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23 March 2023

Dear CDC Policy Team

**SPP response to DWP consultation on extending opportunities for collective defined contribution pension schemes.**

We welcome the opportunity to respond to this consultation.

**Executive Summary**

We are supportive of the Government's intention to extend the regulations to allow more flexible designs, multi-employer and master trust vehicles and decumulation-only offerings. We believe there is a real interest from employers / providers and individuals for each of these different developments.

As a starting point, we believe that combining the existing CDC regulations and those that apply to DC master trusts is a sensible suggestion, although as we outline in our detailed responses some tweaks will likely be needed.

In extending the existing regulations, we believe it will be important to ensure that the regulatory environment is supportive of sensible member decision making, given the additional challenges introduced by multi-employer and commercial offerings. This is likely to encompass some level of regulatory oversight of marketing communications, member charging structures and actuarial conversion or pricing terms, as a minimum. Such an approach may require the existing supervisory regime to be enhanced, which could require additional expertise and resource within TPR.

We also recognise that there is a Government desire to enable more members to benefit from the opportunities of sharing risk. However, there are difficulties with individuals accessing these opportunities of their own accord under the existing occupational pension scheme framework, in particular those who are self-employed. Consideration should therefore be given to whether the legislation could enable individuals to join master trusts or multi-employer vehicles without the need to have an employer linked to the scheme.

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We would be very happy to assist DWP further as it seeks to extend the existing CDC framework for the benefit of many more UK pension scheme members.

### **Detailed Response**

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

We broadly agree with the key principles outlined, and we believe it will be particularly important to enshrine the first principle to mitigate the risk of future regulatory creep. However, we would suggest a few amendments:

- The penultimate principle *“any adjustments made to benefits will be made without variation across the membership”* is potentially overly simplistic. For example, it does not allow a one-off cut to have the same value as the equivalent reduction in pension increase, which could be both desirable and reasonable. We would therefore suggest the principle is instead that *“any adjustments made to benefits should be applied fairly across the membership”*, leaving schemes to come to their own decision as to what they may perceive to be fair.

We assume the principle that *“the CDC fund of whole-life CDC multi-employer schemes should be subject to the 0.75% CDC charge cap”* is using ‘the 0.75% CDC charge cap’ as shorthand to refer to the full range of charging structures outlined in the Occupational Pension Schemes (Charges and Governance) Regulations 2015, i.e. a combination charge structure could also be adopted. It would be helpful for this to be clarified.

We suggest that DWP considers the inclusion of an additional principle along the lines of *“the regulatory environment should seek to support sensible member decision making”* to ensure that there is a focus on member protection (relating to communications, actuarial conversion terms, ongoing TPR supervision etc).

**Question 2: Do you agree with our thoughts on what requirements might need amending to accommodate these new CDC designs? What new triggers for sectionalisation other than a change to the actuarial plan do you envisage might be appropriate in these new schemes?**

We broadly agree with the thoughts set out as to what is required to accommodate the new CDC designs, although further changes will likely be needed to the regulations to allow all of desired design flexibilities, for example:

- The ability for the rate of accrual to be related to contributions paid and specifics of the member, rather than being constant for all members.
- The ability for the rate of accrual to change over time to reflect the current position of the scheme and pension increase level. For example, if pension increases were higher due to

positive investment performance over time, this higher level could be reflected in the cost of new accrual to ensure 'actuarial equivalence'.

- The current regulation 17 will need to be amended to allow "multi-annual increases" as well as "multi-annual reductions", and could also be extended to allow these to be offset by subsequent increases or reductions.
- As outlined in question 1, we believe it may also be desirable to amend the current regulation 17 to allow "multi-annual reductions" to be applied on an 'equivalent value' basis (to the per annum adjustment that would otherwise apply) and not solely on a 'constant rate for all' basis.

There are scenarios where sectionalisation may be desirable, but not necessarily automatic (for example where there has been significant variance in the level of benefit adjustment compared to initial expectations). Consideration should be given as to whether significant changes in investment strategy or actuarial conversion terms may require the reopening of a new section – although that might be best dealt with through ongoing regulatory supervision.

**Question 3: Should the definition of "operates" at section 7(5) of the 2021 Act be amended for whole-life multi-employer CDC schemes? If you agree, please set out how.**

We agree that there will be more distanced relationships between prospective participating employers and the scheme and that a commercial provider is likely to be expecting a profit in due course. However, we do not agree that that means there is lesser justification for the exemption from the prohibition on accepting funding if that funding is limited to the costs of setting up the scheme and obtaining authorisation. There is likely to a small number of schemes and the design being a new one may mean limited willingness for providers to take on the entire start-up costs.

We see no benefit to be gained in preventing prospective employers who are willing to contribute seed funding doing so provided it is not permitted to link that to anything which would restrict market choice in due course (for example by committing the employer to participating in the scheme once authorised) and there is no cost to prospective members.

The arguments against removing this prohibition are even greater in the case of any prospective not for profit schemes such as the new sectorial schemes where the providing organisation (e.g. employer umbrella organisation or Trades Union) may not itself have material assets and/or would be sourcing those assets from prospective employers anyway. For these reasons, we do not consider the definition of "operates" should be amended.

**Question 4: How might legislation capture persons performing the functions listed at paragraph 39 in commercial and sectorial schemes so that they are within scope of the fit and proper persons test? Are there other persons that should be brought within scope of the fit and proper persons test for these new schemes?**

We see the logic of extending the legislation to capture the persons performing the functions listed at paragraph 39 within the fit and proper regime. We agree that mirroring the approach for Master Trusts with respect to scheme funders and scheme strategists is logical. However, we think that if a participating employer is a scheme funder only because it has provided some sort of

costs commitment it may be appropriate to have a reduced assessment and / or exclude them from the fit and proper regime.

It may also be wise to include any person with the power to decide whether to admit an employer to participation in the scheme and any person with power to terminate participation of one or more employers (other than an employer itself or entities within its corporate group), to restrict or prevent accrual by one or more members (other than their employer or entities within their employer's corporate group) or to wind up the scheme.

**Question 5: Do you agree that those marketing and promoting CDC schemes should be within scope of the fit and proper persons test where certain conditions apply, and if those conditions should be similar to those in Master Trust schemes?**

Yes, we agree – it should mirror the Master Trust legislation and TPR code with regard to persons “marketing and promoting” CDC schemes except perhaps the assessment should be mandatory not optional.

We consider that the Business Plan should include a narrative explaining how such distributors will work with the Strategists to ensure that the onboarding of new members and assets is done in a suitably controlled manner which does not prejudice pre-existing members.

**Question 6: Are any changes or additions needed to Schedule 1 of the 2022 Regulations in respect of matters to be taken into account by TPR, as part of the fit and proper test to reflect the new roles envisaged to exist in sectorial and commercial schemes?**

Yes, we suggest mirroring the matters required to be taken into account for scheme funders and scheme strategists under Schedule 1 of The Occupational Pension Schemes (Master Trusts) Regulations 2018. They should also be applied to any person with the power to vary the scheme, any person with the power to decide whether to admit an employer to participation in the scheme, and any person with power to terminate participation of one or more employers (other than an employer itself or entities within its corporate group), to restrict or prevent accrual by one or more members (other than their employer or entities within their employer's corporate group) or to wind up the scheme.

The assessment for Trustees should focus on individual and collective Trustee skills needed to understand and challenge actuarial input, scheme finances, investment strategies, Funder covenant and financial strength etc. Similarly, the assessment for Funder and Strategist needs to recognise that the CDC environment is different to that of DC Master Trusts and that the Strategist in particular needs also to have understanding of actuarial input, scheme finances, investment strategies, Funder covenant and financial strength including if required to manage gated capacity issues.

**Question 7: Are the current scheme design requirements including the tests still appropriate for assessing soundness in the new whole-life multi-employer schemes? Are there any additional soundness considerations or tests needed in light of the new designs?**

No. The Gateway tests use reasonably predictable metrics in single/connected employer CDC schemes but will be conjecture in a commercial scheme – there is ample evidence of over-optimism during the DC MT authorisation process. If similar principles are to be applied they should be subject to significant stress tests.

Some tweaks could also be considered to the existing tests. For example, the first gateway test provides no scope for margin around the level of increases (noting these will vary in line with prevailing market conditions), which may force the need to target a higher central increase to incorporate a buffer; consideration should be given to whether the gateway tests should be re-run periodically especially if there is a sizeable addition to the membership (or indeed if the membership is below expected milestones). We would also point out that it is not possible to run these tests at outset for a commercial entity with no members.

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

We agree that similar scheme funder requirements should apply. We consider that the Funder may need to be subject to more rigorous financial strength requirements, especially to reflect the possibility that an ‘unsuccessful’ scheme may be run as a closed scheme.

We consider that participating employers should be excluded from the definition of scheme funder and from the fit and proper assessment unless any financial commitment from them is material to the scheme’s sustainability. If not excluded entirely, a lower level of requirements for scrutiny should apply.

**Question 9: Should business plan requirements, similar to those for Master Trusts, be introduced for commercial and sectorial CDC whole-life multi-employer schemes? What, if anything, should change? Who should be responsible for preparing the business plan?**

We agree that business plans are required, similar to those for DC Master Trusts, to include appropriate stress tests and milestones plus commentary about the likely impact of failing to meet milestones. As with the DC Master Trust regime, it is appropriate for the business plan to be co-approved by Funder, Trustee and Strategist.

In our view, the success of multi-employer CDC arrangements will depend significantly on the support of intermediaries. CDC is a product which will need to be ‘sold’ to employers rather than ‘bought’ by them, due to their significantly different nature relative to more familiar, conventional DC arrangements (noting that that is already a rapidly maturing market). We suggest that it could be beneficial to separately gauge the level of support likely to be encountered from this sector as an input to the reasonableness (or otherwise) of schemes’ Business Plans and the ultimate success of multi-employer CDC arrangements.

**Question 10: Do you agree that the existing requirements should apply to new whole-life multi-employer schemes and are additional requirements needed to help ensure that**

**communications used in promoting and marketing the scheme are not misleading? How might Schedule 4 of the 2022 Regulations be amended to achieve this?**

The existing communication requirements seem sufficient but we believe it is worthwhile considering the inclusion of some information about financial strength of the Funder. Members of single/connected schemes can infer this from their knowledge of their employer(s) but are unlikely to have such information in a commercial environment. A statement in the Chair's Statement about financial strength and support could be required and reused for this purpose.

We also believe there should be a requirement to include commentary on how any actuarial conversion terms are set (it is essential that members have trust in these, and that members are treated fairly in their application.)

We believe that it will also be important to include sufficient information on:

- The basis upon which transfer values will be calculated and any restrictions on when they can be paid.
- Death benefits.
- Any Dependants' benefits.
- The basis upon which transfers in will be 'converted', including the loss or reduction of any death and dependents' benefits.

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

Largely the systems and process requirements for single employer CDC scheme are equally applicable to the new whole-life multi-employer schemes. However, we see merit in adding others to address participating employer engagement (similar to paragraph 14 of Schedule 5 to the 2022 Regulations in respect of member engagement) and this could extend to having oversight of communications issued by those employers in respect of the operations and features of the scheme.

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

Yes – this is logical although we would comment that the practicality of running a commercial scheme as a closed scheme is even less likely than in a single/connected scheme, given the potential for shareholder pressure if losses occur and are predicted to last.

**Question 13: Do you agree that most of the existing requirements can read across to the new whole-life multi-employer schemes? What changes including the one proposed above do you**

**think should be made to the existing requirements and why?**

As per our responses to questions 1 and 2, we believe “*any adjustment of benefits to apply to all members without variation*” is perhaps overly simplistic, we would agree with introducing the option of an equivalent to the current “multi annual reduction” if pension increases rise above some pre-determined level (as this section proposes) and we would go further in proposing that there should be an ability to offset future increases against existing multi annual reductions or increases.

On a couple of further points of detail, it is not clear from the consultation document, but we believe the one-off increase outlined in paragraph 84 should be an optional scheme design, rather than an obligatory one, and the scheme should have the freedom to choose the level at which it applies.

We would also suggest that the level at which multi annual reductions apply could be chosen by the scheme to be something other than 0%, or something else in addition to 0% (for example, it could be set at CPI-2% pa for symmetry with an upper limit at CPI+2% pa).

**Question 14: Do you think that the list of events in regulation 23 of the 2022 Regulations needs amending for the new whole-life multi-employer CDC schemes? If so, why? Are there new events that should be added or current events that should be removed?**

This seems to be a reasonable read across. However, we believe that consideration should be given to adding ‘employer events’ that meet a prescribed commercial threshold – either the loss of such employers or the ‘acquisition’ of such employers. We consider that the commercial threshold should reflect the scheme’s Business Plan and the relative scale of that employer, rather than a one size fits all metric.

**Question 15: Do you agree that the list of triggering events that apply to single or connected employer CDC schemes needs some revision to accommodate whole-life multi-employer CDC schemes? Are there new events that should be added or current events that should be removed?**

We agree that all those triggering events should continue to apply (but substituting Funder insolvency for Employer insolvency) but suggest that consideration should also be given to material or sustained events which have (or may) fundamentally undermine the scheme’s financial sustainability, such as;

- Investment under performance or a non-correlation of asset mix
- Impact of mortality improvements outside of stress test limits
- Significant Funder events

These may not trigger the activation of continuity options but could perhaps trigger the implementation of some form of continuity plan and formal notification requirements.

**Question 16: Is a similar approach to the wind up commencement time (and the cessation of contributions/accruals) appropriate in respect of the new whole-life multi-employer schemes? If not, why not? Given AE obligations, how might participating employers be provided with sufficient opportunity to make alternative arrangements, before contributions are prohibited in the whole-life multi-employer CDC scheme being wound up, whilst managing risks to members?**

Yes, we believe it is appropriate to largely retain these provisions.

Regarding AE contributions, contributions could temporarily be invested on a DC basis – this could be a section of the same scheme (or a related scheme) or another scheme as per the DC master trust regulations. It may still be possible for these contributions to be actuarially converted back into CDC in bulk if the subsequent continuity option was to transfer to another CDC scheme.

**Question 17: Are the current default and alternative discharge options sufficient for the new whole-life multi-employer CDC schemes?**

Yes, we believe they are, although consideration could be given to including the option to facilitate transfers to more than one arrangement (e.g. for different employer populations).

**Question 18: Do you agree that the existing framework for the wind up of a CDC scheme can read across to the new whole-life multi-employer schemes? What changes, other than the ones mentioned above, do you consider should be made for these new schemes?**

Yes.

**Question 19: Do you agree that the existing requirements, outlined in Chapter 10, which apply to single or connected employer schemes can be read across to the new whole-life multi-employer CDC schemes, other than where a modification has been highlighted?**

We would suggest consideration is given as to whether further protections are needed regarding the ability to significantly change member charging structures after members have initially joined the scheme (especially for those members whose benefits are already in payment, and so are unable to leave the scheme). Perhaps this should require notification to TPR?

We would also suggest consideration is given to amending the auto-enrolment requirements to allow this to be assessed using the individual DC approach where the benefits provided to the member are equivalent to the contributions paid.

**Question 20: Who would be responsible for meeting the costs of establishing the arrangement and the short-medium term operating costs?**

The scheme funder setting up the decumulation-only CDC pension scheme will provide the capital to pay for set-up costs, short-medium term operating costs and the wind-up reserve. The wind-up reserve could be within the scheme or as ring-fenced assets outside of the CDC scheme, which would be called upon if wind up occurred. The scheme funder would need to keep putting money into the scheme while operating costs exceed income from charges and, initially, into the wind-up



reserve as the scheme gets bigger. The scheme funder hopes that charges will exceed operating costs and additions required to the wind-up reserve. At that point the scheme funder starts making profits to compensate for the earlier years of investment.

When a CDC pension is purchased, should it be possible to include some expenses in the purchase price? To avoid intergenerational cross subsidies, charges to members should not include any contribution to set-up costs or the wind-up reserve. However, you could include an expense charge that members would expect to incur over their lifetime in the scheme as long as that cost does not depend on how mature the scheme is.

**Question 21: How could such arrangements establish scale and what evidence is there to support this? In addition, until such schemes achieve and maintain scale do commercial providers envisage providing the funding needed to smooth volatility and deliver the aspired to pension benefits? How would the potential issue of small pots be addressed?**

Scale will come from individuals purchasing a CDC pension at their retirement. When surveyed, people have consistently said that they want an income for life from their pension and that annuities are expensive. CDC pensions will provide retirees with what they have said they want. However, it will still be a challenge to get enough people to buy CDC pensions so that schemes become viable. At retirement, all retirees should be informed about their options – cash, annuities, drawdown and/or variable CDC pensions – and be informed how to pursue each of the options. CDC pensions could become the default option for many DC pensions on retirement.

As stated in the answer to question 20, scheme funders will continue to invest money in the CDC pension scheme until such time as charges exceed operating costs and additions are no longer required to the wind-up reserve.

CDC pension schemes should be able to choose whether or not to quote for the purchase of a pension, including from those with small pots. Also, CDC pension schemes will price the purchase of CDC pensions using best estimate assumptions. If this includes a flat age-related charge for ongoing expenses, then this will make a CDC pension scheme less attractive for those with small pots – CDC pensions are not for everyone.

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

Best estimate assumptions should be used to price the pensions bought within a CDC pension scheme. These assumptions should be consistent with the assumptions used for valuations and other purposes within the CDC scheme. As far as is possible, a new member joining a CDC pension scheme should not cause either a gain or a loss to the funding level at the next valuation.

Mortality underwriting should be allowed if a CDC pension scheme chooses to do so at entry for all new joiners. The mortality underwriting could be simple, just based on age, or take more complex factors into account ranging from sex, postcode to full medical underwriting. Annuities have been unisex for over 10 years – DWP should make a decision on whether the cost of CDC pensions can be sex-dependent or not.

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

DWP/TPR could have a set date each year such as 31 March when any comparisons between products needs to be undertaken for marketing purposes. This would make comparisons easier for consumers and prevent providers from picking and choosing dates when their particular product looks good.

DWP/TPR could set some simple stress tests that each scheme would use. As the market develops, different providers will want to provide alternative information to the potential customers – TPR should ensure the standard information required is shown before the alternative information. All types of communication could be submitted to TPR annually.

Consistent assumptions have to be used for both marketing and pricing. Issues arise where competing schemes use different assumptions for similar products, for example expected returns on equities. Consistent assumptions in every scheme would make it easier for consumers to compare products but TPR may find it hard to decide on best estimate assumptions for each scheme.

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

Should negative indexation be allowed? Consider a member who has bought at a rate of CPI but the scheme has had bad experience since the pension purchase. Once the poor performance has occurred to such an extent that all pension increases have been removed, further reduction in value may be required. Current rules mean a cut in benefits is required. We think members would prefer negative indexation on their pension rather than a cut to their pension. This would also make more sense now in times of high inflation – if indexation is CPI-4%, then an increase of 6% will be granted if CPI inflation is 10% and a decrease of 1% is given when CPI inflation is 3%. If cuts are required, then could the restoration of past cuts be considered?

There is a question as to who is allowed to join decumulation-only schemes and the process for doing so. Challenges could arise as decumulation-only schemes are occupational pension schemes so retirees need to have an employer linked to the scheme in order to be able to join. We believe that decumulation-only schemes should be open to all of society including the self-employed and hurdles to join should be kept to a minimum. In theory, the same issue could also apply to whole-life schemes if a provider wanted to offer entry to all people.

Although we note that the consultation document states that there has been little interest amongst potential providers of contract-based products to date, and a proposed principle is that CDC benefits should therefore only be offered in a trust-based environment for the time being, consideration could be given to extending the legislative framework to accommodating non-trust based schemes in due course.

*Response ends*

Yours faithfully,

**Edd Collins**

CDC Group Chair, SPP

**Fred Emden**

Chief Executive, SPP

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