The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Pensions Regulator’s consultation on “A Code of Practice for authorisation and supervision of collective defined

contribution schemes”.

This response has been drafted by the IFoA’s CDC Working Group chaired by Simon Eagle, with review from the IFoA’s Pensions Board chaired by Leah Evans. Should you wish to discuss any of the points raised in this submission in more detail please contact Caolan Ward, Policy Manager, (caolan.ward@actuaries.org.uk) in the first instance.

**Opening comments**

It is clear that the Regulator has completed a substantial amount of work to draft the Code of Practice to facilitate the introduction of CDC pension schemes to the UK, and we see that as a good thing for pensions which is in the public interest as it will facilitate the first tranche of CDC schemes. We have been pleased to assist the Regulator already with this process, which we know has been a challenge to do before any CDC schemes have been opened and without any experience of authorising such schemes. It is inevitable that over time, as experience emerges, the Regulator’s practices will need to evolve to allow for lessons learned. Further, to the extent other kinds of CDC schemes such as multi employer or master trust schemes become allowed by further changes in legislation, the Regulator’s Code of Practice will need to be updated.

***Therefore******we suggest the Regulator records that the initial Code is to be reviewed to allow for these developments, perhaps within three years at the latest****.*

**IFoA response**

In the following, we have sought to answer only those questions to which actuarial work on CDC schemes will have the most bearing, mainly those relating to Scheme Design. We make a number of comments designed to help the Code allow for particular features of CDC, and in particular we urge TPR under Q27 to make a number of additions to the template actuarial design viability certificate to make it more feasible for a CDC scheme actuary to use the certificate.

As a general comment, we also note that it is unclear from the Code where requirements are just summaries or restatements of requirements in the legislation, where TPR is proposing specific additional requirements and which aspects of what is set out are in the “nice to have but not essential” category. We would prefer the code to be drafted in such a way that this is clearer.

**General question:**

**1. Do you consider that any important areas of the authorisation criteria have been missed in the new code?**

Yes.

The Code is silent on the setting of member option terms. We note that the new regulations require that CETVs are based on ”share of fund” principles using “central estimate” assumptions, but don’t have requirements for other member options such as early / late retirement or commutation. In our view it would be inappropriate to set terms for member options that were more or less generous than those using central estimates (i.e. those viewed as “cost neutral”) as this would impact sound scheme design. It could be appropriate for the Regulator to include points on this in the Code, to act as a reference point when considering proposed scheme rules on the principles for the setting of member option terms, as part of initial authorisation of CDC schemes.

**4. Is it clear what constitutes a section and when you must divide a scheme into multiple sections?**

We recognise that TPR is not responsible for the wording of the regulations it is tasked to implement, nevertheless the IFoA would highlight that the items listed in regulations as triggering a new section (a change of accrual rate, contribution rate or NRA) are not, on their own, necessary and sufficient reasons to trigger a new section. There can be different benefit designs and contribution rates, provided that they fit into a single actuarial management policy. For a simple example, it is actuarially possible to have a group of members on 1/60 accrual and 20% contribution in the same section as another group on 1/80 accrual and 15% contribution, the ratio of accrual to contributions being the same in the two groups. They can be in the same section and share in the same actuarial management policy.

**Member communications**

1. **Is the level of detail we have set out appropriate?**

No.

We note that the draft communications requirements, and in particular the requirements around requiring regular member feedback and reporting on it, go well beyond what is required for any other type of scheme. It is clearly essential that members of CDC schemes understand the nature of the benefits, and the possibility of benefit reductions. However, the extent of member feedback proposed, and its frequency, go well beyond what we think is necessary to get across this simple message. We also have concerns that it will not be workable or practical to implement.

We suggest instead that the feedback requirements are more specifically focussed on key member communications, and that requirements to seek and report on such feedback are much less frequent, Perhaps within the first 12 months of the operation of the scheme, and then only every 3 years or so.

**Scheme design:**

**21. Is the level of detail we have set out appropriate and are there further matters we should consider?**

Yes

We think the level of detail is appropriate.

The trustees and Scheme Actuary will each need to opine on whether the scheme design is sound, and the Regulator will also need to assess this for authorisation purposes. We note that the regulations and draft Code do not specifically define “soundness”, although they do list for each party matters which must be taken into account for their assessment. For the Scheme Actuary, the regulations list in 11(2) four matters to which the assessment will need to have regard, but there are likely to be other relevant matters and so our understanding is that the list is not intended to be exhaustive. We see this assessment as a subjective judgement which will need to take into account the particular circumstances at the time, including expected trends affecting future benefit adjustments. As these opinions on soundness dictate whether the scheme can open and then remain open, it seems to us essential to have some clarity on what this opinion does and doesn’t mean, and for the Scheme Actuary’s certificate we comment further on that in Q27 below.

The implication is that the scheme is by definition “sound” if each of the three parties have reached this opinion having taken into account the matters listed in the regulations. It would be helpful if the Code states this explicitly.

Also, we note that the trustees’ consideration of viability, as recorded in their viability report, will be based in part on advice from the scheme actuary under regulation 10(3)(b). However it is important that the trustees understand that they must reach their own view on this matter, taking into account (“being informed by”) actuarial advice, rather than relying solely on the scheme actuary’s views. The Code could usefully address this point specifically to minimise the risk of the trustees deferring to the Scheme Actuary’s opinion.

Under the regulations, the viability certificate requires the Scheme Actuary to comment on the accuracy of specific aspects of member communications’. However, the draft Code references “their communications to members” and “generic communications and templates” are too generic. We suggest you provide clarity on whether you expect the scheme actuary to review any more than is already set out in the regulations. In our view, this is not necessary.

**22. Are there areas where supporting guidance would be useful?**

No

We note that the Pension Schemes Act 2021 section 19(2) and regulation 18 require the Scheme Actuary to have regard to any guidance issued by the IFoA or the Regulator, when advising on the determination of benefit adjustments. We note that the regulations set out in some detail how benefit adjustments are to be determined, including the required use of “central estimate” assumptions for determining the “required amount”, and at this time we do not consider that guidance is also required in this area.

There are potentially other areas where guidance could be helpful, for example in scheme design viability soundness assessments, or member option terms (if not included in the Code itself as we suggest under 1 above), and we continue to actively consider this and would want to collaborate with the Regulator on this to ensure any guidance issued by the two bodies is complementary.

**23. Is it clear what we expect with regard to testing and modelling, and are there any additional issues or factors which could be relevant?**

No

We find one term unclear, “an examination of the key risks to the scheme’s design”. We consider that the scheme’s design is as set out in its rules, but that it is changes in circumstances that could make that design inappropriate. Therefore we suggest referring to “an examination of the main circumstances in which the scheme’s design might no longer be sound”.

There are additional issues or factors that could be relevant, however in this new area we consider it is impossible for the Regulator to be comprehensive at this stage. This is why we would like to see the Code being reviewed within three years of coming into effect.

**24. In regard to testing and modelling, is it appropriate to expect schemes to conduct asset liability modelling (ALM)?**

Yes

We note that the regulations do not require this, although Regulation 10(4)(c) suggests that the scheme actuary’s viability advice to the trustees could include “modelling” (as well as, or instead of, testing). We consider that, given the variable nature of CDC scheme benefits, it is appropriate to seek to measure variability of outcomes through modelling, in order to further understand the consequences of the scheme design. Also this could be useful for any references in member communications to the potential extent of variability of the benefits. We consider that carrying this out at the “gateway” stage, and then at least once every 3 or 5 years once the scheme is “live running”, would typically be proportionate, although trustees could ask the scheme actuary to bring forward the next exercise if there was a particular need for this for example if there was a material change in circumstances which mean previous modelling is no longer considered appropriate. However we caution that, given the nature of CDC, there will always be the possibility of lower-than-expected benefit outcomes, and that in itself does not mean the design is not sound. It will require judgement as to how much risk of poor outcomes or unintended cross subsidy between members is “too much” for the scheme to open or remain open. Trustees might decide it is appropriate to set some high-level principles setting out how they will assess this, to help take into account long-term context when assessing soundness, and reduce the risk that gradual trends away from an acceptable design are allowed to continue indefinitely based on consideration only of the latest small movement,

**25. Are there any other aspects of the trustees’ stewardship of the investment strategy that we should be assessing in support of a scheme’s design being sound?**

Yes

Note that in some CDC schemes the rules may prescribe investment strategy, as is the case in the design published by the Royal Mail in 2018. Under Trust law, trustees’ investment decisions are then confined to those which meet that prescription. This is not addressed in the draft Code. Also, we would expect this to be one of the elements of the scheme design which is relevant to the consideration of soundness.

We also suggest that you encourage the Trustees to foster close collaboration between the investment adviser and Scheme Actuary.The asset allocation is a key element in the assessment of viability and soundness, and the viability assessment itself might in turn influence decisions on asset allocation. It is therefore important that advice to the trustees on these aspects is joined up.

The consultation says “We expect trustees to explain how their investment strategy supports the scheme design.” We do not think the investment strategy of a CDC scheme has a role of “supporting scheme design”. The principal task of the investment strategy is to earn a good return for the members. The task to assess the expected return and to construct a benefit plan which uses the available resources. The direction of thought is the investment strategy comes first, then the benefit design. Not the other way around as TPR has it, with the design coming first then the investment strategy to “support” it. Of course, the process is not entirely linear. Having devised an investment strategy and an actuarial plan, then tested it with ALM, trustees might then modify the investment strategy.

**26. In respect to the gateway and live running tests, are there any further matters we should consider and is it clear what we expect?**

We suggest you make it clear whether, once the scheme is open, you expect the “central estimate” basis used by the actuary in the live running tests to be the same as that adopted by the trustees for the corresponding valuation. And that prior to opening, you would encourage trustees to have engaged with the actuary to determine (on actuarial advice) the principles they intend to use to determine valuation assumptions, and for the gateway tests basis to be in accordance with those principles.

The gateway and live running tests provide regulatory protections for members. However, passing these tests is necessary but not sufficient. In scrutinising a scheme TPR should think more widely than these tests before deciding whether the scheme is sound and/or running satisfactorily.

This is not to say we are asking TPR to add more tests of its own to the regulatory tests, we do not wish to see a more burdensome code. Rather, we wish the focus to be on the big picture question “is this scheme working as envisaged?” instead of 100 little questions.

**27. Our plan is to provide a standard template for the viability certificate to ensure what is being certified is standardised across CDC schemes. Is this helpful?**

Yes

As noted in Q21 above, viability assessments are likely to be one of the most challenging areas for the scheme actuary, both in forming judgements and appropriately recording advice in a way which manages the risks of the advice being misunderstood or too much reliance being placed on the actuary’s view (for example, of soundness).

We consider that it is helpful to have a template certificate, as long as it is sufficiently robust to enable the scheme actuary to sign it (when of the view the scheme design is sound). We note that as the certificate wording is not set out in regulations the Scheme Actuary can amend it, and it would be clearer if the Code said this.

As drafted in the Appendix to the draft Code of Practice, we consider that, due to the lack of a definition of soundness, the certificate could be misunderstood or open to legal challenge. We request that the certificate is extended to include the following additional notes, to make it clearer what the certificate is and is not saying and also to minimise the chance of actuaries needing to adopt their own versions of such notes. The IFoA would need to consider separate guidance on some appropriate notes if they do not feature in the Regulator’s template.

“*Notes to viability certificate:*

* + 1. *The term “sound” is not defined in the legislation, but a number of matters to be taken into account by me when providing this certificate and considering whether the design of the scheme is sound are prescribed in Regulation 11(2) of the 2022 Regulations. In undertaking this consideration, I have used my professional judgement, based on the results of relevant actuarial testing and modelling, in forming my opinion. .Further detail on the data and information used, and considerations made in reaching this opinion are set out in my advice to the Trustee dated [DATE].*
		2. *The Section’s annual pension adjustments are variable, depending on a number of factors including future asset performance and any changes in future to actuarial assumptions.  Pension increase levels will inevitably vary from year to year, and there is a possibility that pensions could be reduced in future. An opinion that the design of the scheme is sound is not an opinion that any particular pension adjustment level will be achieved, and does not preclude the possibility that pensions will be reduced in future.*
		3. *Separately to my issuing of this certificate, the scheme trustees must also reach their own opinion on whether the scheme design is sound, as required by section 13(1) of the Pension Schemes Act 2021, and the Pensions Regulator must make its own corresponding decision under section 9(3)(b) of that Act. Each decision maker has a separate role and must have regard to different prescribed matters. As such, this certificate is a necessary but not sufficient document to determine ‘soundness’ of the scheme; the scheme will be treated as sound only if the Trustees and the Pensions Regulator also give this opinion.*
		4. *My opinion does not preclude the scheme’s governing bodies from deciding to close or wind up the scheme.  “*

Finally, we question whether the Code is the right place for the template certificate, noting that the template might need to change to allow for lessons learned from experience, and the Regulator might wish to do this without going through the process required to change the Code, particularly, for example, if it found the notes needed adjustment.