Institute
and Faculty
of Actuaries

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Institute and Faculty of Actuaries: Response to DWP's Consultation on *the Occupational Pension Schemes Regulations 2025 (Extension of CDC Provisions to Unconnected Multiple Employer Schemes)*

Actuaries are big-picture thinkers who use mathematical and risk analysis, behavioural insight and business acumen to draw insight from complexity. Our rigorous approach and expertise help the organisations, communities and governments we work with to make better-informed decisions. In an increasingly uncertain world, it allows them to act in a way that makes sense of the present and plans for the future.

The Institute and Faculty of Actuaries (IFoA) is pleased to submit a response to the consultation by the Department for Work and Pensions on draft legislation to extend Collective Defined Contribution (CDC) provision to whole-life unconnected multiple employer schemes.

Within the actuarial profession we have experts in technical detail, executives in small and large financial institutions, and practitioners working within the financial system itself. Our outlook is rooted in our Royal Charter (dating back to 1884) and in our long history of working with policymakers to effect change. We focus forwards on how we can help individuals and organisations solve financial and risk-related problems in the 21st Century.

Key points

- We welcome the Government's proposals to extend CDC to multi-employer and master trust arrangements. We believe this is necessary to allow wider access to CDC. Further access could be provided through facilitation of in-decumulation arrangements, and we are pleased the Government has separately indicated that they will look at enabling that next.
- We think the sectionalisation rules around investment strategy changes need to be clarified, for these to meet the policy intention.
- We believe there is an issue with the timing of the actuarial equivalence test - the test seems to require that accrual rates must be in force from the effective date of their calculation ("relevant date") leaving no time to perform calculations, inform members, and implement the rates in the administration system.
- We question the reasons for different standards to retail financial products.
- We think there are issues with the details of how the benefit adjustments are to be applied where they differ between employers.

Our full responses are shown below. These have been provided by our CDC working party, make up of pensions actuaries, insurance actuaries, and other professionals. We don't answer all questions, only those where we feel we have pertinent points to make. If you have any questions on the response, please contact Caolan Ward (caolan.ward@actuaries.org.uk) in the first instance.

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Chapter 2: Legislation for unconnected multiple employer CDC Schemes

Question 1: Do you think draft regulation 25 delivers the policy intent for the opening of a new section for unconnected multiple employer CDC schemes?

We are supportive of the intended flexibility to allow the benefits of risk pooling across employers with different contribution and/or accrual rates. This is key to avoid excessive cross subsidy or sectionalisation.

The use of changes in investment strategy as a trigger for the creation of new sections leaves a lot of room for interpretation. The long-term nature of CDC will mean that over time, the investment strategy will be expected to evolve e.g. reflecting changes in expected return on asset classes, market conditions and new investment opportunities. Following a change in view on long-term expected return on assets, it may be appropriate / necessary to change the asset allocation to maintain the same expected level of benefits / increases. Such changes would impact the investment strategy but likely keep it within the overall investment philosophy of the scheme

In our view, such changes should not trigger sectionalisation. If it is the intention of the DWP's draft regulations to afford Trustees discretion to maintain benefit accrual within a section when investment strategy changes of this type are made, then we would encourage the DWP to clarify this position.

We note that the draft sectionalisation regulations for multi-employer CDC schemes appear to allow more flexibility than the equivalent rules for single-employer CDC schemes. There are plausible scenarios that would necessitate the creation of a new section for a single-employer CDC scheme but not a multi-employer CDC scheme. For example, a change in future expected longevity may lead to a change in benefit accrual rates. The lack of consistency creates complexity for large employers when deciding whether to join a multi-employer CDC scheme or begin their own single-employer CDC scheme.

Question 5: Does the drafting of the scheme design tests deliver the policy intention of providing a sensible measure of whether a scheme's design is sound, at initial application and on an ongoing basis?

Subject to our point in question 1, we believe that the proposal that the trustees set out what changes in investment strategy would trigger a need to sectionalise in the viability report – and that this assessment can be updated over time by the trustees – would provide the necessary flexibility (provided restrictions are not imposed by the Regulator). In practice, we think it would be very unusual for a change in investment strategy to trigger sectionalisation inappropriately, within this structure. It is more likely that either other actions would be taken (for example, in the scenario envisaged in footnote 16 to paragraph 44, the trustees could award a one-off increase to benefits – with future increases then being reduced to a more typical level) or that there would be legitimate reasons to amend the comments in the viability report on what changes should trigger a need to sectionalise (this might occur in the circumstances outlined in paragraph 45 of the consultation document, where scheme demographics change – for example where a large bulk transfer takes place so that the post-transfer membership has a significantly different demographic profile, the investment allocation will change for the scheme as a whole, but the notional investment strategy for each member will not have changed – the new member profile should not trigger sectionalisation in line with the description in the pre-bulk transfer viability report).

We do have a concern over the requirement (in Regulation 32(2)(b)(ii)) for specific communications to have "accurately described estimates of the rate or amount of <u>any</u> future pension benefits under the design of the scheme". Although this may be possible in a common accrual rate design the requirement could be read as imposing particularly onerous requirements for schemes operating variable accrual rates, which could vary by age, time and potentially other factors such as factors impacting life expectancy. It might be read as requiring potentially voluminous tables in booklets and benefit statements for such schemes. We would suggest that the

requirement be clearly limited – which could be achieved by moving the word "any" to earlier in the sentence – i.e. to require the communications to have "accurately described any estimates of the rate or amount of future pension benefits under the design of the scheme".

We do have comments on the drafting of the actuarial equivalence test as we describe in question 6.

Question 6: Do you have any comments on the drafting of the actuarial equivalence test? Is it clear that the scheme actuary must use the methods and assumptions used in the most recently completed valuation to satisfy the test?

We are happy with a principle that the contributions should equate to the value of the benefits accrued.

However, we have concerns over whether the dates used in the actuarial equivalence tests are sufficiently flexible to work in practice. Our main concerns relate to the how the test under 32(9) would be applied for subsequent viability certificates.

In our view, in order to be able to provide the necessary certification (that "the contributions expected to be made" is (exactly) equal to the "value of rights to benefits… expected to accrue" over the following 12 months, by reference to the chosen relevant date, and in respect of each member/employer (depending on the approach adopted) it would need to be necessary for:

- The scheme to implement new factors from the "relevant date", based on financial conditions at the relevant date – i.e. leaving no time for the practicalities of implementation, or for the scheme to be able to communicate the new factors to members in advance of implementation;
- Those factors to remain in force for a full 12-month period – even where there are significant changes in financial conditions;
- If the certification is delayed so that it is more than 10 months after the premiums were last set, the certification of those factors cannot form part of the viability certificate – it is not clear how such a scheme could satisfy the legislative requirements where the 10 month deadline is exceeded (or why such a deadline is required).

To address these practical issues we would suggest:

- The relevant period should not be restricted to a period commencing at the relevant date (ie the date used to set the financial assumptions for the assessment) – to allow a period between calculation of factors and implementation – this period could be a year to mirror the timescales for an actuarial valuation (ie the benefit adjustment is usually applied 1 year after the effective date of the valuation);
- There should be flexibility for factors in operation over the relevant period to be set based on more than one relevant date - allowing for updated factors to be introduced mid-year where there are significant changes in financial conditions;
- The 10-month restriction in regulation 32(11)(b) should be removed.

In terms of detailed drafting to address these issues:

- In 32(10)(b)(ii) we would suggest rather than referring to "the date which has been agreed in accordance with paragraph (11)", reference is made to "a date agreed between the trustees and the scheme actuary based on the scheme's practice for revising contribution and benefit accrual rates";

- In 32(11)(b) we would suggest the reference to "information as at a date to be agreed" is extended to "information as at a date (or dates) to be agreed";

- In 32(11)(b) we would suggest replacing the reference to ", but not earlier than ten months before….. provided to the trustees" with ", but not earlier than [two months] before the date agreed in accordance with paragraph 32(10)(b)(ii)".

We also have some concerns about the requirement in regulation 32(10) for the expected value to be calculated using "assumptions that would expected to be used for an actuarial valuation" in all cases. In particular, there may be certain assumptions in which additional flexibility would be helpful when setting premiums. For example, trustees may prefer to use the same accrual rates for male and female members, although they may wish to allow for differences in male and female mortality when carrying out the valuation.

(We understand that the policy intention is not to restrict flexibility on setting accrual rates for males and females. However, in order to allow for different factors for males and females our understanding is that an exception would need to be provided for under Section 5(1) of the Equality Act 2010. It is not clear (in our lay view) that Regulation 4(1) of the Equality Act 2010 (Sex Equality Rule) (Exceptions) Regulations 2010 clearly provides the necessary exception.)

Two other more minor points:

- the inclusion of "calculated on actuarial basis" is repeated in reg 32(10)(a), and probably unnecessary.

- The meaning of "in accordance with the scheme rules" is not clear – for example, is this in relation to the benefits, or an actuarial calculation method; or whether the actuary should follow the scheme rules if these are, or become, contradictory to legislation.

Question 7: Do you have any comments on the draft regulations on financial sustainability?

We have two observations on the drafting of the regulations:

- The business plan has a plan period of three to five years, but there is no requirement for the proprietor to revise the business plan once the current one expires. We note that this is the same as for master trusts.

- Paragraph 2(f) of Schedule 3 of the draft regulations appear to be redundant – similar paragraphs from the single-employer CDC regulations have been removed when copied across to the multi-employer regulations.

We have a further observation on the set up of the scheme proprietor – the draft regs require that *"The scheme proprietor only carries out activities that relate directly to the scheme (regulation 14C(3) and paragraph 76)*".

This would mean that a new legal entity will need to be set up. We expect this would likely to be a wholly-owned subsidiary of a commercial provider (for example an insurance company), or a subsidiary of a current Pensions Board or an employer (for not-for-profit schemes). While the activities of the new legal entity may be separated from the parent company, for example with a separate board of directors, given the commercial relationship between the parent and subsidiary we would not expect the new legal entity to be entirely independent, or that such a set up would successfully "avoid any potential conflicts of interest" (paragraph 76). As such it is not clear to us the purpose of requiring a separate legal entity to act as the proprietor, compared to, for example, a dedicated function within the commercial provider or existing pensions board. Setting up and running a separate legal entity would also have associated costs.

We also note the requirement to produce full accounts (regulation 13 and paragraph 82 of the consultation document). While we agree that full accounts of the commercial provider or pensions board are necessary (reg 13: amending section 26A(3)(b) of PSA21), we are not sure the relevance of full accounts of the proprietor whose only operation is in respect of the scheme. Again this would also increase the cost of running the scheme.

On a drafting point, if the scheme proprietor can only carry out activities that directly relate to the scheme, draft Paragraph 20 Schedule 1B to PSA21 seems redundant and potentially misleading.

Question 8: Do you have any comments on the draft regulations on promotion or marketing?

In the draft regs, multi-employer CDC schemes are not being considered as retail products. If there were to operate as retail products then the marketing materials would be subject to Consumer Duty rules, under which there would be a requirement to perform customer testing on any promotion materials.

We request that the DWP explains the reasons why multi-employer CDC schemes, from which proprietors will seek to profit from their operation, should be held to different (and perhaps lower) standards than retail financial products. As a new product in the UK, consumer confidence is crucial in the future success of multi-employer CDC schemes. Promotional literature will play a crucial role in building trust in the operation of these products.

Question 9: Are the draft regulations clear that a trustee's ability to pursue continuity option 3 must not be unduly constrained or fettered and how this would be evidenced to the Regulator?

We support the proposed legislative changes that ensure trustees have the ability to pursue continuity option 3 when it is appropriate and in the best interests of members. It is essential for CDC schemes to provide members with confidence that they can deliver income throughout retirement, and we believe the addition to the authorisation criteria will help support this aim.

For providers and scheme proprietors, the flexibility to exit if the scheme is no longer commercially viable is crucial, and they should not bear substantial costs if trustees opt to continue the scheme in a closed form. Excessive requirements on providers could discourage new entrants and hinder the growth of CDC schemes in the UK, so these factors should be carefully evaluated during the authorisation process.

We however are not clear on the requirements here, as the relevant Act requires funding to run on the scheme for only 2 years rather than the rest of its life. For example, for an immature scheme, this route would be likely to be much more appropriate than running it on for many decades in order to pay 'small pot' pensions. We believe the policy intent would not require this.

Question 10: Are the draft regulations clear on how valuation and benefit adjustments should happen?

We have some concerns on whether the detailed drafting intended to enable different increases to be applied to the members of different employers and whether this is consistent with the policy intention:

- Regulation 38(4)(c) does not clearly distinguish between "an adjustment that may be applied to different employers with variation" and "any change to such an adjustment [that] must be applied to all members without variation", and we are not sure if this works or is clear:
    - Firstly, it is not clear how to distinguish between "an adjustment" and "any change to such an adjustment" (given an adjustment is itself a change to the preceding benefits it seems less than clear what would be considered an adjustment and what would be a change to an adjustment);

- Secondly, we are not clear whether the application of an adjustment to ‘employers’ is appropriate – presumably this is intended to cover adjustments to the benefits of all of the members relating to that employer (without variation).
- Thirdly, we note that Multi-Annual Reductions must be applied within 3 years, however the text above might require many years of reductions for one employer while other employers are receiving increases (ie so that they are both “changing” by the same amount each year). We describe this more in an example below.

- Paragraph 117 of the consultation also appears to be inconsistent and unclear – it states that both ‘adjustments’ and ‘any change to such adjustments’ must be applied to all members of the scheme without variation – which appears to contradict the policy objective set out in the previous paragraph.
- We note that Regulation 40 does not include any specific disclosures in respect of changes in adjustment for members of particular employers. In our view this would need to be included in a valuation report, or the report would not be confusing for members of employers receiving an adjusted increase.

We support the flexibility to allow one-off increases where projected future increases are above a suitable threshold under Regulation 38(5). This flexibility could be extended to single/connected employer CDC schemes. However we have a query on this, as Reg 38(5)(a)(ii) does not require the scheme-based threshold to be above CPI+2%, despite the consultation document stating this to be a “higher threshold” (paragraph 119).

We also support the flexibility to remove multi-annual reductions under Regulation 38(11) where financial conditions subsequently allow, as is the case for single/connected employer CDC schemes.

We do have concerns over how reductions and multi-annual reductions would work where a scheme is applying different increases for different employers, under Regulation 38(4)(c)(i). In particular, one view is that this would be consistent with different reductions or multi-annual reductions applying to different employers and require more extensive legislation to facilitate this. As an example, consider a scheme which was applying 1.75% p.a. increases for Employer A members and 0.5% p.a. increases for Employer B members, for which financial experience over the following year reduces the level of general increases by 1% p.a. For Employer A the new increase rate is 0.75% p.a. and there is no need for any reduction. For Employer B however, the supportable level of pension ‘increases’ is negative and the appropriate outcome is, in our view, an immediate reduction (of c10% say) or multi-annual reduction for its members. As drafted, the legislation does not appear to facilitate this approach. It would require any reduction to be applied to all members of the scheme.

Question 11: Do you think that the significant events listed in draft regulation 44 will provide the information the Regulator needs or are there other significant events that should be added?

We note:

- A change that requires revision of the viability report may need to be reported if proprietor approval is not forthcoming.
- We suggest that persons that are considered fit and proper, ie the scheme proprietor, promotor/marketer, CFO and CIO (reg 7) should be included in the list of persons who have the responsibility to make a significant events report (section 28(2) of PSA21).