ASSOCIATION OF CONSULTING ACTUARIES

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DWP CDC Policy Team
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Dear all

CDC unconnected multi-employer schemes

I am writing on behalf of the Association of Consulting Actuaries in response to the above consultation.

We welcome this consultation and confirmation of the intention to lay these regulations in 2025. We support the new Minister for Pensions' comments on the advantages of CDC pensions in the Foreword to the consultation document.

We also note your comments under 'next steps' concerning trust-based decumulation-only CDC and would encourage urgent continuation of your work with the pensions industry to facilitate this particularly if Government moves forward with requirements for trustees to provide decumulation solutions.

There are some aspects of the proposed legislation that could be further improved. For example:

On the **scheme proprietor** and its role - we do not think it is appropriate for the scheme proprietor to be required to approve the viability report. We also suggest the regulations permit a scheme proprietor to combine this role with acting as the scheme funder and/or scheme strategist for DC sections of the same trust. We also suggest regulations clarify that the scheme proprietor must be UK-based. (See questions 3 and 5.)

On **promotion and marketing**, it would be appropriate for all unconnected employer CDC schemes to have a specific person responsible for this area and for this person to be assessed under the fit and proper person provisions. (See question 3.)

There are aspects of the proposed unconnected employer scheme regime that might be attractive to single/connected employers. In particular, the **additional flexibility** on scheme design, benefit adjustments and multi-annual reductions. Our preference would be for these flexibilities to be incorporated into the single/connected employer regime. (See question 13.)

We also have some concerns over some aspects of the details of the draft legislation and whether, as drafted, they would be consistent with the policy intention.

Our responses to your specific questions are set out below.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In that event, please contact me on 01372 733763 or at peter.willliams@aon.com.

Yours faithfully

Peter Williams
Chairman, Pension Schemes Committee
On behalf of the Association of Consulting Actuaries Limited

APPENDIX

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?

Yes. The focus on material differences relating to a change in investment strategy is appropriate.

Question 2: Do you think the definition of connected in draft regulation 22 can work effectively to establish whether a scheme is a single or connected employer CDC scheme or an unconnected multiple employer CDC scheme?

We would defer to legal experts on this aspect of the proposed legislation.

One aspect which is unclear is what would happen if a scheme which is set up with the intention of being available to unconnected employers, is in practice only likely to be used in future by members of a single or connected employers (either because additional employers do not 'sign-up' or because of a bulk transfer). In our view such a scheme should remain an "unconnected multiple employer scheme", and the trustees/scheme proprietor should not be under any pressure to add unconnected employers in order to maintain its status. The amendment in Regulation 3 might be clearer on this point if it referred to "used, or intended to be used *(either in future or historically)*, by two or more" - i.e. the original intention should be sufficient for the scheme to continue to satisfy the definition.

In our view, it would be simpler if an unconnected employer scheme could be set up for any employer or group of employers. In other words, there needn't be a requirement for the employers to be unconnected – or for there to be an intention for the scheme to relate to unconnected employers. A group of connected employers, or a single employer, could then choose whether they wanted to set up a CDC scheme under either the connected employer regime or this wider CDC regime.

Question 3: Do you have any comments on the draft regulations on the fit and proper person requirements?

We note that the paragraphs preceding this question in the consultation document (paragraphs 22 to 36) cover not only the fit and proper person requirement, but also the requirements for a scheme proprietor and on promotion and marketing and the application in general. Our comments cover all these areas.

We agree that every unconnected employer CDC scheme should have a scheme proprietor, on grounds all schemes will have business and commercial decisions to make. We agree this role should not be held by the trustees (or any individual trustee) given the obvious conflicts of interests that could arise. However, we also suggest the regulations should capture how this could work effectively for those existing (for example defined benefit) trusts that may wish to establish a CDC section and utilise existing surplus to meet set-up costs and/or ongoing contributions for CDC accrual.

We do not agree with the restriction that this entity must only carry out activities that relate directly to being the scheme proprietor. For example, we would suggest the scheme proprietor should also be able to act as the scheme funder and/or the scheme strategist for DC sections of the same trust.

We also suggest the regulations clarify that the scheme proprietor must be UK based.

On promotion and marketing, it would be appropriate for all unconnected employer CDC schemes to have someone responsible for promotion and marketing, for this person to be assessed under the fit and proper person provisions and be able to demonstrate the promotion of the scheme is clear and not misleading.

This affords all employers and members of unconnected CDC schemes the same level of confidence in their CDC scheme which comes from a consistently set high bar for governance.

This would also mitigate risks associated with schemes set up initially for a closed group of employers (such as a specific industry) which later look to expand without appropriate communications, including as part of their initial feasibility discussions with prospective employers.

It will be important for all unconnected employer CDC schemes to communicate clearly with prospective employers (and their employees) prior to them joining. All UK employers ultimately have choice over whether to join an unconnected CDC scheme and, if so, which one to join. Ensuring all unconnected employer CDC schemes have someone responsible for promotion and marketing, assessed against the fit and proper person requirements, avoids the risks associated with employers being automatically brought into so-called non-commercial or sectoral-based schemes that cannot appropriately explain or demonstrate why the scheme will serve in the employer's (and its employee's) member's best interests, and why CDC benefits are valuable to them.

Overall consistency in the requirements for *all* unconnected employer CDC schemes will ensure there is a consistently applied high bar for governance, communication and promotion and marketing. This is important to help all employers (and members) have confidence that the scheme they have chosen (or has been chosen on their behalf) is subject to the highest bar of regulation. This will promote confidence in CDC.

On the application process, the proposals generally sound reasonable although we note that the details of how the Regulator operates the authorisation process in practice will be critical to the development of the market.

Question 4: Do you agree with the functions we have identified for the role of Chief Investment Officer?

We agree with the functions identified and that this will be a key role. Care will be required when scoping to ensure that investment advisers are not brought within the definition.

However, we are not convinced by the need for 'communication' (of the scheme's investment strategy (to members), as referenced in paragraph 32 of the consultation document) to fall within the remit of the CIO's core role.

If the final regulations do mandate for a specific individual to carry out the role of chief investment officer, and to be subject to the 'fit and proper persons' requirements, it would be appropriate for this mandatory role to extend to all unconnected employer CDC schemes. This is because the setting and oversight of investment strategy is critical to support CDC benefits.

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?

We do not agree with the proposed requirement for the viability report to be approved by the scheme proprietor. Whilst we agree with the premise of ensuring co-operation between the trustees, scheme actuary and scheme proprietor when satisfying themselves that the scheme is sound, we are not in agreement that the viability must be effectively 'signed off' by the scheme proprietor. We suggest this requirement be replaced with a requirement to consult the scheme proprietor. This should give rise to fewer perceived or potential conflicts of interest – and also remove undue influence, for example on the assumptions which might be adopted.

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 can vary for example by age and over time. 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 <u>any</u> estimates of the rate or amount of future pension benefits under the design of the scheme". This would still make it clear that all such communication would need to be accurate without suggesting that the scenarios covered would need to be exhaustive.

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 have concerns over whether the actuarial equivalence test is sufficiently flexible to accommodate a suitable range of designs – or even whether it is practical at all without adding further flexibility. Our main concerns relate to the how the test under regulation 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.
- Those factors to remain in force for the 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 benefit accrual rates 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, communication and implementation.

- There should be flexibility for factors in operation over the relevant period to be set based on more than one relevant date – for example, allowing for updated factors to be introduced mid-year where there are significant changes in financial conditions, or for schemes to operate quarterly or monthly updates to their factors.
- The ten-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)".

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

As drafted, inserted section 14C(3) prevents the scheme proprietor from carrying out any activities unless they relate to unconnected multiple employer CDC schemes (and it must also be the scheme proprietor for those schemes). For consistency with the requirements governing 'scheme funders' under the DC master trust regime, it would seem appropriate for limited exemptions to be allowed for this rule, on application to TPR.

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

Paragraph 87 states that "some unconnected multiple employer CDC schemes will operate within a fixed pool of employers so may not carry out this activity". We do not agree with this, as all unconnected employer CDC schemes will need to appropriate promote and market themselves even if serving a closed group of employers. Those employers will need to carry out their own due diligence to assess the merits of the scheme (and could, ultimately, choose to join a different scheme) and so all unconnected employer CDC schemes will need to promote themselves and clearly communicate the benefits and value of their scheme. This is important to ensure all potential employers can make an informed choice, in the best interests of their employees.

As set out in our response to Question 3, it would be appropriate for all unconnected employer CDC schemes to have an identified person responsible for promotion and marketing, and for this person to be assessed under the "fit and proper persons" regime. On this basis, there would then be no requirement for a significant event to be triggered by "a proposal to begin promotion or marketing" (regulation 44((1)(o)) because all schemes will have someone carrying out this role from outset.

TPR's Code will need to set out clearly how TPR will interpret "clear and not misleading" and how they will assess whether a scheme meets this test. Unless prospective providers of unconnected CDC schemes have comfort and clarity on this, the risks of operating such a scheme may be considered too great. We suggest TPR's Code should set out what criteria TPR will follow – for example descriptions and examples of "clear and not misleading" and perhaps also of "unclear or misleading".

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?
No comments.

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

We would observe that flexibility to allow CDC schemes to provide for different indexation targets for different employers (based on different dates of joining) could lead to significant complexity in the operation of unconnected employer CDC schemes. This would arise from potentially continual tranching of benefits between different employer groups over time, which could significantly increase complexity in (and risks of) administering and communicating benefits and increase running costs for schemes. This flexibility could also lead to challenges around how potential employers (and third-party evaluators supporting them) compare and contrast the performance of unconnected employer CDC schemes. There could also be challenges associated with some employers' members receiving increases at a time when others are experiencing benefit cuts. If permitted, this flexibility could detract from the overall value CDC is expected to provide through economies of scale and undermine transparency and confidence in CDC.

If this flexibility is retained, however, then although the approach set out in Regulation 38(4)(c)(ii) does not seems unreasonable, we have some concerns on whether the detailed drafting of the alternative option in Regulation 38(4)(c)(i) is consistent with the policy intention, on allowing different employers to have different increases within a single scheme:

- Regulation 38(4)(c)(i) 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":
    - 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, the application of an adjustment to 'employers' is not as clear as it could be – presumably this is intended to cover adjustments to the benefits of all of the members relating to that employer (without variation);
- 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 be confusing for members of employers receiving an adjusted increase. Arguably, such a disclosure may be implicitly included under Regulation 40(4)(i) but it would be clearer to refer to variations between employers, whether the approach envisaged under Regulation 38(4)(c)(i) is adopted.

We support the flexibility to allow one-off increases where projected future increases are above a suitable threshold under Regulation 38(5). We would also suggest that this flexibility be extended to single/connected employer CDC schemes.

We also support the flexibility to remove multi-annual reductions under Regulation 38(11) where financial conditions subsequently allow. Again, we would suggest that this flexibility be extended to single/connected employer CDC schemes.

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?

The list of notifiable events seems exhaustive, which is helpful.

As suggest above it would seem appropriate for all unconnected employer CDC schemes to have a nominated person responsible for promotion and marketing. If this is the case, there would be no need for the existence of a notifiable event for commencing promotion and marketing.

Question 12: Do you have any comments on the draft regulations that provide for ongoing supervision of unconnected multiple employer CDC schemes?

In due course, it would be helpful for the Regulator to provide guidance on new triggering events 7A and 7B, the different requirements for each to occur, and how they relate to each other.

Chapter 3: Consequential and miscellaneous amendments

Question 13: Do you agree with the changes in Part 6 of the draft regulations?

As drafted, our reading is that a single employer (or group of connected employers) could not set up a scheme under the new regime for unconnected employer schemes – except where the intention is that the scheme will ultimately be available to unconnected employers (see our response to Question 2). However, there are aspects of the unconnected employer scheme regime that might be attractive to single/connected employers. In particular:

- The additional flexibility on scheme design (not requiring sectionalisation where there are differences in accrual rate, contribution rate normal retirement age etc; and increased flexibility built into the revised viability certificate requirements)
- The additional flexibility on benefit adjustments e.g. one-off increases and multi-annual reductions (see our response to question 10).

Our preference would be for these flexibilities to be incorporated into the single/connected employer regime.

Question 14: Do you agree with the changes in the Miscellaneous Amendment CDC Regulations 2025?

No comments.

Chapter 4: Impacts

Question 15: What are the financial costs required to establish and run an unconnected multiple employer CDC pension scheme? Please outline any one-off and ongoing costs.

Individual adviser firms are best placed to provide comments on this question.

Question 16: Considering the draft regulations and criteria for authorisation, could you estimate the costs of preparing the information required for authorisation? Please outline the extent and cost of external contractors where they may be required.

Individual adviser firms are best placed to provide comments on this question.

Question 17: How many members do you consider to be a viable minimum in an unconnected multiple employer CDC scheme? Please also include any information you have on target scheme size and source of members.

Individual adviser firms are best placed to provide comments on this question.

Question 18: Considering potential numbers of schemes, employers and members, do you have any information on the likely size and shape of the unconnected multiple employer market once established?

Individual adviser firms are best placed to provide comments on this question.

We would note however that, regardless of the eventual size and shape of the unconnected employer CDC market, there is value in the existence of a universal provider of whole-life unconnected employer CDC. This would cater for the circumstances and budgets of those employers (including the self-employed) currently served by the auto-enrolment DC master trust providers, allowing them access to building up an income for life in retirement from existing defined contributions.

The existence of a universal provider would also assist other CDC providers in planning for continuity options which include a transfer to another CDC scheme. This is likely to encourage the development of the CDC market.

However, while we generally see value in a universal provider of multi-employer CDC benefits, it is important for government to ensure any provider that establishes on this basis does not have an unfair commercial or competitive advantage. Our view is that the same regulatory requirements should apply to a universal provider as for all other multi-employer CDC schemes. Also, any potential subsidies (or an extension of any existing subsidies) to help a universal provider to establish must be clearly published, together with a plan for how those subsidies would be returned.

Question 19: Do you have a) any comments on the impact of our draft regulations on protected groups and/or how any negative effects may be mitigated? b) any other comments about any of our draft regulations?

No comments.

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