Institute and Faculty of Actuaries

Contracting Out Liabilities Issues and settlement

Anna Copestake – Arc Pensions Law LLP
Glyn Bradley FIA - Mercer Limited

October/November 2016

Getting rid of other peoples' GMPs

HMRC statements after April 2018

- To all individuals who were under state pension age on April 2016
- Confirming who will pay the individual's contracted-out benefits

Future settlement of liabilities?

- Will winding up still be safe Y/N?
- Will it still be possible to buy winding up run-off insurance Y/N?
- Will it be possible to transfer stray periods to an insurer, without paying a premium: N?

- *Urgent:*
  - *Tackle historic exits (i.e. on HMRC records but not on Scheme records), e.g. why has the administrator not already paid CEPs etc to reduce this list?*
  - *Concentrate on service periods, to within a one year tolerance?*
  - *Ignore everyone over state pension age at April 2016?*
  - *£2 per week tolerance (now a luxury item?)*

Institute and Faculty of Actuaries

GMP equalisation

- Equalisation
  - Treaty of Rome (and other treaties) say that men and women should be given equal pay
  - Pensions are “pay” (i.e., you earn them by working)
    - So should be equalised for men and women
    - Decided by case of Barber v Guardian Royal Exchange on 17th May 1990
  - Further cases (such as Coloroll) decided that:
    - Equalisation only required for benefits accrued from Barber date
    - Must equalise to better basis (i.e., lower NRD) until scheme amendment, then can equalise to worse basis (i.e., higher NRD)

Are GMPs pay too?

- Probably but:
  - Are they just a calculation, not a benefit?
  - Are they a state benefit (that doesn’t need to be equalised)?
- Only legal case is Marsh Mercer Pension Scheme v Pensions Ombudsman 2001 (the Williamson case):
  - No arguments on point in front of judge
  - Comments were obiter (so not binding)
  - Held that GMPs don’t have to be equalised
- So, law remains uncertain until another case is taken to the CJEU
  - Do we have time?
  - If we leave the EU, does the law change?
    - Existing law is more likely to extend to GMPs
    - Government can legislate to remove the requirement to equalise
      - Public sector scheme cost is high
      - Do they need the added headache for GMP reconciliation?

Why not just equalise?

- If the law says you should equalise and you don't:
  - Sex discrimination
- If the law says you shouldn't and you do:
  - Also sex discrimination
- So, no easy answer
- If you should, how should you?
  - No case law at all on this point

- In practice, schemes need to operate:
  - In Kenworthy (2015), Pensions Ombudsman made it clear that it is not maladministration for an ongoing scheme not to have equalised whilst the law is unclear
  - In a wind up, schemes need to take advice, and make a decision
    - And consider run off insurance!

Institute and Faculty of Actuaries

Revaluing GMPs

- A quirk for COSR schemes still open to future accrual
- Law was changed so end of contracting-out did not trigger fixed rate revaluation
- 6 April 2016 – switch to fixed rate can only take place when leave pensionable service (as opposed to contracted-out service)

  (*Pension Schemes Act 1993: s. 16*)
- But, scheme rules may not reflect updated statutory position
  - Impact depends on wording of rules
    - Most allow trustees to decide the rate
    - Some say fixed rate until changed
  - Does that wording still work?
  - If it doesn't, s.148 orders apply up to GMP age

Institute and Faculty of Actuaries

Revaluing GMPs: solutions

- So what can be done?
  - Check scheme rules
  - Trustee resolution making power
    - Must be passed before <u>6 April 2017</u>
    - Can be backdated to 6 April 2016
    - Employer consent not required
    - Factors for Trustee to consider – actuarial input
      - Winners and losers for members?
      - Impact on Scheme funding?
      - Conflicts – trustees may be affected

(*Occupational Pension Schemes (Modification of Schemes) Regulations 1996: Reg7C*)

Transfers without consent

- Transfers between pension schemes can be carried out without member consent if:
  - The schemes relate to employment with the same employers, or group employers, or a transaction is taking place between the employers; and
  - Transfer certificate from actuary; and
  - Scheme rules permit transfer

  Occupational Pension Schemes (Preservation of Benefit) Regulations 1991: Reg 12

- Transfers of contracted out benefits can be carried out without member consent if:
  - The schemes relate to employment with the same employers, or group employers, or a transaction is taking place between the employers; and
  - The receiving scheme had been contracted out

  Contracting out (Transfer and Transfer Payment Regulations 1996): Reg 1, definition of "connected employer transfer payment", Regs 4 and 9

What if receiving scheme is new?

- Scheme cannot be contracted out, so cannot receive contracted out benefits
- Problem for:
  - Mergers into new schemes
  - Transfers of ongoing benefits, to make use of, e.g., WULS
  - Transfers on transactions
- What are the options?
  - Use existing contracted out scheme
    - Some “off the shelf” set up already?
  - Leave contracted out benefits behind
  - Wait for the law to change?
    - DWP acknowledge this is an issue, but now suggesting change late 2017, if at all

Institute and Faculty of Actuaries

Settling liabilities
Consider first converting to non-GMP?

Re-categorising GMP as non-GMP may help:

- Pension increase exchange (PIE)
- Buying out GMP liabilities while not winding up the whole scheme
- A bulk transfer of liabilities to a new scheme (that has not previously been contracted-out)
- Buying out DC funds with GMP underpins (on winding up)

Red tape:

- Member consultation
- GMP equalisation required
- Actuary must certify actuarial equivalence
- Still need to keep an attaching spouse's pension (paid if married at DOD)
- Revaluation in deferment (relevant to deferred members)

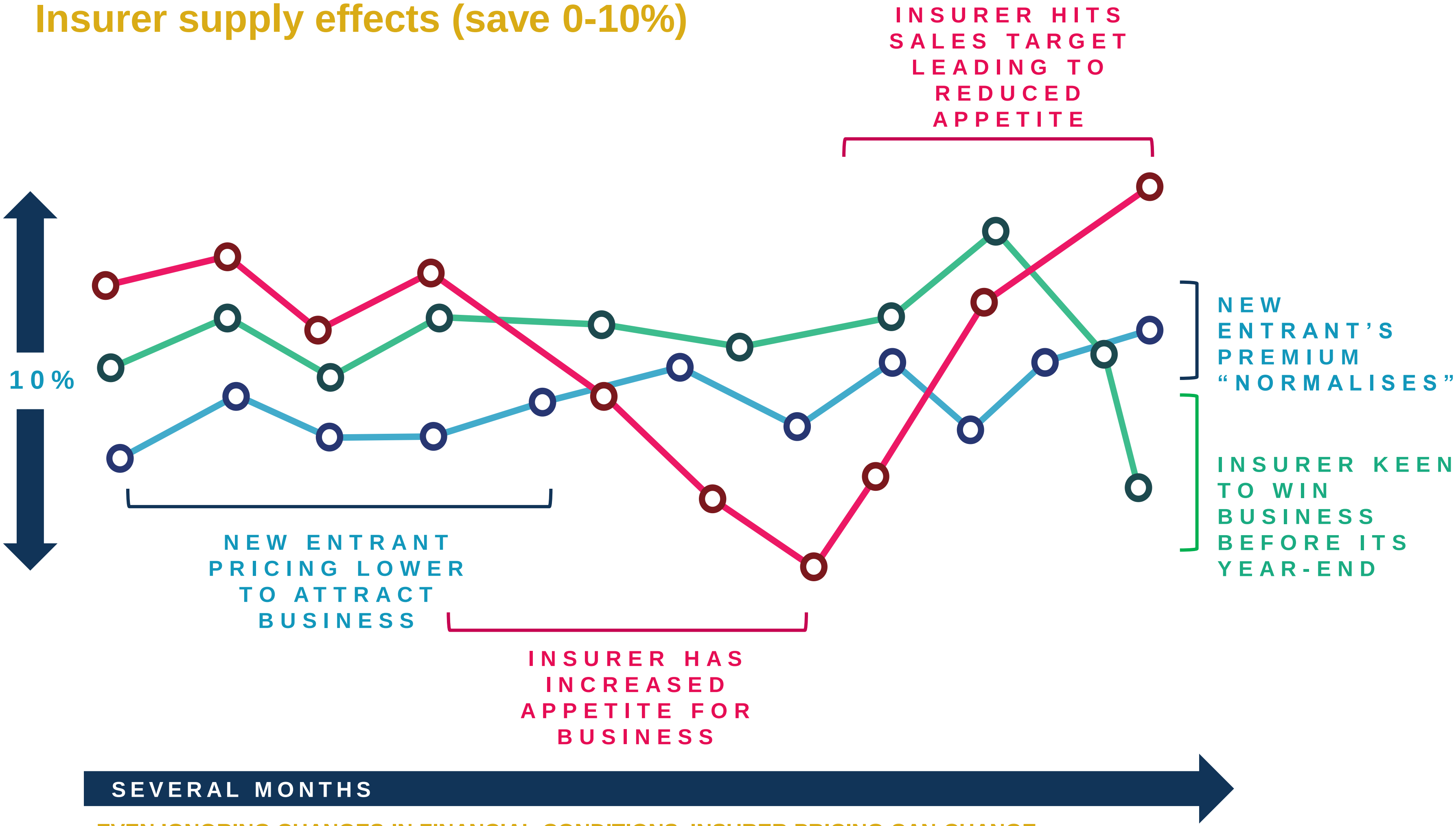
Institute and Faculty of Actuaries

Settling liabilities
Variations in investment opportunities available to insurers (save 0-10%)

Despite falling real yields, there have been (and will continue to be) opportunities to insure at better than expected prices.

Institute and Faculty of Actuaries

Settling liabilities
Insurer supply effects (save 0-10%)

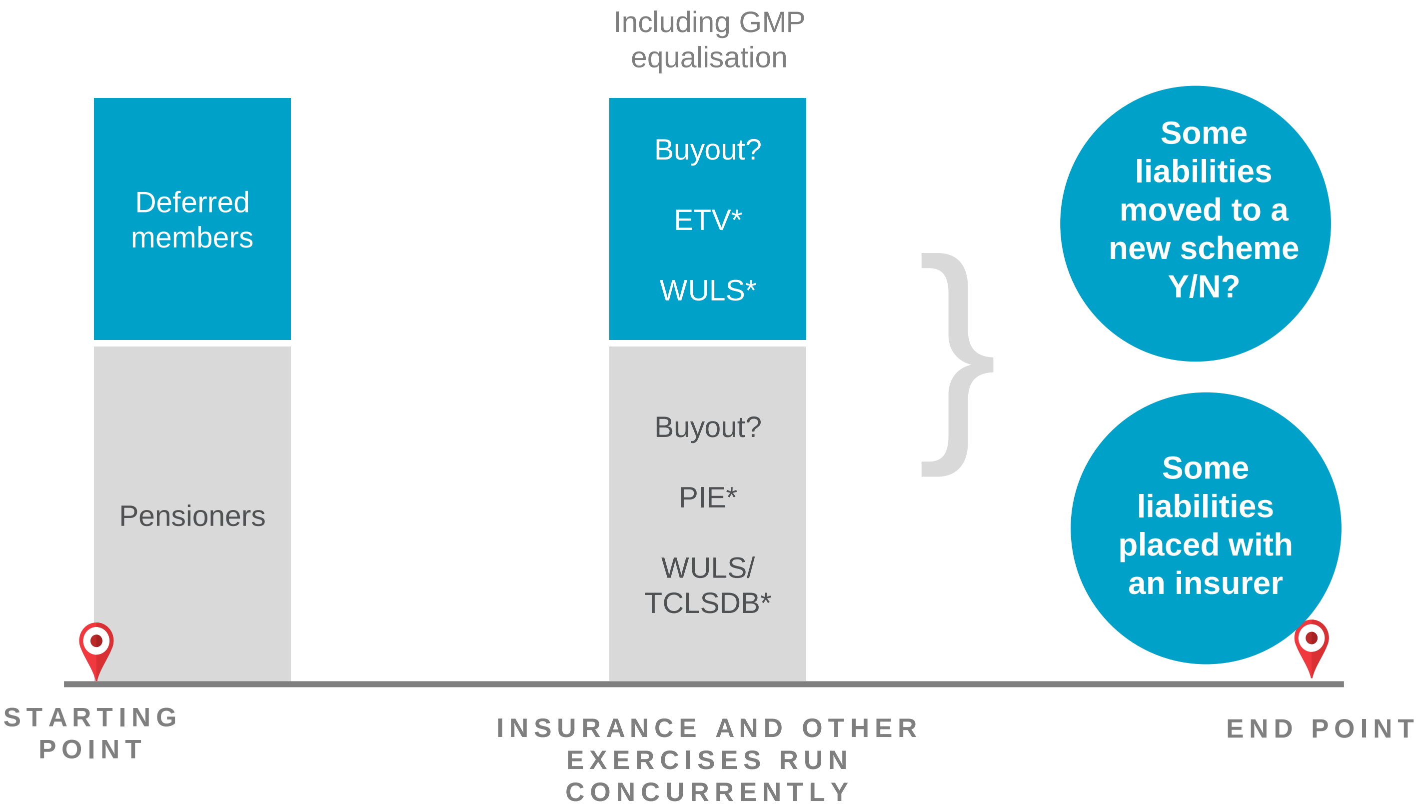


EVEN IGNORING CHANGES IN FINANCIAL CONDITIONS, INSURER PRICING CAN CHANGE

Institute and Faculty of Actuaries

Settling liabilities

Liability management and reducing scheme size (save 5%)



- ETV = enhanced transfer values (25% take up?)
- WULS = winding up lump sums (75% take up?)
- PIE = pension increase exchange (40% take up?)
- TCLSDB = trivial commutation lump sum death benefits (75% take up?)

Institute and Faculty of Actuaries