

Extending opportunities for Collective Defined Contribution Pension Schemes

LCP's response to the DWP's consultation

27 March 2023

This document sets out LCP's response to the Department for Work and Pension's consultation, Extending Opportunities for Collective Defined Contribution Pension Schemes [published](#) on 30 January 2023 (the "Consultation").

Our high level comments on the Consultation

- We strongly believe in the potential for sectorial multi-employer CDC schemes to improve outcomes for future generations of savers and we see these schemes as a key extension to the single and connected employer CDC framework currently in place.
- In principle we believe that only relatively minor legislative and regulatory changes are needed to enable successful implementation of sectorial multi-employer schemes, which might for example be established as an additional section to multi-employer trust-based pension arrangements that already exist.
- We agree with broad benefit design proposals outlined in the consultation which align well with our wider industry discussions over the past year.
- We believe that there are additional complexities in relation to commercial and decumulation only CDC schemes which are likely to require further thought to balance fairness to members with commercial concerns.
- Given the above, we believe there is strong rationale for prioritising the development of multi-employer sectorial schemes as a first step and, if necessary, allowing more time for consideration of factors relating to more commercially focussed schemes, in particular decumulation-only arrangements.
- There is also a strong argument for the set up or appointment in due course of a default CDC scheme, perhaps similar to NEST for the DC world, which would be available for decumulation purposes and to which members of any winding-up CDC schemes would be able to transfer.

We have set out below our answers to the specific questions in the consultation document. We agree with many of the views posed by the Institute and Faculty of Actuaries and Association of Consulting Actuaries regarding authorisation of whole-life CDC schemes, and some of our answers reflect this. However, as we believe initial focus should be towards successful extending CDC to sectorial multi-employer schemes, we have not sought to respond specifically to Questions 20-24 which relate to commercial decumulation only focussed arrangements.

We are happy for LCP to be named as a respondent to the Consultation and happy for our response to be in the public domain. We are happy for you to reference our comments in any response.

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Detailed response

Chapter 3: Key principles for new types of CDC schemes

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.

Yes. We believe the key principles identified naturally extend to whole-life multi-employer CDC models.

In particular:

- We agree it will continue to be important to emphasise that CDC benefits accessed through occupational pension schemes are collective money purchase benefits, so to avoid any perception that they are defined benefit in nature (or could potentially change to DB in future).
- The principle of “reading across” from single or connected employer schemes to sectorial multi-employer schemes should be maintained in future:
 - As a key point, we strongly believe that sectorial multi-employer CDC scheme, where there is a current relationship between employers and trustees through one or more existing trust based multi-employer defined benefit or defined contribution schemes, and where the CDC scheme is expected to be an alternative pension solution to these arrangements, could be established as a simple and straightforward extension to the current single-employer CDC scheme set up. For these schemes (which might for example be set up as a new section to an existing multi-employer scheme), we see no reason to make their set up more stringent compared to single-employer CDC schemes.
 - We agree with proposals to allow schemes to take advantage of appropriate scheme design innovations (such as different accrual rates or age-related scales) (as highlighted in paragraph 22); and
 - It will be helpful to allow single or connected-employer schemes to extend to a sectorial multi-employer scheme should the need arises in the future, such as because of sectorial market developments or as a result of sales and acquisitions.
- We believe the collective combination charge structure which permits a combination of different % contribution charge and % existing rights charge, or flat fee charge and % existing rights charge (as set out in Schedule 7 Paragraph 12 of the 2022 Regulations), should continue to be available to all whole-life multi-employer CDC models.

Chapter 4: Defining qualifying benefits and qualifying schemes

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 agree that “qualifying benefits” as set out in section 2 of the 2021 Act applies to new types of CDC schemes.

We agree that CDC and non-CDC benefits within the same scheme should be offered through separate sections.

We envisage that there could be a need for different CDC sections within the same scheme, where different sets of actuarial assumptions are required, for example:

- employers wish to target different levels of future indexation or different charging structures, or potentially different normal pension ages; or
- there is a need for the scheme to use different mortality assumptions for different groups of members.

However, we believe a single section should encompass all benefits based on a single set of actuarial assumptions and a single indexation, which could be age-related. This could potentially accommodate employers with a range of different contribution structures/accrual rates, provided contributions are converted to units of CDC pensions using the single set of actuarial factors.

In summary, we believe this reduces to a concept that benefits should only need to be separated out into a different section if there is actuarial rationale for them to attract different levels of indexation as a result of scheme experience.

Chapter 5: Authorisation

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 some amendments are likely to be needed.

As well as members and employers or prospective employers, monies could come from other sources, and a person should be considered to be “operating” the CDC scheme if they receive money from any sources in respect of contributions, fees, charges and other purposes.

For sectorial whole-life multi-employer schemes, there could be different sources of seed capital. For example, from a single lead employer (the equivalent of a “principal employer”) establishing the scheme, or from a group of founding employers who initially agree to fund and set up the CDC scheme, a central source such as historic institutional assets, individual member contributions sponsored by unions, or, should legislation permits, direct contributions from employers’ current arrangements if, for example, the scheme is to be set up as a new section to this arrangement.

Legislation should enable the person operating the CDC scheme to accept money from these sources towards setting up and authorising the scheme, without breaching the prohibition. The expectation would be that the relevant parties would come to reasonable agreements as to the share of contributions to the scheme, and any conditions attached to them (e.g. should the authorisation not proceed).

For a commercial whole-life scheme, we would ordinarily not expect further monies to be paid by the commercial provider once the seed money has been paid for initial set up and authorisation, however, given the need for a backer throughout the life of the scheme (Question 8), we suggest a person handling such monies after the initial costs should also be considered to be “operating” the scheme.

We would anticipate that in all cases no payments could be received from (or benefit paid to) individual employees prior to authorisation.

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?

In general we think those persons to be tested for Master Trusts could be read across to CDC schemes. We note, however, that the flexibility for the Regulator to decide if a person is exercising a core function in the Master Trust regulations (Section 7(3)(b) of the 2017 Act and Schedule 1 Para 2 of the 2018 Master Trust Regulations) is not available in the CDC regulations. We suggest that this is useful in a new and evolving environment.

Those establishing the scheme: for sectorial schemes we expect this will be undertaken by a clear body, most likely a pensions board that currently runs DB and DC schemes in that sector. The Regulator’s current CDC code says “*where the roles are fulfilled by a corporate entity, we will assess the appropriate senior individuals, but we will not normally assess the corporate entity*” and we expect this will be sufficient.

Those marketing and promoting CDC schemes to prospective employers and members:

- It may be appropriate to make a distinction between a non-profit making multi-employer scheme and a commercial scheme. We would anticipate that it may not be necessary for a person who makes known to sectorial employers the existence of a CDC scheme, which these sectorial employers can join, to be required to pass a fit and proper person test. On the other hand, a promoter for a commercial CDC scheme should require a test, as per Q5.
- Advisors to corporates and pension schemes who are regulated by their professional bodies, for example actuaries and legal advisors, should not require an additional fit and proper person test.

Scheme funder and scheme strategist: It is likely that the functions of scheme funder and scheme strategist could be performed by separate individuals in some circumstances and so separate definitions could be required. As the CDC regime is in its infancy, it seems unlikely that many potential strategists would pass the competency test at the required level for Master Trusts (especially that they have the appropriate experience to carry out their role).

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?

As for question 4, we believe a distinction between sectorial and commercial providers could be appropriate.

The conditions for Master Trusts appear appropriate for commercial CDC schemes. We note that the Master Trust regulations permit (but do not require) the Pensions Regulator to assess the fitness and propriety of a marketer or promotor, and the details are then filled in in the Code of Practice. We think this would provide the flexibility needed to ensure sectorial and commercial CDC schemes can be treated differently.

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?

We suggest

- the scheme strategist should be included (Q4; Schedule 1 para 3 of the Master Trust Regulations)
- there should be flexibility in the regulations to include other persons who the Regulator decides should be assessed (Schedule 1 para 2 of the Master Trust Regulations)

Otherwise, we believe the fit and proper persons requirements for single-employer CDC schemes are also appropriate for sectorial multi-employer CDC schemes. Where further skills, knowledge and understanding might be required for persons involved with multi-employer schemes, these requirements should be sufficiently covered by Schedule 1 Para 3 of the 2022 Regulations. We note that there are limited opportunities for those involved to have gained sufficient experience on CDC schemes, before being assessed by the Regulator as a fit and proper person.

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?

In general, we agree that the scheme design and viability requirements should read across to multi-employer schemes.

Scheme design requirements

Some adjustments may be required to scheme design, such as Reg 17(4)(c) of the 2022 Regulations, to ensure that flexibilities including different contribution rates and age-related scales are permissible.

Viability requirements

Communication – we agree that the same considerations around communications to members should apply to whole-life multi-employer schemes as for single and connected employer schemes.

It appears reasonable to consider the clarity, completeness, and accuracy of communications to employers and prospective employers. Distinctions may be required between the requirements for sectorial and commercial schemes, for example the information available to be disclosed to the joint founder of a sectorial scheme at outset, would differ from that disclosed to an employer joining a large established multi-employer scheme operated on a commercial basis.

We would expect the information disclosed to prospective employers needs to be sufficient to allow them to understand the potential risks and costs and identify potential cross subsidies between employers. These should at a minimum include details on running costs and expenses, including any potential liability on a triggering event;

how benefits are adjusted and recent adjustments applied, including any multi-year adjustments outstanding; and required investment performance and returns.

Gateway tests and live running tests – we believe that these tests remain appropriate (and are appear likely to be easier to demonstrate for an age-related benefit structure).

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?

For sectorial multi-employer CDC schemes, it is not clear that the concept of a single “funder” is practicable. In practice, the liability for paying additional administration charges would likely be shared between all the participating employers rather than falling on a single employer. In addition, a current employer is unlikely to meet the requirement to only carry out activities that relate directly to the CDC scheme as set out in paragraph 59; whilst there could be processes in place to apply to the Regulator for exemption (such as those for Master Trusts), this seems unnecessary for current employers.

We suggest that the trustees or strategist should be responsible for identifying the source of funding, and this forms part of the initial approval process and annual review. This might include review of covenant, legally binding agreements, cash in bank accounts, escrows etc.

For commercial CDC schemes, we would expect similar funding structures to DC Master Trusts, and agree that the concept of a scheme funder could be appropriate with similar requirements to those applying to the Master Trust regime. Having the same requirements would also simplify the process for current Master Trusts to create new CDC sections.

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 a business plan should be required for both commercial and sectorial CDC multi-employer schemes. We think the framework for the business plan, as set out in the 2018 Master Trust Regulations, would mostly be suitable for both sectorial and commercial CDC schemes, but the contents of the business plan would be expected to differ between commercial and sectorial providers as set out in the Regulator’s code (and again for decumulation only vehicles when introduced).

This business plan should be prepared by the trustees of the scheme.

We would suggest that the business plan includes setting out how the funder expects to recoup initial expenses over the long term as the scheme scales and to limit cross-subsidies between generations. If scheme trustees or the scheme strategist are responsible for identifying and confirming the source of funding, a report of this should be included in the business plan.

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?

For employers and members already in the CDC scheme, we agree the current communication requirements are suitable and would also be suitable for sectorial multi-employer schemes.

We believe that, to mitigate the “over-promising” risk, it is appropriate for the communication used for promotional and marketing purposes to be included in the requirements in a proportionate way. This will be particularly important for commercial CDC schemes.

In addition to the information provided to members on scheme structure, risks, and benefits, we could expect this to include:

- details on running costs and expenses, including any potential liability on a triggering event;

- Required investment returns (and investment performance); and
- Any potential cross subsidies between employer groups or other categories of member.

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?

We expect CDC schemes will become more commonplace over time, and there will be individuals and employers wishing to transfer their pension pots to different CDC schemes and/or different sections of the same scheme. The “member records” requirements need to be able to cater for this.

If the “funder” concept is decided not to be appropriate for sectorial schemes (see our thoughts on Q8), we suggest Para 6 should be expanded to include those who contribute to funding and the trustees’ or strategist’s determination on the suitability of funding.

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?

We agree that the existing requirements are suitable for whole-life multi-employer CDC schemes.

We believe the continuity strategy requirements for single or related employer schemes should also apply to sectorial non-profit making multi-employer schemes, i.e. there should be no additional requirement for an aspiration to operate as a closed scheme following a triggering event. More broadly, we anticipate that schemes would need to mature before operating as a closed scheme became a realistic alternative.

However, we believe there needs to be a strategy for the government to set up or appoint a default CDC scheme to which members of winding-up CDC schemes can transfer, similar to NEST for the DC world.

It is reasonable for commercially set up CDC schemes to aspire to operate as closed schemes following triggering events.

Chapter 7: Valuations and adjustments

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?

We agree that the existing requirements are mostly suitable for sectorial multi-employer schemes. Small adjustments might be required to ensure the different scheme designs (eg age-related scales) work with these requirements, eg Reg 17(4)(c) which requires the same adjustment to apply to all members without variations.

Additionally, we agree with the proposal that the pension increase granted could be subject to an upper limit, and the excess applied as a one-off increase to base pension amount. We suggest schemes should be able to decide whether to apply this threshold, and if so, what this threshold should be. We would envisage it being appropriate to also allow this flexibility to single and connected employer arrangements.

Chapter 8: The ongoing supervision of CDC schemes

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?

Suggested new events to be added to reg 23(1):

- Addition of employers, or current employer leaves the scheme;

- Addition of new sections (this may be covered by reg 23(1)(d)(ii) and reg23(1)(e)) and closure of individual sections

Suggested addition to reg 23(4):

- Where an employer withdraws from the scheme, whether there are consequences to the funding of the scheme and how this might be resolved.

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?

Some of the triggering events may apply to individual sections of a multi-section scheme. For example, item 6 triggering event (a person who has power to do so under the provisions of the scheme decides that the scheme should be wound up) should be applicable at section-level. An employer of a unrelated multi-employer section becoming insolvent may not necessarily be a triggering event; however, if the employer is a sole employer of a section of the scheme then that could be a triggering event.

A funder withdrawing funding should be a triggering event (especially if they are sole funders).

Chapter 9: Continuity options

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?

We think a similar approach should be applied to whole-life multi-employer schemes. The concerns on AE obligations on solvent employers also apply to single- and connected-employer schemes, if wind-up was triggered by events other than items 4 or 5 (and we expect items 4 or 5 triggering event might not be appropriate, in their current forms, for multi-employer schemes).

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

Yes, although a designated default CDC scheme (such as NEST for DC schemes) would be very useful.

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 we agree that the existing framework should also apply to whole-life sectorial multi-employer CDC schemes.

Chapter 10: Other policy considerations

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 agree that the existing requirements mostly apply to whole-life multi-employer CDC schemes.

Transfers (Paragraph 117) – this paragraph states that members of traditional DC schemes may wish to transfer their benefits into their CDC scheme, provided the CDC scheme agrees with the transfer. We would expect that some members in DB schemes may also wish to do so, and should be able to do so provided they meet the current DB to DC transfer requirements (such as requirement to seek advice).

Disclosure and publication requirements (Paragraphs 125 – 127) – we would expect there to be extra disclosure requirements with regards to information provided to potential employers.

Automatic enrolment (Paragraphs 128 – 129) – we suggest that whole-life CDC schemes should have the option to meet the quality requirement for money purchase schemes, instead of the alternative quality test set out in the 2022 regulations.

Chapter 11: Decumulation-only arrangements

We believe initial focus should be towards successfully extending CDC to sectorial multi-employer schemes, which we believe could be achieved relatively simply, and we have not sought to respond specifically to questions around commercial decumulation only focussed arrangements. Whilst we can see the advantages and attractiveness of these vehicles to savers, we believe that the start-up challenges of these arrangements, many of which you have identified, mean more time could be needed to address the complexities of regulating commercial arrangements.

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

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?

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?

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?

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?