DC: Transferring in bulk? Then you don’t need an actuarial certificate…

Darren Philp explains why an actuarial certificate is not the most efficient way to ensure quality when consolidating DC schemes

In what will be a very busy year for pensions, 2017 is likely to see a reasonable amount of market consolidation in the DC space. With that will come a lot of administration for some larger schemes, as they swoop in to rescue schemes that either fail or voluntarily (sort of) decide to exit the market.

One major irritation that we’d argue has no place in bulk DC to DC transfers (of the kind that this sort of consolidation will require) is the need for an actuarial certificate. In fact, we’d argue that not only does it not provide any discernible benefit to scheme members (surely the biggest consideration), it might actually impede bulk transfers being made. It’s a historical legacy. Twenty years ago there were hardly any bulk DC to DC transfers and the DB rules were just copied across without much thought.

Don’t get me wrong. There must be a quality assessment before a transfer takes place. And there need to be quality criteria as to what is required from a receiving scheme. Our view is that these criteria need to be set out by TPR and be applied by the trustees of the ceding scheme.

I’d wager that this criteria will end up being pretty similar to the criteria that underpin the master-trust assurance framework and that will underpin the authorisation criteria that TPR will police moving forwards. On that basis, master trusts that have already met the required criteria probably don’t have to be assessed again, but should be monitored on an ongoing basis to check they still meet the required standard.

Duplicating and adding unnecessary process simply wastes time and money for providers and the regulator. And given that providers only have money belonging to their customers, and TPR only has public money, spend really needs to be kept in check on all fronts.

One reason why the regulator needs to lead the way by issuing guidelines on this is because some, but not all, lawyers are taking the view that in order that the receiving scheme be assessed as ‘broadly, no less, favourable’, the underlying investment funds have to be assessed as delivering the same return as the funds in the ceding scheme.

As it is nearly impossible to predict whether one investment fund will deliver greater or lesser returns than another in the long run, on a strict (but clearly not proportionate) interpretation this requires that any transfer to a receiving scheme requires the latter to set up a fund that mirrors the former. Taking this to its logical conclusion, taking this approach means true consolidation cannot take place after transfer, and that the ceded scheme would, in effect, remain a distinctly-managed entity within the receiving scheme.

If we think about it, fund mirroring makes no logical sense. All funds are managed, even passive ones. So even if a ceding scheme had remained in operation, the mix of assets and investment philosophy would have changed as the macro and micro economic environment evolved. So to truly ‘mirror’, a receiving scheme would not only have to replicate the asset mix on the day of the transfer and the investment philosophy, it would also have to make the same asset adjustments and adaptions of investment philosophy that the fund managers to the ceding scheme would have made, had they continued to manage the fund, potentially for the next 40 years. Makes you tired just thinking about it, doesn’t it!

That’s obviously quite an extreme example, and I’m using a strict interpretation of the law to make a point. But think about what consolidation in the DC market is meant to achieve. Simplicity. Strong governance. High-quality pension schemes. Good retirement outcomes. None of which are things that require an actuarial certificate if a transfer is made to a well-regulated and quality pension scheme. It’s time to bin the actuarial certificate for bulk DC transfers, before consolidation becomes a headache rather than a force for good.

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