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Adrian Mallen
Department for Work and Pensions
Enabling Retirement Savings Programme
Room BP9102
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Newcastle upon Tyne
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Dear Adrian

Workplace Pension Reform – Completing the Legislative Framework for Automatic Enrolment

I am writing on behalf of the Association of Consulting Actuaries in response to the above consultation on draft regulations and guidance.

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.

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

Our response falls into three parts:

1. Missing pieces of the workplace pension reform framework

2. Comments on the proposed certification guidance

3. Response to the questions asked specifically in the consultation paper

We hope that you find our comments of assistance, and would be happy to discuss these issues further if that is helpful. You can contact me on 020 7082 6228 (charles.young@hymans.co.uk) or my colleague Jane Beverley on 020 7839 8600 or by email to jane.beverley@puntersouthall.com.

Yours sincerely

Charles Young
Chairman, Pension Schemes Committee

Appendix A: Missing Pieces of the Workplace Pension Reform Framework

We welcome the DWP's intention 'to provide as much certainty as possible about the entirety of the framework for automatic enrolment'. The delay in the progress of the Pensions Bill through Parliament has only increased the level of potential uncertainty for employers, advisers and individuals. We would welcome early confirmation on two points that are not covered by the current consultation:

1. **The proposed level of the qualifying earnings threshold and earnings trigger**

   The Pensions Bill gives the Secretary of State wide powers in setting these thresholds. Until the initial levels of these thresholds are known and an indication given of how they are expected to rise in future, employers, in particular those who employ part-time workers and/or those on low pay, will remain unclear as to how the employer duties regime will affect them, as will the affected individuals. In particular, such employers are unable to budget for the introduction of employer duties until they know whom they will have to enrol and the earnings on which they will have to pay contributions.

2. **Guidance on the testing of defined contribution schemes which do not meet either the minimum requirements or the alternative tests**

   As set out in our response to the informal consultation, clarity is required on the approach for defined contribution schemes which neither automatically meet the tests in section 20 of the Pensions Act 2008 (because they use an earnings definition other than qualifying earnings), nor the alternative requirements introduced under clause 11 of the Pensions Bill 2010/11 (because the pensionable earnings definition used does not satisfy any of the basic pay and earnings safeguards set out in each of the three tiers).

   We understand from Appendix D of the Pensions Regulator's Detailed Guidance Document No. 4 that the intention is that employers in this position will be able to carry out an 'entitlement check' in relation to qualifying earnings. It appears from the Regulator's guidance that no formal certification would be required, but only a check that, under section 20(1), the contributions 'however calculated, must be equal to or more than' the 3% and 8% of qualifying earnings for the employer and total contribution respectively.

   We ask the DWP to confirm the status of this entitlement check and to legislate for it, as necessary. The scope of the draft Automatic Enrolment (Miscellaneous Amendments) (No. 2) Regulations 2011 limits certification under section 28 to schemes meeting the alternative requirements, but it would seem necessary to make provision within these draft regulations for the entitlement check to be carried out.

   This is because section 28(2) of the Pensions Act 2008 (which is to become 28(2)(a) by virtue of Clause 11 of the Pensions Bill 2010/11) provides the mechanism for such an entitlement check to be prescribed as it clearly enables regulations to be made in relation to certification where a scheme meets the 'relevant quality requirement throughout the certification period'.

   The draft Automatic Enrolment (Miscellaneous Amendments) (No. 2) Regulations 2011 in places refers to certification 'with respect to a relevant quality requirement or an alternative requirement' suggesting that there is an intention to legislate in this area. If so, the draft regulations as presented are incomplete and serve to confuse.

If the DWP does not provide the appropriate legislative support, then we are not sure of the status of the Regulator’s entitlement check.

Appendix B: Comments on the Proposed Certification Guidance

We previously commented on the draft certification regulations and guidance as part of the informal consultation carried out in May 2011. Overall, the draft regulations seem to be much improved, and in particular the pay definitions are now clear. A number of improvements have also been made to the draft guidance, although we do still have several issues that we would like to raise:

Presentation

1. Throughout, we would emphasis the importance of bearing in mind that the target audience is employers (often small to medium-sized) with defined contribution schemes and therefore it is essential that the guidance should be simple and easy to follow, as brief as practicable and focused on the needs of that audience.

2. We also suggest that the material on hybrid schemes is unlikely to be relevant to the vast majority of the audience and therefore would be better placed in a separate document or at least an Appendix. Employers with hybrid schemes are in any case almost certain to have an external adviser who can assist them with certification.

3. We continue to question whether 'relevant legislation' is the right place to begin a guidance document aimed primarily at employers. This information could easily be relegated to an Appendix.

4. We note the first paragraph under 'Who is this guidance for?' actually answers a different question, namely 'What are the new duties for employers?' and would therefore probably be better under a different heading. Overall, an introductory page explaining the employer duties regime and the various means of satisfying those duties would be helpful.

5. The guidance needs to set out at the outset all the various ways in which employers can satisfy the quality requirements by means of a defined contribution scheme and which of those methods will require the provision of a formal certificate. We understand these to be:

   - Automatically, where the employer's scheme uses the same contribution rates and qualifying earnings definition as set out in section 20 of the Pensions 2008. In this case, we believe the policy intention is that no certificate is required and this appears to be confirmed by the statement at the bottom of page 5.

   - By means of the 'entitlement check' discussed above, where the employer's scheme pays contributions at least equal to those set out in section 20 of the Pensions Act 2008. We believe that a certificate should be required in this case.

   - By means of one of the alternative requirement tests being introduced by the latest draft regulations, in which case certification is required.

   A flowchart might be a helpful way of illustrating these alternatives.

6. It is not clear why NEST in particular is referenced in the final paragraph on page 4, nor whether certification is required in all cases in which an employer uses NEST or only in cases where the employer is relying on the alternative requirement tests. (We believe it should be the latter.)

7. We cannot see the need to mention, on page 6, the entirely separate test carried out by the Secretary of State.

8. It seems completely inappropriate, on page 7, to exhort readers of this guidance to familiarise themselves with the Regulator's voluminous auto-enrolment guidance, especially as the stated audience of that guidance is 'professional advisers, large employers with in-house pensions professionals and those with a sound knowledge of pensions'. As noted above, the audience for this certification guidance is likely to much wider and will include smaller employers and those with little pensions knowledge for whom the Regulator's guidance will be far too complex.

Pay definitions

9. Whilst the regulations are now clear on the applicable earnings definitions, the guidance is still unclear in some places – for example, page 5 simply refers to 'basic pay' rather than 'pensionable earnings, subject to a minimum of basic pay' under the first and second set of requirements and 'total pay' under the third set of requirements. Similarly, Step 2 in Annex D says that 'earnings on which contributions are calculated' are 'sometimes referred to as basic pay' and the certificate requires the employer (or authorised person) to certify that they pay pension contributions on 'basic pay'. The definition of 'pensionable earnings' given on page 8 should also reflect the definition given in regulation 32K – at present, it only specifies the condition that it must be no lower than basic pay. It is not reasonable to expect employers to refer directly to the legislation itself; therefore, the definitions set out in the guidance must be clear and not open to any misinterpretation.

10. The statement on page 5 'certification is likely to be of assistance if your definition of pensionable pay excludes variable pay items such as overtime, bonuses, commission etc' would make more sense to a reader if it had already been explained that the definition of qualifying earnings included such items.

Terminology

11. As we noted in our previous submission, the terminology of 'tiers' to describe the three sets of requirements is unhelpful, suggesting as it does some kind of hierarchy of the three. We suggest you use 'conditions', 'criteria' or some such wording. We also do not see the need to have four alternative descriptions 'three tier certification test', 'the certification test', 'the three tier test' and 'the test'. Consistency of wording will make it easier for employers to understand and implement the guidance.

Carrying out the tests

12. It is not immediately apparent, from the manner in which the tables have been set out, that the tier tests are initially one of examining scheme documentation, followed by a numerical calculation (if necessary) in order to address the basic pay and earnings safeguards. The example in Annex A skips over the numerical issue by defining basic earnings as the same as pensionable earnings. We think that this example should be revisited to draw out the potential for a numerical aspect to the tests.

13. The guidance (although not the legislation) defines basic pay as 'the elements of pay that do not vary'. It would be helpful to give further examples on how to identify basic pay where additional allowances are paid, which may or may not vary depending on individual circumstances. For example, shift allowance may not vary for individuals who always work the same shifts, but could differ where individuals sometimes work

night shifts and sometimes day shifts, or where they only work shifts as and when needed. Similar considerations will apply to offshore allowances, where some people may be permanently offshore, whereas others only work offshore on occasion. Are these allowances to be treated as basic pay or not?

14. The position with respect to jobholders with capped pensionable pay or contributions now seems a little clearer than in the earlier version of the guidance. Such individuals are to be excluded from the certificate on the grounds that the minimum level of contributions is being paid on their behalf. However, it would seem likely that some kind of test would still need to be carried out for capped jobholders to demonstrate that they satisfy this minimum level (but separate from that for the uncapped jobholders if that would otherwise invalidate the certification, e.g. if the pensionable pay = 85% total pay definition were being used).

15. The lay-out of the table on pages 14-15 splitting Tier 2 across two pages is not helpful and is hard to follow.

16. Under the description of Tier 2, the guidance specifies that earnings data from the preceding year should normally be used, although it is also possible to use prospective earnings data. However, the draft regulations refer to earnings in the certification period. It is not clear how earnings from the previous year can be used unless the draft regulations are adjusted appropriately.

17. There is no legislative requirement for the test suggested at the end of the Tier 2 box '[i]f you are concerned that a large or identifiable group of people will substantially lose out, you can perform the calculation for each individual jobholder to ascertain the position' and we believe that it should be removed from the guidance. It is not the role of the guidance to introduce additional tests which are not required by legislation. The same comment applies to Step 5 of Annex D.

Authorised signatories

18. The extension of the guidance on who may certify on behalf of the employer is a welcome improvement. It would be helpful to state explicitly that third party advisers cannot certify on behalf of the employer.

Completing the certificate

19. We are still not clear exactly what is meant by providing a 'description of the relevant jobholders' covered by a certificate. In some cases, it may be straightforward to identify members of a particular scheme, or a particular sector of the workforce, but in others the only description that may be possible is simply a list of the jobholders covered by the certificate. The template certificate suggests that details such as grade, pay band etc 'which would enable them to be identified' will suffice, it is not clear who would need to be able to identify them – the employer or the Regulator?

20. We notice that, according to page 11, the certificate requires the employer or authorised person to certify that the scheme is 'able to satisfy the relevant quality requirement'. We wonder however whether this should rather say 'able to satisfy one of the prescribed alternative requirements' or 'can be treated as satisfying the relevant quality requirement', since the whole point of the alternative requirements route is that the employer is not required to carry out a test against the relevant quality requirement in section 20 of the Pensions Act 2008. The wording in the template certificate itself is clearer in that the employer is signing to say that the scheme satisfies 'the requirement set out in the certificate'.

21. The guidance is still not completely clear as to how many certificates need to be provided where different sections comply with different alternative requirements. For example, would Employer A in Annex A have to provide one or three certificates? Our reading is that three certificates should be provided, but it would be helpful if the guidance could confirm this. However, the template certificate also requires a statement as to whether any jobholders have been excluded because they are receiving contributions of at least the minimum required by law. In the event that Employer A did have some jobholders who were excluded in this way, should this statement be completed in the affirmative on all three certificates?

22. The requirement on page 11 that the certificate should expire following a significant change in circumstances does not appear to be set out in the draft regulations. This therefore raises the question of what action the Regulator could take if the expiry date was not altered following such an event. We support the idea of there being significant changes that make the certificate expire ahead of time, but think that this matter should be set out in regulations. However, we are not sure whether you have given yourself appropriate authority via the primary legislation to do this.

Renewing the certificate

23. We welcome the clear statement on page 17 that no retrospective calculation of shortfalls is required where it turns out that the scheme did not in fact satisfy the tests (but it had been reasonable for the employer to give that certificate).

Phasing in of contributions

24. The section on the phasing in of contributions is much improved on the earlier version.

Appendix C: Consultation Questions

Pay reference periods

Q1. We seek views on whether abolition of the Person A rule is a sensible approach.

We are not convinced that the problems being addressed by the Person A rule will simply fall away following the introduction of the earnings trigger (as the consultation paper suggests). However, we accept that the Person A rule is extremely administratively complex. It may therefore be better to remove the rule in the interests of simplicity, whilst accepting that it will give rise to some anomalies.

Once the earnings trigger has been exceeded in one pay reference period, the one-off pay spike would then bring individuals within the scope of automatic enrolment even where their earnings in all other periods are below the earnings trigger. This would appear to create an anomaly in that someone on an annual salary of £7,200 would not be automatically enrolled, whereas someone on an annual salary of £7,150 paid weekly and a one-off payment of £50 would be (because the payment for one week would exceed the earnings trigger). Once within the scope of automatic enrolment, the worker would then be entitled to contributions on all earnings in excess of the qualifying earnings threshold. The DWP could seek to justify this anomaly by noting that the worker on the salary of £7,200 has the right to opt in to receive pension contributions, but employers are far more likely to have to pay contributions where a member is automatically enrolled than where the worker has to opt in.

The consultation paper also assumes that the gap between the qualifying earnings threshold and earnings trigger makes it unlikely that individuals with earnings under the qualifying earnings threshold will be enrolled automatically because of a pay-spike. Certainly it will reduce the likelihood, but it is not difficult to think of examples where this may still occur. For example, consider the case of someone on an annual salary of £5,500 paid weekly and a one-off spike of £50. In such cases, those individuals would then be automatically enrolled, but with contributions only payable for periods when pay exceeds the qualifying earnings threshold, which would lead to individuals having tiny pension pots.

We do not know how likely such cases are to occur in practice but we do not think the examples we have given are unlikely or extreme. Where such cases do occur, it is possible that a number of workers of the same employer will be affected. We would therefore recommend that the DWP gives serious consideration to any representations on this point from affected employers or employer organisations as to whether there is still a need for the Person A rule.

We suspect that, in practice, employers may prefer to deal with such anomalies by reorganising their pay structures to eliminate pay spikes (e.g. by spreading Christmas bonuses over a few pay reference periods) rather than by having the complex Person A administrative process to follow.

Q2. Are there any specific examples of where and how the Person A rule would otherwise be used?

See our answer to Q1.

Q3. Is a period of one week from the day following the starting day sufficient time for all employers to issue a notice?

For larger employers with established recruitment processes, we think the one week deadline should be practicable. For smaller employers, where recruitment is on a more ad hoc basis, making sure the notice is given by the statutory deadline could prove more problematic. However, on balance, one week is reasonable, given that the requirement will only apply to those employers who choose to operate a waiting period and given that workers need to be given early notification in order to opt in.

Waiting periods

Q4. Will employers use a second waiting period?

We are not an employers' organisation, but we would expect that some employers would like to operate a second waiting period in order to streamline enrolment processes. It is also possible that, for example, some employers with a large number of younger workers may use the second waiting period to make the start date for automatic enrolment effectively 22 years and 3 months. We do not know how likely employers might be to take advantage of this.

Q5. For employers using a second waiting period, is a period of one week from the day following the starting day sufficient time for these employers to issue a notice, given that weekly paid employees are generally paid one week in arrears and automatic enrolment should occur from the beginning of the relevant pay reference period? Any extension to this period would have to be balanced with not eating too far into the opt-in window as described above.

For the reasons described above, one week seems an acceptable balance, given that employers only need to provide this notification if they wish to operate a notice period.

Certification

Q6. Does the proposed approach to pensionable earnings give the right balance between a workable definition for employers in using certification and protection of individuals?

Since the informal consultation, the DWP has moved to a much more workable approach to the salary definitions for the purposes of the alternative tests. Both 'basic pay' and 'pensionable earnings' are now defined in the legislation, and the introduction of a 'basic pay' underpin to 'pensionable earnings' will remove an obvious opportunity for avoidance. We note that further work is needed to ensure that the draft guidance explains the pay definitions in unambiguous terms.

Q7. Does the 12 month period for certification seem reasonable given that it is to support an easement for employers?

As we set out in our response to the informal consultation, we believe that a three-year certification period might be more appropriate (similar to the three-year period used for certifying compliance with the Reference Scheme Test for contracted-out defined benefit schemes).

On the specific point raised in the consultation, we understand the rationale for the first certification period starting from the staging date rather than at the end of the waiting period. An alternative approach would be to allow a certificate to last for up to 15 months which would capture both the initial 'up to 3 months' waiting period plus full year of contributions' and the re-enrolment 'full year of contributions plus up to 3 months to re-enrolment date' scenarios, without requiring employers in such a situation to go through an additional certification process in order to align their certification and enrolment dates.

Seafarers and offshore workers

Q8. Do you agree with the estimates provided in summary form and in full in the Impact Assessment which accompanies this consultation of (a) economic costs to businesses and (b) benefits to individuals? If not, please provide estimates and supporting information.

We have no expertise in this area and are therefore unable to comment.

Q9. Do you agree with the estimates provided in summary form and in full in the Impact Assessment which accompanies this consultation of the average earnings for different types of worker? If not please provide estimates and supporting information.

See answer to Q8.

Q10. Can you provide any evidence relating to the number of firms (a) employing eligible seafarers, (b) employing offshore workers and (c) the sizes of those firms?

See answer to Q8.

Q11. Can you provide any evidence which would assist the Government in developing a full understanding of the likely impact of automatic enrolment on the shipping industry?

See answer to Q8.

Q12. Can you provide any evidence which would assist the Government in developing a full understanding of the likely impact of automatic enrolment on the offshore industry?

See answer to Q8.

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