The Actuarial Profession
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Consultation Response
Department for Work and Pensions

Draft Pensions Bill

22 March 2013

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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Pensions Bill Team
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22 March 2013

Dear Sir/Madam

Draft Pensions Bill

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to comment on the Draft Pensions Bill. Our response has been prepared by a number of actuaries who work in the pensions industry.

The IFoA welcomes the overall aim of the Bill. As the introduction to the Bill explains, '…[A] piecemeal approach to state pension reform has resulted in an increasingly complex system where most people do not know what they will get from the State when they retire'. Any steps taken to simplify the State Pension are to be welcomed. We recognise that the simplification of any complex structure will always be difficult and particular care needs to be taken over finding the appropriate balance between those who might be winners and losers in the short-term.

The IFoA commented in its response to the Green Paper, "A State Pension for the 21st Century" (24 June 2011); that public interest would be best served by making a rapid transition to a single-tier pension. Therefore, the IFoA welcomes the proposal to make that rapid transformation, albeit there are likely to be consequences for defined benefit provision in the private sector. In addition, the IFoA welcomes the proposal for regular reviews of the State Pension Age.

The IFoA notes the Chancellor of the Exchequer's announcement that the single-tier pension would take effect from 2016. While we appreciate the desire to move to the new pension as soon as is practicably possible, there are complexities around the abolition of contracting-out. To enable pension schemes to implement any proposed changes to their schemes in time, we believe that having all secondary legislation in place by mid-2014 would be essential for affected schemes.

The IFoA has particular comment on three specific clauses in the Bill:

<u>Clause 5 – Transitional rate of state pension</u>

We note that the transitional arrangements will benefit those who have been contracted-out. It is important to note that most of those contracted-out will have been members of defined benefit schemes. Those individuals are likely to have greater retirement income than those of the same age with similar earnings patterns.

Under the transitional arrangements, contracted-out employees will have the ability to accumulate additional single-tier pension even up to the full single-tier pension. However, for many who did not contract-out, if the foundation amount exceeds the single-tier pension, there will be no opportunity to accrue further benefit.

Comparing outcomes for individuals of similar age and earnings profile suggests that the single-tier pension would benefit those who had previously been contracted-out, even if the foundation amounts were lower than the single-tier pension. With sufficient qualifying years, both groups of individual could receive the full single-tier pension, but the contracted-out group would receive occupational pensions for the period during which they contracted-out. This appears to provide additional State benefit for those who have significant occupational pensions and who may not be a priority for additional State benefits.

That being said, the IFoA understands the reasons for the transitional arrangements and recognises that this is a consequence of the simplification of a complex system.

Clause 24 – Abolition of contracting-out for salary related schemes etc

As referenced above, the IFoA continues to expect that the abolition of contracting-out will lead to a reduction in defined benefit provision in the private sector. The increase in employer National Insurance (NI) contributions will deter scheme sponsors from continuing to offer defined benefit schemes. However, we recognise that the inclusion of Clause 24 (2) may enable some employers to continue defined benefit schemes. The IFoA recognises that there is a detailed regulatory requirement in framing the “employer override” and we would welcome any opportunity to discuss the requirements in further detail.

In our Green Paper response, the IFoA did suggest that the ending of contracting-out could have been reflected within the reform proposals arising out of the Public Service Pensions Commission. As this has not happened and there is no allowance within Clause 24 for any alteration to public service pension schemes, the balance of defined benefit provision will shift further towards the public service employees. As noted by the Public Service Pensions Commission, the trend has been for private sector employers to reduce significantly the value of accruing pensions (including transferring employees to DC pension schemes), whereas until now, public service pension provision (typically more generous than private sector provision) has remained broadly untouched. We would expect these trends to continue once the abolition of contracting-out takes place.

As public service employers will face increased NI contributions arising from the removal of the rebate for contracting-out, there will be greater costs for these employers. Including the impact of the ending of contracting-out has not been reflected in the public service pension reforms. Indeed, it appears from the Impact Assessment that the extra cost to public service employers from the end of contracting out (and the loss of the National Insurance rebate) is likely to exceed the saving from the public service pension reforms for many years to come.

Combining the impact of transitional arrangements and the abolition of contracting-out, a clear category of “winners” from the Bill will be public service pension scheme members, particularly, but not restricted to, those who have sufficient years to accumulate the maximum single-tier pension.

The increase in NI contributions for contracted-out employees will have the greatest proportionate impact on those earning just under the Upper Accrual Point (currently £40,040), as more of their earnings will be subject to NI increases. Again, we recognise this is an automatic consequence of abolishing contracting-out.

Clause 26 – Periodic reviews of rules about pensionable age

The IFoA welcomes the proposal to introduce regular reviews of pension age.

However, we note that the Pensions Bill sets out that the State Pension Age will increase to 67 for those born after 5 March 1961. This could lead many born after this date to believe that their State Pension Age would remain at

67. Anyone affected by subsequent changes to the State Pension Age are likely to have worked on the basis of State Pension Age being 67, consequently, they would have less time to prepare for a later retirement.

Accordingly, individuals could find it helpful to be told the possible path of future State Pension Age changes, even if these were subject to fine-tuning in the light of future longevity changes. We would, therefore, welcome an indication of possible future changes to State Pensions Age being included in the periodic reports to the Secretary of State, in addition to the recommendation as to whether, and from when, the next increase would take place. The IFoA would welcome the earliest possible production of such a report. Indeed, this expected path could be included in the legislation itself. This would provide more clarity to individuals whose retirement planning could be affected by changes in pension age. Future changes would only require fine-tuning of the progression of State Pension Age, rather than a periodic shock. Similarly, increasing State Pension Age gradually, perhaps by 1 month in every few months, rather than in large step changes every few years, may be preferable for the population.

The notes to the Pensions Bill (paragraphs 102 and 103) indicate that the Secretary of State will provide direct specification of factors to be considered and what proportion of adult life should be spent in retirement. The IFoA believes it would be helpful for the legislation to include factors that the reviewer, or review panel, considers relevant, even if not identified as such by the Secretary of State when initiating the review.

The IFoA believes the approach for future reviews of State Pension Age is suitable. However, it would be helpful for the initial review of the State Pension Age to include analysis of how more recent, unexpected increases in longevity have affected the proportion of adult life spent in retirement, particularly in relation to general experience over the past century. Such analysis could be helpful for informing future reviews.

If you wish to discuss further any of the points made here, please contact Philip Doggart, Policy Manager at the IFoA (philip.doggart@actuaries.org.uk 0131 240 1319).

Yours sincerely

Jane Curtis

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