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21 February 2017

Maggie Simpkin
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Dear Maggie

## Bulk transfers of defined contribution pensions without member consent

I am writing on behalf of the Association of Consulting Actuaries in response to the above call for evidence document dated December 2016.

Our comments on the consultation are set out in the Appendix and broadly reflect the proposals that we outlined to you when we met you and your colleague David Farrar on 14 February. There has been one significant addition, which is our response to Question 8, prepared by colleagues from the ACA's Pensions Tax Committee.

Members of the ACA currently advise on DC to DC transfers and frequently experience regulatory barriers to desirable commercial and public interest outcomes in this area. Therefore we look forward to working with your DWP (and HMRC) colleagues over the coming months to deliver an appropriate replacement regulatory regime.

If you have any questions on our response, please do not hesitate to contact me on 020 7432 6635 (david.everett@lcp.uk.com), or either of my colleagues Jane Beverley on 0203 327 5314 (jane.beverley@puntersouthall.com) and Spencer Bowman on 0207 170 2729 (Spencer.Bowman@willistowerswatson.com).

Yours sincerely

David Everett

**David Everett**
Chairman, Pension Schemes Committee
On behalf of the Association of Consulting Actuaries Limited

Sent by e-mail to: Pensions.Bulktransfers@dwp.gsi.gov.uk

# Bulk transfers of defined contribution pensions without member consent

## Chapter 2: DC-DC bulk transfers

### 1. In your view, how common are occupational DC–DC bulk transfers without consent and can you give examples of circumstances in which they occur?

When the bulk transfer without consent legislation was first established, via the Preservation of Benefit Regulations 1991, DB occupational pension schemes were the norm and DC to DC bulk transfers were exceptionally rare, so the fact that the legislation did not distinguish between DB to DB and DC to DC transfers was of limited concern.

Nowadays, DC to DC transfers are much more common as employers seek to consolidate legacy arrangements (whether a DC occupational scheme or DC benefits (such as AVCs) within an otherwise DB scheme). The receiving occupational pension scheme is often a master trust. As a result, actuaries are increasingly being approached to give a certificate in a DC to DC bulk transfer. Indeed, actuaries often need to be appointed to the scheme solely for this purpose.

Furthermore, the Pensions Regulator is advocating large scale master trusts as a good way to ensure strong governance and better member outcomes for those with DC benefits. Many employers and trustees want to do this, but are being put off by the bulk transfer requirements. To place this in context, the Pensions Regulator has recently reported that there are now 34,500 schemes with DC trust-based members. [1] The Regulator would like to see market consolidation deliver a significant reduction in this number.

### 2. Can you give an indication of the time/costs of complying with the current requirements, number of DC-DC bulk transfers per year, time/cost of producing the actuarial certificate, and any other information you think might be helpful?

We believe that the regulations governing bulk transfers without consent must be overhauled in respect of DC to DC transfers as they are unclear as to what they require, are not serving a useful purpose and are putting up unnecessary barriers to scheme reconstructions, transfers and consolidations. We are not alone in this view.

We would be happy to survey our members for an indication of the costs that can arise and the time that can be spent on the actuarial certification aspect, if that becomes a necessary part of delivering reform in this area. What we can say at this point is that both cost and time can be significant, primarily because, unlike DB to DB transfers, it is not clear how to interpret the regulations and there is no generally accepted Counsel's Opinion to assist. This uncertainty results in additional legal costs, with both the actuary and the trustee potentially having to seek legal advice.

Furthermore, requiring the involvement of an actuary when there is no technical actuarial work to be undertaken (which is the case for pure DC cases) not only seems inappropriate (although we accept that it is an accident of history), but it also unnecessarily adds to costs. In

[1] "TPR acts to protect savers as new figures show significant shift to DC" – 27 January 2017

particular, where an actuary has to be appointed to a pure DC scheme solely for the purpose of this certification, there will be the costs associated with the appointment of the actuary and then with the actuary familiarising him/herself with the transferring scheme in addition to the costs associated with the certification itself.

Finally, because the current regulations put up unnecessary barriers, they are imposing further costs – whether they are uplifts in member benefits that (depending on the legal advice) are sometimes necessary in order that the actuarial certificate can be given, or the potentially detrimental impact on members' benefits through being trapped in a legacy arrangement.

**3. Do you think there is sufficient clarity regarding what is meant by "broadly no less favourable" and how consistently do you think it is being applied? Some examples of how actuaries actually apply this provision would be helpful.**

We do not think there is sufficient clarity regarding what is meant by "broadly no less favourable" in the DC to DC context. It is a term that was designed for the DB to DB environment.

In fact, there are difficulties in interpreting three key terms in the actuary's certificate set out in Schedule 3 to the regulations – namely the accrued "rights to be transferred", "broadly, no less favourable" and "discretionary benefits or increases in benefits".

This was exposed in the document published by the Institute and Faculty of Actuaries in February 2016, extracts from which you reference in Annex B of the call for evidence. This document said that where actuaries are in doubt as to the appropriate interpretation they should seek independent legal advice.

From a public policy point of view this is clearly an unsatisfactory position. The law governing DC to DC transfers without consent needs urgent reform so that it is clear what needs to be done before such transfers can proceed.

**4. Do you think that the actuarial certificate or an alternative check of scheme quality still has a role in occupational DC-DC transfers? If so, who ought to carry out such an assessment? What factors should be considered as part of that assessment and which should be excluded? Do you have any thoughts on how the relative strengths and importance of those factors should be weighed up? If not, how would members continue to be protected?**

<u>A trust law approach</u>

As no technical actuarial work can be undertaken in order to give a certificate in relation to pure DC to DC transfers, it seems clear to us that the current requirement for an actuarial certificate should be replaced with requirements which are fit for purpose and proportionate for such transfers.

We note that the actuarial certificate in DB to DB transfers in itself gives little protection to members. Instead it is the wider issues that trustees consider before agreeing to the transfer that provides most of the member protection. In other words it is trust law that delivers most of the protection, not Regulation 12 of the Preservation of Benefit Regulations 1991.

So we disagree with your initial view that, in relation to DC to DC transfers, reliance on trustees' fiduciary duties would not offer adequate clarity for trustees or member protection.

We think that it should be possible for the trustees to agree to a transfer without member consent after their own due consideration given their general responsibilities under trust law. As part of this we would expect trustees to consider the impact on individual members, whilst not taking into account an individual's personal circumstances.

There may be different ways in which this fiduciary duty can be expressed. One is that some appropriate phrase is put into the regulations with that meaning – perhaps "generally in members' interests". Our concern with specific wording is that it might then lead to a variety of potentially restrictive and unintended interpretations. We speak from experience in this matter as the current statutory tests underlying the actuarial certificate were far from straightforward, were subject to continual change after their introduction, and the understanding on them only reached a broad consensus following the publication of a Counsel's Opinion in March 2005 by the Institute and Faculty of Actuaries. Given this, another possibility is for the regulations not to contain any express requirement other than saying that the trustees have to determine whether or not to make the transfer without member consent.

If a trust law approach is adopted, the trustees would be freed to take account of all relevant factors, ignore irrelevant ones and arrive at a balanced decision as to whether to go ahead with the transfer. In this, they may be guided by any legal or other advice they seek. Many trustees may seek such advice given the irrevocable nature of the decision they would be taking. We have more to say on this below.

We have thought whether it would be possible for the regulations to require the receiving scheme to be of a certain quality before the transfer could proceed. Our concern with an approach along these lines is that it could produce unnecessary barriers. Instead we would anticipate trustees looking at a variety of factors in weighing up whether or not to proceed.

Disclosure

Another issue is member disclosure. The current disclosure requirements are very high level and because they need only be made one month ahead of the transfer are essentially for the member to note. There may be a case to enhance the disclosures for DC to DC transfers and to also require them to be made more than one month ahead of the proposed transfer in order to give members a realistic opportunity to transfer their DC pot elsewhere.

Guidance

We think that it would be appropriate for the Pensions Regulator to produce non-statutory guidance to assist trustees in the exercise of their general responsibilities under trust law in this area. Such guidance could cover the following matters that the trustees would need to weigh up:

- Any immediate loss in value that the member may suffer as a result of transaction costs;
- The range of investment options in the transferring and receiving scheme and the extent to which the transferring member can be placed in funds with similar characteristics;
- How the likely future costs levied on the member's DC pot (and the associated terms and conditions – in particular, any rights to increase those costs simply by giving notice to the member) compare between the transferring and receiving schemes;
- The options and facilities that each scheme offers its members; and
- The quality of the administration and governance in the two schemes.

We would leave the weighing up of relevant factors to the judgment of the trustees as they could easily be quite different from case to case. We suggest that the guidance should emphasise that the trustees take a proportionate approach in reaching their decision.

It is important that the guidance is subject to a public consultation before the Pensions Regulator finalises it.

We believe that trust law, along with guidance and perhaps enhanced disclosure, should be a sufficient safeguard to the public interest, especially as DC quality has moved on considerably in recent years through initiatives such as the new charges and governance regulations, restrictions on early exit charges and the DC code and guidance.

Given the argument sometimes made that guidance cannot deliver comfort, an issue that will need consideration is whether the guidance should in fact be delivered on a statutory basis. At the current time, our preference is for the guidance to be non-statutory.

Adviser safeguard

As the trustees would be taking an irrevocable decision, we also suggest that consideration is given to introducing a safeguard akin to that provided through section 36(3) of the Pensions Act 1995. This requires that before investing in most manners, trustees must obtain and consider "proper advice" as to whether the investment is suitable for the scheme and consistent with its statement of investment principles. In the DC to DC bulk transfer without consent context trustees could be required to obtain and consider the written advice of a person who is reasonably believed by the trustees to be qualified by his ability in and practical experience in this area. In practice, this person could be the DC consultant or DC investment adviser who is advising the trustees on the whole project (and could quite possibly be an actuary, but importantly, need not be). One issue that may need to be considered is the potential for this advisor to have a conflict of interest (through having some financial incentive for the transfer to proceed). We envisage that the advisor would assist the trustees to work through all the issues that are relevant to the trustees' decision.

Under the current regime, the trust law protection is aided by the generic APS P1 requirement (in paragraph 4.4) placed upon actuaries to consider whether there are any matters which he/she believes the trustees should bear in mind before taking any action associated with a certificate, draw the trustees' attention to any such matters, and consider whether to take further action if the matters are not appropriately addressed by the trustees. This requirement on actuaries may, in practice, provide more protection to members than the actuarial certificate. In the DC to DC context we think that it would be possible and perhaps desirable for either the regulations, or the Regulator's guidance, to contain an equivalent requirement / expectation on the person from whom the trustees obtain "proper advice".

5. **Sometimes occupational DC pensions have valuable guarantees, either borne by the scheme or another body. How do you think the process should differ for these types of scheme?**

This is a potentially difficult issue and in delivering a much needed reform it may be necessary to focus on the pure DC cases as these will be the vast majority of transfers. We would not want the reform to stall whilst consideration is given to dealing with DC pensions with guarantees.

Our starting point is that the reform we describe above should be limited to those benefits that meet the statutory definition of "money purchase benefits" as set out in section 181 of the Pension Schemes Act 1993. This would mean that a scheme which makes available investment funds delivered by third party providers who themselves offer a guarantee (such as a fund that gives returns linked to an index, a guarantee that its value will not fall below the contributions paid, or indeed is constructed on with profit lines) is likely to benefit from the reform.

However we suggest the following:

- That hybrid benefits (ie those calculated on either a DB or DC basis depending on which produces the higher value at the time when the benefit come to be paid) should remain subject to the current actuarial certificate route. In order for this to be the case, Regulations 4 and 5 of the Pensions Act 2011 (Transitional, Consequential and Supplementary Provisions) Regulations 2014 (SI 2014/1711) may need to be modified as our understanding is that they currently provide for a contingent treatment under which hybrid benefits are tested at the "relevant date" to see whether or not they are money purchase. If at the time of the proposed transfer the DC benefit produces the higher value it does not seem right to us that the DB aspect should be ignored.

- It may be appropriate for a scheme that provides money purchase benefits under which members have an option to internally annuitise on guaranteed terms (but which they have not yet exercised) to be treated as money purchase, but with a requirement for actuarial advice to be taken on the likely value of the option under various scenarios. It might be possible to use some of the ideas exposed in a DWP consultation which closed recently.[2]

- It may also be appropriate for a similar treatment to be applied in the case of a money purchase benefit which has a guaranteed rate of return provided by the scheme in the accumulation phase.

We envisage that if a bulk transfer without consent involved mixed benefits, such as a final salary benefit scale along with money purchase AVCs, those that fell to be treated as money purchase would be subject to the new requirements whilst those that did not would remain subject to actuarial certification.

You also mention life assurance benefits. Since these are not accrued rights they would not fall within the scope of the current actuarial certificate route.

### 6. Do you have any experience of how the scheme relationship condition works in practice? Do you think it serves a useful purpose or does it act as an obstacle in some circumstances? What is the frequency and impact of these obstacles?

We believe that insofar as DB to DB transfers are concerned the scheme relationship condition serves a useful purpose in limiting bulk transfers without member consent to scheme reconstructions within a corporate group and to sale and purchase situations involving different corporate groups. In practice there will be next to no demand for DB to DB transfers

[2] "Valuing pensions for the advice requirement and introducing new consumer protections" which closed on 7 November 2016.

outside these two areas until and if any wider reform is introduced to encourage the consolidation of DB schemes on a non-employer-related basis.

By contrast, the scheme relationship condition makes little sense in the DC to DC context. We suggest that it should be completely absent from the regulations in relation to such transfers.

In the DC to DC context we agree that the condition set out in Regulation 12(2)(a) of the Occupational Pension Schemes (Preservation of Benefit) Regulations 1991 can be unduly restrictive, necessitating devices to be constructed in order that the receiving scheme can be said to "relate to persons who are or have been in employment with the same employer".

**7. What is the impact of the current provisions around bulk transfers for 'orphaned DC schemes', where there are no surviving employers in relation to the scheme? Do you think that we need special provision for such schemes, for example, to allow pension providers to carry out a transfer where certain conditions are met? How do you think this should work in practice?**

We understand the scenario you have in mind is where the employer that has been dissolved is also the corporate trustee and so effectively the scheme neither has a connected employer nor does it have a functioning set of trustees. We would hope that in this situation the Pensions Regulator could step in to appoint trustees, although we understand that in practice it may be constrained from doing so.

We accept that where a scheme has been orphaned in the way described, it will not be possible to use the bulk transfer without consent provisions. We therefore support your suggestion of creating an appropriate provision under which members of such schemes can be transferred without their consent to a continuing scheme.

One possible use for such a provision would be where an employer becomes insolvent and the scheme has both DB and DC benefits. If it takes a long time before the Pension Protection Fund takes the DB part of the scheme on board, the insolvency practitioner may have wound up the business. In such a situation it may not be possible to transfer the DC benefits without member consent to say a master trust.

**8. Are there any other areas of the occupational DC-DC bulk transfer provisions that you think need simplifying and do you have examples of how they are not working?**

In considering whether to make a DC to DC transfer without consent, trustees need to take into account the overall potential impact on members.

Although the consultation focusses on barriers in DWP legislation, we note that HMRC tax law can create significant barriers, as set out below. It would help significantly to achieve the consultation's aim of making the bulk transfer process smoother and more successful, and achieve more consolidation of DC arrangements, if HMRC rules can be changed (or HMRC can read some of the current legislation widely enough).

<u>Compensation for frictional costs</u>

In some DC to DC bulk transfers there can be an initial reduction in the members' fund value either due to transaction costs or a market value adjustment due to early withdrawal. (This can be avoided where transfer can be made in specie, but may be a real risk possibility otherwise.) It may be that the trustees are unwilling to proceed without member consent unless the loss of fund value for the member is "made whole", for example by way of a payment by the employer into the receiving arrangement.

Our understanding of HMRC's reading of tax law is that any such "contribution", even of £1, would invalidate any Enhanced or Fixed Protection (2012/2014/2016) held by a member. This could materially worsen such members' accrued benefits – for example a member who loses Fixed Protection 2012 might currently see their Lifetime Allowance reduce from £1.8m to £1m potentially leading to £200,000 extra tax. (The position for someone with Enhanced Protection could be even more significant.) It is not practical, or possible, for the trustees to find out who (if indeed anyone) has these protections as DC schemes will include members who left some time ago. Indeed many of these people may have applied for these protections once they stopped contributing to the scheme and the administrator will not have a complete record of who has protection. (And it would be natural for an individual to assume that their taking no action means their protection is safe.)

The situation is exacerbated because of the position of Fixed Protection 2016. The Government has chosen to leave the window for registering for this open indefinitely recognising that individuals may take time to realise its importance for them (for their DC and/or DB benefits). A transfer with compensation could, as the law/guidance currently stands, disqualify all the transferred members from registering for Fixed Protection 2016 in future.

Hence the risk of someone losing their existing Lifetime Allowance protection, because of an action the trustee wish to pursue in the best interests of the scheme as a whole, can completely block the desired bulk transfer exercise; and may mean it has to become a with consent exercise with the risk of uncontactable members being left in a residue scheme that has to continue; or else could block a reasonable approach to ensure members are not out of pocket.

We would hope that it is relatively easy to make a change to law or guidance to allow "planned compensation" in these sorts of projects not to cause loss of Enhanced Protection or any of the Fixed Protections.

<u>Issues relating to scheme-specific protections</u>

Not all DC bulk transfers without member consent are in relation to a member's total benefits in the scheme. They may, for example, have been members of a DB section of the scheme and then a DC section due to a change in the scheme benefit structure. Under HMRC tax law, if only the DC benefits are transferred out this would be considered a 'partial transfer' and special adjustments come into play. The situation is different from the above because the group of people who have this protection will be identifiable to the trustees, as it is based on their scheme benefits only. A partial transfer could be detrimental to a member in two circumstances:

- Those with "scheme specific lump sum protection", reflecting the tax free cash they had built up prior to 6th April 2006 compared to the total benefit they had built up. The formula for calculating the maximum permitted tax free cash sum under the current tax regime in these cases is unintuitive and the overall scope for tax free cash may be worsened as a result of a partial transfer.
- The right to a protected normal minimum pension age is lost on the part of the benefits that are transferred.

Where members with such protections and such potential loss exist, trustees might feel they have to ask consent again losing all the efficiency aimed at for bulk transfers.

This is an anomalous position compared to what applies for a transferred member who only had DC in the original scheme – the above protections would continue in the transferring scheme.

It would be helpful if, solely in the cases of genuine bulk DC to DC transfers, and on full transfer of the DC element, a solution is found for better maintenance of the protections. We would be happy to discuss ideas further with HMRC.

## Chapter 3: Bulk transfers from stakeholder schemes

### 9. In your view, how common are stakeholder to stakeholder DC-DC bulk transfers without consent and can you give some examples of circumstances in which they occur?

We are not aware of any, but having said that our members are unlikely to have come across any in the course of their work.

### 10. Do you think that the current restrictions on bulk transfers without consent from stakeholder pension schemes should be lifted so that they are treated in the same way as those from personal pension schemes, ie under FCA principles and rules? If so, to what types of scheme should these transfers be allowed?

We support the suggestion that provision be made so that members of contract-based stakeholder pension schemes could be transferred without consent to an individual or group personal pension scheme, subject to FCA regulatory principles applying. But such schemes are surely outside the scope of the Pension Schemes Act 1995 and the Occupational Pension Schemes (Preservation of Benefit) Regulations 1991?

For those stakeholder pension schemes set up on an occupational pension scheme basis, we suggest that it should be possible for the trustees of such schemes to transfer members without consent to other DC occupational pension schemes, subject to the regulatory regime we have sketched out above. However, one of the factors the trustees would need to take account of is the features of the stakeholder pension legislation if the proposed destination scheme is not stakeholder designated.

### 11. Do you think that providers of transferring schemes should be able to invoke the bulk transfer without consent provisions where a stakeholder scheme has not yet commenced winding up?

Yes. We see no good reason why the regulations should constrain such transfers to stakeholder pension schemes that had started to wind up.

## About the Association of Consulting Actuaries (ACA)

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 all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes.

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