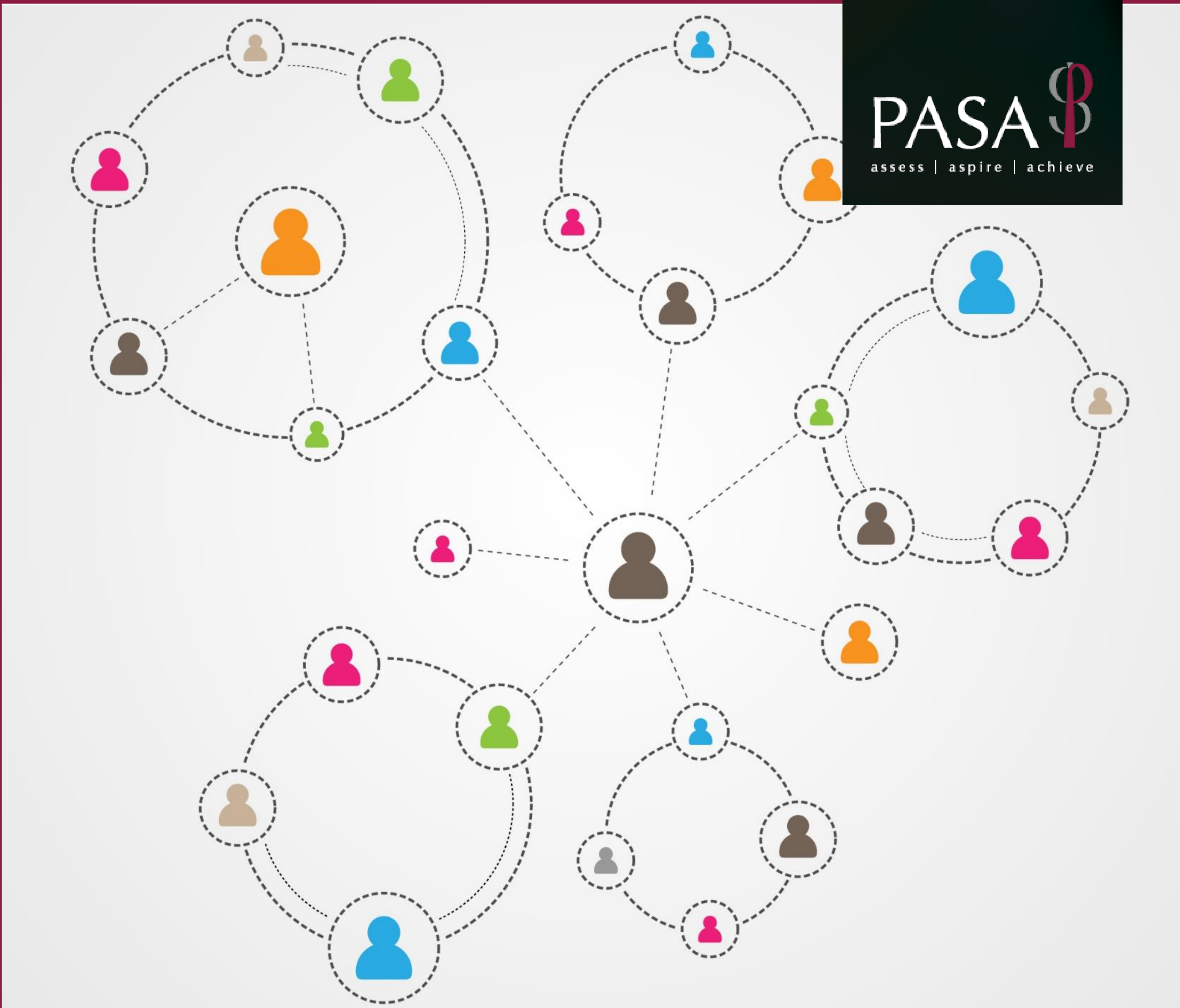


PASA CDCWG

DWP Consultation on Extending Opportunities for Collective Defined Contribution Pension Schemes

March 2023

Contents

Acknowledgements

PASA is grateful to the authors of the Guidance and members of the PASA CDC Working Group (CDCWG) and their employers.

Emma Watkins (Board Sponsor)	**PASA Board Director**
Helen Ball (Chair)	**Sackers**
Amanda Latham	**Barnett Waddingham**
Emma Douglas	**Aviva**
Kevin Wesbroom	**Capital Cranfield**
Martin Willis	**Barnett Waddingham**

About PASA

The Pensions Administration Standards Association (PASA) was created to provide an independent infrastructure to set, develop, guide and assess administration standards.

PASA acts as a focal point and engages with industry and government to create protocols for understanding good administration - but also appreciates there's no one size fits all. PASA develops evidential Accreditation practices allowing benchmarking across and between the industry regardless of how the administration is being delivered.

As well as raising the profile of pension administration generally, PASA focuses on three core activities:

1. Defining good standards of pensions administration relevant to all providers, whether in-house, third party or insurers
2. Publishing Guidance to support those standards
3. Being an independent Accreditation body, assessing the achievement of good standards by schemes

There's no organisation providing such services across schemes, yet there's a demand for evidence of service quality from scheme trustees, sponsors, administrators, insurers, savers and regulators.

1. Consultation Responses

Question 1 - Do you agree with the key principles we have identified as necessary for the new types of CDC schemes and in particular whole life multi-employer CDC models? If not, please set out why?

PASA is supportive of the overall objective to extend CDC provision beyond the single employer model. It would be a positive step for the industry to introduce new types of CDC schemes and, in particular, whole life multi-employer CDC models. This would give employers greater choice over the nature of the pension benefits provided to their employees and would give savers a greater choice of decumulation vehicle when they come to draw an income in retirement .

The principles set out in the consultation paper are a good starting point, i.e. to focus on the authorisation regime which has been used for single employer CDC schemes and build upon it, drawing on the DC master trust regime where appropriate. We have two primary comments:

1. it would be helpful if the DWP's expanded CDC framework could closely align with the DC master trust authorisation and supervision framework. Organisations which already provide authorised master trusts and go on to provide CDC arrangements will avoid being assessed on differing requirements between their master trust and CDC scheme
2. the key concepts and legislation of the DC master trust regime should be used wherever possible, rather than introducing another layer of new concepts/requirements

It makes sense to extend the new regime towards multi-employer schemes first, then to decumulation vehicles later as it's likely there will be more challenges in creating a suitable framework for decumulation-only arrangements.

There are three key characteristics which apply to multi-employer CDC schemes which could mean a slightly different approach is required compared to the framework established for single employer CDC schemes. These are:

1.1 The multi-employer nature of the scheme means the interests of the employers won't always align and the degree of divergence between those employers could increase over time. The scheme (and the authorisation requirements) will need to be flexible enough to deal with changes in the future. For example, employers in a multi-employer scheme may to want to:

- change their pension strategy in future years, to upscale or downsize their involvement with the CDC scheme (which could result in bulk transfers in and out of the scheme)
- change the investment strategy of the section in which they're placed if the nature of their workforce changes
- change the contribution structure over time

This could be in tension with one of the proposed principles in the consultation paper which focuses on benefit adjustments being made "without variation across the membership". This may be more difficult for parties to agree upon within a multi-employer arrangement. For this reason, the principle of "any adjustments made to benefits will be made without variation across the membership" should apply to the membership of a section, rather than to the scheme as a whole.

As any non-connected multi-employer CDC scheme will be an occupational trust-based pension scheme, any proposed scheme design will need to be consistent with the overriding duties of trustees. This includes acting impartially between savers and treating them fairly. This will be of particular importance when considering how much flexibility to allow within the same section of a scheme to offer different accrual rates and choice over target retirement ages, and also how to deal with funding challenges. Although trust law discretion can be very helpful, we anticipate it'll be important to make sure the trustee has the right to make and drive through 'tough' decisions in times of conflicting priorities. Regulations could perhaps require certain trustee powers to be written into the new CDC scheme's trust deed and rules – this way, it's more certain the trustee would have the ability to exercise powers at key moments, particularly if the interests of different groups of savers and/or the interests of the sponsoring employers could conflict with each other.

1.2 Elements of the new authorisation regime which centralise control over key decisions to a 'scheme funder' (see also paragraph 58 of the consultation paper) would need careful consideration because there may not be an obvious candidate suitable to take on this role where the scheme is run on a not-for-profit basis. There are some DC master trusts which don't have a scheme funder and they operate effectively without one because the benefit structure within the master trust is usually similar across different employers. However, a multi-employer CDC scheme will be in a different position to a DC master trust – the CDC scheme will face crucial decisions for parties with competing interests which impact on saver benefits (especially if pensions in payment need to be scaled back for funding reasons). Without a central figure in the form of a scheme funder to make key decisions and fund certain costs, it could be more difficult to hold the different employers to a clear and common strategy.

1.3 For DC master trusts deciding to add a multi-employer CDC section to their existing offering, as noted above, anything relating to the crossover between DC master trust territory and CDC scheme territory will need careful consideration. This is due to the existing authorisation regime in place for master trusts. It'll be important to establish early on whether a scheme could fall within both regimes, or whether a choice would have to be made and a separate scheme (or separately authorised section) established for CDC savers. If a scheme could fall within both regimes the industry would need a firm steer on which would override the other in terms of authorisation requirements e.g. around the fit and proper criteria for trustees who would be appointed to look after both sections. This would need to be resolved and appropriate carve outs or additions would need to be applied to existing law for the legal position to be clear from the start.

Question 8 – If a scheme funder equivalent is introduced for the new whole life multi-employer CDC schemes including master trusts should similar scheme funding requirements to those in the DC master trusts regime apply? Are there any changes needed to ensure there is a clear focal point for TPR scrutiny and liability for meeting relevant costs?

Please see the comment above regarding the role of scheme funder. If a scheme funder is deemed to be essential, it may be necessary to have separate criteria applicable to the scheme funder of a commercial multi-employer CDC scheme compared to a non-commercial multi-employer CDC scheme. This is because:

- a commercial provider may see the longer term financial benefit of taking on the risk of operating a multi-employer CDC scheme, because it will be looking to obtain a profit and there may be synergies between the CDC scheme and its other business propositions. It may be willing to invest more funding to start up the CDC scheme and meet detailed authorisation requirements. For the same reason, the provider may also be comfortable rearranging its operations and corporate structures to meet any requirement for the scheme funder to be a separate legal entity only carrying out CDC scheme business
- it's likely a non-commercial provider would have reservations about taking on the risk and costs of operating a multi-employer CDC scheme if the obligations applicable to a scheme funder are too onerous. If the scheme funder wasn't taking a profit from the CDC scheme, it may struggle to find a separate legal entity able to only carry out CDC scheme business. We anticipate there would be greater risks with running a multi-employer CDC scheme than with running a non-commercial DC master trust because of the additional advisory, administration and communication costs involved – as well as the reputational risk arising if pensions in payment needed to be cut back in the future. If the criteria applicable to a scheme funder are too onerous, this could make multi-employer CDC schemes an unattractive proposition in the non-commercial sector

Question 10 - Do you agree that the existing requirements should apply to new whole-life multi-employer schemes and are additional requirements needed to help ensure that communications used in promoting and marketing the scheme are not misleading? How might Schedule 4 of the 2022 Regulations be amended to achieve this?

The existing requirements should apply to new whole-life multi-employer schemes but with some changes. Multi-employer CDC schemes generally face the same challenges as a single employer CDC scheme regarding the need to communicate the non-guaranteed nature of the Target Pension and the variability of the Target Pension from year to year. This is dealt with under the existing legislation.

Schedule 4 of the 2022 regulations for CDC schemes is clear on the requirements for systems and processes for saver communications, covering all areas we would expect are necessary to effectively correspond and engage with scheme savers. However, there may need to be changes to reflect:

- if the expectation is multi-employer CDC schemes have CDC sections for different employers, then wording may be required to this effect e.g. replacing 'the scheme' with 'the section'

- different benefit designs are likely to emerge in multi-employer CDC schemes, compared with the existing authorised single employer CDC scheme. For example, multi-employer schemes may wish to adopt different accrual rates which vary between employers or sections. If different benefit structures are possible within the same scheme and if those structures could result in different target pensions, then the complexity of the communications needed to explain to savers how the scheme operates increases. A promoter and marketer would need to make sure the right information was targeted at the appropriate group of prospective savers at all times to avoid any confusion

- the difference in benefit designs may have wider reaching implications for other communication materials, such as the content of the annual benefit statement (although in practice we expect online modellers would also be made available to savers to explain how their scheme benefits could be impacted in different scenarios). As well as showing levels of benefit, the CDC scheme will have to stress the non-guaranteed nature and variability of the figures quoted. There are related questions on how much detail should be disclosed about the method and assumptions used to produce the figures shown in the annual benefit statement – both to savers and to the Pensions Regulator (TPR). Too much detail might be overwhelming, but too little detail may not provide sufficient transparency over how certain illustrations of benefits have been created

For the above reasons we agree (in response to question 5 of the consultation) those marketing and promoting CDC schemes should be within the scope of the fit and proper persons test where certain conditions apply and would agree those conditions should be similar to those applicable to master trust schemes.

Question 11 - Are any changes or additions needed to the requirements in Schedule 5 of the 2022 Regulations to reflect the new designs and relationships anticipated in the new whole-life multi-employer schemes?

Schedule 5 of the 2022 regulations are clear on the requirements for systems and processes, covering all areas we would expect are necessary to effectively run a multi-employer CDC scheme. As noted above, if the expectation is multi-employer and master trust schemes have sections for different employers, then wording may need to be added to this effect e.g. replacing 'the scheme' with 'the section'.

Alongside the TPR guidance, we don't consider any other additions necessary to account for master trust and multi-employer structures. Generally, as noted above, it would be helpful if the DWP's expanded CDC framework could, where possible, closely align with the DC master trust authorisation and supervision framework, so organisations already providing authorised master trusts which go on to provide CDC arrangements avoid being assessed on slightly differing requirements for their master trust as for their CDC scheme.

Question 12 - Do you agree that it is reasonable for the existing requirements in regulations 15 and 16 of the 2022 Regulations to apply to the new whole-life multi-employer CDC schemes, and that the continuity strategy should include an aspiration to operate the scheme as a closed scheme?

Using the existing requirements for a continuity strategy for a CDC scheme seems a sensible approach and the continuity strategy should include an aspiration to operate the scheme as a closed scheme for the reasons set out in paragraphs 72 and 73. However, we suggest the option to operate as a closed scheme is stronger than just an 'aspiration', where it's in the savers' interests for it to continue as a closed scheme.

Where a scheme is a sectionalised scheme, we would expect the continuity strategy to clearly set out the strategy in respect of each section of the scheme (as different approaches may be needed depending on the structure of each section).

2. Decumulation only Schemes

Before answering the specific questions posed in respect of decumulation only CDC schemes, we want to respond to a point noted in paragraph 135 of the Consultation.

"Whilst we are open to considering other options, we are minded to include an expectation that schemes aim to provide inflation-linked increases in decumulation as this can significantly smooth the impact of market shocks and reduce the likelihood of cuts in nominal benefit rates."

We support the inclusion of this expectation/requirement in providing CDC decumulation schemes. It could be argued this is an unnecessary restriction – by analogy the annuity market offers both level and increasing annuities. However, over the course of a typical pensioner lifetime we should assume periods of inflation will be the norm. So it's right to require CDC savers to buy inflation proofing if they retire and draw benefits from a CDC scheme. Savers won't be forced to buy a CDC income – they can opt for other retirement products/services from elsewhere if it suits their circumstances better. We believe a solution offering inflation protection is right for the majority of CDC scheme savers (non-advised) who will purchase (or be moved to by default to) a CDC income and the legislation should be framed around this, rather than seeking to provide perfect solutions for all savers.

Question 22 - What mechanism should be used to determine the price at which people might buy into a decumulation only CDC arrangement and what can be done to ensure individuals are treated fairly? In addition, should mortality underwriting be a feature of these arrangements, and how would this best be done?

The mechanism should be such the addition of the new saver doesn't change the level of future increases which can be supported by the CDC scheme. So at any point in time, the assets and membership of the scheme will be of a level of future inflation proofing can be supported (given our comment above regarding inflation proofing being built into decumulation scheme design).

Let's suppose the supported inflation proofing is equal to (CPI inflation – 1.0% pa). For an income quotation for a potential new saver, the scheme would ask what level of income, with (CPI-1) increases is equivalent to the premium, given the investment policy of the scheme. The inclusion of a new saver on this basis is therefore fair, as there's no cross subsidy between existing savers and the new savers.

We prefer underwriting not to be a feature of CDC arrangements – it goes against the universality nature we believe CDC schemes should aspire to. What would the underwriting seek to rule out or penalise, in terms of lower pensions per unit of premium? The answer is savers who are expected to live longer than the existing pool. A diverse heterogenous pool of savers helps with longevity pooling.

Question 23 - What steps can be taken to ensure communications to members help them understand how these new arrangements will work and how can consistent standards be achieved in the way commercial arrangements market their products to prevent over-promising?

Many of the communication problems for CDC income solutions are dealt with, once we 'insist' inflation proofing is built in. We do at least have a level playing field for providers – we can't have a level income competing against an increasing income. The key issue will be to get across the trade-off between a higher income and a more variable income.

Provider A may have a more growth orientated investment strategy. Provider B is more conservative. For each £100,000 of premium Provider A will be able to quote a higher level of income than Provider B. But this income is less 'secure' and can be expected to vary more over the course of the pensioner's lifetime (noting neither income is truly secure in the sense of an insurance provided annuity). How do we make sure this trade-off between higher income and a greater chance of bad outcomes is made clear to savers?

This should be addressed head on. As well as quoting the central level of income, providers should quote a downside income – something their modelling suggests will happen say in a 1 in 6 downside event. This could be expressed as a lower level of inflation protection. The downside threshold needs to be realistic – a 1 in 100 downside would look fairly unpleasant in all cases and wouldn't give the sense of variability between products.

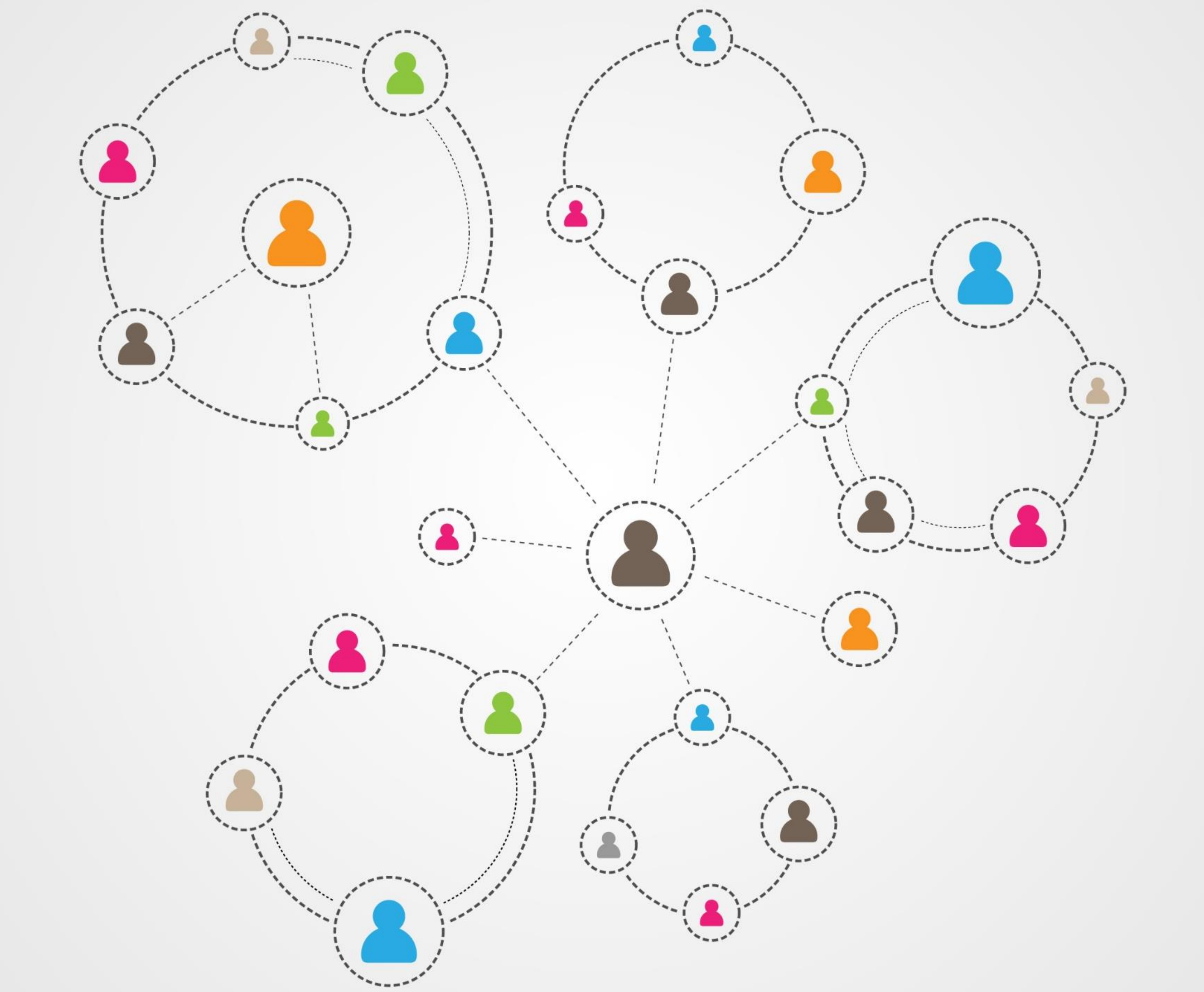
The provider could also quote a statistic for the potential for nominal cuts in income – although not actually as critical as failing to provide inflation protection, it's a very emotive concept for savers, regulators and legislators alike. It should be addressed head on, even if the statistic in isolation may mean little. This Provider has a 3.2% chance of having to reduce the level of your pension in a year. Is this good or bad? Over time, market norms will emerge and enable savers to come to a view on this. In the early days, they should be able to get a sense of how two providers compare.

Question 24 - What other changes in addition to those set out in this document, do you think need to be made to ensure the effective and fair operation of decumulation only CDC arrangements?

If the fairness between providers is addressed by ensuring they quote for similar products (i.e. with inflation proofing) and inherent variabilities are correctly portrayed and communicated, the CDC income market place could fulfil a really valuable role in moving UK pensions forward and offering, as the minister has called for *"on average a better outcome for their retirement than might otherwise be available."*

PASA

assess | aspire | achieve



info@pasa-uk.com

www.pasa-uk.com