THE SOCIETY OF PENSION PROFESSIONALS

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Department for Work and Pensions

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Dear CDC Team

SPP Response to consultation on The Occupational Pension Schemes (Collective Money Purchase Schemes) Regulations 2021

We welcome the opportunity to respond to this consultation.

Key Messages

Overall, we cannot see anything in the draft regulations which raise any 'red flags' against being fit for their intended purpose, i.e. primarily to facilitate collective money purchase (CMP) schemes of a design similar to that proposed by Royal Mail. However, this consultation has taken place over the summer holiday season and is only for six weeks. Some SPP members have not had the opportunity to consider this in as much detail as they would have done otherwise. However, we understand that Royal Mail would like their collective money purchase (CMP) scheme to be up and running as soon as possible.

Our main concern is that the contributions and benefits which members earn for all members and for each and every year have to be fixed at outset, other than the rate of increase. We would like the DWP to ensure that there is flexibility in scheme designs to vary other aspects, such as permitting age-related contributions. All aspects of benefits earned should be able to vary in line with how the cost of providing those benefits varies. However, we do recognise that this might not be readily achieved in the short order wanted to deliver these benefits and as such, we appreciate that this extra flexibility may need to follow separately. We are encouraged by what you say about engaging on further regulations needed for other CDC designs.

These regulations only cover CMP schemes set up for a single employer or connected employers. This will enable an excellent, alternative pensions solution for a portion of the national workforce if their employers decide to go down this route. However, collective money purchase schemes will still not be available to the majority of the population. We encourage DWP to continue their good work by enabling CMP schemes for multi-employer schemes and as an alternative option at retirement for all individuals.

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Detailed Response

1. **Do the draft regulations make it clear to employers whether they are considered to be connected for the purpose of the legislation?**

   The draft regulations seem to make it clear who connected employers are.

   If two employers are in a joint venture and the joint venture ceases, then six months seems quite a tight timescale.

   The definition of connected employers should be a continuing condition rather than just a starting condition.

2. **Are there any other characteristics that should be added to those that are already listed at regulation 4(1)?**

   Does the current draft of regulation 4(1) allow the characteristics of collective money purchase schemes to vary? We have set out below some examples for each of the listed characteristics and given examples of why we think it would be reasonable for them to change:

   - Variable accrual rates may be reasonable if:
     - Members are given a choice of different contribution rates
     - If the cost of accrual varies by age to match the contributions paid on behalf of each individual
     - If the cost of accrual varies according to changes to longevity expectations or changes in market conditions
   - Variable contribution rates may be reasonable if:
     - Members are given a choice of different contribution rates
     - If contributions vary by age
     - If the employer would like the flexibility to change contribution rates at some point in the future (with consequential changes to benefits accrued)
   - Variable normal pension age for the long term if future life expectancy changes (similar to the State Pension Age changing over time)

3. **Do you agree with the proposed fee structure, taking into account schemes containing multiple CMP sections?**

   The Pensions Regulator's authorisation fee appears expensive – if TPR is given access to the advice already provided to a prospective scheme, then there should be no need for TPR to repeat that work, which would keep TPR's fees lower.

4. **Are there any significant practical barriers to schemes meeting these requirements?**

   No.

5. **Do the proposed gateway and ongoing tests provide a sensible measure of whether a scheme's design is sound, at initial application and going forward?**

   It is not entirely clear to us that "sound" is defined for either the actuary or the trustees. If the definition of "sound" is as described in 9(2) then that should be made clear.

   Regulation 9(2) is therefore a crucial aspect of the regulations in defining soundness (in as far as is possible given the constraints of the Pension Scheme Act 2021 on what can be set out in Regulations).

   We feel that too much is being asked of the actuary. The actuary's responsibilities should be entirely actuarial in nature:

   - 9(2)(a) requires the actuary to have regard to whether the scheme rules meet certain legislative requirements regarding the calculation of benefits. This is a legal matter and the

actuary will have to rely on advice from the scheme's lawyers. This should be made clear in the drafting – for example, the actuary might be required to have regard to "legal advice obtained by the trustees on whether the scheme rules meet [the various provisions]".

- 9(2)(b) requires the actuary to assess whether certain matters have been "accurately communicated" in the current member booklet and annual benefit statement. Member communication is a specialist area which will not necessarily be a specialism of the actuary. In addition, a requirement for "accuracy" may lead to information which is not conducive to member understanding. These issues can be addressed by replacing the word "Whether the trustees have accurately communicated… " with "Whether, in the actuary's opinion, the trustees have appropriately communicated… "".

We have concerns that the two ongoing tests for the viability certificate in Regulation 9 could lead to schemes that are working as intended having to close, though if Regulation 4 were amended to allow contribution rates to change that might prevent this.

- Regulation 9(2)(b)(iii) could be clearer that the *annual adjustment* can include a reduction to the annual pension, not just changes to the pension increase rates payable.

- The tests set out in 9(2)(c) seem reasonable at outset, although we note that the legislation does not propose any stochastic tests to assess the range and variability of possible outcomes. We would expect such testing to form part of good scheme design.

- In 9(2)(d)(ii), the future service rates are to be calculated "in accordance with section 20 of the Act and regulations 17 and 19". However, these provisions do not appear to cover the calculation of future service rates. Perhaps the wording could be amended to read "in a manner consistent with the valuation of the required amount, in accordance with section 20 of the Act and regulations 17 and 19".

- The drafting of regulation 9(3)(b) could prove unnecessarily problematic in circumstances where the certificate cannot be provided within 10 months of the reference date. As drafted, a short delay in sign-off could invalidate existing calculations, requiring major re-work, and the ten-month deadline may coincide with the deadline for completing the annual actuarial valuation. As the Act already requires (in Section 13(4)) a certificate to be obtained at least once a year we suggest a small amount of additional flexibility – allowing 12 months rather than 10.

On regulation 10:

- Regulation 10(3)(b) envisages a document prepared by the scheme actuary to inform the trustees consideration of soundness. Our comments above on the lack of a clear definition of soundness are again relevant. The reference in 10(3)(b)(ii) to the inclusion of "any testing or modelling being considered by the trustees…" does not appear to be consistent with the matters the actuary should have regard to when considering soundness, as set out in Regulation 9(2). We therefore suggest that Regulation 10(3)(b)(ii) should be removed, to avoid further obscuring what is meant by soundness. Instead, the contents of this report should reference the matters listed in regulation 9(2) on soundness (and which are also the matters the trustees are required to consider in assessing soundness under paragraph 12 of schedule 2).

- Regulation 10(4)(b) is affected by our comments above on 9(3)(b). We suggest that this 10-month timescale should also be extended to 12 months.

On schedule 2:

- Paragraph 11 – our comment on regulation 9(2)(a) above, in respect of non-lawyers (in this case trustees) being required to provide a legal view, are again relevant here. It should be made clear that the trustees can rely on explanations provided by their lawyers. For example,

the opening text to 11(b) should be redrafted to read "an explanation as to why the trustee's legal advisers are satisfied that the scheme rules meet [the various provisions]".

- Paragraph 12 – as noted above, the trustees are provided with no indication of what constates soundness beyond the list provided in in Regulation 9(2).
- Paragraph 13 – The list provided for TPR (which may have been the most promising place to define soundness, given the constraints of the Act) provides no further illumination. In fact the reference in 13(e)(iii) to the inclusion of "any testing or modelling used…" does not appear to be consistent with the matters the actuary or the trustees should have regard to when considering soundness, as set out in Regulation 9(2). We therefore suggest that paragraph 13(e)(iii) should be removed, to avoid further obscuring what is meant by soundness.

6. **What back-stop should be provided in regulations which would require a CMP scheme to wind up rather than close to further accruals? What might constitute suitable evidence to support this decision?**

   We feel that the decision to require a CMP scheme to wind up should be subjective rather than objective. There is the danger that objective triggers may be triggered by mistake. If objective triggers are breached, then a scheme should be given a period of time in which it can show that there is no need to wind up.

   Triggers could include:

   - There is an expectation that the CMP scheme will be unlikely to be able to meet the charge cap in future.
   - The population of the CMP scheme has reduced to an extent that the pooling (particularly, the longevity pooling) will no longer be effective. Note, that this is hard to judge and it is likely the charge cap will be breached before population reduces to this extent.

7. **Do you think the regulations cover the appropriate matters that must be taken into account?**

   The draft regulations cover the appropriate matters.

8. **What are the financial costs required to set up the necessary systems and processes required to meet the communications criterion? Please outline any one-off and ongoing costs. This may include set up of IT platforms, data management or postal costs.**

   No comment.

9. **Considering the draft regulations and criteria for authorisation, could you estimate the costs of preparing the information required for authorisation? Please outline the extent and cost of external contractors where they may be required. This may include the cost of setting up IT platforms and infrastructure, actuarial support or additional staffing required to support the creation of scheme design and the planning of financial sustainability or triggering events. Please outline if there would there be any significant differences between DB and DC schemes.**

   No comment.

10. **Are the regulations clear about how valuation and benefit adjustment is to take place?**

    The regulations confuse "value" with "amount". "Amount" should be used to reflect yearly or other payments. "Value" should be used for the actuarial value of future payments, e.g. in a transfer value or the cost of future payments.

    Regulation 17 sets out the calculations for how benefit increases should change but then does not say that they have to change.

    Regulation 17 does not allow you to have an increase during a period when you were expecting multi-annual decreases. An example of how this could occur is if there is one year of very bad investment performance following which multi-annual decreases are planned;

however, in the following year the investment markets rebound to such an extent that both the later decreases are no longer required and an increase can be paid.

Regulation 17 does not appear to allow for any recognition of future service contributions or liabilities in setting the adjustment to the rate of the amount of benefits. In our view, the legislation should be more flexible:

- Under the proposed approach, of basing the benefit adjustment only on current assets and past service liabilities, there is likely to be an expectation of a surplus or deficit relating to current accrual, so the scheme is not expected to be in balance by the time of the next valuation, even if assumptions are borne out in practice;
- For a scheme open to new members and new accrual, it might be preferable to allow for a year of contributions (perhaps as part of the "available assets of the scheme") and a year of additional liabilities (perhaps as part of the "required amount") so the scheme is expected to be in balance by the end of the year;
- For a scheme closed to new members but open to new accrual for existing members, it might be preferable to allow for contributions and liabilities for a longer period – perhaps for all future service – to reflect an expected increase in the cost of accrual each year as the average age of active members increases. (This is referred to as the 'attained age method', which is used in DB schemes to address the related issue for closed DB schemes.)

Regulation 17 should be framed to allow the use of either method – perhaps by allowing the available assets of the scheme/required amount to allow for future contributions/service liabilities to the end of a chosen control period – which should be the same for assets and liabilities.

In addition, we have the following more detailed points in relation to this regulation:

- 17(4)(e) requires the trustees to determine whether the assets are sufficient to fund the proposed increases but it does not appear to explicitly prevent increases that are not deemed affordable (or increases that are lower than those that might be justified) being implemented.
- 17(4)(e) requires the cost of funding and increase to be “measured relative to the projected change in inflation”. The legislation would be clearer if this comment was removed – any pension increase rate needs to be affordable, not just increases above inflation.
- 17(9) should clarify that the “smaller reduction” could be no reduction.

On regulation 19:

We think that Regulation 19 should separately cover future service benefits that will be accrued after the valuation date.

19(3)(e) refers only to pensioners. It is not clear why non-pensioners are not included.

The provisions of regulation 19(2) – which allow the scheme actuary to adjust the valuation results for post valuation experience should be amended as the decision to allow for post valuation experience or not should be a decision for the trustees rather than the actuary (consistent with the other funding assumptions).

Further, it is debatable whether the trustees should have that flexibility. This is because:

- The prospect of allowing for post valuation experience will make the process of deciding on an appropriate increase rate much more complicated than if decisions are made based on conditions at a fixed date (the valuation date) – there would be a choice between sets of calculations at a variety of different dates, including dates further into the future before the valuation is completed. It should be clear that allowance can be made for post valuation experience up to a chosen date between the effective date of the valuation and the date of

certification – thus, if necessary, allowing the actuary to carry out the necessary calculations for discussion with the trustees, prior to certification – rather than chasing a moving target.

- The current position will be extremely difficult to monitor from a practical perspective, and potentially increase advisory costs significantly without any obvious benefit.
- Unlike DB scheme valuations, where the problem of addressing the moving target of the "current" position can usually be addressed by adding in a margin for prudence in post valuation experience, CMP schemes are based on best estimates – this makes the process (involving discussion with the trustees etc) virtually unworkable as allowance for market movements up to the date of certification of the valuation, with no margins for prudence, would be required.
- Allowing a choice will also increase the scope for conflicts, with more pressure likely to be exerted on the trustees to allow for post valuation experience in years where such experience is favourable. This could be addressed by the legislation making it clear that schemes should always adopt the same approach and not change from year to year – but this seems to run counter to the one valid reason for including such a provision (which is that in a very extreme year, perhaps where there is a significant market crash after the effective date of the valuation, some allowance for the significantly changed financial circumstances would be reasonable).
- For CMP schemes there are annual valuations and so the post valuation experience from the current valuation will be allowed for in any case within 12 months.

In conclusion, the legislation should make it clear that the trustees should only adopt this approach where there are considered to have been extreme market movements after the valuation date – and that in most years there should be no need to allow for post valuation experience.

11. **Do you think that the events listed in draft regulation 23 will provide the information the Regulator needs or are there other events that should be added?**

A significant change to a scheme's investment strategy in regulation 23(1)(c) is not necessarily well defined.

Is draft regulation 23(1)(i) strong enough? Should it be a significant event if expenses are above the charge cap rather than are unable to be met, which could be far above the cap.

12. **Do you think that draft regulation 29 and schedule 6 meets the policy intent of providing a clear framework in which CMP schemes can be wound up and the interests of members protected?**

An option for discharging the scheme's liability should be to transfer the assets and liabilities to an alternative collective money purchase scheme. This could result in the least disruption to the members' benefits if a similar collective money purchase scheme can be found.

It should not be necessary for notification of events needs to be undertaken by each trustee and participating employer if they are aware that notification has already taken place by another party.

Wind-up cost reserves are likely to be substantial. This risks making CMP schemes look unattractive to set up, despite the demonstrated benefits they offer members. If the authorisation process is rigorous, the likelihood of winding up the CMP scheme for many years after authorisation should be minimal, so a period over which the wind-up cost reserve can be built up would be appropriate.

13. **What are the potential ongoing financial costs associated with ensuring the scheme continues to meet the ongoing supervision requirements? This may include the cost of ongoing actuarial support, communication costs and IT platforms.**

    No comment.

14. **What steps do you intend to carry out in order to monitor equality impacts on members over time?**

    Generally, pension schemes do not collect enough information to monitor equality. Pension schemes collect dates of birth, sex, addresses and some earnings information.

    Sponsoring employers may be better placed to monitor equality impacts on members over time.

    Schemes value benefits by age, which is not considered discriminatory. Some schemes value benefits by sex, which is not considered discriminatory – at least currently. Will schemes also be allowed to value benefits differently by an individual's sex, level of pension, postcode or using other factors that may affect the scheme actuary's best estimate value? What is considered discrimination can potentially change over time so it could be helpful if the regulations made clear what factors could be used to value CMP pensions.

15. **Do you agree with the amendments made to the Disclosure Regulations for CMP schemes?**

    If the information is given in each of the times detailed in 17A.(3) and 22A.(2), then this may be too often. It should be clear that each of (a), (b) and (c) can be combined so that members only have to be communicated with once each year as detailed in (c).

    The regulations confuse "value" with "amount". "Amount" should be used to reflect yearly or other payments. "Value" should only be used for share of fund or the actuarial value of future payments, e.g. in a transfer value or the cost of future payments. Several paragraphs of the inserted Schedule 6A (in annex B, para 1(16)) the word "value" should be replaced with "amount" – in particular, in paragraphs 5, 6, 7, 9, 10 and 11 of Schedule 6A. Note that, later on in Schedule 6A, "amounts" are correctly used.

16. **Are there any other areas within the Disclosure Regulations that you feel should be amended to take account of the unique collective design of CMP schemes?**

    Set up costs and wind up reserves are substantial costs and create a big barrier to setting up a CMP scheme. Consideration should be given whether a CMP scheme can pay or re-pay for these costs over a number of years in the future when it would be easier for the scheme to afford the costs.

17. **Do you agree with the new publication requirements for CMP schemes?**

    The benefit adjustment information that is provided to members should detail both the next increase to pensions and the expected level of future pension increases after the next increase.

18. **Outside of the statutory communications outlined in the draft regulations, are there any regular communications you expect to send out to members? Please consider deferred members and those in decumulation in your response.**

    Communication is very important for CMP schemes and trustees need to consider communications carefully. However, there is a risk that a long list of prescribed communications that are required to be made by legislation would potentially get in the way of clear communications from trustees about important issues.

19. **Do you think the changes we are making to the Occupational Pension Schemes (Charges and Governance) Regulations 2015 (see provisions in Annex A) will implement the charge cap in CMP schemes and protect members in the way we intend?**

    We would like to see more clarity on which charges are excluded from the charge cap and what happens if charges breach the cap, particularly in the first years of a CMP scheme's

existence.

The charge cap should not always be equal to the DC charge cap.

8. Insertion of 5A(3) "Collective funds under management charge" is based on the value of a members' rights. This doesn't seem to be defined, and we would expect it to be based on the value of assets (available to pay member benefits).

12. Insertion of 7A(2) – Calculating the value of members rights every 3 months seems overly onerous. The scheme would not necessarily have accurate asset values every 3 months.

20. Are there any other amendments to existing legislation we should consider?

Member options are not covered in the regulations. Should member options such as commutation, ill-health early retirement, normal early retirement or late retirement be covered in the regulations?

The amendments to the Transfer regulations in Annex D broadly calculate a CMP benefit in much the same as that for an ordinary money purchase benefit, with the calculation date being set as the application date. However, with CMP there is a three week 'reflection period' before which the transfer can be paid. At the moment, the legislation reads such that the scheme would need to 'honour' the transfer value as calculated as at the application date, meaning that the scheme faces the risk that markets fall during this period. We believe it would be better for the legislation to explicitly provide for the CETV to be the recalculated amount following expiry of the three-week reflection period.

Response ends

Yours faithfully

Fred Emden
Chief Executive, SPP

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