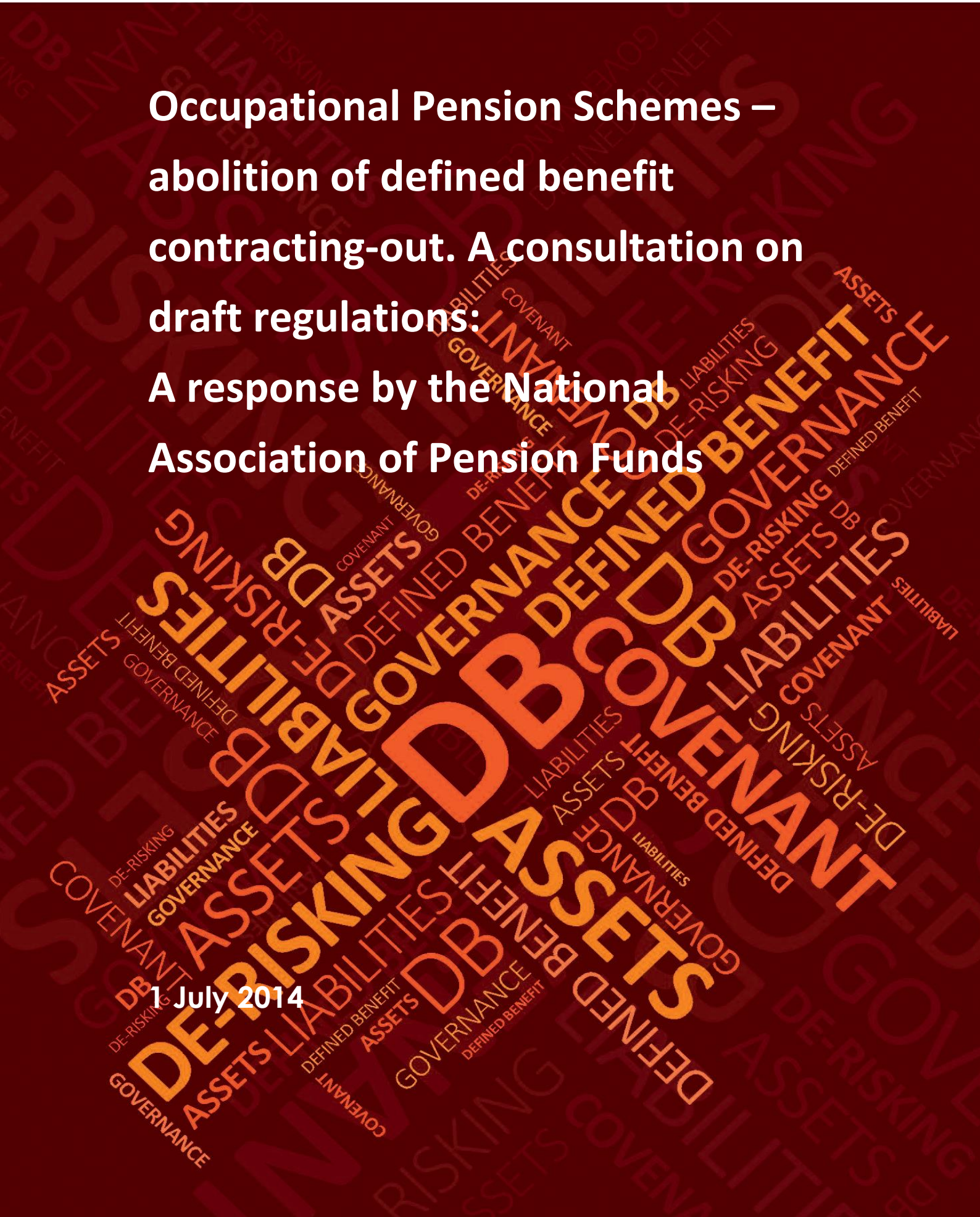
NAPF
Securing the future of pensions

Occupational Pension Schemes – abolition of defined benefit contracting-out. A consultation on draft regulations:
A response by the National Association of Pension Funds



1 July 2014

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About the NAPF

The National Association of Pension Funds is the leading voice of workplace pension provision in the UK. We represent 1,300 pension schemes from all parts of the economy and 400 businesses providing essential services to the pensions industry. We represent both public and private sector schemes, including over 70% of Local Authority pension funds. Our members provide pensions for 16m people and collectively hold assets of around £900bn, making them major institutional investors. Our main objective is to ensure there is a secure and sustainable pensions system in the UK.

Response to consultation

The NAPF welcomes this legislation, which will help employers who continue to provide defined benefit pensions absorb all or some of the extra costs that the end of contracting out will entail.

The end of contracting out will have many implications for scheme administration going forward. The NAPF is pleased to hear that the Government is committed to making the processes required of schemes as contracting out ends as straightforward as possible.

We urge the Government follow through on its plans to communicate the changes that will accompany the end of contracting out to employers and employees as well as scheme administrators. The development of standard materials addressed to members and to employers from the Government will provide some comfort to employees that their benefits are not being subject to arbitrary reduction, and make employers and administrators more aware of their options and the actions that they are required to take.

The Government's commitment to making the change as smooth as possible should also involve an effort to make the reconciliation of scheme records with those held by HMRC efficient, and clarifying the legislation on conversion of guaranteed minimum pension to scheme pension. We look forward to hearing more from the Government in these areas.

We welcome the availability of a statutory override to employers who will now need to pay standard rate national insurance contributions. However, as explained further in our responses to consultation questions, we believe that there is more work to be done, particularly when extending the use of the override to non-associated multi-employer schemes, as these schemes may not have a mechanism in place for appointing a representative employer. Our answers to the questions posed by the Government in its consultation follow.

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July 2014

Responses to consultation questions

Interpretation

Q1 Is the "principal employer" definition clear in light of the explanation given above?

The definition works only for those schemes that have a principal employer or a mechanism for appointing one employer to represent all employers. Non-associated multi-employer schemes, particularly industry-wide schemes in which employers tend to be competitors, will have neither. Therefore it is of limited use for these schemes. For further discussion please see our responses to Q17 and Q21.

Calculation framework

Q2 What issues, if any, do you foresee with the framework?

We believe that the calculation framework is generally fair. There are some points of concern, particularly around how the margin for prudence is stripped from the assumptions used for funding purposes, but we are comfortable that some subjective decisions will simply need to be made by the employer on the advice of the actuary. We understand that these issues will be explored more thoroughly in the comments coming from the actuarial profession.

Q3 Are there ways in which the draft calculation framework regulations could be clearer as to how the calculations are to be performed and the data to be used for this task?

The definition of "total annual employee contributions" in regulation 4 refers to the employee contribution rates shown in the schedule of contributions. However, the "amount" of employee contributions may not be set forth in the schedule of contributions and indeed, employee contribution rates may not be set forth at all in the schedule. For example, in a salary sacrifice scenario, all of the contributions shown will be employer contributions.

We believe that a reference to employee contributions paid in the preceding scheme year, including through salary sacrifice arrangements, would be more useful. There may need to also be an ability to adjust for changed circumstances.

Q4 Is there anything else that would assist the calculation process if provided for in regulations?

We are not aware of anything else that would assist.

Q5 Recorded in the demographic assumptions in the SoFP is the assumption concerning when the member is expected to leave pensionable service that the actuary will refer to where needed in making calculations. Does this need be separated out and more clearly defined?

We do not believe that further clarification is necessary.

Q6 There are benefits that don't accrue for example, ill-health retirement benefits. We would not expect amendments to benefits that don't accrue. Do we need to specify this in regulations?

We believe that any reference to benefits that do not accrue will be unhelpful because there is some controversy over what the word "accrue" means and which benefits can be said to "accrue". Therefore exclusion of benefits that do not "accrue" from the override would cause confusion as to whether, for example, it is possible to reduce a spouse's pension to the extent that it would reduce in line with any reduction to a member's pension. In any case, we do not see why it would be problematic to reduce benefits that do not "accrue" through a statutory override.

Q7 Do the regulations setting out the calculation requirements work for Hybrid schemes?

The interaction between the draft regulations and the new definition of "money purchase benefits" may cause some problems for defined contribution schemes with a defined benefit underpin set to meet the reference scheme test. The benefits could move in and out of defined benefit status, and therefore conceivably become ineligible for the override.

Q8 The employer may choose any calculation date after 31 December 2011. This is to allow the employer to use the scheme's last triennial valuation as a base for the required calculations. However there is some flexibility here because we have not required the employer to use the scheme's last valuation date. Do you foresee any issues with our approach to the calculation date?

No. We welcome the flexibility as to the date chosen.

Unconventional funding arrangements

Q9 Is our understanding of how salary sacrifice arrangements work correct? Is there a need to make provision in regulations for this arrangement?

Salary sacrifice arrangements are between the employer and the employee and need not be provided for in these regulations. The ease with which these arrangements can be changed in order to recoup the lost rebate will vary depending on the way in which they are drafted. Employers who would need to revise numerous employment contracts in order to change contribution rates will probably not look to a change in the contribution rate as a way to recoup costs.

Q10 Our intention is for employers sponsoring shared cost schemes to be able to make use of the override to recoup their increase in NI costs due to abolition of contracting-out. Our expectation is that any amendments made would be proportionate and limited to the minimum needed to recoup the additional costs. For example it would not be appropriate for sponsors of these schemes to use the override power to make scheme rule changes that, in effect, convert a shared cost scheme into a scheme with a more conventional funding arrangement. Do we need to make further provision in regulations to prevent scheme amendments of this magnitude?

We believe that regulation 10 achieves the Government's policy purpose for shared cost schemes.

Q11 Are there any other funding arrangements that may require specific provision in these regulations to allow employers to use the override as intended?

We are not aware of any.

The role of the actuary

Q12 It is for the employer to appoint an actuary. The actuary may be employed by the employer already or an independent or, with the approval of the trustee, the scheme actuary. Are regulations clear that it is for the employer to appoint the actuary or do we need to clarify this?

We think it is clear.

Q13 Is four weeks an achievable and reasonable timeframe for trustees to provide the information or is longer needed – if longer needed, how much longer?

Multi-employer schemes, particularly sectionalised schemes, may be dealing with complicated simultaneous requests from a number of different employers, each of whom will require an individual response. In this case, the four week time period may prove difficult. Perhaps it would make sense to provide for a four week time period unless there are circumstances that would justify a less prompt response.

It is important that the employer's request is required to be reasonable. It is not unimaginable that an employer would ask for information that the trustees consider sensitive (for example, proprietary information that trustees will use in upcoming funding negotiations), or to which the employer has better access to than the trustee (as will be the case for much of the earnings and contribution rate information for active members). It is also possible that an employer would ask for data relevant to multiple calculation dates, which could pose an administrative burden on the scheme administrator.

Q14 By "information" we mean individual membership data as well as scheme data, such as the scheme's benefit structure. Is this clear in draft regulations or do we need to be more specific about the type of data trustees will be obliged to provide? If so, what data should be specified?

In most cases, we believe that the employer will itself have most of the necessary information about the members who will be affected by the override, as the members affected will be in active employment. We think that any further information that should be provided by the administrator can be worked out between the scheme and the employer.

Q15 Is there any scheme information that trustees do not have access to and that the employer is likely to need to be able to make amendments to scheme rules?

There may be individual cases peculiar to the rules of a particular scheme that will make additional information useful or necessary, but again, we think that a requirement that the scheme administrator provide what is reasonably requested would cover these circumstances.

Q16 Can you foresee any problems with providing information to the principal employer for associated employer schemes?

No. This would in most cases be in accordance with normal procedure, although it would be necessary to observe data protection measures in many cases.

Q17 Can you foresee any problems with providing information to the principal employer for non-associated multi-employer schemes?

Few non-associated schemes have an employer that meets the current definition of principal employer. As mentioned above, there may be no procedure in place for appointing a representative employer. In addition, there may be some sensitivity to sharing information about employees of other employers with a representative employer.

We think that the regulations will need to include a procedure for designating a representative employer in these schemes, and in addition may need to place some limits on:

- the kinds of information that the trustee is to provide to that representative employer; and
- the extent to which the representative employer can make unilateral decisions applicable to all employers.

Q18 Are all the things we require the actuary to certify correct? For example can the actuary certify that the amendments comply with Schedule 14 paragraph 3?

We defer to our colleagues in the actuarial profession to answer this question.

Q19 Do the changes in the definitions work effectively for:

a. **Employers sponsoring a single employer section of a segregated multi- Employer Scheme (MES)?**
   We believe that the definition will work for these employers.

b. Employers sponsoring a multi-employer section of a segregated MES where the employers are associated?
We believe that the definition will work for these employers.

c. Employers sponsoring a multi-employer section of a segregated MES where the employers are not associated?
No. See explanation under answers to Q17 and Q21.

d. Employers sponsoring a non-segregated scheme where the employers are associated?
We believe that the definition will work for these employers.

e. Employers sponsoring a non-segregated scheme where the employers are non-associated?
No. See explanation under answers to Q17 and Q21.

Q20 Do you agree that employers sponsoring non-associated multi-employer schemes are able to use the statutory override as we have suggested?

No, we do not think that the rules as currently drafted will meet the needs of employers of multi-employer schemes who would like to use the override. See our answers to Q17 and Q21

Q21 Are there other options you would like us to consider for non-associated multi-employer schemes?

We believe that a mechanism for appointing a representative employer to act as principal employer will need to be established for these schemes. (See the response above to Q17.) Usually they will not have any mechanism for doing so under their trust deed or rules.

This could take the form of an obligation placed on the scheme administrator to poll the employers as to whether they would like to use the statutory override, and if there is interest, to poll them concerning which of them should act as the representative employer. Any such poll should be weighted in accordance with the number of active members employed by each employer.

Q22 Are there any situations where there would be more than one principal employer in relation to a scheme or a section of a scheme?

We are not aware of any such situations.

Cross-subsidy

Q23 Will this regulation help prevent significant cross-subsidy between these member groups?

It is not entirely clear which sorts of cross-subsidy the Government wishes to prevent. There are always some cross-subsidies between members of defined benefit schemes and almost any decision, whether by trustees or employers, will work out better for some members than for others. We do not understand why in this situation an employer should be prevented from taking an approach that is uniform for all members, even though some members might be better off with another solution.

Inasmuch as the regulation requires an employer to consider and separately evaluate the effect of its proposed solution on members who already pay differing rates of contributions or who accrue slightly different benefits, it would appear to be disproportionate to the perceived risk. Many schemes have categories of membership with differing benefit structures, and we believe that employers taking advantage of the override should be given flexibility in determining how to recoup their increased costs. The affected employees will all be active members, and the employer will have an interest in avoiding measures that would be blatantly unfair to a particular group of employees.

Q24 Is there any other provision that would help prevent deliberate cross-subsidy?

As stated above, it is unlikely that some degree of cross-subsidy can be avoided. A certain degree of risk sharing is essential to pension plans.

Actuary's certificate

Q25 Is there any other information that should be included in the actuary's certificate?

We are not aware of any such additional information.

Costs and benefits

Q26 We would be grateful if respondents could include estimates of costs, by scheme sizes, including a breakdown of professional fees where possible.

We do not have this information.

Questions related to the Contracted-out Regulations

Q27 Do you agree that the proposed changes will achieve the intended effect of preserving accrued contracted-out rights since 1978?

We are not aware of any problems with the changes.

Q28 In addition to the amendments to the legislation set out in this document, is there any further legislation that you believe should be revoked or amended in order to meet the intention of preservation of accrued contracted-out rights?

We are not aware of any.

Q29 What changes to scheme rules will trustees be obliged to make to ensure their scheme rules continues to have the same effect as a result of the abolition of contracting-out and the introduction of the single-tier pension?

This is going to be individual to each scheme, depending on the way that the rules are drafted.