PENSIONS AND LIFETIME SAVINGS ASSOCIATION

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DWP CDC Policy Team – Caxton House

Dear Julian and team,

RE: CMP EXTENSION TO MULTI-EMPLOYER – CONSULTATION ON REGULATIONS

We welcome this consultation on the regulations for multi-employer CDC schemes. The launch of the Royal Mail Scheme in October was a landmark moment in the development of CDC in the UK, and we will keenly follow progress as this innovation beds in and the scheme begins to grow. However, we are conscious that few employers are of such a size to implement a similar scheme, so if the greatest number of savers are to have access to the benefits that could be realised by this model, a regime enabling multi-employer schemes will be necessary.

As we outlined in our 2023 consultation response[1], it is vital that the bar is set high for authorisation of such schemes. These are complex arrangements which will require the trust of industry, employers and employees if they are to bear fruit, and therefore we should be seeking to enable a small number of well-governed, large-scale schemes that will last over the long term. It therefore follows that anyone but serious players should be prevented from opening CDC schemes, and we consider that the draft regulations will rightly prevent this from happening.

Meanwhile, we do need to consider the potential market for multi-employer whole of life schemes, and it is clear from our membership there are few 'DC employers' currently interested in the model. In all likelihood, the first multi-employer schemes to set up will not be commercial offerings, but non-profit sectoral schemes. In some respects, regulating these could be simpler – with fewer considerations to make over mis-selling, promotion/marketing, as well as concerns around cross-subsidies between different demographics of members. Looking longer term, any development of a commercial market will be incumbent on the success of these, and so if we aren't to stifle CDC as a model in its early days, proportionate regulation of this type of structure may be needed, provided member protections are in no way weakened.

Below, we respond to the specifics in the consultation by theme, rather than by individual question.

Requirement for sectionalisation (Q1)

We support the proposal that different employers in a scheme would not automatically require separate sections; this would undermine the benefits of pooling. We also agree with the trigger that a fundamentally changed investment strategy would result in sectionalisation; otherwise certain members could be detrimentally impacted by changes made which materially alter their position in

[1] https://www.plsa.co.uk/Policy-and-Research/Document-library/Extending-Opportunities-for-Collective-Defined-Contribution-Pension-Schemes-PLSA-response

the scheme. However, tPR guidance will be required on what does and does not constitute a material change to investment strategy, in order that trustees can appropriately include this in their viability report. Without this, the door is potentially left open to very significant changes. Furthermore, there are certain changes which are likely to occur within an investment strategy which trustees would want to be sure do not constitute a sectionalisation trigger. It could be that a scheme runs a dynamic investment strategy by design, while many schemes' investment strategies are also likely to become more sophisticated and incorporate more private markets and other illiquid assets over time as they gain scale. It will be important that these natural evolutions do not force unnecessary sectionalisation.

Similarly, we think tPR will need to carefully define the parameters for material changes of investment strategy in the scenario of new employers joining the scheme. If a provider is concerned that any change to investment strategy resulting from new joiners would force sectionalisation – and the associated regulatory processes – it might make setting the scheme up less attractive in the first place. We think the solution to this will be clearly defining the scheme's approach in this scenario in the viability report and scheme rules, and further clarity from tPR would provide reassurance in doing this.

Fit & proper persons requirement & scheme proprietor (Q3-4)

We agree with paragraph 29 – that those responsible for funding, promoting, and those with influence over the finances and commerciality of a scheme should be subject to fit and proper requirements.

However, these draft regulations go further than those for DC Master Trusts, with the inclusion of the scheme proprietor. We understand that this approach makes supervision and auditing of the scheme more straightforward, as all the financial responsibility is in one place. However, as we set out in our introduction, some allowance may be needed to reflect the different structure of non-profit sectoral schemes: in these cases a scheme covering a large industry may not have an obvious central entity with the ability to take on this role – especially where that single entity must be singly responsible for covering any potential financing and administrative costs which may arise (paragraph 71). It would be difficult to ask any one employer to take this responsibility for a scheme which includes many others.

Therefore, some flexibility may be needed, specifically for those non-profit schemes, and this could either take the form of the trustee fulfilling the proprietor role, or for the new proprietor being authorised to have access to (rather than directly holding) the required level of financial resources. In either event, it would be crucial the scheme demonstrates impeccable governance both for authorisation and ongoing supervision to prevent any conflicts arising. We are conscious that a trustee acting as proprietor would entail considerable conflict in a commercial set-up, given the natural tension between corporate entity and trustee. However, providing a non-profit CDC scheme could evidence that member protections and outcomes were in no way risked by such an approach, and that the scheme design and viability report evidenced there be no liability on the

employer and no means for profit-taking by any entity, tPR should bear in mind the materially lower risk at authorisation.

For such schemes, the only alternative would be for another entity within the same group to take on the responsibility, however, subject to further clarity on the limitations around a proprietor's other activities, it may mean an entirely new body would need to be set up. The purpose of the proprietor's prohibition from other activities is unclear too. In the scenario above, it would cause inefficiency, and in the case of a DC Master Trust seeking to set up a CDC section, would it need an entirely separate legal entity to fulfil the proprietor role, or could this role reside in the same place as the existing funder? The wording of the regulations might also prevent the proprietor of a multi-employer CDC scheme setting up a single employer CDC scheme, which, assuming the benefits of scale could be realised across the two, would have few other downsides. We would welcome further clarity on the rationale here.

Scheme design - value tests & gateway tests

The proposed gateway tests to ensure only schemes with sound design can open and continue to run are sensible, and we agree that targeting at least CPI increases should be a requirement, in order to protect member incomes and to ensure some uniformity to different market offerings.

We also support the flexibility enabled by allowing the actuarial equivalence test to be satisfied at either member or employer level. It is vital to prevent cross-subsidisation between employers – different workforces may have very different characteristics – so the key is that any potential for unfairness has been minimised here.

However, where an individual employer has a fairly homogenous workforce, it might make sense to allow cross subsidies within that employer – while giving all members the same accrual rate, which could help with member comprehension and engagement. Therefore, we welcome the provision for this model, while we acknowledge some schemes may prefer to implement the value test at member level, thereby varying accrual rates by age.

Paragraph 61 notes that changing between the employer and employee level equivalence testing would be prohibited. While we wouldn't envisage this being a regular occurrence, we're conscious that the nature of certain DB schemes has changed, for instance, moving from being an industry scheme to a fully open multi-employer DB master trust. It is possible that what begins as a sectoral CDC scheme may at some point in the future want to transition into a larger more commercial offering. This would clearly have various implications, but subject to creating a significant event, and working with the Regulator to satisfy any changing requirements, this – in principle - should not be prohibited, and one such change a scheme may want to make, could be the form of equivalence test. In any event, further regulatory guidance would be helpful to advise on the nature of the supervisory interaction during such an eventuality.

With regard to the viability report, while we agree this should be signed off by the scheme actuary, it is unclear that the requirement for the proprietor to approve this is necessary every time. Clearly, extensive advice will be necessary for the trustee in producing the report, but presumably in order

to take an impartial view, the proprietor would be required to use independent advice in reviewing and approving it. This would come at a large additional cost to the scheme, so if this is not the intention, this should be clarified in the regulations and/or guidance. Clarification would also be useful on the source of data used in the viability report used for authorisation. Before a scheme has opened it will have no members; for a single employer scheme, data from existing DB members could be used for the modelling and scheme design (paragraphs 40-55), but for a multi-employer scheme this is less clear. Therefore, could DWP indicate its view on the use of anonymised data from external but existing DB scheme members who are under the same umbrella organisation?

Promotion & marketing (Q8)

The draft regulations on promotion and marketing of schemes are broadly sensible in the case of commercial schemes. It is vital, especially given the complexity and potential for misunderstanding of the benefit structure of CDC schemes, that a high degree of rigour surrounds schemes' ability to promote them in the employer – or employee – market.

However, there are two potential grey areas which need further thought. We support the exemption for sectoral schemes (paragraph 87) from these requirements where they are not conducting promotion and marketing, but regulatory guidance may be necessary to define what exactly does – and does not – constitute this activity. While we would not expect such schemes to be advertising externally for new business, they will be in close contact with existing employers and DB schemes in the sector, so at what point does that interaction cross the boundary into promotion? This dialogue will necessarily be detailed and educational, given the need to explain an entirely new model of pension arrangement to many employers.

Furthermore, as we know from DC Master Trusts, communication from the trustees to employers and employees can be highly valuable, and given the kind of communication we mention above, in the case of a new sectoral CDC scheme, this information is probably best coming from trustees, as an already trusted source. Paragraph 94 suggests such communication would be prohibited, and we consider this may – especially in the case of a non-profit scheme – to be counter to members' best interests. Such ambiguity could result in a damaging lack of communication from the scheme, for fear of falling foul of (well-intentioned) regulations. Similar to our points around the proprietor requirement, we think that where a scheme's design and viability report clearly evidence that no profit is to be taken by any party, and provided tPR is confident this will not change, trustees should be permitted a greater degree of latitude in their communications, as no clear conflict exists.

Continuity option 3 (Q9)

We understand the intentions behind requiring the trustees to be able to run as a closed scheme, and agree that controls need to be in place to protect members where a funder/proprietor decides they no longer wish to run the scheme.

However, in the early days of a scheme, before it has reached sufficient scale, it seems unlikely that trustees would be able to run the scheme on a closed basis. Further, we are conscious of the financial risk that a unilateral trustee power to run the scheme on might place on organisations

considering setting up a CDC scheme. We consider the risk of such a disagreement to be low in reality – if it is no longer commercial for the provider to run the scheme, costs on members are likely to be higher, resulting in poor value, so such a circumstance is unlikely to result in trustees being able to run the scheme in members' best interests. We also acknowledge that the proprietor would only be required to fund running costs for two years, and not indefinitely.

The scenario of a proprietor withdrawing is also relevant to the restriction on trustee marketing. While we discuss the issue of trustee marketing to *employers* separately, in a continuity scenario where a proprietor wishes to withdraw, could DWP clarify whether the trustee would be permitted to market to *new prospective proprietors*. This might be specifically in members best interest, as if a new entity could step in, continuity of member benefits within the CDC structure would be assured.

Decumulation-only

Finally, we remain supportive of continued exploration of the decumulation-only model. For employers reluctant to move from a DC accumulation structure to whole-life CDC, this could enable savers to access the benefits of pooling in retirement, so we are interested in the next steps to enable regulations for this model.

Conclusion

Overall, we are very supportive of the direction of travel with the multi-employer CDC regulations, given the potential benefits these schemes could bring to scheme members. It is right that the bar is set high in terms of member protections, especially in the case of commercial schemes.

There are certain aspects of the draft regulations might make non-profit schemes more challenging to set up, so it might be helpful if this can be factored into the authorisation process, as long as tPR is confident that the scheme design and viability report represent no additional risk to member interests and outcomes. This might require additional protections in some areas, and we acknowledge this comes with additional complexity. However, given we only envisage a small handful of CDC schemes will set up, some element of bespoking – as has arguably already been the case with Royal Mail – should be achievable in a safe and secure manner. Enabling these first schemes is likely to be a deciding factor in the longer-term success of CDC as a model in the UK and whether – or not – large numbers of UK savers have access to the enhanced outcomes it offers. We look forward to engaging further with officials – and tPR as they draft their Code next year – in order to establish a regulatory framework which enables our interested members to set up the UK's first multi-employer CDC schemes.

Yours sincerely

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