the new legislation).

19. The gap between 'full promise' and 'promise' is significant. The former seems to imply that the full promise is fully defined at all times, but that the latter only applies to periods before retirement. It is also not apparent why a benefit calculated with reference to one factor (i.e. longevity) should be distinguished from benefits calculated to any other specific factors (e.g. inflation).
20. The definition of DC scheme would include one that provides annuities within the scheme and holds them as assets of the scheme. There would be merit in clarifying this within the Bill.

Further Questions

21. The IFoA has a number of additional comments about the Bill and would welcome the opportunity to discuss these further:
 - a. It would be helpful to understand the justifications for the inclusion in the Bill of a provision that removes the possibility that a future Secretary of State might want to take away the requirement for indexation in DB schemes.
 - b. The definition of Normal Pension Age (NPA) is different to the Pension Schemes Act (1993) definition. It would be helpful to understand if there has been an assessment of the impact on existing schemes. In particular, if NPA were to change as a result of the new definition, there could be consequences for existing schemes, for example, with regard to their funding positions.
 - c. Trustees of schemes providing collective benefits may be required to obtain investment performance reports on a prescribed basis. There is no analogous provision for DB schemes; therefore, it would be useful to have clarity about the need for regulations. We suggest a sufficient requirement would be to specify policy on monitoring within the Statement of Investment Principles, or alternatively, if this were regarded as better governance, the requirement could be extended to other schemes.
22. The IFoA has a number of working parties exploring DA and we would welcome the opportunity to discuss this work with you. 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



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