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Automatic enrolment alternative quality requirements for defined benefit and hybrid schemes being used as a workplace pension

We are pleased to respond to this consultation.

Key Points

The industry continues to use the alternative quality requirement for defined benefit schemes set out in Pensions Act 2008 Section 23A(1)(b) and Regulation 32M of SI2010/772. For some employers, this is the most straightforward way to demonstrate that their scheme is of the required standard and we are strongly in favour of retaining this option.

However, there are good quality schemes that cannot use the alternative quality requirement and so further easements as set out below would be welcomed.

Detailed response

Question 1: Are the alternative quality requirements for defined benefit and hybrid schemes continuing to deliver the intended simplifications and flexibility for sponsoring employers and pension schemes that are unable to use the TSS?

Yes. The alternative quality requirement set out in Pensions Act 2008 Section 23A(1)(b) and Regulation 32M of SI2010/772 is continuing to deliver the intended simplifications and flexibility for some sponsoring employers and pension schemes.

Our understanding is that this is a two-step test that:

- a) The relevant earnings (i.e. the pensionable salary) of each and every member in a group is at least as good as one of the definitions in SI2010/772 Reg 32M(9); and
- b) The prescribed percentage is at least that set out in subsection (10) of the same regulation.

The first requirement can require a detailed consideration of the myriad elements that might comprise an employer's pay-roll and may have required legal advice. Therefore, any changes should be limited

to additional options as a number of employers have gone through a detailed process to evidence they satisfy these requirements as they stand.

As noted in the call for evidence, the alternative tests were brought in to assist employers with formerly contracted-out schemes (which from April 2016 onwards would otherwise have needed to ensure that their schemes met the TSS). It continues to be the case that the main use of this test is as a **simpler** way to prove that the quality requirement is met, not because the scheme/employer is **unable to use** the TSS.

Question 2: The legislation is not prescriptive about who should apply the alternative quality requirements. In practice, who is carrying out the tests: the employer (i.e. self-certification) or its professional advisers?

In our view, most employers would have sought advice on this issue from an actuarial adviser. However, responsibility for compliance was sometimes retained by the employer, having considered the actuary's advice, because the employer is best placed to confirm that the specifics of their payroll meant it was compliant.

Question 3: Is there anything sponsoring employers or pension schemes want to bring to DWP's attention about the operation of the alternative quality requirements, in particular regarding previously unforeseen issues when compared to the TSS?

There continue to be a number of challenges in relation to the salary definition, making it hard for some employers/schemes to formally certify the requirements despite the scheme clearly being more generous than a basic AE alternative. Firstly, there is uncertainty as to what should be counted as basic pay, so legal advice is often required. Secondly, there may be only one or two members who have non-pensionable earnings which fall under the legislative description of basic pay, but this means that the cost of accruals test cannot be used.

There can also be difficulties where members have particular circumstances e.g. capped or frozen pensionable salaries, or benefits limited by the annual or lifetime allowances.

We note that the legislation provides for a further test under Pensions Act 2008 Section 23A(1)(c). Instead of the two step test under 23A(1)(b) this appears to have just one step namely that, for at least 90% of relevant members, the contributions payable are at least as good as a prescribed percentage of the member's total relevant earnings over that period.

Such a further test, even if based on more than 10% of qualifying earnings, would be a meaningful improvement for a number of employers.

We note that section 4 contained a question regarding opters out. The committees were not aware of any specific cases where this had been a problem. This is on the understanding that it is currently permitted to allow members to opt-down to a non-qualifying scale, albeit that any such opters down would need to be re-enrolled to a higher compliant scale as part of the cyclical re-enrolment process. However, it was noted that at least one employer was considering offering members an 'opt-down' lower cost option in an effort to support employees through the Covid-19 challenges. It is therefore possible that there might be issues at least in the short-term. It would seem undesirable if such ideas, which could allow members to retain DB membership and step up to more generous benefits again in future, were prevented.

SPP response ends

Yours faithfully

Fred Emden
Chief Executive, The Society of Pension Professionals

The Society of Pension Professionals (the “SPP”)

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We do not represent any particular type of pension provision nor any one interest-body or group. Our ethos is that better outcomes are achieved for all our stakeholders and pension scheme members when the regulatory framework is clear, practical to operate, and promotes value and trust.

Many thousands of individuals and pension funds use the services of one or more of the SPP's members, including the overwhelming majority of the 500 largest UK pension funds. The SPP's membership collectively employs some 15,000 people providing pension-related advice and services.

This consultation has been considered by SPP's Defined Benefits and Legislation Committees, which primarily comprise representatives of actuaries, consultants, lawyers and independent trustees.