PENSIONS AND LIFETIME SAVINGS ASSOCIATION

OCCUPATIONAL PENSION SCHEMES DRAFT AMENDMENTS TO CONTRACTING OUT REGULATIONS

OCCUPATIONAL PENSIONS LEGISLATION SUBJECT TO REVIEW

A PROPOSED METHODOLOGY FOR EQUALISING PENSIONS FOR THE EFFECT OF GMPS

"WE BELIEVE THE PROCESS OUTLINED IN THE CONSULTATION ... IS THE BEST METHOD AVAILABLE FOR THOSE SCHEMES THAT WISH TO EQUALISE GMPS."

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LIFETIME SAVINGS
ASSOCIATION

INTRODUCTION

We're the Pensions and Lifetime Savings Association; the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels.

Our purpose is simple: to help everyone to achieve a better income in retirement. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

We welcome the opportunity to respond to this consultation, which introduces an important methodology for equalising guaranteed minimum pension ("**GMP**") by converting it to scheme pension. The PLSA was an active participant in the working group that formulated the ten-stage process for resolving GMP inequalities. We believe that many schemes will find conversion useful.

So long as GMPs remain, the law requires that they be paid on a different basis for men and for women. For this reason, for most schemes, paying a benefit equal in value to a GMP as a scheme benefit rather than as GMP will be the most efficient way to equalise benefits, should they wish to do so.

Resolving the inequality resulting from payment of GMPs is problematic because although a woman usually has a higher GMP than a man with a similar work history in the early years of retirement, the man may be better off later. This is due to differences in GMP retirement age (60 for women and 65 for men) and the fact that the rate of inflation protection for GMPs before and after GMP retirement age. Of course, a greater GMP does not necessarily mean a greater pension overall. Inflation protection applied to the scheme pension in excess of GMP will usually differ from that applied to GMP, so that more GMP and correspondingly less scheme pension may result in a less valuable total pension.

Some schemes will find additional reasons to convert GMP – for example to rationalise and simplify the benefits paid, to allow more flexibility where transfers are anticipated, or to reduce buyout costs. Once the conversion legislation is amended so that current ambiguities and contradictions are removed, we would expect that many schemes will take advantage of the opportunity to convert.

However, while the equalisation method suggested in the consultation is less onerous than the Government's previous proposal, conversion of GMP is a complicated and expensive process. Many schemes will find it counterproductive to devote scarce resources to the correction of what are usually minor differences in payments over a lifetime to men and to women. It is especially galling to embark on this expensive exercise when the inequality in GMP continues to be required by domestic legislation, there been no definitive interpretation of European or domestic law that would

require equalisation, and the future applicability of European legislation is still to be decided.

We answer the questions posed on GMP conversion and other matters below.

CONSULTATION QUESTIONS

1. DO YOU AGREE THAT THE DRAFT CHANGES TO GIVE HMRC DISCRETION TO EXTEND THE NOTIFICATION AND PAYMENT PERIODS FOR CONTRIBUTIONS EQUIVALENT PREMIUMS WILL DELIVER THE POLICY INTENT?

We believe that they do.

2. DO YOU AGREE THAT THE PROPOSED CHANGES WILL NOW CORRECTLY REFLECT THE POLICY INTENTION AS OUTLINED IN PARAGRAPH 1.14 ABOVE?

The reasoning behind the proposed language, which would prohibit rule amendments that result in changes to post-1997 contracted out benefits as to value, amount of payment or the circumstances under which they are paid, have not been explained.

We presume that it is a response to the observation that it is sometimes difficult to obtain an actuary's certification that benefits are "at least equal" to benefits under the reference scheme test, and the changes are intended to substitute for that requirement, currently found in regulation 17(1) The Occupational Pension Schemes (Schemes that were Contracted-out)(No2) Regulations 2015. If these changes to regulation 17 are intended to make amendments affecting post-1997 contracted-out benefits easier, we are sceptical.

Section 67 of the Pensions Act 1995 includes provisions that prevent changes to benefits that reduce their value without member consent, and so it would not seem that recapitulation of its protections is necessary. We understand why the Government would wish to extend its protection to rights of survivors as well as members in respect of contracted out benefits. However, disallowing any change that reduces value, amount of pension or the circumstances of payment leaves very little that can be changed, and a good deal less than can be changed under section 67.

If defined benefit schemes are to run efficiently in the future, and particularly if consolidation is to be encouraged, simplification of benefits will need to be part of the plan. We do not see why the Government would wish to maintain, and even erect additional barriers to simplification in this way. We would welcome the opportunity to discuss this further.

3. DO YOU AGREE THAT THE CHANGES WE HAVE MADE TO REGULATIONS 21 AND 22 MAKE IT CLEAR IN WHICH CIRCUMSTANCES AN INHERITABLE GMP SHOULD BE PAID FOLLOWING THE INTRODUCTION OF THE NEW BSP?

We think the consequential changes are as clear as the original legislation was clear.

4. IT WOULD BE HELPFUL TO KNOW, FROM YOUR EXPERIENCE, APPROXIMATELY WHAT PERCENTAGE OF SCHEMES ARE LIKELY TO PROVIDE AN INHERITABLE GMP REGARDLESS OF THE SURVIVOR'S CIRCUMSTANCES (FOR EXAMPLE AS THEIR SCHEME RULES REQUIRE THAT THIS IS PAID TO EVERYONE), AND WHAT PERCENTAGE WILL PROVIDE AN INHERITABLE GMP BY FOLLOWING THE STATUTORY REQUIREMENTS OF SECTION 17 OF THE 1993 ACT (FOR EXAMPLE BY CHECKING THAT THE APPROPRIATE STATE BENEFIT IS IN PAYMENT OR THAT THE SURVIVOR HAS REACHED THE APPROPRIATE AGE). WE BELIEVE THAT THE LATTER APPROACH WILL REPRESENT A MINORITY OF SCHEMES BUT WE ARE SEEKING SOME QUANTIFICATION:

(I) FOR A SCHEME THAT PROVIDES AN INHERITABLE GMP REGARDLESS OF THE SURVIVOR'S CIRCUMSTANCES (THE FORMER APPROACH), WILL THERE BE ANY COSTS ASSOCIATED WITH THE CHANGE TO REGULATIONS? THESE COSTS CAN BE EXPRESSED IN FINANCIAL TERMS OR IN TERMS OF STAFF TIME (E.G. 1 HOUR FOR 12 ADMIN STAFF).

(II) FOR A SCHEME THAT PROVIDES AN INHERITABLE GMP BY FOLLOWING THE STATUTORY REQUIREMENTS FOR EACH MEMBER (THE LATTER APPROACH), WHAT ADDITIONAL COSTS MIGHT THE SCHEME INCUR FROM UPDATING THEIR ADMINISTRATIVE PROCESSES TO TAKE ACCOUNT OF THE CHANGE, E.G. CHANGING GUIDANCE, MAKING STAFF AWARE OF THE NEW REQUIREMENTS? THESE COSTS CAN BE EXPRESSED IN FINANCIAL TERMS OR IN TERMS OF STAFF TIME (E.G. 1 HOUR FOR 12 ADMIN STAFF).

We believe that most schemes provide the same GMP to survivors regardless of the age of the survivor, the member's state pension entitlement, and whether or not the survivor remarries or enters a civil partnership.

5. DO YOU AGREE WITH THE UNDERLYING EARNINGS INCREASE ASSUMPTION PROPOSED BY GAD?
6. IS IT CORRECT TO ADOPT A MEDIUM TERM VIEW ON EARNINGS ASSUMPTIONS?
7. DO YOU AGREE THAT DWP SHOULD CONTINUE TO APPLY THE 0.5% PREMIUM FOR FIXING THE RATE OR ARE THERE GOOD ARGUMENTS TO REMOVE OR ADJUST THE PREMIUM?

We have not analysed these assumptions in detail, but the earnings increase assumption of 2% seems optimistic, particularly for the medium term. The risk premium could also be considered high, given the current environment and the proportion of the overall rate now being devoted to this premium. Recent experience with fixed rates would suggest that the member should be paying a premium to the scheme for guaranteeing a fixed rate, rather than the other way around, since previously-set fixed rates have exceeded actual inflation for some time.

A fixed rate is helpful to both the scheme and the Government, because it is simple to apply and provides a degree of certainty. However, schemes will not use it if the expense cannot be justified. It is difficult to see how a 4% rate overall is appropriate

given the low level of wage inflation currently, and given what most economists are predicting for the future.

CHAPTER 2: REVIEWS

8. DO YOU HAVE ANY CONCERNS RELATING TO REGULATION 3 OF THE 2013 REGULATIONS WHICH THE DEPARTMENT IS NOT ALREADY AWARE OF?

We think that we now need to look at the changes made to section 17 of The Occupational Pension Schemes (Schemes that were Contracted-out) (No 2) Regulations 2015 as a whole, rather than at a particular amendment to that regulation. See our answer to question 2.

9. APART FROM THE ISSUES MENTIONED, DO YOU HAVE ANY CONCERNS ABOUT REGULATION 4 AND BULK TRANSFER ARRANGEMENTS?

There are a number of issues surrounding bulk transfers between defined benefit schemes that should be addressed, particularly if it is desirable that schemes merge. In particular, there are a number of issues with the circumstances under which benefits can be transferred without member consent under Regulation 12, The Occupational Pension Schemes (Preservation of Benefit) Regulations 1991 and under the contracting out regulations. There are also issues surrounding when a minimal lump can be paid to a member in lieu of transferring benefits. And of course there is a problem with contracted out benefits, which currently cannot be transferred to a new scheme at all.

We believe that most of these have been brought to the attention of the Government in prior consultations and conversations. We are happy to provide more detail on request.

10. ARE THERE ARE ANY ISSUES THAT YOU THINK THE DEPARTMENT NEEDS TO BE AWARE OF IN RELATION TO THE TRANSITIONAL ARRANGEMENTS?

We are not aware of any additional issues.

CHAPTER 3: GMP EQUALISATION

11. IS THE PROPOSED METHODOLOGY THE BEST APPROACH? WHAT, IF ANY, OTHER METHODS SHOULD WE CONSIDER?

We believe that the process outlined in the consultation and further explored in the working group paper is the best method available for those schemes that wish to equalise GMPs. This is because in order to equalise GMPs one must eliminate them – the law requires that they be paid on an unequal basis if they exist. In addition, conversion, unlike other proposals, allows schemes to compare the benefits for the purpose of equalisation but once, which is a distinct advantage over the process last proposed.

12. IS THERE ANYTHING ABOUT THE PROPOSED PROCESS THAT RAISES CONCERNS OR MIGHT NOT WORK – IF SO, WHAT NEEDS TO BE DONE?

The conversion legislation must be amended so that it is fit for purpose. At the moment, it is not. This is discussed in more detail in our response to question 14.

We also believe that it will be important to clarify the application of the tax rules to schemes that change benefits in order to equalise them. If the tax rules are adjusted so that equalisation can proceed smoothly without fear that members will be subject to extra tax charges, this will make the process much more attractive. For example, it would be very helpful if HMRC could clarify that adjustments made in good faith in order to address inequalities will not result in:

- the loss of any pre-existing Lifetime Allowance protections;
- a need to revisit previous Lifetime Allowance testing (where the benefit has been crystallised);
- the loss of the "deferred member carve out" when assessing Annual Allowance; or
- an accrual for the purposes of the Annual Allowance.

GMPs will have been earned prior to 1997, and for many schemes the benefit will have been recorded, but much that underlies that benefit, such as periods of service, wage rates, whether there has been any commutation for tax free cash at retirement, etc, may not be entirely available. Trustees should be allowed to instruct their actuaries to make a best estimate of the probable bases of the benefit where the data is not immediately available. (Most schemes should have accurate records of GMP due to the reconciliation exercises now being conducted.) There should also be some leeway for applying *de minimis* tolerances where equalisation would result in a non-material uplift. See paragraphs 4.2 and 4.3 of the working group paper for a further explanation of the issues and para 7 for suggestions as to how the process could be made more efficient.

In short, anything that can be done to minimise implementation costs will be helpful. It should be borne in mind that very few members will notice a difference to their benefits as a result of equalisation by this or any other method.

13. WHAT ARE THE POTENTIAL ADMINISTRATION COSTS FROM USING THE PROPOSED METHODOLOGY? HOW MIGHT THESE COSTS BE REDUCED?

It is difficult, especially as the changes to legislation are not yet known, to say with certainty what the costs will be. However, we would expect that the costs of conversion will be substantial. Legal and actuarial expertise will be required, judgments concerning tolerances and protocols will need to be made, calculations will need to be run, and systems will need to be changed to run the calculations and change the benefits. As the working group's paper (para 5) makes clear, even the most simple case will be complicated, and difficult to automate.

The cost of the exercise can be ameliorated somewhat if the legislation is clear and the requests for easements and clarifications discussed in questions 12 and 14 are granted.

14. WHAT DO YOU THINK OF THE PROPOSED CHANGES TO THE GMP CONVERSION LEGISLATION? (WE WOULD BE PARTICULARLY INTERESTED TO HEAR FROM SCHEMES THAT HAVE ALREADY CONVERTED GMPS USING THE CURRENT LEGISLATION)?

The conversion legislation should be as straightforward as possible so that schemes can convert GMPs with a minimal need for legal advice as to whether their approach passes muster.

With this in mind, we would urge the Government to remove not only the inconsistencies in the current conversion legislation, but also the ambiguities, and to keep in mind that DWP guidance is of limited utility. Where the legislation is subject to more than one interpretation, a court will have no compunction about replacing the DWP interpretation with its own. Therefore, any lack of clarity will force schemes to take expensive legal advice, even where there is guidance.

Our suggestions are as follows:

- We continue to believe that references to a "GMP converted scheme" or a "converted scheme" are confusing, as not all GMPs in the scheme will necessarily have been converted. The Government has been moving away from the use of the term "scheme" when it means "benefits" in other legislation, and it would be in line with this very welcome change to use the term "benefits" here when that is what is meant. Pre and post conversion benefits are also defined terms, and could be more usefully employed where the reference now is to a "scheme".

- We agree that most of the provisions of the legislation will apply to both members and survivors and so there should be a term that encompasses both. The working group used the term "selected member" in its paper, which includes both members and survivors and gets across the notion that not all members and survivors who have GMP need be included in the exercise.

- The difference between pre and post conversion benefits and the point at which pre conversion benefits become post conversion benefits needs to be crystal clear in the legislation. The definition of each should make clear that it applies to benefits earned between 1988 and 1997,. It is important that the terms should not apply to all benefits in the scheme (as is now the case) because not all benefits will necessarily have been converted.

- If there is no need for employer agreement where there is no employer (consultation para3.33), this should be made clear in the legislation.

In addition, we have some suggestions regarding the substance of the legislation:

- Although the working group included a high level notice to members before the conversion process begins in its 10 stage procedure, perhaps this should be optional rather than required. Notice and responding to the questions that it would raise, is expensive. One notice, delivered after the conversion is implemented, can contain more information about whether and how the member's benefit is being affected might be more efficient for many schemes.

- A policy decision needs to be made as to what steps, if any, will be taken to protect survivor's entitlement to GMPs. We would suggest that there be a benefit to the survivor that is equal in value to 50% of the value of the member's GMP. The current language requires the payment of 50% of the entire pension earned during the period to 1997 from 1978 in the case of a widow and from 1988 in the case of a widower or civil partner, which will often be a much larger survivor's pension that would have been required pre-conversion.

- It is unlikely that most schemes will find it desirable to decrease benefits in payment materially. However, the current conversion condition in section 24B(3)Pension Schemes Act 1993 , which forbids payment of a pension in a lesser amount than the pension in payment immediately before the conversion has presented problems to schemes that wish make amendments to scheme rules that go beyond conversion of GMPs. For example, under amendments effected in tandem with conversion, a scheme may wish to provide a uniform inflation protection to pre and post 1997 benefits. If this results in a smaller pension in payment due to greater pre-1997 inflation protection, the change cannot be made even though the pension attributable to conversion alone has not been reduced.