Department for Work & Pensions

Delivering Collective Defined Contribution Pension Schemes

Response from
The Pensions Management Institute

Pensions
Management
Institute
ACHIEVING PENSIONS EXCELLENCE

Response from the Pensions Management Institute to the DWP consultation 'Delivering Collective Defined Contribution Pension Schemes'

Introduction

PMI is the professional body which supports and develops those who work in the pensions industry. PMI offers a range of qualifications designed to meet the requirements of those who manage workplace pension schemes or who provide professional services to them. Our members (currently some 6,000) include pensions managers, lawyers, actuaries, consultants, administrators and others. Their experience is therefore wide ranging and has contributed to the thinking expressed in this response. Due to the wide range of professional disciplines represented, our members represent a cross-section of the pensions industry as a whole.

PMI is focused on supporting its members to enable them to perform their jobs to the highest professional standards, and thereby benefit members of retirement benefit arrangements for which they are responsible.

Survey

In preparing our response to this survey, we issued a membership survey. This ran throughout December 2018 and received 52 responses. This reflects the views of PMI members with a specific interest in CDC schemes. The answers given form the basis of PMI's response.

The survey contained a number of questions which related directly to the consultation (see below). However, we also asked two questions which assessed the degree of support of our members for the CDC concept. The first of these asked

How supportive are you of CDC schemes being introduced into the UK's pension system?

Responses were as follows:

Very supportive	16
Supportive	15
Neither supportive nor unsupportive	9
Unsupportive	4
Very unsupportive	6
Do not know	2

Whilst there was a small overall majority in favour of the introduction of CDC arrangements, members' comments made it clear that there were significant caveats. One respondent noted that CDC schemes had to be large in order to work effectively, and that unless the CDC design were to be permitted for Master Trusts, this would limit the CDC option to just the largest of employers. Another was concerned that CDC schemes might over time be subjected to the 'regulatory ratchet' in the same way that DB schemes had been affected by regulatory changes in the eighties and nineties. A third concern was the effective communication of the concept to members; the concept of a target benefit without absolute guarantees is new to the UK and unless this is communicated effectively there is scope for members to be confused and disappointed about possible reductions to benefits.

Our second general question asked

How likely do you think CDC schemes will succeed as a meaningful part of the UK's pension system?

Responses were as follows:

Very likely	8
Likely	20
Unlikely	14
Very unlikely	5
Do not know	5

Again, there was a slight majority in favour of CDC, but respondents were generally a little more agnostic about the prospects for this type of scheme. One view was that it was too late for this type of scheme to be introduced and that employers were unlikely to abandon traditional DC in favour of it. Another was that unless CDC were to be permitted via a Master Trust, CDC would only be available via a small number (albeit large) employers. There was concern too about the possible impact on effective risk sharing as a result of transfers out. Again, the importance of effective communication was raised if the concept of a target benefit was to be properly understood by members.

Question 1: Are there other ways in which the introduction of CDC Schemes would give rise to different impacts on individuals in relation to one of the protected characteristics?

We do not believe that the introduction of CDC schemes would have any significant impact on individuals in relation to any of the protected characteristics.

Question 2: Do you agree that CDC benefits should be classified in legislation as a type of money purchase benefit?

Responses were as follows:

Yes	43
No	6
Not sure	3

Members demonstrated a strong preference here for identifying CDC as providing money purchase benefits. Essentially, the benefit promise takes the form of a fixed rate of contribution and emerging benefits, though calculated in a consistent manner, are not subject to formal guarantees. It is therefore appropriate for CDC benefits to be classed as being money purchase.

Question 3: Are there any other areas where the current money purchase requirements do not fit, are inappropriate or could cause unintended consequences?

We believe that current methodology for calculating the Lifetime Allowance (LTA) would not work effectively with CDC. Using the money purchase option would require a regular Share of Fund to be calculated for each active and deferred member. As a CDC scheme would be very large, this would be a complicated (and expensive) exercise. Moreover, members' benefits would be more appropriately expressed as a target pension. This would lend itself more naturally to the DB LTA test, but even this would be problematic: as benefits are not guaranteed, there would need to be a defensible mechanism for calculating any possible tax liabilities on crystallisation.

Question 4: Do you agree that the initial CDC schemes should be required to meet the conditions described above?

Responses were as follows:

Yes	41
No	4
Not sure	7

Respondents showed clear agreement with the conditions set out in paragraphs 66 – 75 of the consultation document. However, some questioned if valuations would be required on an annual basis, noting that this would represent significant cost. Others believed strongly that CDC should not be restricted to large employers, and wanted CDC to be an option for Master Trusts from the outset.

Question 5: Is there a minimum membership size for CDC scheme below which a scheme could not be viewed as having sufficient scale to effectively pool longevity risk to the benefit of the membership?

At least 1,000 members	11
At least 10,000 members	19
At least 25,000 members	5
At least 50,000 members	3
More than 50,000 members	3
No minimum	11

There was no clear consensus as to the minimum size that a CDC scheme needs to be in order to achieve viability, although relatively few respondents believed that CDC schemes need to be very large.

Question 6: Do you agree with the proposed approach to TKU for CDC schemes?

Responses were as follows:

Yes	44
No	8

Respondents were strongly in agreement with the proposed approach. It would be inconsistent to introduce additional TKU requirements for this type of scheme when there are no such requirements for DB schemes, which may also be very large and governance issues every bit as complex (if not more so) than for CDC schemes.

Question 7: Are there any additional TKU requirements that should be placed on the trustees in CDC schemes?

Responses were as follows:

No formal requirement	18
Professional qualification	19
Minimum previous trusteeship requirement	16
Formal CPD requirement	21
Other	6

One respondent was concerned that extending the TKU requirements for trustees of CDC arrangements would be a barrier to the appointment of Member Nominated Trustees. In the case of large employers (who initially would be the only possible sponsors of CDC schemes) this would be problematic.

Question 8: Are there any TKU requirements that should be relaxed for the trustees of CDC schemes?

We see no reason why any existing TKU requirements should be relaxed.

Question 9: Which of the two AE tests would be more appropriate for CDC schemes, and how might either test best be modified to better fit CDC schemes?

Responses were as follows:

Cost of accruals test	12
Money Purchase test	31

A majority of members believed that the money purchase test was the more appropriate test. This is after all consistent with defining CDC benefits as money purchase in nature. However, a significant majority argued that as a target benefit accrues from the outset, this should be used for auto-enrolment purposes. It might ultimately prove necessary to develop a dedicated auto-enrolment test for CDC schemes.

Question 10: What issues might arise from having no in-built capital buffers in the scheme design?

Whilst the absence of capital buffers increases the likelihood that target benefits would be subject to variation, we are persuaded that there would be more equitable risk-sharing within the scheme. In particular, there would be greater fairness on younger members, as their contributions could not be allocated to the restoration of a buffer.

Question 11: How can schemes best communicate with members to ensure they understand the risk that their benefits could go down as well as up, even when in payment?

Effective communications represent a significant challenge for all pension schemes. We do not believe that there should be any new mandatory disclosure requirements for CDC schemes, but expect that trustees would be aware of the importance of effective communication if CDC benefits are to be properly understood.

Question 12: What additional issues may arise from using a best estimate basis for valuation, and how should those issues be addressed?

We are not aware of any additional issues. We share the view that the best estimate approach to valuations is the more appropriate option.

Question 13: Should we restrict CDC scheme designs to those schemes which would be sustainable without continuing employer contributions?

Given that members of CDC schemes will not be eligible for Pension Protection Fund (PPF) benefits we believe it is important that any CDC scheme should be capable of remaining viable without continuing employer contributions.

Question 14: We would welcome feedback on how best to manage risk generally going forwards.

We are satisfied that structures as proposed are appropriate.

Question 15: Does the proposed CDC scheme framework, as set out in this consultation document, address concerns about risk transfer between generations? We welcome thoughts on any other measures that could also address this.

Many commentators have expressed concerns about inter-generational fairness within CDC schemes. We are satisfied that the proposed absence of capital buffers would do much to ensure that inter-generational risk transfer would be properly equitable.

Question 16: We would welcome thoughts on appropriate wind up triggers and how best to manage associated risks

We suggest that an appropriate wind up trigger would be for closed scheme's funding level to fall to a point where members' benefits fell to a defined percentage of the original target benefit.

Question 17: Are there any elements of the proposed regime that it is not appropriate to apply to CDC schemes?

We are satisfied that all aspects of the proposed regime are appropriate for CDC schemes.

Question 18: Are there any additional authorisation requirements that should be placed on CDC schemes?

We do not believe that any additional authorisation requirements are necessary.

Question 19: Are there any other investment requirements that should be required in addition to those proposed above?

We do not believe that any additional investment requirements are necessary.

Question 20: Are there any other disclosure of information requirements that should be required in addition to those proposed above?

We are satisfied that no additional disclosure requirements are necessary.

Question 21: Do you agree that CDC schemes should be administered under the requirements for money purchase benefits, but with added requirements to appoint a scheme actuary and carry out annual valuations?

Responses were as follows:

Yes	45
No	3
Not sure	4

Whilst broadly in favour of the appointment of a scheme actuary, respondents held differing views on the frequency with which valuations should be conducted. Some felt that a requirement for an annual valuation would be excessive and would drive up running costs.

Question 22: Do you agree that CDC benefits should be subject to a similar cap to the automatic enrolment charge cap?

We agree that, in the interests of consistency, members' benefits should not be suppressed as a consequence of charges and other costs and that the automatic enrolment charge cap is the obvious comparison. However, it must be borne in mind that any investment charges would actually be borne at scheme rather than member level. As we have noted elsewhere, larger schemes will be better placed to enjoy economies of scale. Additionally, schemes could ensure compliance if the sponsor were to absorb some or all of a scheme's investment costs.

Question 23: Do you agree with the proposal that charge cap compliance should be assessed on the value of the whole scheme's assets?

Responses were as follows:

Yes	40
No	12

There was a general view that (a) costs should be capped and that (b) the cap should be based on the whole scheme's assets. The cap would in itself prove a significant driver for the establishment of large schemes, as economies of scale would permit a wider range of assets to be held.

Question 24: What would be an appropriate approach to handling transfers out of or into CDC pension schemes?

Responses were as follows:

Share of fund	35
Other	10
Transfers should not be permitted	7

Few respondents believed that transfers should not be permitted at all. One respondent was concerned that transfers out might have a disproportionately detrimental impact on remaining members unless the scheme was exceptionally large.

Those who believed that transfers should be permitted showed a clear preference for the share of fund option as described in paragraph 167 of the consultation document.

Question 25: Should transfers be restricted in any way – for example, to take account of the sustainability of the fund?

Responses were as follows:

Yes	36
No	16

A commonly-cited concern was that transfers out might compromise a scheme's capacity to share risk effectively and that a large number of transfers might have a detrimental impact on the benefits of remaining members. With this in mind, there was a strong preference for allowing trustees to restrict transfers.