Department
for Work &
Pensions

Automatic enrolment: guidance for actuaries on certifying defined benefits and hybrid pension schemes

April 2014

Contents

Part 1 – Introduction

1.1 Relevant legislation

Sections 16 and 21-24 of the Pensions Act 2008 (“the Act”).

The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 (“the Regulations”).

The Hybrid Schemes Quality Requirements Rules 2012.

Northern Ireland has its own body of pensions law and references to Great Britain legislation are to be taken, where necessary, as including references to the corresponding Northern Ireland legislation. Annex F lists the corresponding references.

1.2 Who is this guidance for?

This guidance is for actuaries. It applies where an employer wishes to use a defined benefit or defined benefit element of a hybrid pension scheme to meet its duties under the workplace pension reforms in respect of some or all of its workers and an actuary is required by legislation to determine whether the scheme satisfies the test scheme standard.

Separate guidance has been prepared for employers, to enable them to decide whether or not an actuary is required to determine that the scheme satisfies the test scheme standard. This is available at: Employers' guidance on DB & Hybrid schemes If an actuary is not required by legislation to determine whether the scheme satisfies the test scheme standard but the employer has asked them to do this on their behalf then they should follow the guidance for employers although see 3.3 on actuaries’ professional judgement. Also part 5 of this guidance may still be relevant in respect of career average schemes.

All references to “the actuary” in this guidance should be taken as references to the scheme actuary unless the scheme in question is one that is not required to appoint a scheme actuary.

There is a glossary of some of the terms used in this guidance at Annex A.

1.3 What is the legal status of the guidance?

This is statutory guidance[1]. An actuary who is required by legislation to determine whether a defined benefits or hybrid scheme satisfies the test scheme standard must follow this guidance.

Although the DWP has done its best to ensure that this guidance is comprehensive it does not cover every circumstance so actuaries may wish to consider referring to other guidance such as the Pensions Regulator's Guidance relating to employers' automatic enrolment and related duties: The Pensions Regulator's guidance for employers. Ultimately it is the legislation which takes precedence and employers should also consider referring to the legislation itself (see 1.1 above).

The Pensions Regulator is responsible for helping employers to understand how to comply with the law. In this regard it will answer queries about the certification legislation and guidance that are regulatory in nature.

The DWP is responsible for answering questions relating to the policy intentions behind the legislation and statutory guidance on certification and for considering any requests for changes to be made.

The guidance is correct as of April 2014. Please ensure that you have the most recent version, as the content may need to be updated over time because of changes to the law. The DWP will periodically review the guidance.

1.4 The employer duty

Employers have a duty to automatically enrol their eligible jobholders into an automatic enrolment scheme and to maintain active membership for those already enrolled. Occupational pension schemes qualifying under the employer duty legislation have to meet certain standards set out in sections 16 and 17 of the Act. This includes meeting the relevant quality requirement. For a defined benefits scheme the quality requirement is automatically satisfied without further consideration if there is a contracting-out certificate in force in relation to the scheme and all relevant jobholders are in contracted-out employment[2]; a scheme with a contracting-out certificate must however satisfy the test scheme standard in relation to relevant jobholders not in contracted-out employment. For a scheme without a contracting-out certificate, the test scheme standard must be satisfied in relation to all relevant jobholders.

Defined benefits and hybrid schemes providing average salary benefits (career average schemes) must, in addition, satisfy the separate requirement that they provide for the

[1]Other than 5.1 of this document which is not statutory guidance but is intended to help clarify the requirements under regulation 36 of the Regulations and suggest best practice so that actuaries can consider all of the relevant factors relating to whether a scheme may be used as a qualifying one under the Act.

[2] See 3.8 for more information on the treatment of contracted-out schemes. Contracting-out will, subject to Parliamentary approval, be abolished in 2016.

annual revaluation of accrued benefits at least at a minimum level. See Part 5 for more on career average schemes.

Employers’ enrolment duties are being staged in and they started in October 2012. The Pensions Regulator is notifying employers when their enrolment duties start, with the largest employers going first. The Pensions Regulator has also made available guidance on how employers can comply with their automatic enrolment and related duties: The Pensions Regulator's guidance

Part 2 – The test scheme standard

The test scheme standard is one of the scheme quality requirements set out in sections 21 and 22 of the Act. The schemes in relation to which the test scheme standard applies are:

(a) UK defined benefits schemes and the defined benefits element of hybrid schemes[3] with members in employment that is not contracted-out of the State Second Pension Scheme (non-contracted-out schemes); and

(b) defined benefits schemes with their main administration outside of the UK (non-UK schemes)[4]

The key features of the test scheme are set out below, depending on the type of pension scheme being tested. Further details of the testing against the standards are covered in Part 3.

1. Key features of the test scheme for a scheme that provides a defined benefits pension, either final salary or career average:

pensions are payable for life;

pensions are payable from the 'appropriate age'[5];

pensions accrue at 1/120th of final qualifying earnings;

final qualifying earnings are the average qualifying earnings in the three tax years preceding the end of pensionable service;

pensions accrue every year up to a maximum of 40 years;

pensions are revalued in deferment in line with section 84(1) of the Pension Schemes Act 1993 (according to the final salary method); and

pensions are indexed in payment in line with section 51 of the Pensions Act 1995.

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[3] See 6.3 for more information on contracted-out hybrid schemes.
[4] Additional quality requirements for non-UK pension schemes are set out in regulation 45(3) and (5) of the Regulations. Non-UK schemes with their main administration outside of the European Economic Area cannot be used for automatic enrolment but can be used as qualifying schemes for workers who are existing members at the time the automatic enrolment duty arises.
[5] The 'appropriate age' is 65 or, for a member whose pensionable age (the age from which entitlement to State Pension Age begins) is higher than that, the age at which the member attains pensionable age.

2. Key features of the test scheme for an average salary lump sum scheme:

For the purpose of the comparison against the test scheme, the actuary may choose between two alternative tests of equivalence. Whichever alternative is chosen it must apply to all of the relevant jobholder members in the scheme.

EITHER

Benefits are payable from the appropriate age[6] and

an amount for the provision of a pension accrues annually up to a maximum of 40 years at the rate of 16% of qualifying earnings, and

the accrued amount is revalued throughout the period of active membership at the minimum rate specified in regulation 36(4) of the Regulations, i.e. RPI or CPI up to 2.5% and in deferment in accordance with section 84(1) of the Pension Schemes Act 1993 as modified by regulation 37(3) of the Regulations, i.e. by the final salary method of price inflation capped at 2.5% pa compounded over the whole period of deferment or by the average salary method.

OR

Benefits are payable from the appropriate age and

an amount for the provision of a pension accrues annually up to a maximum of 40 years at the rate of 8% of qualifying earnings, and

the accrued amount is revalued throughout the period of active membership at 3.5% a year in excess of the minimum rate specified in regulation 36(4) of the Regulations, i.e. CPI or RPI up to 2.5%, and in deferment at 3.5% a year in excess of either of the statutory methods of revaluation (see above).

3. Key features of the test scheme for a final salary lump sum scheme:

benefits are payable from the appropriate age;

an amount for the provision of a pension accrues annually up to a maximum of 40 years at the rate of 16% of average qualifying earnings in the three tax years before the member leaves pensionable service;

lump sums are revalued in deferment in line with the statutory final salary method of revaluation[7].

[6] See footnote 5 on page 7.
[7] Price inflation capped at 2.5% pa compounded over the whole period of deferment.

Part 3 – Comparison of benefits against the test scheme standard

3.1 The comparison required under the test scheme standard

The scheme benefits for the purposes of carrying out the comparison required under the test scheme standard are those which the actuary expects will accrue in the three years after the effective date.

For the purposes of determining those benefits the actuary must -

(a) assume (for both the scheme being tested and the test scheme) that the jobholder leaves pensionable service –

i. three years after the effective date or

ii. if the jobholder attains the normal pension age of the scheme being tested before the end of that three-year period, on the date on which the jobholder attains normal pension age,

(b) assume that benefits are payable from the date on which the jobholder attains normal pension age[8] and are payable immediately in respect of any jobholder already over normal pension age;

(c) where the jobholder has accrued their maximum benefit under the scheme either before the effective date or will do so during any part of the three-year period after the effective date, assume that that maximum benefit accrues at the same rate for each year of the pensionable service which the jobholder is likely to complete up to a maximum of 40 years.

And for the purposes of carrying out the comparison required under the test scheme standard the actuary must use –

[8] Those over normal pension age are assumed to have zero accrual under both the test scheme and the scheme being tested.

(a) where a statement of funding principles has been prepared or revised for the scheme under section 223 of the Pensions Act 2004 (statement of funding principles), the actuarial assumptions in the most recent such statement, and

(b) any other actuarial assumptions which the actuary considers necessary and consistent with the assumptions used in (a).

The actuarial assumptions must be used for valuing both the benefits provided under the scheme, and the benefits which would be provided under the test scheme.

See section 5.2 for information about limitations on assumed rates of revaluation when testing a career average scheme against the standard.

The test scheme standard must be satisfied only at the level of the scheme as a whole and not separately at the level of each benefit scale.

The actuary may not certify that a scheme satisfies the test scheme standard if the benefits to be provided for more than 10% of relevant members are not at least as valuable as the benefits which would be provided for them under a test scheme.

3.2 Benefits excluded from the test

In determining whether a scheme satisfies the test scheme standard, the actuary must not have regard to the benefits set out in regulation 39(4)(b) of the Regulations. Defined lump sum benefits provided in addition to rather than by commutation of the pension at retirement from pension schemes do not feature in that regulation and should be included in the test.

3.3 Professional judgement

It is a matter of professional judgement as to how much analysis is required for an actuary to determine whether the scheme's benefits satisfy the test scheme standard. For some schemes, it may be necessary to conduct detailed calculations for every individual member. In other cases, an approximate analysis may be sufficient and the actuary may, for example, use the simplified calculations in the guidance prepared for employers in order to satisfy their statutory duty.

3.4 Remuneration data

The actuary must use any information about a jobholder's remuneration which –

(a) the actuary considers is relevant for the test scheme standard certificate,

(b) is the latest readily available information, and

(c) relates to a period of one year ending on the effective date.

However, where –

(a) the actuary is satisfied that the information about the jobholder's remuneration which refers to a period of one year is significantly abnormal, and

(b) the employer writes to the actuary confirming this,

the actuary may use such information in certifying the scheme that covers a period of three years ending on the effective date.

3.5 Longevity factors

Some schemes have introduced provisions to allow members' benefits to be amended to reflect expected longevity changes in the future. Such schemes may be used for automatic enrolment, provided that they satisfy the general requirements for qualifying schemes. Actuaries certifying such schemes should take into account the likelihood of a longevity adjustment factor affecting benefits earned in the next three-year period and the possibility that such a factor would lead to the test being failed on the basis of actuarial equivalence.

3.6 Hybrid pension schemes

The test scheme standard applies to certain hybrid schemes, where rules made under section 24 of the Act have the effect that the test scheme standard is to be applied either by itself or in association with the money purchase quality requirement. In relation to certain descriptions of hybrid schemes, the application of the test scheme standard is modified in the Regulations and these modifications are covered in Part 6 of the guidance.

3.7 Newly established schemes

Where, on the effective date, the scheme has not been established but is in the process of being established, for the purposes of carrying out the comparison required under section 22 of the Act and regulation 39 of the Regulations (the comparison required under the test scheme standard), the actuary must use estimated membership information, i.e. any information about the jobholders who the actuary expects to join the scheme when it is established which –

(a) the actuary considers is necessary for the purposes of the comparison required under the test scheme standard; and which

(b) may include information on the age, gender and earnings of those jobholders.

3.8 Contracted-out schemes

In some cases, an employer may wish to use a contracted-out scheme to meet its duties for jobholders who are not in contracted-out employment, for example jobholders who are above the State Pension Age. In such cases, it will be necessary for the scheme to satisfy the test scheme standard in respect of those jobholders.

When determining whether a contracted-out scheme satisfies the test scheme standard in relation to a jobholder who is not in contracted-out employment a simplified approach can be used. It will be sufficient to establish that the benefits to be provided for that jobholder and any other members of the scheme who are not in contracted-out employment are calculated in the same way as the benefits which would be provided for the other members of the scheme who are in contracted-out employment. This means that there must be no differences in normal retirement age, accrual rate, definition of pensionable pay, maximum service periods, methods of indexation and revaluation, etc.

If there is no difference in treatment between members who are in contracted-out employment and those who are not then the scheme satisfies the test scheme standard. If there are any such differences, then the standard approach as set out in the rest of this guidance must be applied.

From April 2016, if the Pensions Bill 2013-14 is approved by Parliament, contracting-out will be abolished.

Part 4 – Certification

4.1 Who may determine whether a scheme satisfies the test scheme standard?

The determination of whether a scheme satisfies the test scheme standard must be undertaken by an actuary, unless the scheme meets the requirements set out in the table in Annex C in which case the employer can make the determination. The relevant actuary for a scheme with its main administration:

(a) in the UK is an actuary who meets specified requirements as to qualification and experience (or approval) or one who has been appointed to a scheme which is exempt from those requirements;

(b) in a member state of the European Economic Area (EEA) other than the UK is a person who is suitably qualified as a scheme actuary, in accordance with the requirements of the EEA state in question; and

(c) outside of the EEA is an actuary who meets the requirements set out in section 47 of the Pensions Act 1995 and the associated regulations.

4.2 What information should be included in the certificate?

If the actuary is of the opinion that the test scheme standard is met they should complete a test scheme standard certificate which should:

(a) state that, in the actuary's opinion, the scheme satisfies the statutory standard in relation to the provision of pensions or benefits for the relevant members in the scheme; and

(b) specify the date of the information used by the actuary for the purposes of completing the certificate (referred to in this guidance as the "effective date").

The actuary should consider whether there are likely to have been material changes in data or circumstances between the effective date and the date of assessment and consult with the employer if necessary.

4.3 Who is the certificate provided to?

The actuary should provide the completed and signed test scheme certificate to the employer who is required to retain the signed certificate for six years.

Where the employer asks the actuary to advise whether the statutory standard is satisfied, the actuary should inform the trustees or managers of the scheme that the employer has asked for that advice, unless the actuary has previously informed them.

4.4 Format of the certificate

There is a template certificate in Annex D. Actuaries can develop their own certificates but any alternative format should include at least the information set out in the template.

4.5 Employers with more than one scheme

An employer is obliged to meet the automatic enrolment requirements for each jobholder s/he employs. However, an employer may use different schemes to meet this requirement for different jobholders or groups of jobholders (always subject to any other legal requirements, for instance in respect of equal treatment). The test scheme standard must be satisfied separately for each scheme.

4.6 Schemes with more than one employer

Where more than one employer participates in a pension scheme, the scheme is tested for the jobholders of each participating employer. The actuary should therefore provide a copy of the signed certificate to each of the participating employers. Each employer should retain a copy of the certificate for six years.

4.7 Reviewing the scheme's continued ability to meet the test scheme standard

The actuary should review a scheme's ability to continue to satisfy the test scheme standard at the earlier of:

- the actuary being informed of changes to the scheme (see below);
- the employer asking the actuary to review the scheme; or
- the third anniversary of the effective date of the existing certificate or the date of the most recent review of that certificate, if there has been such a review.

Where the actuary has been informed of any material changes to a scheme, the actuary should, unless the scheme is no longer required to satisfy the test scheme standard, consider whether those changes would prevent the scheme from satisfying the standard. In particular, consideration is required where the actuary has been informed of any changes to:

i. the scheme rules, or

ii. the membership of the scheme (including changes to the remuneration of scheme members or, after estimated membership information has been used in certifying a newly established scheme, where the actual information becomes available); or
iii. the legislation and/or guidance concerning the requirements for meeting the test scheme standard.

If there have been any changes referred to above, the actuary should inform the employer in writing if the actuary considers that the scheme would no longer satisfy the test scheme standard. The employer will have the option of improving the scheme or designating a different automatic enrolment scheme within the timescales required under section 2 of the Act.

However, if the actuary is of the view that the scheme continues to satisfy the test scheme standard, the test scheme standard certificate remains valid.

4.8 Which jobholders are included in the test

Determining whether a scheme satisfies the test scheme standard involves a comparison of the benefits to be provided under the scheme for relevant members with those that would be provided for them under a test scheme. Relevant members are all those jobholders not in contracted-out employment in relation to whom the test scheme standard will apply, i.e. those who are active members of the pension scheme at the date of the determination.

The following must not be included in the initial test based on the position at the effective date: individuals who are not jobholders and jobholders for whom automatic enrolment has been deferred over the transitional period. In subsequent tests after they have first been automatically enrolled into qualifying scheme membership the following must also not be included: jobholders who have opted out or who have voluntarily asked to be able to accrue benefits at a rate which is below that required to satisfy the test scheme standard. Once these jobholders have been re-enrolled back into qualifying scheme membership they should be included in the testing again until/unless they opt out or ask to accrue benefits at a lower rate again.

Whether or not benefits in respect of any individual must be included in the test is a separate matter to whether or not that individual must be automatically enrolled or re-enrolled into a qualifying scheme. These enrolment duties will still stand in relation to all jobholders.

Once the scheme has been certified as satisfying the test scheme standard then both existing employees who are not yet eligible to join the scheme but who subsequently become eligible and future new employees who join the scheme will be treated as covered by the certificate, i.e. the scheme will be considered to be qualifying in relation to them subject to the need (see 4.7 above) to keep the scheme under regular review to ensure it continues to meet the test scheme standard.

Part 5 – Career average schemes

5.1 Additional requirements for in-service revaluation for career average pension and lump sum schemes

Career average schemes can be used as qualifying schemes.

To qualify, in addition to having a valid contracting-out certificate or meeting the requirements of the test scheme standard in relation to all relevant jobholders, career average schemes must provide for each year's accrual to be revalued, whilst the member remains in service, at least at the minimum rate set out in regulation 36 of the Regulations. The minimum rate is the lesser of the increase in the RPI, CPI and 2.5% each year.

Such in-service revaluation can only be provided on a discretionary basis (or a part-discretionary part-guaranteed basis) if the funding of the scheme (as documented in its statement of funding principles, or equivalent) assumes in-service revaluation of at least the minimum rate above.

Where career average schemes rely upon discretionary revaluation, either partially or wholly, to meet the requirement above, we recommend that the actuary or other adviser (as appropriate) provides written confirmation to the employer that the revaluation meets the necessary requirements under regulation 36 of the Regulations. This would provide the employer with confidence that the scheme can be used as a qualifying scheme. Note that this paragraph is intended to be helpful only, and is not statutory guidance.

On the timing of the revaluation, regulation 36 leaves flexibility for schemes to take a reasonable and practical approach. The minimum rate is described in regulation 36(4) of the Regulations as an annual increase in RPI or CPI capped at 2.5% 'for the year by reference to which the revaluation is made'. This permits schemes to use a year other than the immediately preceding one as the relevant reference year for the purposes of the comparison of the scheme's rate of revaluation with the minimum required. We understand that it is common operational practice in career average schemes for there to be a time lag before benefits accrued in each year of membership are revalued. Such a practice would fit within the Government's policy intentions in this area provided the time lag is reasonable. Once a member leaves service the revaluation requirement in deferment becomes relevant.

Changes to regulation 36, which take effect from 1 April 2014, mean that a scheme which is not able to guarantee that it will meet the minimum level of revaluation in any year, e.g. if revaluation under the rules is based on the change in average earnings, would still be a qualifying scheme provided that the funding of the scheme assumes that accrued benefits will be revalued at or above the minimum level and the funding is provided for in the scheme's statement of funding principles (or its equivalent). And if the scheme is a new public service career average scheme, it will meet the requirements of regulation 36 if revaluation in service is by at least the rate specified in an HM Treasury order (made under section 9 of the Public Service Pensions Act 2013).

5.2 Testing against the test scheme standard

When testing against the test scheme standard, the assumed rates of revaluation (both in service and in deferment) should be limited as follows:

(a) where the scheme provides for discretionary increases the actuary must consider the scheme's actual experience of awarding discretionary increases and the likelihood of awards being made in the future; in the overall context of the scheme, its current funding position and its future funding plans where known;

(b) the assumed rate of revaluation in deferment in the scheme being tested, must for the purposes of this test, be the lower of the assumed rates of revaluation in service and the assumed rate of revaluation in deferment (that would otherwise apply).

Note that the limitations described in this section (5.2) only apply when testing a career average scheme against the test scheme standard, and not when assessing the additional requirements described under 5.1.

Part 6 – Certifying hybrid schemes

6.1 The quality requirements

The quality requirements for hybrid schemes are based on the quality requirements for defined benefits schemes and money purchase schemes. For certain types of hybrid scheme those requirements have been modified.

To be used to fulfil the employer duties in Chapter 1 of Part 1 of the Act, hybrid schemes must comply with the requirements in section 24 of the Act which in turn cross refer to:

(a) the quality requirements for money purchase schemes which are set out in section 20 of the Act or a prescribed modification of those requirements in regulation 43 of the Regulations (‘the money purchase quality requirements’); and
(b) the quality requirements for defined benefits schemes which are set out in sections 21-23 of the Act or a prescribed modification of those requirements in regulation 43 of the Regulations (‘the defined benefits quality requirements’).

The Hybrid Schemes Quality Requirements Rules 2012[9] issued by the Secretary of State determine which quality requirement applies to particular descriptions of schemes and whether the requirement is to be applied with or without any modification prescribed in the Regulations.

6.2 Common types of hybrid schemes

For the purposes of these regulations and guidance, some schemes are termed ‘hybrid’ to reflect that they have both a money purchase element and defined benefits element and to make it easier for employers to identify and apply the appropriate quality requirements. This designation has no implications for other regulations or legislation, and is used merely for convenience of categorisation here.

For ease of reference, the common types of hybrid scheme are set out in Annex B which directs the reader to the relevant legislation and specifies the quality requirement for each type of scheme.

[9] https://www.gov.uk/government/publications/hybrid-schemes-quality-requirements-rules-2012

6.3 Contracted-out hybrid schemes

A contracted-out hybrid scheme will qualify in relation to scheme members who are jobholders in contracted-out employment on the basis of the contracting-out certificate, which is taken as evidence that the scheme satisfies the quality requirement in relation to all jobholders in contracted-out employment. However, in addition, contracted-out career average schemes (including career average hybrids) must provide at least for the minimum level of in-service revaluation required by regulation 36 of the Regulations.

6.4 Alternative quality requirement for money purchase schemes and the money purchase element of certain hybrid schemes

Employers who offer money purchase schemes (both trust and contract-based schemes) but do not calculate their pension contributions on qualifying earnings will be able to self-certify that their scheme satisfies the relevant quality or alternative requirements. Where employers offer hybrid schemes with a money purchase element, the actuary may be needed to certify the scheme. Where only the money purchase element of a hybrid scheme requires certification the employer is responsible for the certification but may authorise someone else, such as an actuary, to sign on their behalf. There is no requirement for certification, if a scheme, or an element of a scheme, complies with the quality requirements in section 20 of the Act (quality requirement: UK money purchase schemes). The money purchase certification test is set out in separate guidance to which you will need to refer: Money purchase scheme certification guidance

6.5 Applying the modified test scheme standard and modified money purchase requirements to combination hybrid schemes

Where a scheme provides a mix of defined contributions and defined benefits accruals, the actuary can determine the percentage of the money purchase quality requirement or alternative requirements covered by the projected defined contributions, and the percentage of the value of the test scheme (or modified test scheme) benefits covered by the projected defined benefits accrual. The scheme is deemed to qualify if the sum of these two percentages equal or exceed 100%. An example is provided in Annex E.

If the employer has opted to use the certification test for the money purchase element of the scheme, refer to the guidance on the certification of money purchase and the money purchase element of hybrid schemes.

6.6 Complex hybrids

Some hybrid schemes may have any number of the features of the different hybrid schemes which are described in the Hybrid Schemes Quality Requirements Rules 2012. These schemes may therefore not fall within any single definition of a hybrid, as set out in the rules and the above paragraphs of the guidance. An example would be a sequential hybrid that has underpins on both sections. To determine whether or not the scheme satisfies the relevant quality requirement, the actuary will be required to compare the value of the scheme's benefits against those under the test scheme or modified test scheme.

6.7 Transitional provisions

Employers offering hybrid schemes will be able to phase in their costs by deferring the automatic enrolment date of existing jobholders, who were eligible to join the scheme but declined membership, until the end of the transitional period in September 2017.

To use the transitional period, an employer will be required to provide an individual with a notice setting out their intention, along with their new automatic enrolment date. Individuals must retain the right to opt in to the scheme before the end of the transitional period.

The Government is now amending the law to make it clear that only defined benefits (whether offered under a hybrid scheme or a defined benefit scheme) offered to the jobholder in question would satisfy the pre-conditions for employers to defer automatic enrolment under section 30(2) of the Act. The amendments[10] to the provisions of that Act relate to the transitional period for defined benefit and hybrid schemes. The legislation will have retrospective effect from the date of the announcement – 19 December 2012.

Employers offering money purchase benefits are still able to use the transitional arrangements under section 29 of the Act, which permit a gradual phasing in of the contribution requirements over a transitional period. These arrangements are currently available to employers offering money purchase benefits as part of a hybrid scheme where those benefits satisfy the relevant quality requirement and (from 1 April 2014) where the money purchase benefits are certified as satisfying the alternative requirements under section 28 of the Act.

[10] Currently clause 40 of the Pensions Bill 2013/2014. Royal Assent is anticipated later in the spring of 2014.

Annex A – Terms used in the guidance

"Accrual rate" -	The rate at which, under the scheme rules, rights to the pension, or lump sum used to secure a pension, accrue over time by reference to periods of pensionable service.
"The Act" -	Pensions Act 2008 .
"Appropriate age" -	The 'appropriate age' is the pension age in a test scheme. It is 65 or, for a member whose pensionable age (the age from which entitlement to State Pension Age begins) is higher than that, the age at which the member attains pensionable age.
"Effective date" -	The date of the pay data used for determining whether the scheme meets the test scheme standard.
"Eligible jobholder" -	A worker aged at least 22 and under State Pension Age who is working or ordinarily works in Great Britain, with qualifying earnings in excess of the automatic enrolment earnings trigger in section 3 of the Act (as amended - the trigger is £10,000 in the tax year 2014/15). See also "Qualifying Earnings".
"Final qualifying earnings" -	The average qualifying earnings in the three tax years preceding the end of pensionable service.
"Jobholder" -	A worker, who at the effective date, is aged at least 16 and under 75, who is working or ordinarily works in Great Britain with earnings in excess of the lower threshold of the qualifying earnings band set out in section 13 of the Act (as amended). See also "qualifying earnings".
"Normal pension age" -	The earliest age at which a jobholder may be entitled to the payment of an unreduced pension.

“Qualifying earnings”-	Earnings within the band set out in section 13 of the Act. It is this band of earnings on which pensions contributions will be calculated for money purchase schemes and which is also used when assessing the benefits that would be provided from the test scheme. This is subject to periodic review and has now (for 2014/15) been uprated to £5,772 to £41,865 with £10,000 as the automatic enrolment trigger.
“Qualifying scheme” -	A pension scheme which can be used to satisfy an employer’s enrolment duties because it satisfies at least the minimum quality requirements in the Act in relation to a jobholder.
“Quality requirement” -	The criteria which a scheme must meet in order to be a qualifying scheme.
“The Regulations” -	References to ‘regulations’ are to The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 unless otherwise stated.
“Relevant members” -	All jobholders (not in contracted-out employment) whose benefits will be assessed against those from the test scheme, i.e. those who are active members at the date of the determination.
“Test scheme” -	A scheme whose terms are defined in the Act used as a benchmark against which an actual scheme is compared to determine whether it satisfies the test scheme standard.
“Test scheme standard” -	The benchmark of scheme quality for defined benefits schemes (and the defined benefits element of hybrid schemes) with members not in contracted-out employment.
“Transitional period” -	The period over which employers offering members defined benefits in a defined benefits or hybrid scheme are able to defer automatic enrolment.

Annex B – Common types of hybrid schemes

Hybrid scheme type	Relevant legislation and guidance	Quality requirement
A hybrid scheme that is contracted-out	Rules 3 and 4-8[11] Sections 20, 21-24 and 28 of the Act This guidance and the guidance on certifying money purchase schemes and money purchase elements of hybrid schemes.	For those jobholders who are in contracted-out employment the quality requirement is met and for those who are not in contracted-out employment the requirements in the appropriate hybrid scheme rule 4-8 apply.
Non-contracted-out final salary schemes and career average schemes with ancillary money purchase benefits	Sections 21-23 and 24(1)(b) of the Act This guidance.	The defined benefits quality requirement, i.e. the scheme satisfies the test scheme standard. Only the main benefits in a scheme, i.e. those mainly responsible for providing a pension to the member from retirement on age grounds should be considered in the quality requirement tests. Ancillary benefits must therefore be disregarded.
Money purchase schemes with ancillary defined benefits	Sections 20, 24(1)(a) and 28 of the Act	Money purchase quality requirement applies or certification under section 28 of the Act and associated regulations and guidance

[11] The reference to a rule in this Annex is a reference to the Hybrid Schemes Quality Requirements Rules 2012. https://www.gov.uk/government/publications/hybrid-schemes-quality-requirements-rules-2012

Hybrid scheme type	Relevant legislation and guidance	Quality requirement
	The guidance on certifying money purchase schemes and money purchase element of hybrid schemes.	Only the main benefits in a scheme, i.e. those mainly responsible for providing a pension to the member from retirement on age grounds should be considered in the quality requirement tests. Ancillary benefits must therefore be disregarded.
Non-contracted-out underpin schemes (which provide the better of a money purchase or defined benefits pension)	Rule 4 Sections 20-24 and 28 of the Act This guidance and the guidance on certifying money purchase schemes and money purchase element of hybrid schemes.	Money purchase quality requirement applies or certification under section 28 of the Act and associated regulations and guidance **or** the defined benefits quality requirements, i.e. the scheme satisfies the test scheme standard.
Non-contracted-out sequential hybrid schemes	Rule 5 Sections 20 and 24(1)(a) and (b) of the Act This guidance and the guidance on certifying money purchase schemes and money purchase element of hybrid schemes.	The defined benefits quality requirement applies to the defined benefits element i.e. the scheme satisfies the test scheme standard **and** the money purchase quality requirement or certification under section 28 of the Act and associated regulations and guidance) applies to the money purchase element.
Self-annuitising hybrid schemes (some times referred to as self-annuitising money purchase schemes)	Rule 6 Sections 20 and 24 of the Act This guidance and the	Money purchase quality requirement applies or certification under section 28 of the Act and associated regulations and guidance.

Hybrid scheme type	Relevant legislation and guidance	Quality requirement
	guidance on certifying money purchase schemes and money purchase element of hybrid schemes.	
Non-contracted-out combination hybrid schemes (sometimes referred to as top-up schemes)	Rule 7 Sections 20, 21-23 and 24(1)(a) and (b) of the Act (with modification, if appropriate, in the Regulations) This guidance and the guidance on certifying money purchase schemes and money purchase element of hybrid schemes.	The quality requirement will be dependent on the nature of the scheme: - the DB quality requirement, i.e. the scheme satisfies the test scheme standard, **and/or** the money purchase quality requirement or certification under section 28 of the Act and associated regulations and guidance, **or** a combination of the above requirements modified and satisfied in aggregate.
Complex hybrid schemes (schemes with a combination of hybrid features not falling within the definitions in rules 3-8) e.g. a sequential hybrid scheme with underpins on both sections	Rule 8 This guidance.	The quality requirement will depend on the nature of the scheme. Treat the schemes as if each of its hybrid provisions were those of a separate scheme and test the applicable quality requirements.

Annex C – Who may determine whether a scheme satisfies the test scheme standard

Circumstances in which an employer can certify[12]	Circumstances in which an actuary must certify
Employers can certify only where actuarial comparisons or calculations are not required such as in circumstances where: • the pensions provided by a scheme are of the same value as or better than, in every respect the pensions that would be provided by the test scheme (including the earnings on which they are calculated: qualifying earnings); or • the earnings on which the pension is calculated are not of the same value or better than qualifying earnings but the scheme compensates for this by a higher accrual rate[13] or vice versa: the scheme has a lower accrual rate offset by a definition of pensionable pay better than qualifying earnings; and	Cases in which an actuary is required to certify that a scheme satisfies the test scheme standard include: • circumstances in which the employer is unable to certify (or chooses not to); • any determination which requires the value of the accruing liabilities to be tested actuarially (the full 'test of equivalence'); • schemes where the normal pension age is higher than the appropriate age in the test scheme; • schemes in which the normal pension age is lower than the appropriate age in the test scheme and the

[12] Note that employers can also delegate the responsibility to an actuary in these circumstances.
[13] A table is provided in the employers' guidance.

Circumstances in which an employer can certify[12]	Circumstances in which an actuary must certify
• the scheme's normal pension age (the age at which an unreduced pension would be payable as of right): o is not higher than the appropriate age in the test scheme, or o if it is lower than the appropriate age in the test scheme the employer decides not to allow for this lower pension age to count towards satisfying the test scheme standard.	employer wishes to take credit for this lower age; • schemes in which the employer wishes to take credit for lump sum benefits payable at retirement; • schemes in which the employer wishes to take credit for revaluation or indexation which is higher than provided in the test scheme; • combination hybrid schemes which do not pass either the money purchase quality requirements in full or the test scheme standard in full, but which may be satisfactorily assessed on a modification of both, taking into account the combined benefits in the scheme rules; and/or • in any other case in which the employer is not explicitly permitted to certify such as determinations that require comparison or assessments of a description usually carried out by an actuary.

Annex D – Template Certificate

Certificate given for the purposes of certifying that a defined benefits and/or hybrid scheme satisfies the test scheme standard

Name of scheme:

Pension Schemes Registry Number(s) (PSR):

Type of scheme select as appropriate)(for schemes with several sections, you can tick more than one)::

☐	Career average or final salary pension
☐	Average salary lump sum
☐	Final salary lump sum
☐	Hybrid (please give details of the type of hybrid or benefit structure)

Name and Address of employer:

Effective Date:

Satisfaction of the test scheme standard

I certify that, in my opinion, the above scheme satisfies the test scheme standard in relation to the jobholders employed by [name of employer] who are relevant members of that scheme.

[If signed by an actuary in respect of a hybrid scheme where the employer is certifying the money purchase elements: I am placing reliance on the employer's certification of the money purchase elements of this hybrid scheme, a copy of which has been supplied to me.]

In determining whether this scheme meets the test scheme standard, I confirm that I have complied with the relevant statutory requirements and with the guidance for [actuaries] / [employers] issued under those requirements by [the Secretary of State for Work and Pensions] [the Department for Social Development] which is for the time being in force.

Signature:

Position and qualification:

In what capacity signed: [Employer/Actuary because certification delegated/Actuary because full tests of equivalence required]

Name:

Date:

Annex E – Applying the modified test scheme standard and modified money purchase requirements to combination hybrid schemes

Approach 1 - Starting with money purchase benefit

1. Consider the money purchase benefit first:

    a) Similar to the projection of the earnings for calculating the scheme pension and the test scheme pension required for applying the test scheme standard, project the amount of contributions that would be payable by the scheme over the next three years.

    b) The employer contributions payable into the scheme for each jobholder are then compared with the employer contributions that would be payable under the money purchase requirements in section 20 of the Act.

    c) The comparison would then show what percentage of the money purchase quality requirements is met for each member: this percentage will vary from member to member because the earnings definition is not the same as qualifying earnings. This percentage might be called X1 for member 1, X2 for member 2 etc.

2. A projected money purchase contribution equal to 3% of qualifying earnings would count as 100%[14]. Transitional provisions exist relating to the phasing in of contributions and the principles here should be applied consistently during that transitional period.

3. The percentage of the test scheme standard that needs to be satisfied is therefore (100 – X1) for member 1, (100 – X2) for member 2 etc. The test against the test scheme standard in Part 3 can then be carried out in the normal way, except that the scheme only needs to meet (100-X1)% of the test scheme standard for member 1, etc. The test is therefore different for each member.

Approach 2 - Starting with the defined benefits

4. Alternatively consider the defined benefits pension first: a comparison is made between the test scheme's benefit and the actual scheme benefit, assuming the member leaves service in three years. This guidance sets out how this determination is to be made.

5. The comparison would then show what percentage of the test scheme standard is met for each member: this percentage will vary from member to member because the earnings definition is not the same as qualifying earnings. This percentage might be called Y1 for member 1,Y2 for member 2 etc.

6. The percentage of the money purchase test that needs to be satisfied is therefore (100 – Y1) for member 1, (100 – Y2) for member 2 etc. This part of the test might be done in the same way as for Approach 1: a comparison is made between the actual scheme contributions and the contributions required under the money purchase quality requirements, adjusted by the relevant percentage ((100 – Y1) etc), over three years.[15]

7. The total contribution towards the money purchase benefits and the defined benefits accruals when aggregated should equate to at least 100%.

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[14] This example assumes that the scheme is using the money purchase quality requirement but it is also possible for a hybrid scheme to use the alternative money purchase quality requirement. If that were the case the relevant percentage of the contributions required under the 3 tiers would apply.

[15] To simplify the aggregation required by regulation 43 of the Regulations.

Annex F – Corresponding Northern Ireland legislation

GB legislative reference	**NI legislative reference**
Pension Schemes Act 1993 section 84	Pension Schemes (Northern Ireland) Act 1993 section 80
Pensions Act 1995 section 47 section 51	Pensions (Northern Ireland) Order 1995 Article 47 Article 51
Pensions Act 2004 section 223	Pensions (Northern Ireland) Order 2005 Article 202
Pensions Act 2008 Chapter 1 of Part 1 sections 2 and 3 section 13 sections 16 and 17 sections 20 to 24 sections 28 to 30	Pensions (No. 2) Act (Northern Ireland) 2008 Chapter 1 of Part 1 sections 2 and 3 section 13 sections 16 and 17 sections 20 to 24 sections 28 to 30
The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 regulations 36 to 39 regulation 43 regulation 45	The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations (Northern Ireland) 2010 regulations 36 to 39 regulation 43 regulation 45
The Hybrid Schemes Quality Requirements Rules 2012 rules 3 to 8	The Hybrid Schemes Quality Requirements Rules (Northern Ireland) 2012 rules 3 to 8

Annex G – Changes since July 2012

The following is a summary of the significant changes to the version of this guidance published in July 2012:

Part 1 - Introduction

1.2, 1.3 and 1.4: Clarification provided on the circumstances in which this guidance applies; the legal status of the guidance and the employer's duties under the Act. Guidance corrected in relation to the in service revaluation requirement on career average schemes which is not a feature of the legislation on the test scheme standard.

Part 2 – The test scheme standard

Corrections to the description of key features of the lump sum test schemes, e.g. consistent references to the 'appropriate age' and revaluation in deferment.

Part 3 – Comparison of benefits against the test scheme standard

3.1: Clarification provided on the assumptions to be used in the comparison under the test scheme standard.

3.2: Confirmation that lump sum benefits should be included in the test.

3.3: Section removed on applying the test scheme standard separately in respect of different benefit scales.

3.8: New section added to confirm how to determine that a contracted-out scheme satisfies the test scheme standard in relation to jobholders not in contracted-out employment.

Part 4 - Certification

4.2, 4.3, 4.4 and 4.7: Clarification on what should be included in the certificate and the circumstances in which the actuary should review the scheme's ability to meet the test scheme standard.

4.8: Summary of who is included in the test calculations and who can be treated as covered by a certificate replaces table in Annex D of July 2012 version.

Part 5 – Career average schemes

5.1: Separate part provided on career average schemes to confirm additional requirements for in service revaluation do not form part of the test scheme standard.

5.2: Some material formerly included in 4.8 of the July 2012 version moved to this separate section and changed to make clear it relates to the assumed rates of revaluation when testing against the standard.

Part 6 – Certifying hybrid schemes

6.5: Paragraph removed relating to the calculation of the total contribution. Where the money purchase quality requirements have been modified under regulation 43 of the Regulations so that a combination hybrid can satisfy them in aggregate only a proportion of the employer contribution is required.

Annex A – Terms used in the guidance

New entry for “Appropriate age” and amended definition of “Qualifying earnings”, “Relevant members” and “Test scheme”.

Annex B – Common types of hybrid schemes

Table re hybrid schemes on page 23 of the July version removed as it largely duplicated this table.

Annex D – Template certificate

Changes made to confirm that the in service minimum revaluation requirement for career average schemes does not form part of the test scheme standard.

Confirmation that what is being certified is that the scheme satisfies the test scheme standard.

Minor changes to scheme ‘identifiers’, type of scheme being certified and capacity in which certificate is being signed.

Annex E – Applying the modified test scheme standard and modified money purchase requirements to combination hybrid schemes

Changes made in Approach 1 to reflect point in Part 6 mentioned above

The following is a summary of the significant changes to the version of this guidance published in September 2013:

Part 2 – The test scheme standard

Page 8 - Changes made to reflect the amendments to the test scheme standard for lump sum schemes which took effect from 1 November 2013.

Part 5 – Career average schemes

5.1 – Changes made to reflect amendments to the requirement for career average schemes to revalue accrued benefits in service at a minimum level which took effect from 1 April 2014.

Part 6 – Certifying hybrid schemes

6.7 – Changes made to reflect amendments to the regulations regarding hybrid schemes and transitional provision which took effect from 1 April 2014.

Annex A - Terms used in the guidance

Changes made to reflect the amendments to the ‘appropriate age’ in the test scheme which took effect from 1 November 2013.

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