ASSOCIATION OF CONSULTING ACTUARIES

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The House of Commons Public Bill Committee
London
SW1A 0AA

Dear all

Pension Schemes Bill – call for evidence

I am writing on behalf of the **Association of Consulting Actuaries** in response to the call for evidence on the Pension Schemes Bill.

The Association is the representative body of some 1,700 UK consulting actuaries, who are the key pension and financial advisers to the vast majority of the £1.4 trillion of the UK's private sector defined benefit schemes including undertaking the statutory role of Scheme Actuary. Our members are also advisers and actuaries to thousands of defined contribution schemes and the funded public sector schemes.

We support many of the measures in the Bill but have some suggestions for refinements. We have summarised some of the key points detailed in our consultation response below.

- As representatives of actuaries advising both trustees and employers, we support the inclusion of the 'Powers to pay surplus to employer", which include provisions for appropriate additional safeguards to be set out in regulations.
- We have some specific concerns on the Defined Contribution provisions, as outlined below, and a more general point about the timing of new requirements for trustees to select 'default pension benefit solutions' and the roll-out of anticipated legislation to enable decumulation-only Collective Money Purchase schemes (or 'D-CDC' schemes) to be established. In our view, trustees should be able to select their default pension benefit solutions from a menu of options which include D-CDC schemes.
- The powers given in the Bill for greater Government intervention in how and where LGPS assets are invested could lead to potential conflicts with a scheme manager's fiduciary duties, increasing the likelihood of sub-optimal future funding outcomes. Given this, we would expect more detail around when or how these powers are to be used to avoid any future Governments taking actions which could be to the detriment of scheme managers having sufficient funds to pay members' benefits.

Our detailed comments on your questions are set out in the Appendix.

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 this event, please contact me at on 07799 893797 or stewart.hastie@isio.com

Yours sincerely

Stewart Hastie
Chair of the Association of Consulting Actuaries Limited
On behalf of the Association of Consulting Actuaries Limited

APPENDIX

Evidence from the Association of Consulting Actuaries (ACA) to Public Bill Committee on Pension Schemes Bill

Part 1 – Defined benefit pensions

Local Government Pension Schemes

1 – In clauses 1(2)(b) and 1(2)(e) there is no definition of “prescribed circumstances”. Whilst it would be expected that the circumstances are set out in secondary legislation and subject to consultation, this does still give scope to current and future Governments to use the powers for actions which are not in the best interests of the LGPS and/or an individual scheme manager and be at odds with scheme managers’ fiduciary duty. It would be preferable to include more detail around what circumstances would qualify for these powers and/or additional guardrails around their use.

2 - On clause 1(2)(e), the definition of “specified” is very broad and unclear. The efficient performance of investments is vital to making the LGPS affordable for employers and ensuring there will be sufficient monies to pay members’ benefits in the long-term. Therefore, giving the power for current and future Governments to make directions that could have a material impact on investment performance with no detail on scope, remit or guardrails is concerning and has the potential to increase the likelihood of sub-optimal future outcomes.

Powers to pay surplus to employer

3 - It is helpful to put the proposed powers to allow payment of surplus to an employer in context. Where a scheme has sufficient funds to buy-out its liabilities with an insurance company, whether to do this or run-on will need to be a balanced decision reflecting the pros and cons of each approach. The prospect of generating surplus, which might be released to employers (using the provisions set out in the Bill) and potentially benefit members, is likely to be an important advantage of run-on, along with retaining control over discretionary benefits. The advantages of buy-out will include reducing the regulatory and governance burden for the employer/trustees and removing the risk of the employer having to contribute in future. Trustees are also likely to consider how the protection provided by the employer covenant compares with the protection provided within the insurance environment.

4 - As representatives of actuaries advising both trustees and employers, we support powers allowing surplus payments to be made to scheme sponsors, provided appropriate safeguards are put in place to protect the interests of scheme members. The provisions in the Bill (in particular Clause 9) would enable appropriate additional safeguards to be set out in regulations. We therefore support the inclusion of the 'Powers to pay surplus to employer' in the Bill.

5 - We set out our comments on appropriate safeguards in our response to the 'Options for DB Schemes' consultation in April 2024. Our preference is for a two-tier approach enabling surplus refunds through a simple process where funding is very high whilst also allowing employers with strong enough covenants to take surplus refunds at lower levels of funding. So, for example, if funding is above, say, the actuary's estimate of solvency, then no further conditions would apply. If funding is above the low dependency target but below solvency, then the covenant and/or other contingent assets would need to be considered strong enough to support this difference.

6 - On clause 8, it will be important for the new power to override any explicit prohibitions on payments of surplus to employers in scheme rules. That appears to be the intention of the new Section 36B(3), to be inserted by clause 8, but it is not completely clear to us whether this would be effective for all current explicit prohibitions (as non-lawyers).

7 - Relating to these provisions but for inclusion in a Finance Bill, we again call for additional flexibility to make one-off payments to members without adverse tax consequences. In combination with the surplus refund measures in the Pension Schemes Bill, these changes will likely make investing for surplus by DB schemes more attractive, with a view to sharing surplus between members and employers and may also encourage greater investment in growth assets, or schemes holding on to growth assets for rather longer than currently planned.

8 - We would support further flexibility on the use of surplus – in particular, subject to suitable safeguards, permitting surpluses in defined benefit schemes to be transferred to other trusts (including Master Trusts) without incurring a tax charge, in order to fund future pension accrual for employees. This would help to ensure that all employers, regardless of size, can use their DB surplus to fund current employee pension accrual in a straightforward way and without a possible tax penalty. It would also help to drive consolidation and scale in Master Trusts.

Part 2 – Defined contribution pensions

Value for Money

9 - We have concerns that the framework as drafted risks penalising the governance bodies of schemes who are taking positive actions for the long-term. For example:

- Productive investments in private markets are very long-term assets where returns take time to come through, and over shorter to medium term periods these assets can underperform public markets.
- Private markets have higher costs but as the metrics are currently backward-looking, schemes will be penalised on costs while not yet "benefiting" from the future returns.
- It would be helpful for all parties to have a "test and learn" period where data does not need to be public which would allow the Government, the Pensions Regulator, and other stakeholders to take stock of how the framework is operating and whether amendments need to be made to avoid unintended outcomes.

Scale

10 - We recognise that the mandation debate is a sensitive one but believe that the ability to mandate asset allocation is not in the best interests of schemes, their members or employers and should therefore be removed. If there are attractive UK investments, schemes will invest in them. If there are not, mandating that is likely to require schemes to select less attractive investments. A better focus for government would therefore be to find incentives to encourage development of assets into which UK schemes want to invest. The proposed mandation power overreaches into fiduciary duties, blurring responsibility for asset allocation. We believe that the adoption of the Mansion House Accord reflects broad support by the industry and forcing a segment of the market risks inefficiencies (for example, bidding up prices if a significant amount of capital is required to be invested in a limited number of opportunities with a fixed timeline).

Guided retirement options

11 - We applaud the recognition that people will need an "income" in retirement but note that for many smaller pots this will just not be practical. Therefore, a default solution for some populations may not be an income.

12 - Retirement is likely to mean different things to different people, in particular where phased retirement is particularly common. As part of this it will also be difficult to determine at what point the default provision of retirement income is to apply, what form of income should be provided and for how long.

13 - A key challenge in determining this on an individual basis, and for governance bodies when determining the default retirement solution, is the lack of visibility of the extent of entitlement to State Pension, the presence of other assets held by members and their household situation. Together, these factors mean that a default retirement solution is rarely likely to be a suitable solution for an individual member.

14 - The default retirement solution will also have knock on consequences for default investment design – if there is a requirement to secure a guaranteed regular income for life, this would have a significant impact on the de-risking approach adopted by schemes and may conflict with some of the Government's other objectives here – namely adoption of private market investments.

15 - We believe it would be sensible for schemes to be required to make available a decumulation solution that meets value for money tests and can be integrated with the pre-retirement arrangements, with a more consistent, higher quality member journey, such that fewer members reach the "last resort" option of being defaulted into a decumulation vehicle without making an active choice. We do however recognise that a last resort approach will be needed in some instances and look forward to further engagement with Government on what this looks like. For example, there are other possible combinations such as the member always having to make a positive choice about the date when income commences (to cater for phased retirements, other income etc) but then there could be a default product for the income phase after that chosen age, potentially with a long stop of 75 for putting the pension into payment.

We also note that the market is developing financial advice solutions that are more accessible for members with pot sizes that would not traditionally seek advice and the adoption of these types of solutions should be encouraged. In the longer term, an enhanced Pension Wise service, pulling data from Pensions Dashboards into a 'what if' modeller for members could provide richer support.

16 - In relation to Chapter 5, there is a general point about the timing of new requirements for trustees to select 'default pension benefit solutions' and the roll-out of anticipated legislation to enable decumulation-only Collective Money Purchase schemes (or 'D-CDC' schemes) to be established. In our view, trustees should be able to select their default pension benefit solutions from a menu of options which include D-CDC schemes. We believe D-CDC schemes would meet the overarching policy intent of facilitating a stable lifetime pension income from money purchase benefits whilst enabling continued investment in productive assets. It is therefore important that the necessary legislation for D-CDC be rolled out quickly (and/or the date on which the requirement for schemes to have a decumulation solution pushed back), enabling such schemes to be set up and be operational, before trustees are required to select their default pension benefit solution. If defaults are established before D-CDC is an option this could undermine the inception of D-CDC, for which economies of scale will be a significant determinant of their success.

Part 3 - Superfunds

17 – Clause 52 provides that a superfund scheme is an occupational pension scheme. Our understanding is that because it will have received defined benefit liabilities, then unless otherwise provided for, it will be subject to all the DWP law applicable to such schemes – eg bulk transfers without consent, clearance, contribution notices, employer debt, employer surplus payments, financial support directions, GMP conversion, LPI, modifying accrued rights, notifiable events, PPF eligibility, scheme funding, transfer values, winding up – asset apportionment. However, it is not clear to us whether all these requirements have been considered and appropriately allowed for, where necessary, in the Bill.

18 – Clause 53 relates to the potential division of a superfund scheme into stand-alone sections. It is not clear to us whether the Bill wording achieves the desired segregation.

19 - Clause 58(2) sets out the proposed onboarding conditions for superfund transfers. These correspond with the 'gateway principles' adopted under the interim regime except that the existing principle that "a transfer should only be considered if a scheme has no realistic prospect of buy-out in the foreseeable future, given potential employer contributions and the insolvency risk of the employer" has been removed. This is a material change to the principles that could allow more schemes to transfer to a superfund, in particular for schemes where there is a realistic prospect of buy-out in the foreseeable future. We note that the consultation on consolidation of defined benefit schemes carried out between 7 December 2018 and 1 February 2019 proposed maintaining the 'no realistic prospect of buy-out in the foreseeable future' test (see para 205 of the consultation) and the response to this consultation did not indicate that there would be a material change from this proposal as a result of consultation. We suggest that the Committee asks the Minister why this weakening is being proposed.

20 – Clause 58 also provides that approval of a superfund transfer is possible only if the ceding scheme does not have any active members. We think this is unnecessarily restrictive and suggest that it be adjusted so that the proviso is that active members are not transferred.

21 – Clause 59 has not addressed section 74 of the Pensions Act 1995 which applies where a scheme with defined benefit liabilities is being wound up. It seems that this may need to be modified, or regulations made under it, to enable, for such PPF+ cases, the superfund transfer route. The July 2023 DWP response indicated that changes would be considered to remove legislative restrictions that prevent such transfers taking place.

22 – Clause 69 sets out certain key functions which all seem to be appropriate. However, it is not clear to us how these key functions work alongside those applicable more generally to occupational pension schemes from which authorised master trusts and collective defined contribution schemes

have been exempted. Maybe section 249A(3) of the Pensions Act 2004 should be extended to exempt superfund schemes from these requirements. If so, an amendment could be made to the Schedule to the Bill that deals with changes to the Pensions Act 2004.

23 – Clause 72 relates to the approval of superfund trustees. It is not clear how this is intended to operate alongside the Member-nominated trustee requirements (also from the Pensions Act 2004) which will remain applicable unless one of the existing exemptions applies.

24 – Clause 73 lists certain events that must be reported to the Pensions Regulator. We note that, although the Bill is silent on the matter, the existing notifiable events law under the Pensions Act 2004 is also applicable, with separate notification obligations applying to the trustees and the statutory employer.

25 – Clause 90 lifts the bulk transfer without consent actuarial certificate in PPF+ cases but does not remove the "connected employer" requirements of Regulation 12 which will complicate superfund entry for such schemes.

Part 4 – Miscellaneous

26 - We welcome the additional flexibilities in relation to pension protection levies, under clause 95, allowing the PPF funding levels to be reflected more accurately in determining the levies required. However, we would encourage the changes to go further and allow for the abolition of the administration levy relating to the pension protection fund (under Section 117 of Pensions Act 2004), in line with the recommendations of the Departmental Review of the Pension Protection Fund published in December 2022. In practice the levy was suspended for two years following this review but has been reinstated for 2025/26.

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