ASSOCIATION OF ACA CONSULTING ACTUARIES

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19 December 2013

Defined Ambition Team
Private Pensions Policy and Analysis
Department for Work and Pensions
Caxton House
6-12 Tothill Street
London SW1H 9NA

Dear Sir,

Reshaping Workplace Pensions for Future Generations

I am writing on behalf of the Association of Consulting Actuaries (ACA) in response to the consultation named above.

We commend the Government for its willingness to look at other models of pension provision between the current regulatory extremes of final salary and money purchase. The ACA's recent Pension Trends survey, *The unfinished agenda: Growing workplace pensions fit for purpose*, and the DWP's own research suggest that there are many employers who are searching for new pension models that would enable them to cap their costs whilst also meeting their employees' legitimate calls for greater certainty over the pensions that are being delivered.

The consultation paper contains a number of proposals which provide a way forward to both reshaping and reinvigorating workplace pensions. We believe that the timing is critical and some kind of defined ambition scheme is urgently needed.

With the abolition of contracting out coming in 2016, it is important that some defined ambition options are made available as soon as possible, so that large employers with defined benefit schemes still offering accrual of benefits have choices in front of them other than simply closing their schemes and replacing them with defined contribution alternatives (given that contributions to such alternatives tend to fall significantly short of the level required to provide a reasonable level of retirement income).

In the short term, therefore, we believe that it makes sense to prioritise the development of 'flexible DB' designs (including the removal of mandatory indexation) in time for the abolition of contracting out.

In the longer term, we think there is also considerable merit in the DC guarantee and collective DC models being considered in the consultation paper. We encourage the

Government to continue to work with the insurance industry and other providers to explore the viability of such models.

We make two further points in relation to DC models:

- Given that significant numbers of employers have already adopted DC provision as their auto-enrolment vehicle (or are likely to do so in future), ongoing delays in the availability of 'DC plus' designs may hamper their adoption.
- The likely size of CDC schemes would mean that even a relatively small number of such schemes could lead to a significant impact on large numbers of individuals.

There is no question specifically on the interaction of new defined ambition models with the quality requirements for the purpose of the employer duties legislation. However, it will be essential for the quality requirements to be restructured to allow defined ambition schemes of all the designs being considered to qualify.

Although we have included some brief responses to the technical questions in this consultation, we believe that these issues are best addressed through further detailed discussions in the Industry Working Group. The ACA looks forward to continuing to work with the DWP in developing these ideas in the future.

Yours faithfully

Jane Beverley
Deputy Chairman
ACA Pension Schemes Committee

Sent by e-mail to definedambition.pensionsconsultation@dwp.gsi.gov.uk

ACA'S RESPONSE TO SPECIFIC QUESTIONS

The demand for defined ambition

1. **Do you agree that a greater focus on providing members with more certainty about savings or preferably income in retirement may increase confidence in saving in a pension?**

   As advisers to employers and/or trustees, the ACA does not have direct experience of public attitudes to savings. However, what employers have said to us clearly indicates that they believe that providing a greater degree of certainty to members would encourage confidence in pensions saving.

   For example, the first report of the ACA 2013 Pension Trends survey, *The unfinished agenda: Growing workplace pensions fit for purpose*, found that 61% of employers thought that providing a pension guarantee that builds each year would lead to more employees considering joining the scheme or paying higher contributions and 39% felt that a guaranteed return of total contributions would have a similar effect.

   The impact of such guarantees (on underlying costs and possible reductions in expected overall investment returns) should not, however, be ignored.

2. **As an employer, do you have experience of, or can you envisage any issues with, employees being unable to retire due to DC pension income levels or certainty about income levels?**

   We are aware that some employers are increasingly concerned that DC pension income may not be sufficient in all cases to provide an incentive for employees to leave service. This may particularly be an issue for employers given the abolition of the default retirement age.

   It is important, however, to distinguish the reasons for the possible failure of DC to provide adequate income levels.

   For some members, it will be the volatility of investment returns and annuity prices that lead to them being unable to purchase the level of income they had expected (i.e. the failure to achieve the desired income is a direct result of the DC design).

   However, a more significant issue is the much lower rates of contributions typically paid to DC schemes as compared to DB. This is not an intrinsic feature of DC design, and could be addressed by employers making higher contributions to DC.

   It may therefore be worth exploring with employers in more detail the nature of any concerns about DC.

3. **Do you have any further evidence or research planned which might help inform the development of DA pensions?**

   The first report of the ACA 2013 Pension Trends survey, *The unfinished agenda: Growing workplace pensions fit for purpose*, was published on the same day as this consultation and contains several questions on the options for DA schemes. A number of its findings are incorporated into this response.

Flexible DB: Design 1 – Ability to pay fluctuating benefits

4. What are your views on the feasibility of this scheme design?

The ACA has previously argued in favour of the removal, for future accruals only, of mandatory pensions indexation. We believe that a model that provides a flat rate core DB benefit with purely discretionary indexation or one-off bonuses paid on top could be an attractive design that would encourage employers to retain existing schemes. It requires only a minimal change to scheme rules (or the use of an employer override where this is not possible) and would have some effect in reducing cost and removing one type of risk in the scheme. It would also be relatively easy to achieve in legislative terms.

Any employer override will need to address the fact that scheme rules may be written in different ways (either looking directly through to the definitions of statutory indexation in legislation or hard-coding the indexation into scheme rules). It should be possible for employers to take advantage of the removal of mandatory indexation, however the rules are drafted.

The main concern with this model is that employers have seen this sort of DB design before. Before 1997, increases were very often provided on a discretionary basis, with some schemes targeting, but not guaranteeing, a particular level of increase. Periods of high inflation led the Government to feel that members needed to be protected against the erosion of their benefits in real terms and to introduce mandatory indexation. Employers will reasonably have some concerns that they may embrace a design with discretionary indexation now only to discover several years later that the Government makes that aspiration mandatory. Whilst this argument applies to all the DA models under consideration, it is particularly strong in this case given that employers have had practical experience in the past of a move from discretionary to mandatory indexation.

Whilst we understand the arguments (set out on page 57 of the consultation) why it is not possible to future proof a DA regime, employers will still fear regulatory creep. At the least, some sort of cross-party consensus would help to provide reassurance to employers that they will not have to go through the same process of discretionary to mandatory when inflation starts to rise again.

We understand that the DWP hopes that the segmentation of schemes into DB, DA and money purchase will make the nature of the employers' promise clearer and would therefore make it more difficult for a future Government to impose additional regulation on private sector provision. However, this remains unproven, and we suspect that employers will continue to be sceptical about possible future changes in legislation.

5. Are employers likely to be interested in providing benefits in addition to a simplified flat-rate DB pension on a discretionary basis or otherwise?

Our 2013 Pension Trends Survey found that 63% of larger employers (i.e. with 500 or more employees) thought that legislation should be passed to allow the removal of mandatory indexation and a further 11% thought it should be considered.

37% of larger employers thought that legislation should be passed to enable a core DB scheme with a funded fluctuating element to supplement core benefits in good years (and a further 20% thought it should be considered).

6. **What role do you see for scheme trustees in relation to discretionary payments? For example:**

   - **Should they be involved in deciding whether a discretionary payment is made at all?**

   - **Should they be involved in setting out how these payments are apportioned to members or should this be down to the employer?**

   Given the aim (as expressed in the next question) to keep regulatory requirements to minimum, we believe that this should be a matter to be set out in scheme rules rather than legislation. We might expect that typically the decision will be reached after discussion between trustees and employers, taking account of the scheme's current funding position and objectives (but do not see a reason for legislation to mandate this).

   In practice, employers are only likely to set up such schemes on the basis that the employer has the veto on any discretion giving rise to an additional employer cost.

7. **Do you agree that our starting point should be to keep regulatory requirements around discretionary benefits to a minimum?**

   There should be no new regulatory requirements in respect of discretionary benefits.

8. **How do you see funding for the non-discretionary DB element being sufficiently protected while allowing for extra discretionary benefits? For example, is there a risk that paying discretionary benefits could threaten the funding for non-discretionary DB benefits for younger scheme members?**

   As noted above, we do not believe that there should be extra regulatory requirements for discretionary benefits. The protection will come out of the desire of trustees and employers to create a sustainable pension scheme and the good governance associated with that desire.

   It is worth noting that 'discretionary benefits' covers a spectrum of different types of scheme design. Probably the most common type of discretionary benefit will be discretionary increases. The treatment of such increases for valuation purposes is already well understood.

   However, the creation of a new definition of DA scheme may facilitate the development of new more targeted schemes: for example, where the promise may be a 1/100th pension but the employer targets provision of a 1/80th pension. Clearly, the employer will need to fund for the additional promise, but that funding should be a matter for discussion and agreement between the employer, trustees and/or actuary (depending on the specification in scheme rules) and not for legislative prescription. It will not be in an employer's interest to target the provision of a benefit without funding for it as well.

   We also note that employers are likely to be using their DA scheme to meet the employer duties quality requirements and therefore this will discourage employers from setting up a scheme with a very low level of guarantee (such as a scheme guaranteeing £1 of pension per annum and then targeting an 1/80ths benefit), since that would not meet the employer duties requirements.

   It is difficult to envisage circumstances in which the payment of discretionary benefits could threaten the funding for accrued non-discretionary DB benefits for younger scheme members, since all accrued non-discretionary benefits will need to be funded in line with the Pensions Act 2004 scheme funding requirements. However, younger members do face the risk that they may not receive the same level of discretionary benefits as older members over their lifetime in the scheme. This seems less significant than the risk they already face in a DB scheme, namely that the scheme may be closed to future accrual altogether.

Flexible DB: Design 2 – Automatic conversion to DC

9. What are your views on the feasibility of this scheme design?

The ACA's Pension Trends survey found that 46% of employers with at least 500 employees were in favour of this proposal with 22% thinking that it should at least be considered. Whilst this design has slightly less support in our survey than Designs 1 and 3, it does still appear to have significant support amongst employers.

We believe that this design is feasible, but it will take more work to implement because of the likelihood that some additional legislative measures may need to be introduced to restrict avoidance opportunities.

The design is most likely to appeal to those employers for whom:

(a) a significant proportion of their employees will retire from active service and thereby receive a DB pension (if no members receive a DB pension, then the employer might prefer to provide a DC scheme or different type of DA scheme without the additional costs of the DB phase while members were in employment); and

(b) a significant proportion of their employees will leave the scheme before retirement and thereby receive a DC transfer (otherwise the employer might as well provide an ordinary DB scheme). The ability to remove from the scheme the risks and administrative burdensarising fromlarge numbers of early leavers (especially those with small deferred pensions) is one of the major attractions of this model.

The model may also be attractive even to employers who do not expect a significant number of employees to retire from active service as an extension of the cash balance model, where greater certainty is given in the DB phase to the calculation of the member's final pot, whilst the risk is transferred to the employee on leaving.

Beyond the issue of the scheme design itself, we note that there may be an economic argument for pursuing this model if large numbers of small DB pensions are effectively transferred into accumulated DC funds, which are likely to be invested in asset classes which can fund economic growth.

10. If employers are able to use scheme designs 1 and 3, do you think it is still helpful for legislation to allow for this scheme design?

The ACA's 2013 Pension Trends survey suggests that this option has slightly less support amongst employers in general than designs 1 and 3 and therefore that it might be reasonable to give lower priority to design 2. However, the survey does indicate some considerable interest in the idea.

11. Do you think this scheme design could be extended to permit employers to automatically transfer members out of the scheme at retirement?

The whole idea of DA is to encourage flexibility of design. We do not therefore see why the design could not be extended to the retirement phase as well.

12. **What would be the most suitable way for benefits to accrue under this model? And how might this best be communicated to ensure members understand the value of their pension benefits?**

As indicated above, we do not think it suitable to prescribe a single model for accrual (although we think the model could work particularly well as an extension of a cash balance model). The appropriate method of communication should be determined by reference to the scheme design, the nature of the workforce and any general additional disclosure requirements for DA schemes (as discussed on page 55 of the consultation paper).

13. **Assuming a CETV would not represent 'fair value' for the accrued rights when the member leaves or retires, how might it best be calculated? Should the basis for calculation be different when the transfer is initiated by the employer (for example on redundancy)?**

The only option envisaged in the consultation paper (other than the cash equivalent basis) is a buy-out basis. We do not think this is a viable option: having to pay transfer values on a buy-out basis on leaving would make the design even less attractive to employers than a traditional DB scheme. At present, employers can already fund for all pensions in payment to be bought out with an insurer (but this is not an option that is widely taken up).

We do not necessarily agree that a CETV is not a 'fair value' for the accrued rights, so long as the member has always been informed that this is the basis on which their benefits are accruing (and it is therefore what they are expecting).

Another approach is simply to specify a formula-based transfer value in advance and then explain to members how this operates. It therefore becomes part of the scheme design and there is no need for separate transfer value calculations.

We agree, however, that there might need to be avoidance provisions to prevent employers triggering a leaving event (such as redundancy) in order to treat members as leavers.

14. **For schemes providing a lump sum benefit, what are your views on how the cash value should be calculated for members who leave before retirement? Should the net present value of the lump sum be calculated on how many years away from pension age they are?**

As indicated above, we believe that the precise mechanism should be a matter to be determined on an individual scheme basis.

15. **Could the accrual rate and pension value be along similar lines to existing cash balance arrangements?**

Yes, they could, but we do not believe that legislation should restrict the options available to employers.

16. **What forms of regulatory requirements would be needed to:**

- **prevent avoidance activity?**
- **ensure the scheme has access to sufficient funds to enable a transfer when a member leaves?**

As indicated above under Question 13, we believe that some anti-avoidance provisions may be needed.

We also agree that there could be liquidity constraints in the event that a number of transfers or a particularly large individual transfer took place. Under CETV legislation, it is possible for transfers to be reduced in such circumstances. Perhaps legislation could specify that, in the event that transfers would have to be reduced because of underfunding, the automatic transfer would not take place and instead notional DC pots would be created within the scheme until the transfer value could be paid in full.

Flexible DB: Design 3 – Ability to change scheme pension age

17. What are your views on the feasibility of this scheme design?

65% of larger employers responding to the ACA Pension Trends Survey thought that legislation should be passed to allow this option, and a further 15% thought it should be considered. We believe that this is a very feasible design and would be likely to be an attractive option for larger employers with open DB schemes (possibly in conjunction with other 'flexible DB' ideas).

18. It could lead to more schemes having proportions of accrued pension payable at different pension ages. Would this further complexity outweigh the benefits?

This is a matter for individual employers and schemes to comment on. If schemes are concerned about the complexity, then they can opt not to introduce differential pension ages. We note, however, that most schemes already have at least two pensions ages for a large proportion of members because of sex equalisation, and therefore this is a problem that they already have to deal with, at least to some extent.

As with Barber adjustments, we would expect that, although members may have different pension ages for different periods of service, there would be only one NRA for each member with the member's retirement age being moved up for all service, but with appropriate late retirement uplifts being applied to service with a lower pension age. Alternatively, it could be possible for the NRA to remain unchanged (with benefits accrued by reference to a later pension age being reduced for early payment).

Member communications will need to explain clearly which pension ages attach to which periods of service, and also the actual age at which it is expected that members will retire and how tranches of service with other pension ages will be adjusted.

19. What role do you see the scheme trustees playing? Should they be involved in setting a new NPA, or should this be down to the employer and the employer's actuary?

This should be a matter to be decided on an individual scheme basis.

20. What are your thoughts on how future pension ages are set?

- **For GAD to publish a standard index based on longevity assumptions?**
- **Or do you prefer schemes linking their NPA with the State Pension age, so that when the latter changes, the scheme's pension age automatically changes in line with this?**

We do not see why legislation needs to prescribe only one or other of these alternatives. In practice, however, we suspect that the transitional phasing-in of changes to State Pension Age will make employers reluctant to link their NPA to it automatically. A GAD index based on the same principles as are used to set the State Pension Age, but operating on a simplified basis with integer ages, might therefore be preferable.

21. How might the decision to change the NPA work in multi-employer schemes?

This is likely to depend on a number of factors, in particular the agreement under which employers participate in the scheme and the rules of the scheme itself.

Amending schemes and past accrual

22. As an alternative to opening a new scheme, do you agree it should be possible for an employer to modify the rules of an existing scheme so that it can be re-designed as a Flexible DB scheme in relation to new accruals, for example, it is possible to change the NPA and/or introduce automatic conversion to DC when a member leaves?

Yes, we agree that it should be possible to amend existing schemes for new accrual. If it is not possible to do so, we believe this would act as a significant obstacle to employers wanting to introduce flexible DB design.

23. Do you agree that employers should not have the power to transfer or modify accruals built up under previous arrangements into a new arrangement, beyond what is allowed under current legislation?

The ACA Pension Trends survey found that the majority of employers (especially large employers) supported the conversion of accrued pension benefits into a consolidated 'new' scheme benefit at 'fair' value. Overall, 61% of employers were in favour, rising to 76% for those with 5,000 employees or more.

Further consideration could be given to allowing a facility for transferring legacy DB to DA so long as the transfer was carried out on a 'fair' basis certified by an actuary (similar to current section 67 requirements). Such a facility might encourage employers to adopt DA provision, since it would enable them to run their whole scheme on a DA basis (including past service benefits). We note, however, that permitting the conversion of existing accrued DB benefits into non-DB benefits runs counter to the DWP's current policies and might well be challenged by members.

24. Should there be a requirement to provide independent financial advice in all cases where an employer offers to transfer a member's accrued rights from a traditional DB scheme to a new arrangement?

We would expect such transfers to be carried out in a manner akin to that applying for enhanced transfer value incentive exercises, i.e. in line with the industry code of practice on such exercises. A transfer from a DB to DA scheme will inevitably involve some loss of a guarantee or certainty and members will need to understand that before accepting the transfer. However, the advice should be proportionate and reflect the extent of the guarantee being given up.

It should also be noted that appropriate advice may not be easily obtainable because of the complexity of the issues involved, for example in a context where members were being offered an incentive to transfer to a scheme with an NPA linked directly or indirectly to the SPA.

DC guarantees

25. Do you think having more certainty than traditional DC would be welcomed by members, and help generate consumer confidence and persistency in saving?

Please see our answer to Question 1.

26. As an employer, if these products mean there is no funding liability, only the requirement to contribute as for a traditional DC scheme, would you be interested in offering these products to employees?

We are not responding to this consultation as employers. However, the ACA Pension Trends survey indicates that 61% of employers thought that providing a pension guarantee that builds each year would lead to more employees considering joining the scheme or paying higher contributions and 39% felt that a guaranteed return of total contributions would have a similar effect. The impact of such guarantees (on underlying costs and possible reductions in expected overall investment returns) should not, however, be ignored.

27. In relation to medium- and long-term guarantees outlined in model 2 (capital and investment return guarantee), and model 3 (retirement income insurance), would removal of the legislative barriers be sufficient to stimulate the development of market-based solutions?

Possibly, although we think that representatives of the insurance industry and the DC Plus Sub-Group of the Defined Ambition Industry Working Group would be better placed to respond.

28. As insufficient scale has been identified as a barrier to providing affordable guarantees, is there a role for the Government in facilitating different types of pension vehicles that would create greater scale for this purpose?

We believe there is a potential role for Government in this area, with the Pension Protection Fund and NEST providing examples of how the Government can successfully facilitate the development of large-scale pension vehicles (without remaining responsible for them in the longer term). However, this would need careful consideration and consultation with the pensions industry to avoid distortions in the market or competition issues.

29. Are there any additional legislative barriers that stand in the way of innovation of products with guarantees?

We do not have any specific insight into this area. Representatives of the insurance industry and the DC Plus Sub-Group of the Defined Ambition Industry Working Group would be better placed to respond.

30. Do existing protection arrangements for DC products provide sufficient protection for members in the event of provider insolvency?

We do not have any specific insight into this area. Representatives of the insurance industry and the DC Plus Sub-Group of the Defined Ambition Industry Working Group would be better placed to respond.

31. Would any protection mechanism need to apply in order to provide extra security for members and reassurance for the employer that it would not be liable in the event of any deficits arising?

We do not believe that an additional protection mechanism is required. However, it would be important for the wording of any participation agreement to put beyond doubt that employers had no liability for any deficits arising. In practice, we do not see employers being prepared to be the ‘back-stop’ to such guarantees, but instead the guarantees being provided by the pension provider and/or inherent in the pension product or investment fund.

32. Are these models likely to be an attractive option for employers and members?

Yes, see our answer to Question 1.

33. On model 4 – pensions income builder – what are your views on this model in which members are in effect deploying their own capital to guarantee their own entitlements?

We think that, in the longer term, this has the potential to be a very attractive model for both employers and employees. 61% of employers thought that providing a pension guarantee that builds each year would lead to more employees considering joining the scheme or paying higher contributions. It is also notable that this option was particularly popular amongst smaller schemes with 70% of smaller employers (those with fewer than 50 employees) thinking that this would make a significant difference.

The cost and ultimate benefit implications of this option would need to be carefully considered and communicated to avoid creating disappointment at ultimate benefit levels (i.e. there is a trade-off between certainty and the cost of purchasing deferred annuities).

Collective DC

34. Do you agree that CDC schemes have the potential to provide more stable outcomes on average than traditional DC schemes?

Yes, we believe that CDC models can provide more stable outcomes than traditional DC schemes and so further consideration should be given to the idea of CDC models. However, recognition of its 'flaws' should be made from the start and consideration given to how these can be addressed.

35. Given there is no tradition of risk sharing between pension scheme members in the UK, are individuals going to be willing to share the benefits of protection from downturns in the market and increased certainty of outcome, with the potential disadvantages of intergenerational risk transfer?

Clearly, such a model will require more member communication and explanation than is currently the case. We are not sure that sufficient research has yet been carried out into individual attitudes to collective schemes to enable this question to be answered properly. Experience of this could be collected from other countries where CDC has been in use for some time and has gone through periods where market movements have required the reduction/limitation of benefits.

36. Is a CDC scheme designed to manage funding deficits by cutting benefits in payment going to be acceptable in the UK where traditionally maintaining the value of benefits in payment has been an overriding priority?

Again, we would agree that this presents a communication challenge, but we do not think this need be insuperable. It is, however, a clear challenge: specifically people tend to believe that the worst will not happen and, when it does, state that they did not understand what they had signed up to.

37. What levels of funding do you consider would be appropriate to ensure that a CDC scheme has sufficient capital to meet the liabilities and minimise the risk of benefits in payment being cut?

As with a number of these questions, this is an issue to follow up in more detail with the CDC Sub-Group of the Defined Ambition Industry Working Group.

38. Given the need for scale and an ongoing in-flow of new members to ensure the sustainability of a CDC scheme, will it be possible to set up a scheme without some form of Government intervention?

CDC schemes are likely to be of interest to the largest employers and so each scheme would benefit large numbers of employees. We do not think that Government intervention would necessarily be needed, although it might help to make the benefits of CDC schemes available to smaller employers, especially at the start-up stage.

The exact nature of any Government intervention would require very careful consideration.

39. As a mutual model, it has been suggested that CDC schemes might prove attractive to the trades unions and other social partners – might this be an option worth exploring?

Yes, we agree this is an option worth exploring.

Scheme definitions

40. Do you agree that creating a unified and identifiable legislative framework that brings together the legislation relating to DA schemes would be preferable to simply amending existing legislation?

Whilst we are in favour of the creation of a new definition of DA, we do not think the precise policy intention is sufficiently clear (as we set out in our answer to the next question).

It should be noted that we are not lawyers, and it should be for lawyers primarily to advise on how to create a DA framework in legislation. However, we make a few comments in our answer to the next question.

41. Do you have any comments on how to characterise the defining characteristics of DA pensions?

We think that the definition of DA on pages 50-51 of the consultation paper may be too widely drawn. It would appear, for example, to include any hybrid scheme under which the member was entitled to both DB and DC benefits and would therefore embrace existing schemes where members had benefits in both closed DB and open DC sections under the same scheme.

The definition also embraces 'any DB scheme which offers anything on a discretionary or uncertain basis'. It is very common for the rules of existing DB schemes to contain a rule under which discretionary increases may be granted (even though in practice no such increases may have been granted for decades). It would not seem helpful to reclassify such schemes as DA and subject to additional governance and communication requirements.

Whilst pages 50-51 seem to envisage a wholesale reclassification of existing schemes, page 55 talks about <u>changing</u> scheme status. It is not therefore entirely clear whether the intention is for some existing schemes to be reclassified or for the definition to apply only to new schemes or schemes which have made a change to their rules to become DA in nature (for example by introducing an NPA linked to a GAD index).

The new definition also appears to apply to 'schemes' not to 'benefits'. This would appear to mean that a scheme that had always provided DB benefits, but now introduced an NPA linked to a GAD index for future service would become a DA scheme (even though most of the benefits provided under it are DB in nature). Is that the intention?

We wonder whether there is an argument for basing the new definitions on benefits (or at least sections of schemes) rather than schemes as a whole.

It is worth noting that essentially identical schemes may end up being classified differently, whether the intention is to reclassify existing schemes or not. If the intention is **not** to reclassify existing schemes, a DB scheme with a discretionary increase rule already in it would be classed as DB, but a DB scheme that previously had no discretionary increase rule but introduced one after this legislation had come into force would be classed as DA. If however the intention **is** to reclassify existing schemes, then a DB scheme with a discretionary increase rule in it (which it may never have used) would be classed as DA, whereas an otherwise identical scheme with no such rule would be classified as DB, even though the two schemes may always have paid the same benefits and would be likely to continue to do so.

There is also a risk that, because of the decision to specify separate definitions for DB, money purchase and DA, a scheme type may arise which appears to satisfy none of the definitions (or indeed may satisfy more than one). This contrasts with the existing position, where everything that is not money purchase is automatically DB. We wonder therefore whether a better definition for DA would be anything that is neither DB nor money purchase.

We also note that the proposed definition of DA scheme could potentially embrace DB schemes since the risk of the scheme falling into the PPF means that members do not have complete certainty over the level of income they will receive in retirement. The definition may need to be amended to make the intention clearer. In general, any legislation will need to be careful in its use of the word ‘guarantee’ since not even benefits from a DB scheme are fully **guaranteed** (though they are **protected** by the PPF).

Although we are not lawyers, we think that further work may be needed on the definitions,for the reasons given above.

42. Do you agree that it makes sense to define DB schemes in their own right rather than simply by contrast to money purchase?

See answer to Question 41.

43. Do you agree that defining DA, DB and money purchase schemes should facilitate clear and proportionate regulation according to scheme type?

See answer to Question 41.

44. **Do you have any comments in relation to the suggested definitions of DA, DB and money purchase schemes?**

See answer to Question 41.

Regulatory Own Funds and the regulation of collective DC

45. Are you aware of any schemes operating in the UK under the Regulatory Own Fund provisions?

No.

46. Aside from Regulatory Own Funds vehicles, are there any other vehicles which might be appropriate for the provision of collective CDC which offers some form of guarantee or promise?

We are not aware of any such vehicles.

47. Do you think that setting up a CDC scheme should be subject to formal approval, for example licensing by a regulator?

Such schemes could be subject to similar requirements to those being proposed for DC Master Trusts.

48. Do you think that CDC schemes which do not provide a guarantee or promise should also be licensed?

We have no views on this question.

49. Do you agree that such CDC schemes should also be subject to DA requirements on governance and member communications?

Given that the benefits from such a scheme would be DA in nature, it seems appropriate for them to be regulated as DA schemes (and therefore subject to the same requirements).

50. Should there also be an option for schemes that currently offer DC to convert to CDC?

We suspect there would be relatively few schemes in this position. Although we would not view such an option as a priority, we would not wish to see it excluded completely.

51. In the absence of both a guaranteed pension entitlement and an individually defined pool of assets, how should assets in a CDC scheme be apportioned such that pension accruals can be measured for tax purposes against the Annual Allowance and the Lifetime Allowance?

The tax treatment of DA schemes will require substantial and early discussion with HMRC (and not just for CDC schemes).

An apparently simple approach for CDC schemes would be to treat them as DC schemes for annual allowance purposes (i.e. simply testing the employer and employee contributions to the scheme rather than the value of benefits being promised) and then treat the pension income payable as scheme pensions for lifetime allowance purposes. However, this is a matter that will require careful consideration (especially if the model allows pensions to reduce in payment).

Requirements for DA schemes

52. What specific areas should we address in relation to governance and member communications for DA schemes?

Given the wide variety of DA models under consideration, we believe that any additional requirements in legislation should be kept high level and principles-based. There may be a need for the Pensions Regulator to provide additional guidance (along the lines of its new regulatory package for DC schemes).

53. Do you have any comments on the assumptions in relation to scheme funding requirements?

We agree with the principle that scheme funding requirements should only apply to the guaranteed element of any DA scheme. Schemes may choose (or be required under their scheme rules) to fund for non-guaranteed benefits but this should not be a matter for the scheme funding legislation. It will not be in an employer's interest to target the provision of a benefit without funding for it as well. Employers will rightly be concerned about regulatory creep if there is any attempt to introduce funding requirements for non-guaranteed benefits.

54. What specific areas should we address in relation to governance and member communications for DA schemes?

The primary objective of communications for a DA scheme will be to ensure that members have the materials available to enable them to understand the nature of their benefits and the risks attaching to them. In fact, it could be argued that exactly the same principles also apply to benefits under DB and money purchase schemes and therefore one option would be to introduce a requirement to explain the risk attaching to benefits across all scheme types.

About the Association of Consulting Actuaries (ACA)

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19 December 2013