ASSOCIATION OF CONSULTING ACTUARIES

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David Hone
Automatic Enrolment Policy
Department for Work and Pensions
1st Floor, Caxton House
6-12 Tothill Street
London SW1H 9DA

Dear Sir

Technical changes to automatic enrolment: public consultation on draft regulations and other proposed changes.

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

We are grateful for the opportunity to comment on these technical amendments, many of which are issues that the ACA has previously raised with the DWP.

We hope that you find our comments of assistance and would be happy to discuss them further if that is helpful. Please contact either me on 020 7432 6635 (david.everett@lcp.uk.com) or my colleague, Jane Beverley, (who helped prepare this response), on 020 3327 5314 (jane.beverley@puntersouthall.com).

Yours sincerely

David Everett

David Everett
Chairman
ACA Pension Schemes Committee

Sent by e-mail to workplacepensionreform.consultation@dwp.gsi.gov.uk

ACA'S response to the consultation

Q1 – Does the existing approach to pay reference periods cause you any difficulties? If it does, can you explain how, if possible with specific examples?

We understand that the current approach has given rise to problems along the lines described in the consultation document. However, we are not able to provide any specific examples.

Q2 – Will adding the proposed alternative method of determining a pay reference period to align with tax and NICS periods make assessing jobholder status more straightforward?

The new approach should be more intuitive and easier for employers and their advisers to understand. The proposed alternative method will also simplify analysis and processing where this is done in conjunction with payroll (which is likely to be the case for many smaller employers).

Q3 – Should both the old and the new definitions of a pay reference period remain in force? If so, for how long?

It is important that those employers who have early staging dates should not find themselves doubly penalised, first by having had to adapt to the existing non-intuitive approach to pay reference periods and then, once they have implemented or prepared to implement the existing approach, to find that they are required to shift to a different method.

We do not therefore see why both definitions of a pay reference period cannot run indefinitely with employers being able to choose whichever works better for them.

The consultation paper reads, however, as if the DWP is minded to withdraw the existing definition of pay reference period entirely at some future date. If that is the case, that date should be some years into the future. For those schemes using the existing definition (or in the process of planning to do so), we would suggest that the least disruptive time to revisit the definition would be around the automatic re-enrolment date in three years' time (since employers will already need to be paying particular attention to automatic enrolment issues at this point). This would suggest that dual running of the two definitions would be needed for at least four to five years.

Q4 – If we allow a period where both the old and new definitions of a pay reference period are in force, would it be useful to bring the new requirements as soon as possible.

Yes. The alternative definition will need to be in force as soon as possible for employers coming up to their staging date to be able to make use of it.

Q5 – Does adopting the revised definition of a payroll reference period for assessing scheme quality remove any possible need for annual reconciliation?

We are not aware of any circumstances in which annual reconciliation would be required in the event that the revised definition of pay reference period is adopted.

Q6 – Are there any potential difficulties with the proposed change you wish to highlight?

There may be some employers who have already taken action based on the existing scheme quality requirements, so we would suggest that the revised definition for the pay reference period for assessing scheme quality should exist alongside the current definition rather than as an alternative to it.

Q7 – Is there any reason not to bring the revised definition of a payroll reference period for assessing scheme quality into force as soon as possible?

We are aware that a number of schemes are currently facing the prospect of annual reconciliation because of the current definition of pay reference period. Having to reconcile payments on an annual basis would lead to administrative costs as well as practical difficulties in the event that a 'shortfall' was identified because of the discrepancy between pay reference periods. We would therefore agree that the revised definition should be brought into force as soon as possible.

Q8 – Does extending the deadline for passing over employer contributions make administration easier?

We agree that applying the extended deadline to all contributions should make administration easier in respect of new joiners. However, the 19th (or 22nd) deadline will continue to apply for contributions being paid by existing members so schemes will always have to operate with two deadlines.

Q9 – Are there any risks associated with extending the deadline in this way?

The legislation already permits this delay for jobholders subject to automatic enrolment, so we do not believe that there would be any significant additional risk from extending the deadline for other categories of worker as well.

Q10 – Is there any reason not to bring the change to contribution payment deadlines into force as soon as possible?

No.

Q11 – Should there be a prescribed period under section 3(4) of the Pensions Act 2008 to turn off the automatic enrolment duty? Please set out the reasons for your view.

It is now clear that many employers are considering using contractual enrolment because they find it administratively simpler to operate. We believe that this approach should be encouraged, in that it is in line with the overall policy intention, and may indeed lead to more workers being automatically enrolled for a longer period, leading to higher savings outcomes than under the strict terms of the automatic enrolment legislation. The comments in paragraph 90 of the consultation document notes that employers using the contractual employment route are 'arguably doing more than they need to'. Assuming that the DWP agrees that schemes should not be deterred from offering contractual enrolment, it seems appropriate that obvious legislative obstacles should be removed.

The requirement to re-enrol individuals who have just opted out of contractual enrolment is a potential disincentive to employers wishing to use this approach. We therefore believe that there should be a period during which the automatic enrolment duty is suspended in cases where contractual enrolment operates.

Q12 – If so, how long should that period be?

The period should be the same length as that for employees who have opted out and then face automatic re-enrolment, i.e. 12 months.

Q13 – Does the ongoing monitoring requirement limit how useful this would be as an easement?

We are not clear as to why the easement to suspend the duty to enrol cannot be optional, as this is not explained in the consultation response.

Assuming that the easement does only apply on a compulsory basis, then it is possible that the requirement to monitor which employees have opted out would add a small amount of additional administration for some employers. It is likely, however, that this would be significantly outweighed by the administrative burden (and associated confusion for employees) if employees who had just opted out of contractual enrolment were to find themselves re-enrolled shortly afterwards.

Q14 – Do the proposed changes on the form of opt out notices make it easier to design and use?

We agree with the policy intention in this case; however, the wording 'it is in substantially the same form as the form set out in Schedule 1' seems to be almost as demanding as the current requirement. Perhaps wording along the lines of 'contains the same information as the form set out in Schedule 1' would be an improvement.

We also agree with the proposal to put beyond doubt the validity of existing opt-out notices.

Q15 – Is there any reason not to bring the clarification on the form of opt out notices into force as soon as possible?

No.

Q16 – Do you think extending the deadline from one [month] to six weeks strikes the right balance between the needs of employer and jobholders?

We think that this is a proportionate approach.

Q17 – An extended joining window could cut across the disclosure requirements that are currently linked to a one month joining window. Would this cause administrative difficulties? [wording on page 20]

Would the domino effect on, for example, refunds and the proposed disclosure requirements cause administrative difficulties? [wording on page 28]

The disclosure requirements should be aligned with the extended joining window.

The alternative form of this question also raises the issue of the timings for refunds of contributions in regulation 11 of the Automatic Enrolment regulations. This should also be revisited.

Q18 – Does the proposed amendment to the definition of appropriate age have the desired effect?

We have previously raised concerns with the DWP about the drafting of these regulations, so we are pleased that the DWP is proposing to amend them.

We are not convinced that the proposed revised drafting is completely correct in reflecting the exact increases to SPA as set out under statute. The proposed wording is also not future-proof, and in particular does not reflect the proposed increase in SPA to 67 by 2028 in the draft Pensions Bill. It will also need amending every time further changes are made to SPA, which could start occurring on a five yearly basis assuming that the measures in the draft Pensions Bill are brought into force. We would therefore suggest that the drafting simply looks through to the definition of SPA in existing legislation.

Q19 – Does the proposed amendment to maximum service limit for lump sum schemes have the desired effect?

We have previously raised our concerns with the DWP about the drafting of the regulations on lump sum schemes and are grateful that these comments have been taken on board. We are in agreement with the proposed approach in respect of the maximum service limit.

Q20 – Does the proposed amendment to the revaluation requirement for certain lump sum schemes have the desired effect?

Again, this is an issue that the ACA had raised with the DWP. We agree with the revised wording which makes clear that the 3.5% in-service increase for the test scheme requirement is in addition to the inflation requirement in regulation 36(4).

Q21 – Is there any reason not to bring the changes to the test scheme requirements into force as soon as possible?

No.

Q22 – Are there categories or descriptions of worker for whom automatic enrolment is inappropriate? If yes, can you say who they are and why?

We agree that employees with enhanced or fixed protection (and, in due course, fixed protection 2014 when introduced into the statute book by this year's Finance Act) should be exempted from the requirement to be automatically enrolled.

However, such an exemption can only be used where employers are aware that members have such protections. Given the potential severity of the tax consequences if enhanced or fixed protection is lost, there is an argument to allow members with such protections an extended opt-out window if they subsequently realise that they have been automatically enrolled and did not opt out within the usual statutory opt-out window.

It would be helpful if the approach used for automatic enrolment for fixed and enhanced protection could also apply where employers are operating contractual enrolment.

We also agree that it is appropriate to exempt members who have already given notice of their intention to retire or leave employment.

We will be happy to participate in the formal consultation on draft regulations in due course.

Q23 – Would it be a good idea to allow employers contractually enrolling all workers into an automatic enrolment qualifying scheme to be certified or to self-certify that they are meeting the policy objectives and therefore are exempt from the explicit employer duties?

As noted above under Q11, contractual enrolment appears to be an attractive and simpler alternative to statutory automatic enrolment for many employers.

In principle, we are therefore attracted to the idea of enabling employers who have adopted contractual enrolment to be able to demonstrate in as straightforward a way as possible that they comply with the legislative requirements.

In practice, however, we are not sure how easy it would be to construct a certification process of this kind without either creating potential loopholes on the one hand or establishing a process that is itself rather onerous on the other hand (potentially just as onerous as having to monitor compliance with the automatic enrolment legislation). However, it is an idea that merits further consideration.

It may be, however, that it is better to focus on dealing with obvious discrepancies in the legislation (such as the re-enrolment point covered by Q11) rather than creating a new certification process.

Although the question refers to employers who contractually enrol <u>all</u> workers, we do not see why the same approach should not also apply to employers who have contractually enrolled some employees and used automatic enrolment for others.

Q24 – What would employers need to demonstrate, beyond contractual enrolment of all workers into an automatic enrolment qualifying scheme, in order to be certified or allowed to self-certify?

If such a certification regime is to work successfully, the certification requirement should be as simple as possible, and therefore we do not believe that anything further should be required.

Q25 – For the purpose of automatic enrolment, is a quality requirement needed for DB schemes at all?

We have considerable sympathy with the view that virtually all DB schemes currently open to future accrual provide a level of benefits well above that required under the quality requirements for money purchase schemes. However, if the Government were simply to specify that all DB schemes were qualifying schemes as of right, this could in theory lead to very low value DB schemes being set up specifically in order to take advantage of this. We would expect that this would be a relatively small risk, since an employer setting up a DB scheme, however low value, would also have to take on the considerable regulatory burdens associated with DB schemes (scheme funding, PPF levy, section 75 debt etc).

It is also worth noting that, under current legislation, DB covers anything that does not satisfy the definition of money purchase. Any blanket exemption for DB schemes could therefore end up exempting schemes that would otherwise be characterised as money purchase but for the fact that they provide a small investment guarantee or annuitise funds within the scheme. This may also not be desirable.

On balance, then, we believe that the DWP should retain some sort of quality requirement for DB schemes.

Q26 – Is there a simpler way of determining whether a DB scheme is "good enough" to be used for automatic enrolments?

We have two suggestions.

The first is to simplify the regime for formerly contracted-out DB schemes with effect from 2016. According to the latest NAPF survey, 83% of schemes that are currently open to future accrual are contracted out. At present, these schemes qualify automatically, but with effect from 2016, they will be required to meet the test scheme standard. This means that a large number of schemes will find themselves having to certify themselves as meeting the test scheme standard.

As set out in our response on the draft Pensions Bill, we believe that there should be some simpler route to allow schemes which previously qualified on the basis of the Reference Scheme Test to continue to qualify so long as either the scheme has not been amended at all, or possibly also where the scheme has been amended using the employer override power set out in schedule 14 of the draft Bill.

The second suggestion is to allow DB schemes to certify that they provide benefits of at least equivalent value to the minimum contribution requirements for money purchase pension schemes. The attraction of this approach is that it would provide a method of certification that would work for defined ambition models that do not currently exist in the UK but may exist in the future (for example, schemes with optional indexation) without any further amendments to the test scheme standard. We would envisage that this would operate alongside the existing certification mechanisms for DB schemes, i.e. DB and defined ambition schemes could certify on the grounds that they:

(i) Provide benefits at least as good as those under the test scheme; or

(ii) Formerly held a Reference Scheme Test certificate (and have not amended their rules, or only to the extent permitted by the employer override); or

(iii) Provide benefits of at least equivalent value to the minimum contribution requirements for money purchase schemes.

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.

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

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