Department for Work & Pensions

Delivering Collective Defined Contribution Pension Schemes

Public consultation

November 2018

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Contents

About This Consultation

Who this consultation is aimed at

We expect this consultation to be primarily of interest to:

- Employers who sponsor an occupational pension scheme
- Trustees
- Those seeking to establish a CDC scheme
- Pension professionals

Purpose of the Consultation

This consultation seeks to set out our thinking about CDC pension schemes. The consultation document contains a number of questions about specific aspects of the policy. It does not include draft legislation.

This consultation applies to England, Wales and Scotland. It is envisaged that Northern Ireland will make corresponding legislation.

Duration of the Consultation

The consultation period begins on 6 November 2018 and runs until 16 January 2019.

How to Respond to this Consultation

Please send your consultation responses to:

CDC Team
Private Pensions and Arm's Length Bodies
1st Floor, Caxton House
6-12 Tothill Street
London
SW1H 9NA

Email: caxtonhouse.cdcconsultation@dwp.gsi.gov.uk

Government Response

We will aim to publish the government response to the consultation on the GOV.UK website. The consultation principles encourage Departments to publish a response within 12 weeks or provide an explanation why this isn't possible. Where consultation is linked to a statutory instrument responses should be published before or at the same time as the instrument is laid.

The report will summarise the responses and outline our next steps.

Consultation Principles

This consultation is being conducted in line with the revised Cabinet Office consultation principles published in March 2018. These principles give clear guidance to government departments on conducting consultations.

Feedback on the Consultation Process

We value your feedback on how well we consult. If you have any comments about the consultation process (as opposed to comments about the issues which are the subject of the consultation), including if you feel that the consultation does not adhere to the values expressed in the consultation principles or that the process could be improved, please address them to:

DWP Consultation Coordinator
2nd Floor
Caxton House
Tothill Street
London
SW1H 9NA
Email: caxtonhouse.legislation@dwp.gsi.gov.uk

Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published consultation report.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact the Central Freedom of Information Team:
Email: freedom-of-information-request@dwp.gsi.gov.uk

The Central FoI team cannot advise on specific consultation exercises, only on Freedom of Information issues. Read more information about the Freedom of Information Act.

Ministerial Foreword

I am delighted to publish this consultation setting out the government's proposals for Collective Defined Contribution – CDC – schemes.

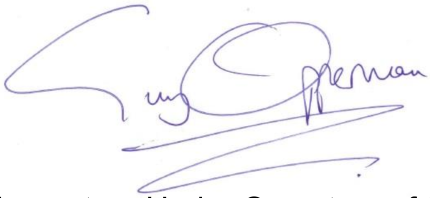
I am always keen to welcome innovation when it comes to something as important as people's retirement outcomes, but I also recognise that such innovation needs to be based on sound foundations.

It is important to be clear that CDC schemes are not a catch all solution. Such schemes must be based on realistic targets and robust assumptions, and members will need to understand how their benefits work and that their monthly pension will fluctuate in value and can decrease. I recognise that this is a new concept for British pension savers, and one which will pose some communication challenges for schemes, employers and the government. But this challenge is surmountable.

As we are seeing, the Royal Mail and the Communication Workers Union are already working to establish a CDC scheme in the UK, with both united in their belief that such a scheme will be advantageous to everyone involved. I recognise that Royal Mail's plans may be of interest to others, and I understand that it will be providing more details of its scheme's design during the consultation period.

The UK has a world-class occupational pension system – but I believe that there are always opportunities for further innovation which can be made for the benefit of savers and business alike. A robustly designed and appropriately regulated CDC regime is one such opportunity.

I look forward to hearing your views on our proposals.



Guy Opperman MP, Parliamentary Under-Secretary of State for Pensions and Financial Inclusion

Chapter 1: Collective Defined Contribution Schemes

1. The concept of Collective Defined Contribution (CDC) provision – where contributions into the scheme are pooled and invested with a view to delivering an aspired to benefit level - is not a new one.

2. Advocates suggest that such schemes can be attractive to members as they -

    - Provide a savings and income in retirement option within one package that is potentially attractive to those people uncomfortable making complex financial decisions at the point of retirement

    - Enable the sharing of longevity risk between members, thus providing each individual member with an element of longevity protection without the cost of accessing the insurance market

    - May achieve greater scale than some non-pooled schemes and be able to invest at lower cost as a result. The recent emergence of master trusts in the individual Defined Contribution (DC) space has already shown some of the benefits of scale

    - May allow the trustees to adopt an investment allocation which is tilted towards a higher proportion of higher return assets over the member's lifetime than may be usual in an individual Defined Contribution scheme, although the emergence of the draw-down market may see trends in the individual DC space follow a similar path over time.

3. CDC schemes could also be attractive to employers by allowing them to offer their employees a pension scheme, which offers an income in retirement in the form of a pension from the scheme's own assets, but without the risks and balance sheet impact of sponsoring a Defined Benefit plan. This is dependent on sufficient clarity in CDC-related legislation so that there is no obligation on the employer to fund any shortfall in funding – although clarity in legislation does not

remove the need to communicate the precise nature of CDC schemes to members.

4. The government recognises there is a growing interest in such provision – in particular from Royal Mail (discussed below). The Work and Pensions Select Committee also recently recommended that the government should act quickly to legislate to allow CDC schemes.

5. As the Work and Pensions Select Committee's report and other commentators have acknowledged, however, there are a number of issues that need careful consideration and handling if this type of scheme is to be properly run, and if members and employers are not to be exposed to unacceptable risk.

6. In this document we discuss our broad proposals as to how a particular form of CDC scheme might work in the UK, and the legislative and regulatory regime that would be needed to support any such scheme. The document gives an indication of our policy intentions and likely focus of the legislation. We are not consulting on draft legislation, but are seeking views on our proposed approach.

1.1 Royal Mail

7. The government acknowledges that interest in pooled pension provision amongst employers has been limited to date, with many preferring to remain with established methods of pension provision, whilst others have been waiting until the government's position on pooled provision in the UK is clearer.

8. Nevertheless, Royal Mail (RM) and the Communication Workers Union (CWU) have been working together over the last 18 months to develop plans for a new CDC pension scheme for RM's workforce as both parties felt that such a scheme would suit their needs better than an individual DC scheme. As they developed clearer proposals and details of the scheme's design, RM approached the government to see whether it could facilitate its planned approach in legislation.

9. From those discussions we can see that RM's initiative could be a model for other employers and other workforces to launch their own CDC scheme and we are therefore consulting on a framework that reflects this type of scheme design, as well as exploring the policy and regulatory issues that CDC schemes raise more generally.

10. We understand that RM will be publishing more information on its proposed CDC scheme during the consultation period so that those with an interest can consider its approach.

1.2 The Current Pensions Framework

11. Broadly, the current framework for pensions in the UK provides two main benefit choices for occupational pension schemes.

Defined Benefit (DB) based pension schemes

12. In a Defined Benefit (DB) scheme, the sponsoring employer aims to provide members with a specified income in retirement that is typically predetermined by a formula based on the employee's earnings history and tenure of service. Both members and the sponsoring employer may make financial contributions to the scheme, but individual pension outcomes do not depend solely on the value of contributions and investment returns. Rather, the employer underwrites the risk that the cost of providing the specified income in retirement exceeds the original contributions (plus investment returns), and accepts that it will need to pay more money into the scheme if this is necessary, in order to pay the promised benefits. Usually, the benefits would be reduced only if the employer becomes insolvent, with the Pension Protection Fund acting as a safety net to limit that reduction.

13. DB schemes therefore offer members a high degree of certainty of a regular income in retirement, which we know members of these schemes have valued.

14. These schemes can be attractive to an employer too, for example for employee recruitment and retention purposes. However, they can be expensive and risky

for employers due to the obligation on the employer to underwrite the scheme as inflation, investment and longevity risks can all impact on the cost of this employer commitment.

Individual Defined Contribution (DC) based pension arrangements

15. In an individual DC arrangement contributions are paid into an individual account for each scheme member. The contributions are invested and the returns on the investment (which may be positive or negative) are credited to the individual's account. On retirement, the account is used to provide retirement benefits, requiring the member to choose from options such as income draw-down, a cash lump sum, or the purchase of an annuity which then provides a regular income.

16. Unless and until an annuity is purchased, individual members carry the ongoing risk of inflation, investment and longevity themselves as their income in retirement is determined by the value of their account (often referred to as their ‘pot’) at retirement and the impacts of individual decisions made when they retire and in retirement (for example, the purchase cost of an insured annuity or the effects of different post-retirement investment options). If, rather than purchasing an annuity, an individual member chooses income drawdown in retirement, there is no pooling of longevity risk and so the member is responsible for managing the risk of drawing down funds either too quickly or more slowly than necessary to provide a regular income for life.

17. Individual DC arrangements do offer individual savers a high level of flexibility around their retirement options. However, this flexibility means that individuals have to make significant financial decisions at retirement. We know that some people can be nervous about making these decisions so the government has introduced the Single Financial Guidance Body to help vulnerable members make decisions about their retirement.

18. Individual DC savers who annuitise can experience very different individual retirement outcomes depending on when they do so, as they will lock in investment gains or losses and annuity pricing at the point they make a decision

to purchase an income product. For example, pension income outcomes may be markedly different for two individuals with the same contribution histories but who are retiring only a few years apart if there is a significant shift in asset values or annuity pricing over that period.

1.3 CDC Pension Schemes

19. In a CDC scheme, financial contributions are invested in a collective fund. Broadly, a particular member's pension would be calculated as follows –

    - estimating how much money is needed to provide the target level of benefits to each member;

    - adding up the values for each member to determine the total assets available to provide target benefits to all members;

    - If the assets available are higher or lower than the estimated money required to meet target benefits, make corresponding adjustments to (i) the current payment of benefits to each pensioner member and (ii) the prospective pensions payable to active and deferred members;

    - adjusting the future target level of benefits so that the total value of benefits is equal to the total value of assets

20. The collective nature of a CDC scheme, and the way it adjusts the level of pensions and prospective pensions, should mean that the overall membership will enjoy an element of cushioning from volatility as investment risk is adjusted for over time and longevity risk is pooled across the membership. Because the fund is administered and managed on a collective basis, there is also no need for members to make choices about the investment of funds or the ways of converting that fund into an income stream in retirement.

21. However, there are risks as well as potential benefits from such provision.

1.4 Key Issues to Consider

Uncertainty around benefit levels, ensuring appropriate communication to members

22. A key principle of CDC schemes is that the benefit level offered can only ever be a target or an estimate. It is not guaranteed by the employer and members will need to recognise from the outset that the benefit levels aspired to may not be achieved and that the level at which pensions are paid or prospectively payable may go down, while the rate at which benefits are uprated each year will be subject to a degree of uncertainty.

23. While legislation will need to be clear that there is no obligation on employers to meet shortfalls in funding, the way CDC schemes work will pose a significant member communication challenge. We recognise that this approach is a new concept in UK pensions and it may take time for members to become accustomed to. In particular, the possibility of a decrease in a pension in payment will be very different to current experience, notwithstanding the shift of some members towards drawdown as a way of delivering an income in retirement.

24. The uncertainty around benefit levels in CDC schemes makes the quality of communication with members before entry, during accumulation and when drawing benefits a significant factor in the successful operation of such schemes. Members will need to be aware of and accept the risks involved, so clarity around when benefits may be subject to reductions, and how this will be managed should be a key part of any communications strategy in such schemes.

Risk sharing and inter-generational issues

25. Many financial products have an element of collective risk pooling; there are various ways to describe this, from risk sharing to risk transfer to cross-subsidisation. In insurance, for example, where products are bought as a means to offset some of the risks of negative events such as flood or theft, those who do not have reason to claim in effect subsidise those who suffer misfortune and do claim.

26. Similarly, cross-subsidisation is an inherent feature of most traditional means of providing an income in retirement. For example, in a DB scheme, or for those who buy an annuity, individual longevity will result in cross-subsidisation between members.

27. Cross-subsidisation is also a feature of CDC schemes, with the type of cross subsidy dependent on the scheme design. As in a DB scheme, the actuarial value of the benefits being built up can vary according to the age of the member. For example, where flat-rate contribution and accrual rates apply, accumulating credits within the scheme for younger members is likely to be less expensive because it is assumed that there is a longer time-period in which to achieve sufficient investment returns on the contributions paid before such members begin to receive a pension income. Older members, however, may be more costly for the fund because there is a shorter time-frame to achieve real investment returns.[1] However younger members may get less value from flat-rate contributions under such an approach if they decide to transform their credits within the scheme into a transfer value.

28. Other criticism of pooled provision has focused on schemes designed to prioritise the protection of current pensioners from reductions at the expense of younger members who are still contributing, for example by increasing their contributions to the scheme to improve the scheme's ability to pay current benefits.

29. It is important that those designing CDC schemes are alive to these issues and take account of them, and that attention is given to the way in which the potential for differential impact on different generations or groups of members is communicated to the membership.

30. We recognise that the Equality Act 2010 protects the following characteristics –
    - age
    - disability

[1] To put this another way, £100 invested for ten years should achieve a higher investment return than £100 invested for two years.

- gender and gender reassignment
- ethnicity
- marriage or civil partnership
- pregnancy and maternity
- religion or belief
- sexual orientation.

31. We have set out some of the issues relating to inter-generational impacts and equal accrual rates for different ages earlier in this section and will want to understand whether there are any specific Equality Act issues than will need to be addressed.

Question:

1. **Are there other ways in which the introduction of CDC Schemes would give rise to different impacts on individuals in relation to one of the protected characteristics?**

Use of capital buffers in CDC schemes

32. Some CDC scheme designs feature a mandatory 'capital buffer' or 'margin for prudence' which impacts on the assessment and application of member increases. In other words, benefits may be lower than the best estimate of what the assets will fund so as to allow a financial buffer of a set level to be built up within the scheme.

33. This buffer reduces the chance of the scheme having to cut pensioner incomes in the future, but can impede the payment of increases once economic conditions improve if the capital buffer needs to be returned to a required level.

34. While some members might appreciate this added level of predictability, these buffers have been viewed by some as unwieldy and problematic, particularly if

they introduce risks or burdens on younger members (for example, through higher contributions or lower pensions).

Chapter 2: Legislative Approach

35. The Pensions Schemes Act 2015 (the 2015 Act) was drafted to provide for a range of new risk sharing options for employers and other pension providers, as part of the wider Defined Ambition (DA) framework. This reflected the intentions of the government at that time.

36. As part of these wider changes, the 2015 Act included provision for 'Collective Benefits', which would have allowed for pooled schemes to fit within the proposed pensions framework in a particular way, once appropriate regulations had been brought forward.

37. Following the 2015 election the government decided to put the commencement of the DA framework, including the provisions relating to pooled schemes, on hold following feedback from employers, schemes and the industry.

38. However, in RM and the CWU we now have an employer and a workforce who are united in their desire to establish a CDC scheme, and that have come forward with a detailed scheme design for consideration which may also be of interest to other employers and their employees. There is therefore new impetus for the government to consult on the issues that need to be addressed under such models and how we might facilitate and regulate appropriate scheme designs.

39. When government was approached in early 2018 by RM and the CWU, we considered the extent to which their proposals fitted within legislation already on the statute book.

40. After much consideration, we concluded that existing legislation does not contain suitable definitions or set out an appropriate framework for the proposed RM scheme and similar such schemes.

41. In respect of provisions in the 2015 Act specifically, we concluded that these were not suitable for our needs for reasons that include -

- The collective benefit provisions in the 2015 Act are enmeshed with other provisions which are designed to deliver the wider DA framework. There continues to be no appetite amongst employers, workers and pension providers to significantly recast the pension regime to introduce this entire framework.

- Under the provisions of the 2015 Act collective benefits cannot be money purchase benefits. This is due to the way collective benefits were intended to work within the wider changes to the pension regime and scheme classification envisaged by the DA Framework.

- While we could seek to tackle this issue by limiting the application of the various non-money purchase requirements (such as mandatory indexation and employer responsibility for deficits) we believe that this could be confusing and brings too high a risk that employers would be put off from providing CDC benefits for fear that they could be obliged to meet any shortfall between the value of the scheme's assets and the benefit level aspired to. (For a further discussion of CDC benefits as a type of money purchase benefit, see chapter 3 below).

- Our analysis of the most appropriate way of providing for CDC benefits has moved on since 2015. This means that some of the provisions in the 2015 Act - for example, those around managing benefits based on the probability of delivering a benefit being within a specified range – do not sit easily with current proposals in respect of scheme design, and would make it more difficult for such schemes to operate.

42. **We have therefore concluded that fresh primary and secondary legislation is needed to deliver an appropriate legislative and regulatory framework for CDC schemes. These new provisions will make clear that CDC benefits are a type of money purchase benefit, as well as providing for the necessary supporting regulatory framework.**

2.1 Brief Outline of Proposed Legislation

43. As set out above, we intend that -

- CDC benefits will be a type of money purchase benefit so that employers have clarity about their liabilities to the scheme.

44. We also intend that -

- ‘CDC schemes’ will be defined in legislation so that we can attach an appropriate regulatory and assurance regime to them. This is discussed further in chapters 3 and 5.

45. Where appropriate, detailed provisions related to valuation, adjustment of benefits, transfers, wind up, disclosure and other technical requirements will be provided through secondary legislation. This will allow greater flexibility to adapt the legislation as needed as these schemes become more established in the UK or if issues emerge once the initial tranche of schemes are in operation. To the extent that it is feasible and appropriate, these provisions will be based on what was set out in Part 2 of the Pension Schemes Act 2015, with appropriate modification as discussed in the chapters that follow.

46. Consequential amendments will be made to other legislation as necessary to ensure that CDC benefits and CDC Schemes are referenced appropriately.

47. Finally, we intend to make such repeals of the unneeded parts of the 2015 Act as may be appropriate.

48. **Our intention is to present the necessary legislation to Parliament as soon as Parliamentary time allows.**

2.2 Scope of Our Legislative Approach

49. As mentioned, though the recent debate around the viability of introducing CDC schemes in the UK has been active, so far the number of schemes and

employers considering and developing detailed models has been limited. Given there has been some uncertainty around the operation of CDC models and how such provision fits with current legislation, this isn't perhaps surprising.

50. However, in the case of RM we have an employer that has developed a detailed proposal with input from CWU and its workforce, and which is committed to operating such a scheme.

51. The government believes that it is right that we support innovation aimed at providing good outcomes for members seeking an income in retirement, and the type of pooled scheme proposed by RM deserves consideration.

52. With this in mind, we are focusing initially on creating an appropriate legislative framework for CDC schemes of the broad form and nature proposed by RM. The initial tranche of pooled risk schemes will have to operate within that framework.

53. We are not ruling out the possibility that the regulatory regime might be modified should employers or others come forward with different proposals and designs that are appropriate, but the feedback so far suggests that employers want to see the RM scheme bed in before doing so. We also think it is right from a regulatory perspective that we learn from the experience of the RM scheme before we seek to make provision for other types of pooled risk schemes.

54. **We therefore propose to legislate to create the regulatory framework which will enable the type of CDC scheme proposed by RM to operate. We also intend to make provision for the legislation to be able to be modified and adapted by means of secondary legislation. This will allow us to take account of changes needed in the light of experience arising from RM. This will also allow for a more flexible and responsive approach if we need to adapt the regime for other CDC schemes.**

Chapter 3: Fitting CDC Schemes into the UK Pensions Landscape

55. The previous chapters discussed the benefits and risks of CDC schemes in broad terms, as well as other factors which have influenced our proposal to facilitate a particular approach rather than legislating for a wide range of schemes and designs to operate from the outset.

56. In this chapter we focus on the need to –

    - define CDC benefits within legislation as a type of money purchase benefit to address establishing employers' concerns

    - provide for CDC benefit schemes within pensions legislation so that we can prescribe specific requirements and quality features for schemes seeking to provide such benefits, where necessary.

57. As previously stated, this consultation paper gives an indication of our policy intentions and likely focus of the legislation. We are not consulting on draft legislation but seeking views on our proposed approach.

58. **It should be noted that our approach is not intended to alter the categorisation of existing pension benefits and schemes.** Rather, it is instead designed to allow new schemes (or new segregated sections of existing schemes) to be established for newly earned pensions going forward where the scheme (or segregated section) is clearly designed for members, and only members, to pool investment and longevity risk in providing a pension in retirement.

3.1 CDC Benefits as Money Purchase Benefits

59. The UK's current pension legislation in effect divides occupational pension benefits into two categories –

- money purchase benefits.
- non-money purchase benefits.

(There are also hybrid schemes, where schemes offer a mixture of both through separate sections within the same scheme.)

60. As mentioned in chapter 1, a key principle of CDC schemes is that the benefit level offered can only ever be a target or an estimate. It is not guaranteed by the employer.

61. In the CDC schemes we intend to facilitate, pension income will be determined by reference to the overall value and assumed future performance of the collective fund and its membership. While the scheme will provide projections as to the level of benefits which it expects to pay out of the fund there is no obligation on the employer to make additional contributions should the funding level fall short of that needed to pay this level of benefits. This more closely resembles money purchase type provision.

62. **Our view therefore is that CDC benefits should be categorised in legislation as a type of money purchase benefit, to provide clarity for members and establishing employers of CDC schemes.**

63. To support this approach, we will require CDC schemes to be clear in their communications with members that the level of CDC benefits is not guaranteed and will depend on the value of the scheme assets and other scheme experiences and assumptions as to future performance. How benefit entitlements accrue and reduce or increase to take account of changes in asset values and other experiences and assumptions should also be conveyed clearly to members. Potential communication and disclosure requirements are discussed in more detail in chapter 5.

64. As a consequence of CDC benefits being a type of money purchase benefit, the Pension Protection Fund would not be expected to pay compensation in respect of CDC benefits should the employer become insolvent.

65. We recognise that there are certain areas where the existing legislation as it applies to money purchase schemes may need to be adapted or modified in its application to CDC schemes. For example, that relating to automatic enrolment, revaluation of deferred benefits, subsisting rights and transfers of benefits between schemes.

Questions:

2. **Do you agree that CDC benefits should be classified in legislation as a type of money purchase benefit?**

3. **Are there any other areas where the current money purchase requirements do not fit, are inappropriate or could cause unintended consequences?**

3.2 CDC schemes

66. We propose to make provision for schemes providing CDC benefits as a specific category of pension scheme within pensions legislation so that we can prescribe specific requirements and quality features for such schemes, where necessary.

67. **We feel it is appropriate that CDC schemes are required to be occupational trust-based pension schemes with their main place of administration in the UK**.

68. **They will also need to be registered with HMRC for tax purposes, and be authorised by The Pensions Regulator (see chapter 5) before they can receive contributions.**

69. If a scheme containing a CDC section is a hybrid scheme (i.e. it contains a section that provides non-money purchase benefits), the non-money purchase section will need to be clearly separate from the CDC section including having segregated assets. We expect that a section which contains employer guarantees will continue to appear as a liability on the employer's balance sheet and will be considered accordingly within the legislative and regulatory framework. We propose however to make the necessary provision in legislation so that the two sections can be treated in effect as separate schemes.

70. Whilst CDC schemes will be based on some familiar foundations, we will incorporate new conditions specific to CDC schemes. The initial framework is intended to facilitate provision by single or associated private sector employers who wish to consider alternative pension provision options following appropriate consultation with their workforce and trade unions where relevant. The legislation will therefore initially restrict CDC benefit provision to such schemes.

71. We will also require that CDC schemes undertake annual actuarial valuations in order to determine whether benefit adjustments up or down are required, and specify principles that will apply to those valuations (this is described further in chapter 4).

72. We do not feel it is appropriate for CDC schemes to be accrual-only vehicles, as feedback suggests that it is the combination of smoothed investment and pooled longevity risk which is likely to generate interest in CDC schemes.

73. We believe that CDC schemes will need sufficient scale to be able to pool longevity risk across the membership. We would be interested in views on the required scale.

74. While we intend to facilitate a particular design of CDC provision initially, we recognise that interest in pooled arrangements may grow once the initial tranche

of CDC schemes are bedded in. We therefore intend to provide sufficient flexibility in regulation making powers to allow us to adapt the way in which CDC schemes are defined to accommodate alternative models and providers – i.e. multiple-unconnected employers or commercial provision - if a clear need arises in the future and such models can be justified.

75. In this way, we intend to create an initial platform and gateway which provides an opportunity for single or connected employers wishing to take up this type of provision, while allowing flexibility in the legislation to adapt the CDC benefits regime to future demands.

Questions:

4. **Do you agree that the initial CDC schemes should be required to meet the conditions described above?**

5. **Is there a minimum membership size for CDC scheme below which a scheme could not be viewed as having sufficient scale to effectively pool longevity risk to the benefit of the membership?**

3.3 Trustee Duties and Requirements

76. As mentioned above, CDC schemes in the UK will be required to be established under irrevocable trust.

77. There has been some discussion of whether such schemes warrant more stringent requirements in respect of trustee knowledge and understanding (TKU), to ensure that their trustees are fit and proper to oversee the challenges pooled schemes might present. However, we take the view that the current TKU requirements in respect of trustees of occupational pension schemes, alongside general trust law, should be sufficient. Current TKU requirements, in effect, are expressed as being sufficient for the particular scheme of which the person is a trustee, so these should be flexible enough to incorporate CDC requirements.

However, given the potential significance of the trustee role in relation to CDC schemes, we are minded that as part of the authorisation process (discussed in chapter 5) The Pensions Regulator will consider the collective expertise and experience of persons acting together in the capacity of trustees in such schemes.

78. Current requirements on trustees to obtain professional advice where relevant (for example on investment) will continue to apply.

79. As discussed, our initial approach is intended to facilitate CDC provision by schemes established by employers with a sufficiently large workforce to pool longevity risk and sufficient resources to develop an appropriate design, and which have a history of pension provision and an established governance structure in place alongside experienced advisors. While this should help in bedding in these new schemes, we are mindful that there may be a case for expecting higher levels of governance in CDC schemes generally, and will be considering this further in the light of responses to this consultation.

80. Proposed requirements on trustees or scheme advisors in respect of valuations, member-borne charges, transparency, reporting and communications are discussed further in chapter 5.

81. We will consider whether more stringent TKU requirements are needed should a greater appetite emerge among providers who do not fit the template described above. To allow for this possibility we propose to make provision in the legislation to enable the requirements on trustees to be adjusted should we take the view that more stringent requirements are needed in the future.

Question:

6. **Do you agree with the proposed approach to TKU for CDC schemes?**

7. **Are there any additional TKU requirements that should be placed on the trustees in CDC schemes?**

8. Are there any TKU requirements that should be relaxed for the trustees of CDC schemes?

3.4 Tax Treatment of CDC Schemes

82. Tax relief is available for DB and DC pension schemes, and schemes that are a combination of both, provided they are registered with Her Majesty's Revenue and Customs (HMRC) for tax purposes. We intend that individuals and employers paying into CDC schemes will have the same opportunities to benefit from tax relief.

83. CDC scheme pension payments will be subject to income tax in the normal way. If a CDC scheme makes payments that are not authorised for tax purposes, tax charges for the individual and the scheme will apply as they do in connection with similar payments made out of other registered pension schemes.

84. Due to the innovative nature of CDC schemes, changes to tax legislation may be needed for them to receive equivalent tax treatment as existing registered pension schemes. Following this consultation, the government will consider whether further legislation is needed for tax purposes and how best to fit CDC schemes into the current Finance Act 2004 framework, for example for the purposes of testing benefits against the individual's annual and lifetime allowance.

3.5 Automatic Enrolment Requirements

85. Automatic enrolment (AE) was brought in under the Pensions Act 2008. AE aims to help more people save for later life by making it compulsory for employers to automatically enrol their eligible workers into a qualifying pension scheme. We expect that employers wishing to set up CDC schemes will want to use them to meet their obligations in respect of AE. As with any AE scheme they will need to meet certain qualifying criteria and minimum requirements.

86. Our intended approach will mean that CDC schemes will have certain characteristics hard-wired into their design that will assist them in meeting particular AE requirements. For example, a CDC scheme will need to be a UK occupational pension scheme that is registered with HMRC for tax purposes, and with its main administration in the UK.

87. However, CDC schemes will also need to meet other criteria which seek to ensure that -

- There is no barrier to the employer automatically enrolling a jobholder – e.g. there should not be an inappropriate age barrier in scheme rules preventing this.

- Jobholders are not required to provide information or make choices in order to remain an active member of the scheme.

- The scheme meets certain obligations in respect of member-borne charges (discussed in chapter 5 below).

88. We also need to consider further what minimum quality requirements and accompanying tests should apply to a CDC scheme.

89. There is already a range of quality tests in AE legislation, which differ according to pension scheme type. In broad terms –

- The most common test for a UK-based money purchase scheme is linked to minimum contribution levels for each individual based on a percentage of that individual's prescribed earnings.

- In a UK-based DB scheme the test is usually framed in terms meeting a benchmark for a jobholder's entitlement to benefits, or for the cost of providing those benefits.

90. At first glance, a money purchase type approach might be considered a logical fit for a CDC scheme (or section in a hybrid scheme), given we intend to categorise CDC benefits as a type of money purchase benefit. However, there may be an argument that a test linked to contributions payable in respect of individual jobholders is not the most suitable approach in a scheme in which contributions are not allocated to individual member pots but rather paid into a collective fund within which the value of the benefits being accrued by each individual member will typically vary by the age of the individual member even though the nominal rate of contribution and benefit accrual may be flat regardless of age (see section 1.4). In such a scheme, a quality test which considered the scheme-wide cost of accrual, for example, might be argued to be a more suitable option.

91. It is worth noting that an AE 'cost of accrual' test already exists for DB schemes and is based on the cost of providing members' benefits. A cost of accrual test in a CDC scheme might be informed by the scheme actuary's annual report.

92. Broadly, for a DB scheme to pass the current 'cost of accrual' AE test, the cost of providing benefits in respect of each tranche of members must require a contribution of at least 10% of 'qualifying earnings'. There are variants of this test available to make it easier for employers to identify qualifying earnings and the appropriate test that should apply. One option would be to apply this type of test to CDC schemes, if this is felt to be appropriate. However, we would welcome responses on what AE quality test might best suit the intended scheme design.

Questions

9. Which of the two AE tests would be more appropriate for CDC schemes, and how might either test best be modified to better fit CDC schemes?

Chapter 4: Target Benefits and Scheme Valuations

93. In a DB scheme, the total value of the scheme's assets is compared to total benefit liabilities. If the scheme's fund value cannot meet the cost of the liabilities, the sponsoring employer is required to pay more money into the scheme.

94. In an individual DC scheme, contributions are invested on behalf of each member to build up an individual fund comprising of their contributions and investment return which members then use to provide themselves with retirement benefits. If a member wants the security of an income for life, then if the fund value at the single point in time when they turn their fund into an annuity is low due to market conditions at that point, or the cost of annuity is high, the member will be locked into a lower level of income for life.

95. In broad terms, within a CDC scheme contributions are invested on behalf of members into a collective fund and the membership is paid a benefit from the fund from a scheme retirement age. The trustees will set out the benefit level aspired to, but this is not guaranteed.

96. Target benefits should be realistic. Given this, we favour placing a requirement on schemes looking to provide CDC benefits to undertake a peer review of their underlying actuarial assumptions prior to seeking authorisation by The Pensions Regulator. This peer review would be undertaken by actuaries independent of the scheme actuary. This will allow these assumptions and the scheme's design to undergo wider scrutiny before the formal scheme authorisation process commences.

97. This should not be interpreted as undermining The Pensions Regulator's decision-making powers or the authorisation process generally, rather it is intended to provide assurance to all parties that scheme design and planning decisions are being made on a reasonable basis and difficult choices are not being avoided by deliberate or unintended caution or optimism in respect of likely investment returns.

98. **We will require that CDC schemes undertake annual actuarial valuations once they have been authorised in order to determine whether benefit adjustments are required and to test the overall sustainability of the scheme**. The principles that will apply to those valuations and the potential decisions that arise from them are discussed further below.

99. **In addition, given the complexity of CDC schemes compared to individual DC schemes, we feel it is appropriate for the former to be required to appoint a scheme actuary. This is discussed further in chapter 5.**

4.1 Managing Fluctuations in Scheme Funding and Communicating Variations in Benefits

100. As discussed in section 1.4, some existing CDC schemes outside of the UK are designed - through the inclusion of mandatory financial buffers - to deliver greater predictability around payment of a 'base rate' level of benefits. Nevertheless, significant under-performance in investment returns can lead to the erosion of this buffer and result in reductions to benefits in accrual and in payment.

101. While this type of approach has the advantage of offering the pensioner members greater predictability, this design is relatively more expensive to operate and carries a higher risk of being misunderstood by members as being guaranteed. The restoration of the buffer places an additional burden on younger members in particular, whose contributions may be used to help retain and restore this buffer when depleted.

102. Alternative models, such as that proposed by RM, seek to pay out benefit levels based on the current total value of the fund (i.e. without reserving some of it to use as a buffer). Members' benefits would be adjusted each year in light of the most recent valuation. This model gives the membership less predictability than a buffer model. However, under this approach the scheme would be more transparent and would protect it from claims that it is stockpiling a sizeable surplus at the expense of increases for current members.

103. Experience from other countries' pooled risk schemes suggests any form of unexpected, large benefit cut can be difficult for individuals to accept. As discussed, members will need clear and effective communication to understand the extent to which their benefit levels may be affected by the performance of the collective fund, changing investment return assumptions, and the actual and assumed longevity experience of other scheme members.

104. Clearly, a CDC scheme will not provide the certainty of an annuity, or of a well-funded DB pension supported by strong sponsoring employer so timely, clear and simple communication to all members on the risks that they retain in a CDC scheme and how the trustees are mitigating these risks can help members understand and anticipate the impact of a potentially variable pension in retirement.

Questions:

10. What issues might arise from having no in-built capital buffers in the scheme design?

11. How can schemes best communicate with members to ensure they understand the risk that their benefits could go down as well as up, even when in payment?

4.2 Universal Application of Benefit Increases and Decreases

105. **We believe that it is reasonable that all members - pensioners, active and deferred - who have saved collectively for a pension should, as far as possible, share the effects of both investment out-performance and under-performance.** While pensioners and deferred members will experience these scenarios in different ways, both benefits in accrual and pensions in payment should be affected to preserve the collective nature of CDC schemes.

106. An increase or decrease in benefits resulting from scheme performance or changed assumptions should therefore be applied across the entire membership. In other words, if a 1% adjustment up or down to benefits is applied, this should be reflected in accrued prospective pension income for active and deferred members and in the pensions in payment to pensioner members.

107. The approach to adjusting benefits should be clear and unambiguous in the scheme rules, and communicated clearly to members.

108. **To help ensure this operates in an impartial way, our view is that this adjustment should be based on a mechanism set out in scheme rules, rather than trustee discretion.**

4.3 Meeting Benefits - High Level of Probability versus 'Best Estimate'

109. We recognise that a CDC scheme that contains a capital buffer may offer greater predictability in respect of paying out prospective benefits with minimal likelihood of reduction, and that this may have attractions for some members. However, as discussed earlier, such an approach may have its downsides

110. Designs which favour valuing a scheme on a 'best estimate' basis are by contrast comparatively clearer cut, albeit there is less predictability for the membership.

111. **On balance, we favour a 'best estimate' approach with no in-built buffers which potentially dilute decisions on benefit adjustment.**

112. We would also expect schemes to consider how best to manage volatility in the design of their projected benefits. For example, funding aimed at providing inflation increases to the projected benefits could have the effect of helping to absorb minor dips and increases in the fund's value by adjusting the level of annual increase accordingly. This could lessen the risk of absolute cuts to the target benefit level including cuts to pensions in payment.

113. Once a scheme's design is finalised and the peer review complete, supporting calculations and assumptions, including the underlying investment strategy, will need to be submitted by the scheme's actuary to The Pensions Regulator as part of the authorisation process, discussed in section 5.3 below.

Question:

12. What additional issues may arise from using a best estimate basis for valuation, and how should those issues be addressed?

4.4 Managing Risk Going Forward

114. Employers wishing to set up these schemes should be in no doubt that the government expects them to be established on sound foundations and underpinned by realistic assumptions and planning, and intend to legislate for an appropriate regulatory framework to that end. This should include ensuring that the scheme's design is robust to changes in scenario, for example closure or reduction in the inflow of new members, and a strategy to manage operational risks should they arise over the lifetime of the scheme.

115. Once a CDC scheme is up and running, we will expect the annual actuarial valuation process to consider emerging risks and threats, and to look at whether these risks significantly impact on the probability of projected benefits being met to an extent that calls into question the viability of the scheme. In such a scenario, we envisage that the scheme actuary would consider whether it is appropriate to recommend that the scheme be discontinued on sustainability grounds. Winding up the scheme, including potential triggers, is discussed at 4.5 below.

116. We recognise that there have been some concerns expressed within the industry that poorly designed CDC schemes could pose a greater risk to particular groups - for example younger members who may become exposed to significant risk of reduced benefits if contributions coming into the scheme reduce below a sustainable level.

117. One way in which schemes might tackle this is by ensuring that the scheme is designed from the outset to not be reliant on continuing contributions from active members. In order to achieve this, the pension increase/reduction process could be required to be based on a valuation which makes no allowance for any potential new accumulations after the valuation date, if that is considered an appropriate approach.

118. Alongside this, the chosen investment strategy would be linked to the maturity of the scheme's population so that, if the scheme's active member headcount materially reduced or the scheme closed to new accumulations, the scheme would gradually increase holdings in low risk assets so that benefits in a maturing scheme would not be expected to become materially more volatile. This long-term investment strategy would be required to be anticipated in all actuarial valuations so that there is not a reduction in increases due to the switch to low risk assets.

119. It is our understanding that the RM scheme has been designed on this basis.

120. We envisage that consideration of this mitigation strategy and scheme design will be part of the initial authorisation process.

121. Going forward, annual valuations will need to be submitted to The Pensions Regulator as part of the intended regime - and if sustainability concerns arise during or between valuations - trustees will be required to notify The Pensions Regulator, who will consider whether action is needed to protect members.

122. We are considering whether The Pensions Regulator needs additional powers to intervene should it believe a scheme has become unsustainable and members' benefits are at risk.

Question:

13. Should we restrict CDC scheme designs to those schemes which would be sustainable without continuing employer contributions?

14. We would welcome feedback on how best to manage risk generally going forwards.

15. Does the proposed CDC scheme framework, as set out in this consultation document, address concerns about risk transfer between generations? We welcome thoughts on any other measures that could also address this.

4.5 Potential Scheme Wind-Up

123. While we hope that CDC schemes will be in place for many years to come, we know that schemes can be forced to wind up for various reasons.

124. We will require scheme rules to be clear on what will prompt the winding up of a scheme, including a trigger relating to scheme sustainability. CDC schemes will also be required to have an accompanying strategy explaining how this process will work, including how members will receive a share of the pooled fund. Again, this should set out how detriment to members will be minimised, including the impact of winding up costs.

125. We acknowledge that some employers pledge to meet the wind-up costs themselves. However, schemes cannot rely on such help in the event of employer insolvency. One potential solution is to require an expense reserve to be in place to take account of this possibility.

126. In order for a CDC scheme to be permitted to run on without its establishing employer, the scheme's valuation would need to show that the scheme is financially sustainable over its envisaged life-time, and that running on in this way would not result in excessive administration costs being borne by the

membership. If these requirements are not made, there is a clear risk that administrative costs could significantly erode the membership's target retirement income.

Question:

16. We would welcome thoughts on appropriate wind up triggers and how best to manage associated risks.

Chapter 5: Specific Requirements for UK CDC Schemes

127. The legislative requirements applicable to CDC schemes will be a blend of familiar, money purchase type requirements and new or amended requirements to reflect the unique features of this type of pension provision.

128. Broadly, we envisage new or amended legislation will be needed to cover the following -

- Authorisation
- Mechanisms and rules for adjusting benefits in respect of all members so that scheme assets and liabilities match at each valuation
- Valuations and requirements around testing underlying assumptions in relation to expected benefit levels and their expected volatility
- Disclosure, transparency and information issues
- Member-borne charges
- Levies and scheme administration costs
- Requirements around transfers into and out of a pooled scheme
- Winding up triggers and exit strategies
- The Pensions Regulator's powers

129. This chapter explores some of these areas in further detail, as well as highlighting areas - such as investment - where the existing money purchase benefits legislation may continue to be appropriate.

5.1 Scrutiny and Authorisation by The Pensions Regulator

130. All occupational pension schemes are complex and require a high degree of competence to run - and it is clear that CDC schemes will pose their own administrative and communication challenges. CDC provision will be breaking new ground in some areas: this may generate some uncertainty and nervousness at the outset as employees, employers, trustees and the industry more widely get to grips with new requirements and approaches.

131. The case for some form of quality control for large, trust-based money purchase pension schemes is not a new one. The recent emergence of numerous commercial Defined Contribution master trusts, which provide a service to multiple unconnected employers but which fall outside of the Financial Conduct Authority's scrutiny, prompted a substantial discussion of whether stricter regulation of these schemes was needed to protect savers.

132. These discussions ultimately led to the requirement for both existing and new Master Trust pension schemes to be authorised by The Pensions Regulator in order to continue to operate in the pensions market.

133. As CDC schemes are breaking new ground we feel it is appropriate that they undergo pre-scrutiny as part of an authorisation process overseen by The Pensions Regulator before they can begin to take on contributions. We envisage that much of the detail will be set out in regulations.

134. Our initial view is that the CDC scheme specific authorisation process will need to cover some familiar considerations, such as -

- *Fit and proper*: whether the individuals who have a significant role in running the scheme can demonstrate that they meet a standard of honesty, integrity and knowledge appropriate to their role.

- *Systems and processes*: does the scheme have sufficient IT systems and processes to enable the scheme to run properly and are there robust processes to administer and govern the scheme.

- *Continuity strategy*: is there is a plan in place to protect members if something happened that may threaten the existence of the scheme, including how the scheme would wind up, if appropriate.

- *Financial sustainability*: does the scheme have a business plan and enough financial resources to cover set up, running costs and also the cost of winding up the scheme if it fails, without materially impacting member benefits.

135. However, CDC schemes may present additional challenges and risks, so our view is that the authorisation process may also need to consider additional matters such as -

- *Communications*: do these set out what is reasonable for members to expect from the scheme under all circumstances (including transfer values); do these explain how benefits will be accrued for members of different ages / how different age groups are treated / how value for members is achieved.

- *Investment/funding/increase arrangements*: what is the basis on which contribution rates are expected to be adequate to provide the target benefit levels with the scheme's investment strategy (including certification by the scheme actuary); what is the relationship of contributions to benefits; and how are adjustments and valuations carried out, and do these deliver adjustments on a universal basis.

- *Member options*: how has the actuary determined individual transfer values and decided the member's share of the fund.

- *Further winding up provisions*: including how pensioner members are treated - for example, a pension in payment could be converted to a DC drawdown fund, or be used to secure an annuity.

136. As is the case in master trusts, the onus would be placed on the scheme to provide The Pensions Regulator with the necessary information to obtain authorisation, and that would be dependent on The Pensions Regulator being satisfied that the relevant criteria are met.

137. As in the case of master trust authorisation, our view is that the costs incurred by The Pensions Regulator in scrutinising and authorising a CDC scheme should be met by the scheme to avoid directly placing these costs on other pension schemes.

138. We also envisage that CDC schemes will be subject to ongoing scrutiny and ongoing information and notification requirements to ensure that high standards are maintained. In order to effectively supervise CDC schemes, we are considering whether further requirements are needed such as:

- A CDC scheme specific Chair's Statement.
- Additional significant events reporting requirements.
- Specific annual CDC scheme returns (including valuation, adjustment to benefits).
- Accompanying obligations on specified persons to provide this information.

139. We are also considering whether The Pensions Regulator needs additional powers, for example to –

- obtain further information as needed.
- apply penalties for providing false or misleading information to The Pensions Regulator or in member communications.
- commission a skilled persons report (paid for by the CDC scheme).
- amend target benefits or set appropriate valuation assumptions / adjustment rates.
- close a CDC scheme to new entrants/future accrual.
- wind up the scheme other than in circumstances that would generally apply.

140. We recognise that interest in CDC provision may expand beyond the large employers that are likely to establish and sponsor the initial tranche of CDC schemes, so we will include provision in the legislation to enable us to make provision for such additional requirements as might be needed.

Questions:

17. Are there any elements of the proposed regime that it is not appropriate to apply to CDC schemes?

18. Are there any additional authorisation requirements that should be placed on CDC schemes?

5.2 Investment Requirements

141. It is matter of long-standing government policy not to direct pension scheme trustees' investment strategies. Trustees have and will continue to have primacy in this matter, subject to any pre-set rules in their scheme's governing documentation.

142. Trustees' investment duties are already set out in the Occupational Pension Scheme (Investment) Regulations 2005. They include broad principle-based requirements around the way trustees should manage investments limits on employer-related investments and the production of a Statement of Investment Principles (SIP). These apply to both money purchase and non-money purchase benefits. Our view is that it would be appropriate for the same requirements to apply to CDC schemes, which will be considered a type of money purchase benefit under our proposals.

143. In addition, relevant schemes - broadly, schemes offering money purchase benefits, except where those benefits are solely attributable to Additional Voluntary Contributions - are required to produce a default SIP in relation to the scheme's default arrangement(s).

144. The default SIP was introduced in response to the recognition that where members bore all the investment risk and had made no choice of how their pension scheme was invested, then additional oversight was appropriate to

ensure that the default arrangement adopted an appropriate investment strategy, and reported against it regularly.

145. We envisage that a fund used for CDC benefits should be required to produce a SIP modelled on that currently required for a default SIP. Where CDC benefits are offered alongside non-money purchase benefits, such as a closed DB section, a SIP would be required for the whole scheme's investments, and for the CDC benefits. Where a scheme only offered CDC benefits, the SIP and the default SIP would have an identical scope. This does not mean unnecessary publication of two identical documents. Rather a single document could serve as both the SIP and the default SIP.

Questions:

19. Are there any other investment requirements that should be required in addition to those proposed above?

5.3 Disclosure of Information

146. Current disclosure requirements for money purchase occupational pension benefits as set out in the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 include requirements in respect of basic information to be provided to members: benefit statements, information at the point of accessing benefits and information about winding up, among other things.

147. We envisage that most of the existing framework will apply to CDC schemes. For example, information about benefits payable under the scheme will be required under current regulations – including how benefits are calculated, how and when benefits in payment are increased, the rate at which rights to benefits accrue, and the conditions on which benefits are payable. But some specific requirements will be required to reflect the nature of CDC schemes. For example –

- It is particularly important that the risk of benefit reductions is communicated to members clearly, and that the system for distributing reductions and increases is clear and transparent.

- CDC schemes should be required to be completely transparent about their approach to expected benefits and the underlying factors and assumptions supporting these.

- Schemes must also be clear on their approach to how different classes or cohorts of members might be affected differently by the above.

148. CDC schemes will be required to publish this key information on a publicly accessible website so that it is freely available to all.

149. In addition, as CDC schemes will be classified as providing a sub-set of money purchase benefits, we propose that CDC schemes will be subject to recent requirements introduced by amendments to the current regulations. This will mean publishing -

  - The levels of charges and, as far as trustees are able, transaction costs borne by members of the scheme

  - An illustration showing the compounding effect of those charges over time

  - The trustees' assessment of the value the scheme offers to its members

  - The scheme's SIP and its default SIP

  - The implementation statement explaining how the trustees have acted on the principles set out in the SIP.

150. Finally, we envisage that the Annual Report produced by CDC schemes will contain all of the appropriate information - for example, details of the last annual valuation by the scheme actuary, a SIP, and a Chair’s Statement (including publication of relevant information on cost and charges and investment duties).

Questions:

20. Are there any other disclosure of information requirements that should be required in addition to those proposed above?

5.4 Administration

151. Current legislative requirements in the Occupational Pension Schemes (Scheme Administration) Regulations 1996 distinguish between benefit type or combination of benefits, and whether the scheme is single or multi-employer. This section sets out our proposals in relation to the application of those requirements to CDC schemes.

152. Certain requirements apply to all schemes, subject to certain limited exemptions. This includes the appointment of auditors and fund managers. We propose that these should also apply to schemes solely offering CDC benefits. Similarly we propose that the requirements in relation to legal advisers and custodians, where appointed, as well as the other provisions relating to trustees and fund managers in sections 32 to 39 of the Pensions Act 1995 and further requirements and exemptions under part III of the current regulations, should apply.

153. In keeping with our treatment of CDC benefits as a type of money purchase benefits, we propose that in most circumstances the money purchase administration requirements should apply. This means that we propose schemes should have requirements to -

- (where the scheme consists solely of money purchase benefits) Prepare, maintain and revise a payment schedule, and to notify The Pensions Regulator of non-payment by the employer.

- Exclude any provision in the scheme rules or the trust deed that requires the administration, fund management, advice or other services to the scheme to be provided by a given person, or otherwise restricts the choice of provider.

- Appoint a chair of trustees.

- Ensure that financial transactions are processed promptly and accurately.

- Calculate the level of charges and (as far as they are able) the level of transaction costs and assess the extent to which they represent value for members.

- Report on all these matters and others in the annual Chair's Statement.

154. One key area where we propose that CDC schemes should have broader legal duties than money purchase schemes is in the appointment of actuaries. Clearly, actuarial assessment and estimate is central to the provision of CDC benefits. Therefore we will dis-apply the exemption for money purchase schemes from appointing an actuary where any of the money purchase benefits are CDC benefits.

155. It is not our intention to make provision for CDC schemes which are promoted as schemes for unconnected employers at this stage. Therefore we do not propose that any of the multi-employer scheme requirements regarding the appointment of non-affiliated trustees or representation of members should apply, although the normal member-nominated trustee/director requirements would apply as for other occupational pension schemes.

Question:

21. Do you agree that CDC schemes should be administered under the requirements for money purchase benefits, but with added requirements to appoint a scheme actuary and carry out annual valuations?

5.5 Member-Borne Charges

156. A charge cap for particular money purchase arrangements came into force in April 2015. It protects so called 'double-defaulters' (savers who were automatically enrolled into a pension scheme without making any choice as to how their contributions were allocated) from high charges. This decision was driven by the lack of any clear link between higher costs and improved net performance. The cap is set at an annual 0.75% of funds under management, or an equivalent contribution charge.

157. The charge cap has been a success – average charges in pension schemes used for automatic enrolment are now between 0.38% and 0.54%, depending on scheme type. Pension scheme trustees are therefore not being constrained by the charge cap in delivering investment strategies which they deem to be good value for their members.

158. The charge cap only applies to money purchase benefits. Non-money purchase benefits, such as those offered by salary-related defined benefit schemes, were excluded from the cap. This is because the member does not bear any investment risk, and the ultimate value of their pension is not affected by the level of the charges paid on their behalf.

159. As CDC benefits will be a type of money purchase benefit, the members will bear all the investment risk and the value of their pension will be affected by the level of charges. **We therefore propose that CDC benefits will be subject to a similar charge cap at the same level. However, the detail of how that is**

applied is likely to need adjustment to reflect the nature of pooled benefit provision rather than individual pots. Our favoured approach to this is explained later in this section.

160. We do not believe that a charge cap will unduly limit the investment choices made by trustees of sufficiently large schemes offering CDC benefits. Transaction costs (the costs of buying, selling, lending and borrowing investments) are currently excluded from the current cap, and this will also be the case in CDC schemes. We have previously announced that the costs incurred as a result of holding property – which includes other 'real' assets – are also excluded.

161. While the administration of CDC benefits will include valuation-related costs in actuarial and other fees in excess of those paid by savers in individual DC schemes, we expect that these costs can be defrayed across the membership and the scheme assets, whilst complying with a charge cap. This means that a CDC scheme will continue to offer value for money. Risk sharing is a benefit of CDC provision, but that should not mean that members of these schemes are subjected to unreasonable or unfair charges.

162. Charge cap compliance for money purchase benefits is currently assessed at an individual level. No one individual should pay over 0.75% or an equivalent permitted combination charge; percentage-based funds under management charges which permit some savers to pay over 0.75% as long as enough other savers pay less than 0.75% are not permitted. This approach is less meaningful for CDC schemes, where the assets are not held by individual savers but are pooled.

163. We therefore intend that charge cap compliance as it applies to CDC schemes should be determined by one test applied to the whole of the scheme's CDC benefits. This would calculate all charges taken from the pooled assets of the scheme (and those charges taken from membership and employer contributions to pooled assets) divided by the assets of the scheme, on a regular ongoing basis.

164. Where schemes are used for automatic enrolment, we propose to limit the permitted charging structures in the same way as for individual DC schemes. These are a percentage funds under management charge, and a funds under management charge combined with either, but not both, of a contribution charge and a flat fee.

Questions:

22. Do you agree that CDC benefits should be subject to a similar cap to the automatic enrolment charge cap?

23. Do you agree with the proposal that charge cap compliance should be assessed on the value of the whole scheme's assets?

5.6 Transfers of Benefits Between Schemes

165. In broad terms, we see no reason why a member of a CDC scheme should not have the opportunity to transfer out of the scheme before they start to draw a pension. We are considering how existing legislative requirements should apply in relation to advice and information.

166. The existing approach to cash equivalent transfer values for money purchase benefits is based on determining the 'realisable value' of a member's benefits, and gives trustees a discretion to pay a higher amount. This approach may need adjustment for CDC benefits.

167. One potential approach under consideration would require CDC transfer values to be determined as the member's share of the total fund reflecting investment performance to date and any benefit from risk sharing and efficiencies up to the point of transfer but no further. The member's 'best estimate' share of the total fund would in effect be determined as part of each annual valuation, adapted by the scheme actuary to determine the transfer value.

168. We also recognize that some CDC schemes may wish to allow transfers in, for example to allow members to consolidate other pensions into the collective fund. We do not envisage prohibiting this as it may hold advantages for both the individual member and the membership as a whole. However, we may need to implement some requirements to ensure members are made aware of the non-guaranteed nature of the CDC benefit they will be purchasing with their transfer, and that once transferred into the scheme the member is treated like any other member when it comes to adjustments to benefits.

169. We are also considering whether transfers into CDC schemes should be restricted so that transfers can be received only where the transferring member is actually accruing benefits. We do not intend to permit decumulation-only CDC schemes at this stage, although this is something we may consider in future.

Questions:

24. What would be an appropriate approach to handling transfers out of or into CDC pension schemes?

25. Should transfers be restricted in any way – for example, to take account of the sustainability of the fund?

Chapter 6: Next Steps

170. Legislating for a new kind of occupational pension scheme is an important opportunity for us to introduce innovation into the UK pension system. We are keenly aware that our work will also have a significant impact on the lives of the scheme's membership. While we want to progress this, to ensure that members and employers can benefit as soon as possible, we are thinking carefully about the impacts of our proposals at every step in order to address the risks appropriately.

171. We will analyse the results of this consultation in order to strengthen our understanding of the issues and solutions and further develop the technical details of our CDC approach.

172. We are keen to bring forward legislation to facilitate the setting up of this form of CDC scheme as soon as Parliamentary time allows.

173. The details of the CDC scheme requirements will be set out in secondary legislation (regulations). We will be bringing draft regulations forward to follow on from the necessary primary legislation. Using regulations to set out the details of CDC schemes will allow us to focus carefully on precise technical issues; it will also give us the flexibility to adjust the provisions more easily as CDC schemes bed-in and become more established, and as we learn from the experience of the first tranche of these schemes.

174. As we have made clear in this consultation paper, this is very much the beginning of our work on CDC. We will be working closely with RM and the CWU, and with any other interested parties, as the initial tranche of CDC schemes are established and bedded in.

175. We will continue to monitor and evaluate their performance in advance of introducing any further flexibility in the CDC space. We are always keen to see positive new developments in pension provision – but are very clear that

innovation cannot lead to unacceptable risk for people looking to make sensible decisions about their retirement.

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