



THE SOCIETY OF PENSION  
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The Pensions Regulator

17 March 2022

Dear Pensions Regulator

**SPP Response to consultation on A Code of Practice for authorisation and supervision of collective defined contribution schemes**

We welcome the opportunity to respond to this consultation.

**Key Message**

While the draft code of practice appears comprehensive, overall, we have concerns about potential unintended consequences. We feel that the demands and hence cost of the code of practice are significantly too onerous. As drafted, it risks repelling any nascent interest in CDC on the part of single employers, due to the level of detail. We expect that outcome to be the probable, unintended consequence of such a draft, which may negatively impact the future of CDC.

**Detailed Response**

**1. Do you consider that any important areas of the authorisation criteria have been missed in the new code?**

No.

The Regulator has clearly put a significant amount of consideration into the appropriate governance structures for CDC schemes and the draft Code is extremely comprehensive. Our response inevitably focuses on a number of areas in which we would like to see changes made – however, our over-riding concern is that the draft Code goes too far in a number of places, rather than there being omissions.

We note there are no questions on the supervision and reporting section of the code. Question 1 therefore appears to be the “least inappropriate” question under which to flag the following issues:

- Once a CDC pension scheme is in place, what are ongoing fees that the Pensions Regulator will charge?

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- The proposed deadline of 2 days for notification of “Significant events relating to the ability of the scheme to meet its running costs or maintain the required reserves in appropriate proportions” is impractical. As a minimum, this should refer to “2 working days”.

### **Introduction and Applying for authorisation.**

#### **2. Is the level of detail we have set out appropriate?**

No.

It is helpful to see this level of detail so that we know what to expect. However, we think that the authorisation requirements are excessive for single (or associated) employer CDC schemes.

We would suggest the Regulatory attention for single employer CDC be focused on ensuring that benefit adjustments (if required) are set at a sensible level each year, that member communication is not misleading and that there will be sufficient funds in the event of a future wind-up. In other areas – particularly where the risks are similar to or less than a typical DB scheme – we would suggest that the Regulator should not require more than it asks of DB scheme trustees and scheme sponsors and so the Code needs to make it clear that TPR would take a proportionate approach in such circumstances.

We note that parts of this draft Code are very similar to the Regulator’s Code of Practice 15 on the authorisation and supervision of master trusts. We accept that such requirements – as set out in the current draft – are likely to be appropriate when (as is anticipated) the CDC regime is extended to allow CDC Master Trusts, which may involve entities with wider motivations, including profit. In our opinion, little extension of the draft Code would be needed to accommodate new forms of CDC such as profit-making CDC Master Trusts.

#### **3. Are there areas where supporting guidance would be useful?**

Yes.

As noted in response to Question 22, guidance on allowance for member options, such as transfer values and commutation factors, is likely to be appropriate. TPR could helpfully confirm that, as a condition of authorisation, such options should be based on central estimate assumptions.

One additional issue requiring clarification – preferably in the Code itself, but failing that in guidance – is the possibility of providing a lump sum benefit as a ‘qualifying benefit’ from a CDC scheme. As drafted, the ‘What is a CDC scheme?’ section of the Code suggests that a lump sum must be provided through a separate (non-CDC) section – by providing an example of “a lump sum” as a benefit that “must be separated” into a different section that is not subject to authorisation. We agree that a lump sum could be provided separately, but it should be made clear that CDC sections can also provide lump sums.

#### **4. Is it clear what constitutes a section and when you must divide a scheme into multiple sections?**

No.

See our comments in question 3, regarding the suggestion of separate (non-CDC) sections for lump sums.

We note that this part of the Code will need to evolve as (we anticipate) legislation evolves. In

particular, we do not think different sections are required for different benefits.

**5. Is it clear how the authorisation fee will be set for schemes with multiple sections?**

Yes.

Extra detail would be appreciated of the fees involved when a new section is created. In particular where the change involves only a tweak to benefit details (where we would expect the cost to be low).

**Fitness and propriety**

**6. Is the level of detail we have set out appropriate?**

No.

As noted in our response to question 2, we would hope that a more streamlined assessment of trustee fitness and propriety might be proportionate for a single employer CDC scheme.

We note that:

- The requirements are tough – which even if it is considered appropriate at first, may need to be reviewed in time.
- It is hard to have experience of CDC schemes before many (or any) have been set up.
- It is hard to demonstrate and measure a potential trustee’s competence.

There are a few places in the draft Code where there are lists of requirements. This also applies to questions 9, 15 and 18. It would be helpful to distinguish between:

- New requirements that are not in the regulations.
- Restatements and summaries of the regulations – making clear that the regulations apply rather than the restatements/summaries (as the code of practice does not always follow the regulations exactly).

Footnotes 34 and 35 may not be correct.

**7. Are there areas where supporting guidance would be useful?**

No.

It may be useful to see examples of how prospective trustees could evidence fit and proper behaviour.

It would be useful to provide more detail on who the “appropriate senior individuals” will be who are assessed when a corporate entity is appointed.

It may be helpful for this section to be included as guidance rather than a stricter code of practice.

**8. Is it clear what the expected level of trustee competence is to successfully govern a CDC scheme?**

Yes.

We suggest it would be helpful to add a CDC module to your toolkit. Alternatively, is there going to be a CDC qualification?

Because the competence levels are high, this could make the trustees be selected from a small pool, which could have unintended consequences:

- Less diverse

- MNTs may struggle to meet the criteria
- Young people may be excluded as trustees

We understand that you actually would like diverse trustee boards but the high competence levels required may discourage individuals.

It is not clear to us what a “comparable scheme” is for previous experience.

### Systems and processes

#### 9. Is the level of detail we have set out appropriate?

No.

As noted in our response to question 2, we would hope that a more streamlined assessment of systems and processes might be proportionate for a single employer CDC scheme.

We feel there is too much detail in this section which is too onerous to follow. Even if TPR considers this level of detail appropriate for the first few schemes, we suggest TPR may want to review this as they and CDC trustees gain experience.

However, it is useful to have a clear understanding of TPR’s expectations, particularly for the first few schemes that are set up. Rather than including a long and wide-ranging list of “matters more likely to satisfy TPR” it would be more helpful to have a much shorter list of the essential requirements of interest to TPR, in the context of single employer schemes, reflecting the fact that such schemes are likely to be set up by large, relatively paternalistic, employers.

It would also be helpful to comment on whether the assessment process could be removed or reduced if a party, e.g. an administrator, has already been through the process with another scheme – and intends to adopt similar (or identical) systems and processes.

#### 10. Are there areas where supporting guidance would be useful – for example preparing a governance map?

Yes.

It would be useful to have examples including, as you say, of a governance map.

#### 11. Is it clear what constitutes an effectively administered and governed CDC scheme?

No.

As noted above, the provision of a long list of “matters more likely to satisfy TPR” does not provide clarity. However, we do appreciate the flexibility that TPR is giving itself to approve (or not) a CDC scheme.

### Member communications

#### 12. Is the level of detail we have set out appropriate?

No.

It is very extensive and too onerous. This is an area in which the requirements are significantly more onerous than for DC Master Trusts. This seems disproportionate given the need for DC members to make significant investment, disinvestment and decumulation decisions, which are not necessary for CDC members.

Member communication is crucial but the risk is that it can get too complicated. Sometimes shorter and less frequent communications can be more effective. Suitable communication

very much depends on the member – some will want more information, some will engage better with less – signposting to a place to find further information is a good compromise rather than providing more detailed communication.

We must make sure that members understand their benefits – and the possibility that benefits can be reduced – but the current plan is much too onerous, particularly the frequent feedback.

As a minimum – if you do retain explicit requirements for trustee and member reporting on communication (which do not appear to us to be explicit requirements of legislation), these should be much less regular. We would suggest no more frequent than annual reports for trustees and no more frequent than 3-yearly reports for members.

Additionally, we could question any requirement to “establish whether members understand the communications” as being virtually impossible to implement practically – who is to say whether members truly understand what is being communicated to them?

**13. Are there areas where supporting guidance would be useful?**

No.

**14. Do you see any barriers in meeting our expectations for effectively using members’ feedback and communicating how benefits may potentially vary from target?**

Yes.

See our response to Q12. In addition, the issue seems rather circular – a member would need to properly understand the risks, in order to comment on whether the risks have been adequately communicated to them.

We agree that good communication is important – particularly on the risk associated with CDC benefits – but quarterly feedback from members is unlikely to help achieve this.

**Financial sustainability**

**15. Is the level of detail we have set out appropriate?**

Yes.

It is helpful to understand what TPR will consider.

It should be clarified that reserves to be held for the 24 month run on period do not need to include investment expenses which would be deducted from the scheme’s assets in the normal operation of the scheme.

The ‘information about the employer’ seems excessive for employers that have agreed to provide support for the ongoing costs of the scheme. In particular, the Regulator will be collecting (and presumably analysing) much more information than it would collect from a typical DB scheme sponsor – who would typically be responsible not only for ongoing costs but also for a much more significant and potentially open-ended contributions towards the cost of funding the defined benefits. The information seems particularly disproportionate given the size of the employers likely to be considering setting up single employer CDC schemes, where the ongoing costs of the scheme are likely to represent only a small proportion of the employer’s outgoings.

**16. Are there areas where supporting guidance would be useful?**

No.

**17. Is the structure of the Costs, Assets and Liquidity Plan reasonable for this type of model?**

No comment.

**Continuity strategy**

**18. Is the level of detail we have set out appropriate?**

No.

It seems that you are trying to cover every possible angle. This is probably impossible and one of the reasons trustees exist is to decide on solutions when a tricky situation arises.

It is quite helpful to have the detail, but it seems too onerous. We would hope that the strategy document could be relatively high level, given the trigger event will generally be expected to be many years in the future and there will therefore be a significant level of uncertainty on the details that might be relevant at that time.

It is very hard currently to set out a detailed plan for how a CDC scheme could transfer to another CDC scheme.

**19. Are there areas where supporting guidance would be useful?**

Yes.

Some of the detail in the code of practice could be moved to supporting guidance. This could also apply to other areas of the code.

**20. Is it appropriate for a CDC scheme to not plan for continuity option three (closure) when it first comes for authorisation and are there any risks to this?**

There were a range of views expressed on this point.

Note that a CDC scheme should be allowed to continue without an employer if it is big enough.

We would like to flag the specific risk that, if a CDC scheme does not plan for option 3, then you may be more likely to follow options 1 or 2 in practice. Option 3 is likely to mean the smallest change to member's expectations. If there aren't any other suitable CDC pension schemes, then options 1 and 2 could result in members either having to buy an annuity or transferring to a DC pension, both of which change member's outcomes significantly. A significant change to member's expectations could create a bad reputation for CDC pension schemes.

**Scheme design**

**21. Is the level of detail we have set out appropriate and are there further matters we should consider?**

Yes.

We are broadly happy with the comments on scheme design although we do have some comments on the details.

The viability certificate requires the scheme actuary to comment on the accuracy of certain specific aspects of member communication – as you list in the 'scheme communication' section under points a to c. However, the paragraph which follows refers more widely to "their

communications to members” and “generic communications and templates”. It needs to be clarified that the actuary need only consider the specific aspects of member communication set out in the legislation and listed at points a to c above.

The comment under ‘testing and modelling in respect of the scheme’ that “the assumptions used in testing and modelling should be central estimates” may not always be correct. Some testing may be of stress scenarios where central estimates will not be used.

**22. Are there areas where supporting guidance would be useful?**

Yes.

Guidance on allowance for member options, such as CETVs and commutation factors, is likely to be appropriate. TPR could helpfully confirm that such options should be based on central estimate assumptions.

Regulation 19(2) allows trustees (subject to scheme rules) to instruct their actuary to allow for post valuation experience in completing the actuarial valuation. As CDC schemes are in any case subject to annual valuations, and post valuation experience will make it difficult to complete a valuation based on a moving target, we suggest that the guidance should state that this approach is only expected to be adopted in exceptional circumstances – perhaps where the Regulator has agreed it is appropriate to make such an adjustment.

See our comments under the next question, on guidance relating to testing and modelling.

**23. Is it clear what we expect with regard to testing and modelling, and are there any additional issues or factors which could be relevant?**

No.

It is clear that some testing and modelling will be required but not the required extent of such testing and modelling. The comment that “This will include an understanding of the downside risk and the likelihood of cuts in benefits, as well as the level of variation” is helpful.

TPR should provide more details on the level of testing and modelling required as your thinking evolves in this area. This could be communicated by guidance or, at least initially, by less formal means – such as a TPR blog. In particular, TPR should seek to avoid a situation where applications for authorisation are rejected because TPR internal requirements have firmed up or moved on without this being communicated to the industry.

We agree that long-term assumptions should be set out with the rationale behind them. We note that if long-term assumptions change then that can have a bigger impact on benefits than some market volatility.

We are unclear what “key risks to the scheme’s design” mean. Does this actually mean “key risks to the members’ target benefits”?

**24. In regard to testing and modelling, is it appropriate to expect schemes to conduct asset liability modelling (ALM)?**

Yes.

This would be appropriate at set up and perhaps every 3 or 5 years thereafter, or if there are significant developments. We strongly support your comment in the draft code that annual asset liability modelling would not be expected.

The results of such modelling may also help members understand what benefits they are likely to receive, if the results are appropriately communicated to them.

**25. Are there any other aspects of the trustees' stewardship of the investment strategy that we should be assessing in support of a scheme's design being sound?**

Yes.

It will be important for the investment adviser to liaise closely with the actuary, and the Code of Practice should encourage this. The actuary is likely to consider the investment strategy as part of their consideration of 'soundness' and if changes to the investment strategy, or perhaps the investment adviser's views on central estimates, were not considered reasonable by the actuary this could potentially prevent the actuarial certification being provided. Clearly, it would be in all parties' interests for any such areas of disagreement to be debated well before the actuary's certification is required. We would suggest that the Code encourages the trustees to allow the actuary an opportunity to comment on any material proposed changes in the investment strategy, for this reason.

There is no clear definition of 'sound'. However, we do not consider it would be worth introducing a definition at this stage without consultation.

**26. In respect to the gateway and live running tests, are there any further matters we should consider and is it clear what we expect?**

Yes.

It is not clear if best estimate assumptions should be used for all tests.

It would be helpful to add commentary on what should happen in circumstances where the actuary is unable to provide the certification, before all of the live running tests are not met.

It would also be helpful to clarify that the second gateway test and the first live running test refer to each active member, rather than each member.

**27. Our plan is to provide a standard template for the viability certificate to ensure what is being certified is standardised across CDC schemes. Is this helpful?**

Yes.

We suggest that it might also be helpful to make it clear on the document that that the scheme design allows for benefit reductions in certain circumstances and that certification does not mean that benefits will not need to be reduced.

***Response ends***

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