ASSOCIATION OF CONSULTING ACTUARIES

Association of Consulting Actuaries Limited · First Floor (129) · 40 Gracechurch Street · London · EC3V 0BT
Tel: +44 (0)20 3102 6761 · Email: acahelp@aca.org.uk · Web: www.aca.org.uk

21 October 2020

automaticenrolment.consultation@dwp.gov.uk

Department for Work and Pensions
Automatic Enrolment Policy Team
1st Floor, Zone C
Caxton House
Tothill Street
London SW1H 9NA

Dear Sirs

Automatic enrolment: alternative quality requirements for defined benefit and hybrid schemes being used as a workplace pension

I am writing on behalf of the Association of Consulting Actuaries in response to the above call for evidence. Our thoughts are set out in the Appendix to this letter. They relate to the cost of accruals test only (your "test two"). We support its continuation and have some suggestions for reform.

In relation to your "test one" under which schemes that are regarded by the auto-enrolment legislation as defined benefit, but have a money purchase-type structure, are assessed against the money purchase quality requirements, we understand that this was designed to assist one particular scheme. You may wish to make contact with that scheme to establish whether they have any concerns, but from our viewpoint we think that a test of this type should continue.

In due course you will need to consider what tests should apply to collective money purchase schemes, but that is for another day.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In that event, please contact me on 01372 733763 or at peter.williams@aon.com.

Yours faithfully

Peter Williams
Chairman, Pension Schemes Committee
On behalf of the Association of Consulting Actuaries Limited

APPENDIX

Automatic enrolment: alternative quality requirements for defined benefit and hybrid schemes being used as a workplace pension

1. Are the alternative quality requirements for defined benefit and hybrid schemes continuing to deliver the intended simplifications and flexibility for sponsoring employers and pension schemes that are unable to use the TSS?

The alternative quality requirements for defined benefit and hybrid schemes were brought forward not to assist those unable to use the test scheme standard, but rather in recognition of the unacceptable compliance burden that would otherwise have applied on 6 April 2016 to all schemes that until this point had been contracted out on a salary-related basis and for whom nothing was changing other than their ceasing to contract out.

The cost of accruals tests were very welcome and, together with the transitional easement, which as you have noted, ended in April 2019, alleviated this burden, other than for a handful of formerly contracted out schemes that had to use the test scheme standard.

The check that a scheme continues to meet the alternative quality requirements in relation to any future accrual is now carried out as part of the scheme's funding valuation. As such, there may be a number of schemes that have yet to undertake this check without the benefit of the transitional easement. Nevertheless, we are not aware that the requirement to carry out the cost of accruals test at benefit scale level where there is a material difference in the cost of providing benefits between different groups of members is proving to be problematic.

However, as we suggested in our response to the 2017 review, we think it would be useful to modify either the regulations or the guidance to make clear that the margin above the minimum contribution threshold (the "prescribed percentage") can be taken into account in assessing whether there is a material difference in benefit scales. So, if you have a scheme with both a 60ths and an 80ths scale, both of which have a cost of accrual that is significantly in excess of the prescribed percentage, there should be no need to carry out the test at benefit scale level.

2. The legislation is not prescriptive about who should apply the alternative quality requirements. In practice, who is carrying out the tests: the employer (i.e. self-certification) or its professional advisers?

Our experience is that in many cases the scheme's actuary carries out this test, typically as part of the scheme's funding valuation.

3. Is there anything sponsoring employers or pension schemes want to bring to DWP's attention about the operation of the alternative quality requirements, in particular regarding previously unforeseen issues when compared to the TSS?

There can be an issue where a scheme's pensionable earnings definition does not map to one of the relevant earnings possibilities, but there is little doubt that the benefit accruing is such that the scheme is of sufficient quality to be used as an automatic enrolment vehicle. In some cases not only does it become necessary for the test scheme to be applied, but the test scheme itself may be less than straightforward to pass.

In order to address this, and in recognition that the cost of accruals test is the approach used by the vast majority of DB schemes open to future accrual, we would like to see some further simplification of this test as follows. We understand that it is not permissible to check in £ terms that the cost of accrual is equal to or more than the result of applying a prescribed percentage to a relevant earnings figure. It is a two-stage process – one must first check the scheme's pensionable earnings definition to see whether it is as good as one of the relevant earnings definitions for each member benefitting from future accrual and only if this is passed are contribution rates compared. So, a scheme with an unusual definition of pensionable earnings that is not as good as any of the five relevant earnings definitions available, but has a generous accrual rate, cannot use the cost of accruals test.

We would like to see the guidance explicitly enable the cost of accruals test to be passed if the contribution amount required is not less than the contribution amount obtained through consideration of one of the five current options – ie by multiplying the relevant earnings by the prescribed percentage.

Failing this we would like to work with you to explore pensionable salary definitions that don't naturally fit within the five current possibilities to see whether further definitions of relevant earnings should be created.

Disclaimer

Produced by the Association of Consulting Actuaries Limited October 2020