PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

PLSA RESPONSE:

EXTENDING OPPORTUNITIES FOR COLLECTIVE DEFINED CONTRIBUTION PENSION SCHEMES

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ABOUT US

The Pensions and Lifetime Savings Association is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

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EXECUTIVE SUMMARY

The PLSA is supportive of all initiatives which seek to improve the outcomes experienced by pension scheme members. We therefore welcome this consultation, which represents the logical next step for CDC by extending the existing single employer regime to multi-employer and decumulation-only models. There will inevitably only be a small number of employers that are large enough to consider a standalone scheme, but these new options will vastly increase the number of members who could potentially benefit from CDC schemes.

Multi-employer CDC schemes have the potential to enhance outcomes for a great number of pension savers. Therefore, we believe that now is the time for prospective providers to come forward, present evidence and make the case that CDC will indeed improve member outcomes according to the particular business plan and scheme structure they would like to establish. We do not see it as the role of the PLSA to comment on the precise viability of different CDC modelling and investment strategies, however, on the basis that government wishes to press ahead with the broadening of the CDC regime, we do see CDC as one potential avenue which could help DC savers with the complex decisions facing them at retirement. Through our Guided Retirement Income Choices (GRIC) framework[1], we have long advocated for more support for DC savers at retirement, both in terms of guidance and solutions which provide a sustainable means of access to their savings over the course of their retirement, and CDC incomes have the potential to offer this. Therefore, we view that CDC must be considered in the round with DWP's concurrent work on decumulation.

As well as the clear benefits of more stable and sustainable retirement incomes, whole-life multi-employer CDC schemes, through investment pooling, allow for longer term investment strategies, which could enable more allocations to "illiquids", i.e., assets such as infrastructure, green energy and private equity. This would assist both the government initiative of investing in key growth areas of the economy, while theoretically garnering higher investment returns and thus improving pensions adequacy.

Generally, we would encourage the Department to consider developments in CDC in the context of the wider DC reform agenda; we can infer that the Government is intending to support innovation and consolidation (both at a scheme and a pot level), but that the ultimate intended DC and Automatic Enrolment saver outcomes, and required market composition, have not yet been set out with clarity. It will be important that all proposals work in concert with one another to achieve this vision, and that any points of tension to achieve the wider Government strategy for the UK pensions industry are identified in each policy strand and resolved. Scheme and provider strategy is of course dependent on the shape and scale of the market of the future, and therefore contingent on all interventions, such as these on CDC.

[1] https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Building-on-the-Pension-Freedoms-Guided-Retirement-Income-Choices.pdf

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Market & demand for CDC

We consider it important to mention, up front, the ongoing discussion over the market which may – or may not – exist for new CDC structures. Having engaged extensively with our membership, as well as attending various external fora on the topic, views are split throughout the industry over whether there is sufficient immediate demand from employers to support the required scale of schemes. In terms of multi-employer CDC, we are still in the earliest stages and there is some way to go in terms of wider employer awareness of the model (see government's own qualitative employer research[2]). Thus, in this sense, a clear, supportive, regulatory framework may be required to increase demand. We do know that there is demand for a sustainable retirement income, that ideally tracks the cost of living, so as more concrete models emerge from providers which demonstrate this capability, research tracking employer awareness and their developing views of CDC, would be highly instructive.

Whole-life & decumulation only

The bulk of this consultation pertains to whole-life CDC. This is understandable, since the starting point we have in the UK is in the existing single-employer whole-life arrangement and so it makes sense that the regulation for this would provide the basis for multi-employer arrangements. We understand that the majority of substantive industry contributions DWP has received are with regard to whole-life schemes, and there is, of course, good rationale for this model. With a steady stream of accumulation members, the scheme will itself generate the scale required for the mortality pooling post-retirement. The pooling of investments through accumulation further boosts the potential upside seen by CDC retirees as well as removes the need to 'de-risk' on the approach to retirement, while scheme members are not faced with the complex one-off decisions which would face those considering entering a decumulation-only arrangement. As such, we welcome the detail DWP dedicates to whole-life CDC.

However, we would like to see some more detailed consideration of the decumulation-only model from DWP. We are aware of considerable interest in this model as well and believe that it could deliver many of the same benefits (scale, mortality pooling) for savers whose employers do not choose a CDC scheme, while also avoiding the complexities of maintaining intergenerational fairness during the accumulation phase. Additionally, while the precise figures are largely dependent on prevailing market conditions and annuity prices, WTW's 2020 modelling[3] indicates that the pooling in retirement will often provide a more substantial benefit than accumulation phase investment pooling and smoothing. There are clearly challenges with this model, as covered in the consultation questions, the most notable of which is scale. With very few schemes of this type internationally to compare with, and as those have some differences to the intended UK regime, there is no real precedent. However, existing UK Master Trusts do have large accumulation customer bases with members in need of support in securing sustainable retirement incomes and this would be the obvious place for decumulation-only schemes to establish themselves.

[2] Workplace Pensions and Automatic Enrolment: employers' perspectives 2022 (publishing.service.gov.uk)
[3] WTW Analysis: How CDC pension levels compare with other types of schemes; September 2020

Therefore, we would recommend that DWP progress with both CDC models on an equal basis, although we appreciate that the onus will also be on providers to put forward detailed plans on the decumulation-only option.

Where to set the regulatory bar?

As above, it makes sense that the existing regulatory regime forms the basis for the new models, and we agree with most of the instances in the consultation where a direct read-across is proposed. There will naturally be some areas of variation, especially where there are differences between commercial and sectoral schemes. In many instances, the answers will be simpler for commercial set-ups: the provider will be responsible for all regulatory duties and financing the scheme. However, where a sectoral scheme represents a workforce, the sole entity 'on the hook' may be less clear, unless a particular industry has a central body with the resources to take on these responsibilities. However, for both whole-life and decumulation-only, careful regulation of commercial schemes' marketed income levels and target increases will be necessary in order that employers (for the former) and individuals (for the latter) are not swayed by unsustainably high target pensions.

More broadly, we support the fact that the bar is placed high for authorisation by tPR. Given the absence of guarantees in a CDC income, the possibility for benefit reductions below initial expectations – and individuals' misinterpretation of their pension - is high. As a result, it is vital only the most reputable providers can come to market so that all CDC schemes are robustly designed and properly communicated. We are therefore very supportive of regulatory attention to a principles-based approach to communications to ensure they understand the variability of these arrangements. We see it as unrealistic for all members to fully understand CDC and the actuarial assumptions and calculations on which it is based, but it is crucial they understand the nature of variable benefits – especially for those members who have previously saved in a DB scheme. Regulation will, nonetheless, need to be mindful that this is a new pensions model for the UK, and so a balance will need to be struck to allow providers enough flexibility to enter the market in the first place.

Other models

It would be beneficial for DWP to remain open minded regarding possible similar innovations which might deliver many of the same benefits as the scale and pooling in the proposed CDC models. One particular alternative to decumulation-only CDC discussed in the consultation might come in the form of a DC Master Trust offering a separate pooled retirement section, which would pay a variable annuity income based on the mortality pooling within that section. Such a model would be – by comparison – relatively inexpensive and straightforward to establish by leveraging the existing systems, administration and trustee capabilities of some existing Master Trusts, but still allowing members to benefit from mortality pooling.

However, such a structure would neither qualify as CDC through the Pension Schemes Act 2021, as it would not pool investments, nor as Money Purchase, since the longevity pooling would run

contrary to the definitions in the Pensions Act 2011. Thus, our understanding is that changes to the Master Trust regulations, including primary legislation, would be necessary to enable it.

Another possibility which has been raised is the possibility for whole-life CDC schemes to also provide decumulation-only vehicles, were they enabled to accept transfers in at the point of retirement. Such a model may bring many of the benefits of decumulation-only while also being able to demonstrate scale more easily (given their longer-term nature and flow of entrants). We appreciate these alternative models are not the focus of this consultation, however if DWP is looking at pooling to improve outcomes, we believe all options should be considered.

Below we outline our responses to the consultation questions, including greater detail on the points above.

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CONSULTATION QUESTIONS

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.

1. In our view, the key principles broadly reflect the necessary features of whole-life multi-employer CDC schemes. It will be crucial that tPR authorises and supervises new models of CDC. Additionally, many of the definitions and criteria applicable to single-employer schemes will need to read across to whole-life schemes as many of the same risks apply, including intergenerational unfairness, member misunderstanding of benefits and unsustainable scheme design.

2. Elsewhere, the consultation references the need for varying accrual and contribution rates, and these should be added as key principles. Following auto-enrolment, workplace scheme contribution rates in money purchase schemes vary enormously from the minimum 8% to well over 20%. Therefore, a scheme with numerous unconnected workforces will only be feasible if each employer can apply its own contribution rate, which would be uniform across all ages within its own membership. Accrual rates would then be calculated based on these contributions and the ages of members. However, we would note that further clarity is required concerning the granularity of the age cohorts for such a scale.

3. We also agree with the application of the default charge cap to CDC schemes as members' outcomes are still impacted by charges in the same way as in DC. Furthermore, while returns, with the benefits of pooling and a longer investment horizon should be greater than in DC, the scale of CDC schemes should mean they have the bargaining power to drive down administration and investment fees. However, with the application of the cap comes the need for thought to be given to equality between CDC and DC, as well as not creating a comparatively disadvantageous regulatory environment for CDC schemes; for example, at the point that savers enter decumulation and when seeking innovative, high yield solutions when schemes don't yet have sufficient scale.

4. Government will, meanwhile, need to be mindful of constraints that the cap will put on prospective providers in a new market, especially early on, when the recouping of set-up costs through charges, as well as the cost of higher growth investments, may provide little room for flexibility. We understand there is a possibility within the 2022 regulations (6A) for an alternative cap of *2.5% of contributions + 40bps,* and some members have raised that this methodology might reflect costs more fairly in early stages; however, consideration would need to be given to how and when schemes might fairly transition to the 75bps cap though.

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?

5. We agree that the "qualifying scheme" requirements enabling the establishment of a CDC scheme will need amending. In the single employer model, the employer clearly has a central role in setting up a CDC scheme whereas, as referenced in paragraph 34 of the consultation, employers will have a more transactional role in a multi-employer or Master Trust scheme, and it should be the provider – commercial or otherwise – subject to these rules.

6. Regarding sectionalisation, it makes sense that schemes offering CDC and non-CDC benefits will need to do so through different sections; the complexity of including the latter within the same CDC section, along with other employers, would be a significant barrier. Overall, we would expect schemes to maintain as few sections as possible in order to harness the benefits of pooling. As a result, it would only be in rare circumstances, perhaps an extended period where markets were

unusually volatile and ensuring fairness across very different employer cohorts became impossible, where sectionalisation might be considered. Similarly, where there are benefits which are not actuarially equivalent, for example, targeting a different level of indexation, there would be inherent unfairness and so if this scenario occurred, separate sections would be needed.

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.

7. Regarding both commercial and non-profit schemes we have heard a variety of views over the exception to allow employer funding under the definition of "operating".

8. We would expect a commercial provider establishing a whole-life multi-employer scheme to meet all set up costs without receiving any funds from a prospective participating employer, until the scheme is authorised. However, it is perhaps unrealistic to expect prospective schemes not to have liaised with potential employers prior to establishing the scheme, and some form of pre-agreements may be necessary for the provider to have the assurance of the required scale. There would, however, need to be strict rules around the source of any funding, which at the outset must not come out of the pension scheme itself or from employee contributions. If pre-agreements were not permitted, it is possible fees levied once the scheme is up and running would be higher, as providers seek to recoup their initial investment. It is our understanding that the restriction on employer pre-agreements may be to prevent the creation of DB-like structures, so more information on how DWP sees this functioning would be helpful.

9. Set-up costs for a non-profit sectoral scheme clearly create a more complex debate, and might depend on the particular workforce concerned. Certain industries may have a central entity (or one single large employer) from which funding could be derived, and who would bear the various regulatory responsibilities involved in authorisation; however in industries without such a representative organisation this remains an open question, and it may come down to a number of involved employers contributing.

10. Fundamentally, there may be instances where it is unclear whether a multi-employer scheme is a commercial or a sectoral scheme. There may be workforce wide organisations seeking to establish a CDC, but who have employers which serve different industries, so it would be beneficial to establish the point at which this would cease to be treated as a sectoral scheme. We are aware that some PLSA members, who may wish to establish sectoral scheme, have concerns over unnecessary complexity should a sectoral scheme be subject to regulations and codes geared towards commercial providers, so some distinction between the two will be needed.

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?

11. Replicating the *scheme funder* and *scheme strategist* roles from the DC Master Trust regime would appear a sensible approach to defining individuals subject to the fit and proper test. The current *scheme funder* definition should cover the *profiting* and *financial assistance* functions, while the *strategist* definition covers the responsibilities of establishing a scheme, making business decisions and marketing. It may also be suitable that the scheme actuary or others involved in calculating benefit adjustments and valuations are subject to the fit and proper test.

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?

12. Those responsible for marketing a commercial whole-life multi-employer CDC scheme should be subject to the fit and proper requirements. This is an area of difference from the single-employer model, and of similarity with commercial Master Trusts, in that these schemes will be sold to employers for a profit.

13. It is particularly important in the case of CDC schemes, given the relative flexibility and non-guaranteed nature of benefit payments. Marketing strategies which "over-promise" on target benefit levels need to be restricted, especially as we would expect both employer and employee understanding of the functioning of such schemes to often be limited, and that they may therefore be susceptible to overly ambitious claims. Therefore, those responsible for these activities need to be subject to appropriate scrutiny, and so we agree with the two conditions which currently apply to those marketing Master Trusts.

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?

14. Overall, it is paramount that those running these schemes are suitably experienced and skilled as the consultation notes. Given the potential for bad member outcomes from a poorly run whole-life multi-employer CDC scheme, for instance, through poorly managed intergenerational pooling or employer cross-subsidies, the Regulator, as part of the authorisation process, will need to uphold the highest standards.

15. Individuals responsible for the running of these schemes will need expertise, not just in the actuarial assumptions on which the scheme's accrual, valuation and benefit adjustment processes are based, but in the approach to member communication too.

16. In addition to these roles, it would be helpful to understand DWP's intentions around the requirements on trustees of these schemes. As we noted in our submission[4] to tPR on the CDC code for single employer schemes, member protection must always be front of mind for those running schemes and, as such, the highest standards of Trustee Knowledge and Understanding will be required. This strengthens the case for multi-employer schemes, while careful thought will need to be given to the representation of member perspectives, whether through Member Nominated Trustees (though the appointment of these would seem complex) or via some form of member panels. Furthermore, certain requirements of professional trustees may be suitable for multi-employer schemes, and some of our members have flagged the importance of appointing trustees with a considerable understanding of investment in growth assets for CDC schemes to realise their potential more generally.

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?

17. We agree that tPR needs to be able to assess that a whole-life multi-employer scheme is sound, as with single-employer schemes and that the scheme's design and ability to deliver its aspired benefit payments are central elements of this. Within this, there is clear read across in terms of actuarial

[4] https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/TPR-CDC-code-consultation-submission-PLSA-submission.pdf

advice being acted on by the scheme and shaping communications given these factors are just as important in the multi-employer model.

18. Employer communications, as discussed at paragraph 50, will, in our view, require considerably more attention in a multi-employer model. The complexity of accruals, valuations and benefit adjustments in CDC is a much-discussed theme regarding scheme members, but we must not assume all employers will necessarily have a greater understanding of how these schemes work. Many employers choose a workplace scheme simply for cost or practical reasons, e.g., ease of administration or payroll integration, and as such it is not evident, they will all fully engage with – and understand – the workings of a CDC scheme.

19. The result of this could therefore range from employer misunderstanding, or perhaps even more dangerously, employers being misled by communications which, if from a commercial provider, might be over-ambitious in terms of target benefits. Therefore, we agree that employer communications – and planned marketing of the scheme – should be factored into the soundness test. The consultation proposes that to address this risk, "standard wording would be agreed"; it is not clear whether the intention is that this would be regulator defined or scheme specific, so would welcome further detail here. We would also raise the point that employers must understand the potential risks for younger members of their workforce, and the handling of potential intergenerational unfairness, and it will be incumbent on their member communications to highlight such scheme features.

20. In terms of the gateway test requiring schemes to at least target CPI increases (and have contributions to match this), we agree this is suitable, as most members would hope their income would keep pace with the cost of living. Furthermore, the CPI requirement would retain some consistency in the market, preventing schemes from offering higher – but more volatile – starting pensions to gain a competitive advantage, and crucially reduce the probability of benefit cuts due to the 'buffer' that the targeted increase affords. Furthermore, there may be greater member dissatisfaction risk stemming from absolute cuts (to a higher – but flat – target income), than cuts to the annual increase element.

21. Our members would, however, like to clarify the meaning of "at initial authorisation, the contributions paid to the scheme are expected to be sufficient to provide benefits which increase each year at least in line with" CPI means in practice. It is important that this means the scheme should beat CPI *on average over the life of the scheme,* rather than *on a year-by-year basis*. Over shorter periods market movements will have a large impact, and schemes would need a higher proportion of expensive inflation-linked assets, negating the possibility CDC offers for exposure to more growth seeking assets, and equities which, combined with risk-sharing over the long term, should provide good inflation protection. Assuming CPI alignment is smoothed over the life of the scheme, there will be more investment flexibility in meeting this goal. This could ultimately allow schemes more latitude over adjustment of benefits, and probably better outcomes over the long term. Alternatively, if it must be met only for employers newly joining the scheme, this could be possible if such employers formed a new 'tranche' of benefits where initial increases were recalibrated to at least CPI (with accrual rates adjusted accordingly).

22. However, we would stress that the overall soundness of a multi-employer scheme – and the assessment of it – will be more complex than that of a single-employer scheme, so the read-across may not be as straightforward as envisaged. As the consultation notes, the new model will need to enable varying accrual and contribution rates, given each employer will have different arrangements with its employees. The scheme actuary will then need to establish suitable conversion rates for those contribution rates, which will likely change based on age of members, in order to define benefit payment levels. These calculations will be enormously complex, and the importance of getting them right is considerable, as member pensions – as well as the integrity of the whole scheme – depend on them. There is little attention paid in the consultation to how the soundness of a prospective whole-life multi-employer CDC scheme's business model will be assessed, and we consider that this should be a crucial element of authorisation and ongoing supervision.

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?

23. We agree that whole-life multi-employer schemes will not involve tPR authorisation of an employer as is the case in the single-employer context. Therefore, we feel the scheme funder requirement, as per DC Master Trust authorisation, would ensure a suitable entity, i.e. a commercial provider, is on the hook for backing up any financial or administrative needs of the scheme. It also makes sense to only have just one funder, so while we are unaware of any potential business models of this ilk, it is unclear where the responsibility would lie, were a partnership structure to establish a multi-employer scheme. Similarly, it is not clear how the scheme funder role would be allocated in a non-profit sectoral scheme, so more detail here is needed.

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?

24. We agree that tPR needs to have confidence in the scheme's business plan to assure that it will be able to cover relevant costs, especially early on when these costs will be high, as the consultation notes. In this regard, we would agree that the Master Trust authorisation regime, and its assessment of business plan is a good starting point, given the high bar and level of scrutiny it imposes. This is consistent with our 2021 submission[5] on the single-employer regulations.

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?

25. Clear and effective member communications are evidently a vital part of any successful CDC scheme, given the complexity of how these schemes work, and the need for members' expectations to be appropriately set as to the level and variability of benefits.

26. These are significant challenges in the single-employer model, and this is even more the case with multi-employer schemes. Explaining variable benefits is one thing for a single workforce, who will have a lot in common, but the challenge will be considerably larger where risks are pooled between a completely unconnected group of members with different characteristics. In fact we would argue it is perhaps unrealistic to expect members to fully "understand how their scheme works" as noted at paragraph 66; the actuarial calculations behind the demographic and mortality assumptions on which accrual and benefit conversion rates are based, are inevitably going to remain unintelligible for most people. Therefore we need to be pragmatic with the aims of member-facing communications, and target understanding on key principles, i.e. the variability of benefits, rather than detailed understanding of how exactly the calculations work. With this in mind, some parties interested in the development of CDC, for instance the Royal Society of Arts CDC Forum, have proposed a role for 'super consumers' to effectively digest the complexities of the market and produce unbiased consumer-digestible comparisons. To enable this, schemes will, of course, need to be fully transparent and publish full assumptions and modelling around pooled risks (investment, mortality, inflation etc.).

[5] Occupational-Pension-Schemes-Regulations-2021-PLSA-response.pdf

27. Regarding members' expectations of CDC schemes, and the risk of them misinterpreting the target income for a DB-type guarantee, we will - to some extent - need to adapt to experience. There was misinterpretation of Dutch CDC when introduced in 2005, and the UK can learn from this in writing its communications, but until CDC schemes are up and running in the UK, we will not know for sure how members will view them. We would also suggest that as the DB to DC shift continues, people's perception of *what a 'pension' is* will likely evolve. Those with DB pensions will consider a pension primarily in income terms, which they are used to being told is guaranteed – and so it is they who would be at greatest risk of misunderstanding a CDC income. However, those with solely DC entitlements are perhaps less likely to view their pension in these guaranteed terms, the focus through their careers having been on accumulating a pot. So younger populations may be less likely to confuse a CDC variable income with a guarantee and member communication requirements will need to remain open to change over the next 10-20 years.

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?

28. The required systems and processes outlined in the 2022 regulations appear suitable for the new models of CDC schemes discussed. We would consider all these requirements as suitable, and they should not pose any difficulties for the modern administration systems on which we would expect these schemes to be run.

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?

29. We do agree that the existing requirements in regulations 15 and 16 should apply to whole-life multi-employer schemes. All features of a single-employer scheme continuity strategy, including triggering events, will apply to the new models. Likewise, we agree that tPR will need a clear view of scheme administration charges (as per Regulation 16) in order to assess the financial implications of the continuity strategy.

30. In terms of significant events, for a multi-employer scheme to remain open and benefiting from the pooling and scale which make it viable, there is clearly a dependence on the continued participation of the various employers in the scheme. We note that items 4 & 5 in section 31 of the 2021 Act cover employer insolvencies and the status of individual employers; however different events with individual employers in a multi-employer scheme will have different impacts. It may therefore be helpful to include a significant event which takes effect and prompts regulator intervention when a sufficient number of employer insolvencies is reached which will have a material impact on its structure.

31. Finally, we agree that commercial multi-employer schemes should be required to run as a closed scheme in the scenario that the provider no longer wishes to operate. As with every aspect of the regime, the security of member benefits must be the primary concern, and as the consultation notes, forced transfers out to a DC scheme are unlikely to lead to good outcomes for savers.

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?

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32. Most of the existing regulations on valuations and adjustments are suitable for whole-life multi-employer schemes.

33. The proposed change, capping increases to CPI + 2%, would appear sensible to maintain a certain sustainability and comparability to increases offered by different schemes. The 2% figure would therefore maintain risk sharing within sensible bounds, preventing excessive indexation and uncompetitively low starting pensions. Such a scenario would lead to unfairness on shorter-living members, as too much weight would be placed on increases later in retirement.

34. The 2% figure does, however, appear somewhat arbitrary. Some of our members have suggested that rather than a fixed cap, schemes should be able make the case for a cap at whatever level they see as sustainable, as part of the authorisation process, with tPR able to deem the scheme design sound or not as a result. In line with the point, we make at paragraph 20 of this response, if increases were allowed as an average over a period longer than a year, this would have implications for the cap which would then in turn need to be multi-year.

35. It is of course important for schemes to have a mechanism through which to make increases – or payments – after a period of good performance. In the same way that spreading material underperformance creates unfairness, spreading material outperformance does the same. Therefore, payments of one-off increases are one way to account for this risk, though we note this will reduce smoothing in performance of the scheme. We would also flag that scheme communications will need to be very clear to differentiate between increases and one-off payments and ensure scheme members understand this; some alteration to the regulations may be required in this respect.

36. Varying current and future increases equitably amongst a diverse membership – both in terms of age and workforce - while ensuring that each year the scheme is 100% funded, would add complexity, but could be necessary if new joiners want to have expected increases close to CPI, rather than whatever the scheme is currently achieving; we understand this could be achieved through tranching of joiners' initial increase targets within a section.

37. Meanwhile, we support the requirement in the regulations of "any adjustment of benefits to apply to all members without variation", even though it will mean younger members will see their values changed more since a benefit adjustment is not just for that year, but for future years too. In the scenario of reduced benefit increases, a 1% lower increase will bear out for many more years for member in their twenties, than for someone near retirement, and of course that impact will be compounded over time. The same, would of course, be true for increases though. The alternative would be administering different benefit increases, which could lead a higher degree of perceived member unfairness, where, for instance one person could receive a cut at the same time as a colleague received an increase.

38. Finally, some of our members have raised a potential amendment from the single-employer regime regarding the treatments of benefit cuts and subsequent recoveries. Under current rules, cuts, following an economic shock, must be taken immediately (or over up to 3 years at most), but if markets rebound in short order, those increases must be spread over the scheme duration, meaning a member's pension will only recover a small proportion of the original cut, even if markets regain all lost ground. This asymmetric treatment means the impact of an economic shock on any given scheme might simply come down to its valuation date, causing distortions in the market. This could be avoided by allowing losses to be restored over a similar timeframe to the original cut, or cancelled before the cut is applied. Consideration would need to be given to the maximum period after the cut in which it might be considered a rebound and any upward adjustment could be made.

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?

39. Our view is that most of the significant events detailed in regulation 23 will apply to multi-employer CDC schemes. As per the point we make in response to Q12 on significant events, some consideration will need to be paid to major events with an impact on participating employers and the structure of the scheme. However, it may well be that 23 (1) (g) "an event which, in the opinion of a person mentioned in section 28(2) of the Act (duty to notify the Pensions Regulator of significant events), undermines, or is likely to undermine, the soundness of the design of the scheme" would cover such eventualities.

40. In addition, it might be suitable for multi-employer schemes to have to notify the regulator in events such as changes of scheme funder/strategist, or a change of ownership of the scheme, as well as any significant change in active member numbers.

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?

41. As per our response to Q12, as well as paragraph 92 of the consultation, while the insolvency of a single employer may not constitute a triggering event for a multi-employer scheme, if a certain number of employers become insolvent – perhaps more a possibility in the case of a non-profit sectoral scheme, where events in one industry could have a major impact – then the soundness and ability of the scheme to remain open will come into question, so the list of significant/ triggering events needs to reflect this.

42. We agree that – certainly in the case of a commercial scheme – the ongoing integrity of the provider and/or scheme funder is a necessity, and so any risk of failure of one of these entities would need to be communicated to tPR.

43. Our members have, however, also raised that there are a range of possible events, external to the scheme or employer which could have a significant impact on a scheme and its future viability. For instance, material changes to savings, tax and pensions policy that resulted in fewer people contributing to workplace pensions might mean a gradually reducing stream of members, affecting the scheme's ability to remain open. Such scenarios could come about for numerous reasons, but may have consequences worthy of a triggering event.

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?

44. In principle, application of the wind-up commencement time would appear reasonable for these new CDC models, however we appreciate the complexities around employer AE obligations. Our view is that a temporary AE amnesty, where employers' obligations were paused until they appointed a new scheme, is unsuitable. As we covered in our 2022 Five Steps to Better Pensions[6], retirement savings levels are already, in most cases, inadequate, so employees must not lose out on AE contributions through no fault of their own.

[6] https://www.plsa.co.uk/Policy-and-Research/Document-library/Five-steps-to-better-pensions-time-for-a-new-consensus

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45. The appointment of a new workplace CDC provider would no doubt be complex, so where this cannot be completed quickly, the solution may be for contributions *in the intervening time* to be made in DC form to a temporary provider.

46. Overall, with security of member benefits our priority, we would support the intention that a commercial scheme would ideally continue as a closed scheme, were the provider to deem it no longer commercially viable. We would argue there needs to be a long-term commitment from the scheme to deliver CDC benefits if members are to be assured of reliably good outcomes and for confidence in the model to grow. Indeed, we do not feel this level of commitment to delivering equivalent benefits is conveyed in the current articulation at paragraph 75: "*so that members can have **some** confidence that their schemes will be around to provide an income over the course of their retirement"*. Where a scheme is deemed to have no option but to wind up, the preference should always be to transfer members to another CDC scheme, rather than to discharge benefits into a DC arrangement. However, given the complexity of this process, and that in the early days of the model, there may be few other schemes to choose from, as well as the high costs of long-term commitments for the provider, this may not always be possible. Therefore, providers will need to retain the worst case option of decollectivizing, which we would hope would not be detrimental to members' outcomes if the membership was, on average, younger and the scheme wound up quickly after launch.

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

47. The default and alternative discharge options outlined in the regulations do appear to cover most eventualities or member preferences regarding receipt of their accrued rights.

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?

48. We agree that the existing framework broadly provides for the wind up of a whole-life multi-employer CDC scheme, although as per our previous answer, a 'worst case scenario' option of decollectivizing with members able to transfer to individual DC is necessary.

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?

49. Yes, we agree. A number of these measures are there to increase and ensure member protection, and we consider this, and the safety of members' pensions to be the priority with new CDC schemes. As such, there is no reason the charge cap should not apply to these schemes, in fact we would expect most to operate inside it with considerable headroom, once scale is achieved, given the pricing power multi-employer schemes should be able to negotiate thanks to their scale. Finally on charging, it may be that schemes need to adjust admin charges over time to ensure fairness: otherwise, earlier members may end up paying a premium at a time the scheme is setting up.

50. We also support the application of existing subsisting rights protections to prevent DB schemes being able to reduce their own benefit payments, a risk we raised in our 2021 submission[7].

[7] Occupational-Pension-Schemes-Regulations-2021-PLSA-response.pdf

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51. Regarding transfers, we agree that the current process will largely read across, although as the consultation notes, the calculations of a member's individual share will be more complex within a multi-employer scheme. In our 2021 submission we raised the point that wording on transfers "should be such that the valuation calculated is not guaranteed and can go up or down by the time the transfer occurs", similar to with DB transfer values. This would seem appropriate for multi-employer schemes too. That said, the majority of PLSA members canvassed agree that transfers out of a scheme would only be possible up to the point of drawing an income. Once this threshold is crossed, transfers out would necessitate a hugely complex process, with extensive mortality underwriting, to ensure fair treatment of existing members.

52. Possibly the one exception where transfers out might need to be enabled is where a pension sharing order was in place following a divorce. In this scenario one solution would likely be an actuarially calculated transfer value for the former spouse.

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

53. Given non-profit sectoral multi-employer schemes would usually be set up to provide pension arrangements for an active workforce, we would consider it likely that decumulation-only schemes will be limited to commercial models.

54. It should be the provider who covers set up and short-medium term operating costs, until the scheme can support itself sustainably; members in the scheme at the outset should not have to cover these initial costs. Whether this initial outlay is considered feasible and worthwhile, will therefore, as with any commercial investment decision, be down to the provider.

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?

55. Establishing and maintaining scale is the primary challenge for decumulation-only models, given they will not have a workforce contributing to the scheme. That said, exactly what level of scale would be deemed 'sufficient' is likely to be driven by the need to be cost effective, and this scale remains to be seen, and would differ between different prospective providers, but we would expect it to require members in the thousands. It is worth noting, however, that for decumulation purposes, given longevity is effectively capped, the scale required for mortality pooling to become beneficial may not be as large as some would expect; we understand providers may come forward in due course with modelling on this point.

56. The most obvious way for a provider to be assured of sufficient scale, would be if an existing DC Master Trust established a linked decumulation-only scheme, into which the Master Trust's accumulation members would transfer for retirement, although absent a large cohort entering at the outset, there would still be a long period until scale was achieved. Without this existing customer base, establishing scale would be even more difficult, and the scheme would be dependent on external retirees transferring in, in which case some sort of defaulted transfer process would probably be necessary, otherwise the scheme would be reliant on savers assessing CDC and choosing it over other options. Either option would pose challenges; the default may be seen as contrary to "freedom and choice", while such a decision for any individual would be highly complex, with even more to analyse than with existing retirement products and where concerns about the complexity of decision already exist.

57. Regarding the funding required until that scale is achieved, as per our response to question 20, this would be the responsibility of the commercial provider. We do not know, however, how quickly

providers would expect to establish sufficient scale, and how long they would be prepared to back the scheme in the absence of any return by way of net revenue. Clearly, providers would want return on their investment as soon as possible though, so careful consideration would be needed to ensure that earlier joiners to the scheme received fair treatment compared with those later on.

58. Overall, we would recommend that decumulation-only CDC is considered in the round with DWP's ongoing work to reform decumulation. As per our 2022 research[8], there is increasing attention being paid to the support DC savers receive around their retirement options and so we support a soft default option for savers, provided (or signposted to) by their scheme. Bulk transfers into a CDC option would be one way of easing that decision-making burden for members of own-trust schemes, in particular. Furthermore, one of several elements we call for in our Guided Retirement Income Choices[9] framework, is a blend of income and flexible access to suit retirees' changing needs. CDC incomes may well be suitable to provide the income element of such a hybrid product mix.

59. Small pots would clearly be a challenge for such schemes. While we do consider (as per our suggestion at paragraph 56) that existing Master Trusts may be best placed to establish decumulation-only schemes, those with a large number of members with low value pots might find CDC a less attractive proposition. Either way, we would expect many decumulation-only schemes to set a minimum threshold pot size for transfers in. Much will also depend on the resolution of DWP's current consultation on the consolidation of small pots, as for most savers, some form of automatic consolidation will be necessary. For those who actively wish to consolidate their pensions though, we see no reason they could not transfer a number of DC pots into a decumulation-only scheme.

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?

60. We agree that entry pricing mechanisms need careful consideration so that no particular cohort is disadvantaged, and to keep the entry price relatively stable as markets move. It is also important, as with whole-life multi-employer CDC, that pricing cannot be manipulated by providers, e.g., by promising overly ambitious target income levels to entice new joiners. In this context it is important that schemes do target CPI increases, rather than, say, offering higher initial pensions with lower indexation/increases which might mislead savers when comparing schemes.

61. Given a benefit increase cap has been proposed for whole-life CDC, for consistency, this might make sense for decumulation-only, and it would also impose some control over providers using pricing for marketing purposes. We think that the suggestion to calculate adjustments for different cohorts of members separately would run counter to the fairness objective unless they belonged to distinct tranches.

62. Regarding entry pricing and target increases, we agree on the need for stability, and the consultation suggests two possible solutions. In our view, the cap on annual increases, combined with one-off bonus payments would be the better option, as this would be consistent with the proposed regime for whole-life CDC. This would maintain some level of consistency between schemes in the market in terms of increases offered and entry pricing. The proposal to calculate adjustments separately for different groups amounts to creating a new section for new member cohorts. Clearly, the more sections, the less pooling, and so the creation of these would inevitably dilute the fundamental benefits of CDC. As such, we think that providers would only want to consider sectionalisation in extreme circumstances. However, as we discuss at paragraph 21, it may be possible to tranche

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[8] https://www.plsa.co.uk/Policy-and-Research/Document-library/Retirement-choices-the-evolution-of-products-and-support

[9] https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Building-on-the-Pension-Freedoms-Guided-Retirement-Income-Choices.pdf

members within a section (maintaining the risk pooling), so that new joiners can have expected increases close to CPI, in exchange for a lower initial pension.

63. Mortality underwriting would be a sensible inclusion for decumulation-only CDC. As opposed to in other countries such as Australia and Canada, where retirement product pricing is based on age, in the UK the annuity market uses mortality underwriting across the board. We view it as a positive practice as this means customers will likely receive a price more accurately tailored to their own circumstances. It is also worth raising the circumstances of poor outcomes and the reputational damage done in recent years where certain pension providers failed to alert customers of their eligibility to impaired annuity rates. Such a scenario playing out with nascent decumulation-only CDC schemes would benefit no one. Finally, assuming all members were in the same section, a lack of underwriting could lead to certain demographics – those with lower life expectancies – receiving unfair treatment in the form of lower increases as a result of other member demographics with, on average, better health.

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?

64. As per our response to question 10, we believe it unrealistic to expect most individual savers to understand fully the functioning of CDC schemes, and this includes "how their buy-in price has been calculated". The key will therefore be to ensure members do not mistake their *target income* for a *guaranteed income*. As such, stringent communication processes, which have been tested on consumers, will be required to ensure people are not misled. There is arguably a greater danger of these misapprehensions in the decumulation-only space given these products will be retail in nature and so savers will less likely have employers and their advisers to rely on in terms of getting good value from their choices. Again, the suggestion of a role for "super consumers" in response to question 10 applies to decumulation-only schemes to aid member comprehension and shopping around if CDC decumulation were to become available on the open market. There could also be a role for some standardisation of illustrations of risk, so that individuals can compare risk between two CDC products in an unbiased way.

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?

65. The consultation does not touch on various options that members of a CDC scheme might have concerning how they access their pension. Some of these could be similar to options available in the annuity market; we list some possible considerations below:

- Could a member target lower annual increases, e.g., tracking CPI, in return for a higher initial income?
- Could minimum pension periods be an option in decumulation-only schemes, similar to guarantee periods with annuities, e.g., five or ten years?
- What would the intended treatment of spouses' pensions be after death?
- With retirement now a more flexible concept than in the past, and with increasing numbers choosing to continue working (or restart work in some form) post-retirement, would schemes offer the option to pause income and restart it later, at a higher level?
- Within the wider decumulation debate, reference is often made to 'hybrid' or 'blended' approaches, where both flexible and steady income streams are desired, but that often in the

latter stages of retirement, people value the steady income more. As such, would schemes enable members to transfer additional funds into their CDC part way through retirement?

66. There are myriad features providers could build into their CDC designs, though clearly, the more complexity, the higher the cost of providing the product. The regulatory regime will need to draw a balance between enabling these, thus avoiding too homogenous a market, while providing safe boundaries within which a reliable market can develop. Given the various challenges discussed in the consultation, notably to do with establishing scale, it may be that a smaller, simpler market would be more effective in the early stages as CDC establishes itself. In this sense, we support rules around required and capped increases and restrictions on transfers, but regarding other flexibilities, it will be for prospective providers to make the case to DWP for the effectiveness and sustainability of particular business models, ahead of the final regulations being decided on.

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