ASSOCIATION OF
CONSULTING ACTUARIES

Warnford Court, 29 Throgmorton Street, London EC2N 2AT
Tel: +44 (0)20 7382 4594 Fax: +44 (0)20 7374 6220 EMail: acahelp@aca.org.uk
Web: www.aca.org.uk

27 October 2008

Maureen Rafferty
Department for Work and Pensions
Private Pensions Policy
3rd Floor
Adelphi
1-11 John Adam Street
LONDON WC2N 6HT

Dear Maureen,

The Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009

We are writing on behalf of the Association of Consulting Actuaries, in response to the consultation on the above draft regulations.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and are subject to the code of professional conduct of the Faculty and the Institute of Actuaries. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes.

The ACA is the representative body for consulting actuaries, whilst the Faculty and Institute of Actuaries are the professional bodies.

We welcome the introduction of this ‘GMP conversion’ facility. Although we doubt that there will be a flood of schemes wishing to take immediate advantage of it, it will be a useful option for schemes in certain circumstances, including schemes that wish to wind up. However, for many schemes a big stumbling-block to use of the facility is the longstanding uncertainty over ‘GMP equalisation’.

We set out below our response to the six specific questions raised. Two issues with the draft legislation to which we would particularly like to draw attention are:

- The wide range of possible assumptions, with its potential to require more detailed advice and to result in significantly different outcomes;
- The need for a 'window' of time between the effective date of calculations and the actual conversion date (when the rules change).

<u>Question 1: Do you think the draft regulations will allow GMPs to be properly converted into ordinary scheme benefits, whilst retaining the requirement for the converting scheme to pay a survivor's benefit?</u>

We will leave comment on the detailed drafting of the legislation, and whether it will 'work', to lawyers. However, we would mention two key matters which, with the proposals as they currently stand, we believe are likely to be a deterrent to use of the conversion facility.

The really important one is the continuing uncertainty on what to do about the inherent 'sex inequality' of GMPs. Currently, there is uncertainty as to whether anything needs to be done to achieve 'GMP equalisation' – and if so, 'what'. Schemes that convert their GMPs under this new legislation will (in 'equalising up' their post-conversion benefits) be crystallising an 'equalisation cost' which might not actually exist. In addition, there is scope for argument as to precisely how a post-conversion 'equalised benefit' should be determined, which leaves trustees who do convert with some uncertainty as to whether or not their approach will subsequently be deemed to have been wrong.

In addition, many trustees could be put off by the proposed requirement to retain all the 'GMP' rules regarding the circumstances in which dependants' GMPs must be payable. Worthwhile simplification could be achieved by bringing these requirements into line with those that apply to post-97 contracted-out rights, enabling schemes to apply the same rules across the whole of a member's service.

<u>Question 2: Do you consider the roles of the trustee and actuary to be clearly defined and correctly balanced for the purposes of achieving actuarial equivalence?</u>

We would have expected that the method for determining 'actuarial equivalence' would have been the same as that underlying section 67 of the Pensions Act 1995, which is essentially use of the cash equivalent transfer value basis. However, the proposed 'GMP conversion' regulations permit a much wider range of approaches, with the trustees being responsible for deciding which to adopt.

The actuary has a role at the beginning of the process (advising trustees on the assumptions) and the end (performing the calculations and certifying that the actuarial equivalence requirement has been met). The certification exercise appears to be merely mechanical – i.e. the actuary is undertaking calculations on a basis determined by the trustees and in giving his certificate is expressing no opinion on the 'reasonableness' or otherwise of the assumptions adopted (and any other features of the basis for determining the post-conversion benefits); we agree that this is appropriate.

The considerable flexibility in choice of assumptions does, however, need some thought. Presumably, it permits trustees to choose a 'prudent basis' approach (which seeks to leave the funding position unchanged), or an 'economic value to the member' approach, as alternatives to a 'best estimate' approach similar to transfer values (CETVs). And if a 'best estimate' approach is adopted, then presumably this could either be the same as for CETVs (with an assumption that everyone leaves service at the effective date of the calculations) or an adjusted CETV calculation (with allowance for 'in service' revaluation either to an assumed later date of leaving service or to pension age). The existence of a variety of options is likely to mean a higher 'advice' cost (because there is potentially a lot that needs to be considered with respect to the difference between them), and the different approaches might also give rise to some reasonably substantial effects on some members' benefits.

Question 3: Is it clear that the value of the post and pre conversion benefits should be actuarially equivalent on the conversion date? Should the regulations be more specific in setting out the conversion date?

It is unclear from the regulations (and the 'simple guide') whether it is envisaged that the actuary's certificate will be given *after* the date the conversion takes effect or whether it is supposed to take place *before* it. Paragraph 3.16 of the 'simple guide' might imply the former, whereas paragraph 3.18 indicates the latter.

If the certificate is to be given prior to the effective date of the conversion, then there is a serious practical issue with the way in which the draft legislation is structured in that there appears to be a requirement for the actuary to certify equivalence using a basis which cannot (if it is in any way market-related) be known until after the certificate has been given. If, on the other hand, the certificate is generally intended to be given after the effective date of the conversion, this problem does not arise but instead there is the problem (for current pensioners in particular) that benefit payments on the converted basis may well need to be made before the post-conversion benefits have all been worked out.

We first suggest that the DWP makes clear whether it envisages a pre- or post-event certification. In either case, we then further suggest that the legislation should allow for the actuarial equivalence calculation to be at an effective date which is up to, say, three months before the date on which the benefits are actually converted. If certification is pre-conversion, this would get around the 'show-stopper' problem mentioned above; or if it is post-conversion, it would provide some time to determine the revised benefits before they fall due for payment.

Question 4: Do you, as an employer or trustee, consider that you will simplify your administrative processes by converting GMPs into scheme benefits? If so, when do you envisage that this will happen?

We will have to leave employers and trustees themselves to answer this question more directly. However, from our knowledge of our clients we would expect that most of them will take the view that their administrative processes and systems by now deal adequately with GMPs and their various complications, and therefore that the costs of conversion (especially if there is an extra 'equalisation' element as discussed earlier) would outweigh the future cost savings.

Question 5: Should GMP conversion be extended further? For example, should it be available in individual cases of early or ill health retirement?

Yes, we would welcome extension of the facility to 'individual member' cases, such as those members who are prevented from taking early retirement and/or part of their benefits as a cash lump sum by the requirement to provide a minimum pension from GMP age. We believe that in principle this would be possible under the legislation as drafted, given that trustees are free to apply 'GMP conversion' to as many or as few members as they wish, but in practice the process is too detailed to be a viable proposition for individual cases. A practicable alternative process to cover these would be desirable.

Question 6: Do you think additional restrictions should be placed on onward transfers from schemes which have converted their GMP liabilities?

No, we do not think that there should be any such restrictions. If they were introduced, they would add to schemes' administrative burden and would be inconsistent with the proposed deregulation of protected rights.

We hope this is helpful.

Kind regards,

Yours sincerely

Charles Young
Chairman
Pension Schemes Committee