



Institute
and Faculty
of Actuaries

Occupational pensions: draft regulations, legislative review and Guaranteed Minimum Pensions equalisation methodology

IFoA response to Department for Work and
Pensions

16 January 2017

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.



Department for Work and Pensions
Contracting-out policy Team
First Floor
Caxton House
Tothill Street
London SW1H 9NA

16 January 2017

Dear Sirs

IFoA response to “A proposed methodology for equalising pensions for the effect of GMPs”

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this consultation. Members of the IFoA’s Pensions Board have drafted this response.
2. The IFoA supports the publication of these draft regulations. We have a limited number of specific comments about the regulations. Consequently, we have only answered the relevant questions.
3. We note that the consultation, while offering a proposed methodology for equalisation, does not formally confirm that the Government’s view is that equalisation is required. Schemes are most likely to want clarity from the Government that equalisation will be required and even post-Brexit, will continue to be required for all UK schemes that had been contracted out over the relevant period. In addition, the comments in the consultation on the impact of Brexit are limited, and still leave open the issue of what will happen in due course when, as is now expected, the UK leaves the EU. Since this is a legal issue, we do not express any view on the legal requirements for GMP equalisation now, or in future. However, we are aware that due to the nature of the issues, any methodology for addressing GMP equalisation will require significant one-off legal, actuarial, communication and administration costs.
4. We also welcome the publication of the proposed methodology for the equalisation of GMPs. We have a number of more detailed comments to make about the methodology, which are made on the understanding that this approach is in fact a legal requirement

Chapter 1: The draft Pensions (Schemes that were Contracted-out) (Miscellaneous Amendments) Regulations 2017

Q1. Do you agree that the draft changes to give HMRC discretion to extend the notification and payment periods for contributions equivalent premiums will deliver the policy intent?

5. Yes. We support the approach taken in providing extensions. However, we note that the extensions are only for issues identified as part of the HMRC reconciliation process. We would encourage DWP to consider the benefit in extending this so that HMRC could have

London 7th Floor · Holborn Gate · 326-330 High Holborn · London · WC1V 7PP · **Tel:** +44 (0) 20 7632 2100 · **Fax:** +44 (0) 20 7632 2111

Edinburgh Level 2 · Exchange Crescent · 7 Conference Square · Edinburgh · EH3 8RA · **Tel:** +44 (0) 131 240 1300 · **Fax:** +44 (0) 131 240 1313

Oxford 1st Floor · Park Central · 40/41 Park End Street · Oxford · OX1 1JD · **Tel:** +44 (0) 1865 268 200 · **Fax:** +44 (0) 1865 268 211

Beijing 6/F · Tower 2 · Prosper Centre · 5 Guanghua Road · Chaoyang District · Beijing China 100020 · **Tel:** +86 (10) 8573 1000 · **Fax:** +86 (10) 8573 1100

Hong Kong 2202 Tower Two · Lippo Centre · 89 Queensway · Hong Kong · **Tel:** +11 (0) 852 2147 9418 · **Fax:** +11 (0) 852 2147 2497

discretion to apply it in other circumstances as well (for example, where the scheme has identified an issue as part of its own general data cleansing process).

Q5. Do you agree with the underlying earnings increase assumption proposed by GAD?

6. We note that the assumption proposed by GAD is higher than actual earnings increase assumptions over recent years. Also, we agree with the assumption in paragraph 1.10 that a majority of individuals will be within 10 years of GMP Age and our expectation would be that most such scheme members may experience lower than average increases in earnings in the future period to retirement. Therefore, in our view the underlying increase assumption proposed by GAD is on the high side.
7. However, market implied expectations for inflation have increased somewhat since GAD's calculation. This acts as a partial counter-balance to the amount of expected real increases. We are therefore of the view that the proposed 3.5% pa nominal rate is within the range of reasonable assumptions that could be adopted.

Q6. Is it correct to adopt a medium term view on earnings assumptions?

8. As we noted in our response to the previous question, in our view this is a reasonable approach taking into account those to whom this will apply.

Q7. Do you agree that DWP should continue to apply the 0.5% premium for fixing the rate or are there good arguments to remove or adjust the premium?

9. Past experience of fixed-rate revaluation in comparison with actual earnings increases does not suggest that it has been advantageous to schemes. We recognise that this could be due to many factors and the future could be very different. However, in our view the consultation does not make a strong argument for retaining the 0.5% fixed addition. Also, as we noted in our response to question 5, there is good reason to believe that earnings increases for the remaining cohort of active members with GMPs may be lower than in the past. In our view therefore this additional margin on the assumption is unnecessary
10. It is also worth noting that, proportionately, the fixed addition to the rate has a more material overall impact when assumed earnings increases are lower.
11. Finally, we note that changing the fixed rate of revaluation has administrative implications for many schemes. This includes the need to change pension calculations and transfer valuation calculations for all members who will become deferred in future. We therefore suggest the Government consider lengthening the period before the next review of the rate, possibly for as long as 10 years, which would mean that far fewer schemes would need to deal with further complexity in this area.

Chapter 2: Reviews

Q8. Do you have any concerns relating to regulation 3 of the 2013 Regulations which the Department is not already aware of?

12. We do not have any additional concerns to add.

Q9. Apart from the issues mentioned, do you have any concerns about regulation 4 and bulk transfer arrangements?

13. We support DWP's intention to reach a workable solution for what is a practical problem that we are aware is constraining schemes and employers from responding as they may otherwise have done to corporate changes. In some cases, trustees are unable to implement what may be the most beneficial option for members and employers as a response to organisational change. We would support any efforts by the DWP to reach a rapid solution.

Chapter 3: GMP Equalisation

Q11. Is the proposed methodology the best approach? What, if any, other methods should we consider?

14. The IFoA welcomes the move by the DWP to recognise that an equivalent value approach (as implied by the example in Appendix D) is acceptable rather than the significantly more generous method proposed by the DWP in 2012.
15. The IFoA does not believe it is helpful to consider whether the proposed methodology is the best approach, but rather to make clear that it is a workable approach (and that other workable approaches could also be used, especially where also based on an equivalent value approach), There would be significant benefit in the DWP providing examples of other approaches that did not involve conversion which would also be acceptable. As trustees will still take legal advice (which could be subject to challenge) on equalisation, there may be alternative approaches that would be suitable for certain schemes. In practice, some trustees may opt for a simpler approach.
16. Despite the view expressed that "the Government is not placing any obligation on schemes to use this method" (para 3.24), it is likely that trustees will view the methodology presented as being better than all others given it appears in the industry paper, especially if this method is one they might not want to implement (for example, because they are uncomfortable imposing a change on the nature of the pension increases on part of a member's pension without obtaining individual consent).
17. It might be that this point could be partially managed by providing another example. For example, you could illustrate the approach of keeping the existing actual-sex GMP unchanged and providing just the additional value via a non-GMP benefit.
18. Given that caveat, the approach outlined is helpful and offers trustees useful indicators of how equalisation could work.
19. We support the suggestion that a scheme's own Cash Equivalent Transfer Value (CETV) basis might represent the most appropriate calculation basis for GMP equalisation work. However, there are at least two areas that should be considered further.
- One is that CETV bases are typically designed specifically for deferred members with no explicit regard to the liabilities for pensions in payment. It might (but might not) be obvious how such a calculation basis should be extended to deal with pensions in payment. In many cases there will be more pensioner and spouse records than deferred

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pensioner records and so some level of comment from the DWP or from the Pensions Regulator (tPR) might be helpful.

- The other is the statement that the basis should be unisex. It is not clear why this should be a requirement or even an encouragement. We understand that allowance for the member's actual sex is still legal in the calculation of benefit values for UK pensions. Further, when the calculation converts one benefit into another similar benefit, the precise choice of calculation assumptions does not normally make a significant difference to the outcome.

Q12. Is there anything about the proposed process that raises concerns or might not work – if so, what needs to be done?

20. There are a number of specific areas that would require further clarification:

- The example given is relatively straightforward; other calculations are likely to be more complex, for example taking into scheme practices for anti-franking and historic increases for pensions in payment.
- The methodology shown considers only future payments; our expectation is that the legal view will be that past payments must also be addressed in some way. Experience on schemes which have equalised as part of a buy-out process is that this can be a time consuming and complex calculation to undertake.
- There is likely to be insufficient data to perform full perfect calculations for every member, and for many schemes this will be a significant issue. Guidance from the DWP or tPR on what may be acceptable approaches to pragmatically addressing missing data would be useful.
- The process is written on the assumption that the trustees and the employer will agree a process. There is no indication of any process in the event that the parties fail to agree.
- Conversion is heavily reliant on the assumptions adopted, especially those for inflation when converting between pension increase types.
- Under the existing legislation, there is no ability to reduce pensions in payment, which constrains the options for existing pensioners and may lead to conversions to predominantly lower rate increases.
- It would be helpful for there to be an explicit statement that trustees following the GMP equalisation process do not additionally have to follow "section 67" processes.
- We note that the requirements on a separate spouse's pension also constrain options.
- Finally, we agree fully that HMRC implications around Annual and Lifetime Allowance limits will need to be carefully considered and clarity provided on how these issues should be dealt with as part of the process.

Q13. What are the potential administration costs from using the proposed methodology? How might these costs be reduced?

21. The exact approach used by schemes for calculating GMPs and "excess" pension and applying anti-franking requirements can differ significantly from scheme to scheme, as will the levels of revaluation and pension increase on excess pension. Schemes will therefore require a customised approach to equalisation which cannot be easily generalised by service providers such as administrators and actuaries and is therefore likely to lead to high one-off costs of implementation.

22. We encourage the DWP to consider the amount of cost incurred relative to the likely benefit for most members. As GMPs earned during 1990-1997 will, in many cases, be small, equalisation of GMPs will not lead to large benefit increases for most members, as confirmed in Annex D. However, we do recognise that some specific scheme members could benefit from significant benefit increases.

23. Significant additional costs will arise if schemes feel obliged (because of statements made by the DWP) to construct calculation bases using unisex mortality assumptions.
24. Schemes will likely face high costs in reconciling past data. As equalisation will be required for current and future pensioners, such work could be extensive for many schemes. Schemes may also have a rectification process for past payments to follow that could be particularly complex, again leading to high costs.
25. The costs associated with communicating with all scheme members should not be underestimated. We support the approach of notification rather than consultation, but the costs of having to do so twice in a legally-valid manner are potentially significant.
26. Whilst the consultation paper recommends that GMP reconciliation with HMRC records should be undertaken before launching an equalisation process, it fails to acknowledge the severe difficulties being experienced by schemes trying to complete such reconciliations. In the spirit of "joined-up government" we encourage the DWP to recognise the reality of the timescales involved in GMP reconciliation projects before publishing the next document on GMP equalisation.

Should you wish to discuss our response further please contact Philip Duggart, Technical Policy Manager (philip.duggart@actuaries.org.uk / 0131 2401319) in the first instance.

Yours faithfully



Fiona Morrison

Immediate Past President, Institute and Faculty of Actuaries