Delivering Collective Defined Contribution Pension Schemes

Response by Prospect

January 2019

www.prospect.org.uk

Latest revision of this document: https://library.prospect.org.uk/id/2019/00137
This revision: https://library.prospect.org.uk/id/2019/00137/2019-01-16

INTRODUCTION

1. Prospect is an independent trade union representing over 144,000 managers, specialists and professionals in the private and the public sectors. Prospect members work in a range of industries and organisations including aviation, agriculture, defence, energy, film, scientific research and telecoms.

2. The government's consultation on Collective Defined Contribution (CDC) pension schemes has the potential to significantly impact the retirement savings of many thousands of Prospect members in various industries in the future. This submission reflects the views of Prospect representatives and members about CDC schemes.

3. If there are any questions on issues raised in this submission, we are happy to discuss these in more detail.

SUMMARY

4. In common with many other workers, Prospect members have direct experience of the increasing trend in pension provision in the private sector away from defined benefit and towards defined contribution schemes. Prospect's longstanding policy on occupational pensions has been to defend defined benefit pension provision for members who still enjoy it and to campaign for improvements to defined contribution arrangements for members of those schemes. However members of defined contribution schemes have become increasingly disillusioned with the gulf between these traditional forms of pension scheme design and, last year, a motion calling for Prospect to investigate and promote potential alternatives to defined contribution pension schemes was passed overwhelmingly at our National Conference.

5. CDC schemes represent one potential alternative to traditional defined contribution pension schemes. This month Prospect held a briefing event to explain the basics of CDC schemes to representatives and employers in the energy supply industry and there was good level of interest in exploring whether these schemes might represent a better approach for both employees and employers than traditional defined contribution schemes.

6. Consequently Prospect is supportive of any measures that help deliver CDC schemes in practice and of this consultation in particular. Delivering a regulatory regime that allows for CDC schemes to be established will offer many Prospect members in different companies and industries a potentially better alternative to current traditional defined contribution pension arrangements.

DETAILED COMMENTS

7. Please see our detailed comments in response to the questions in the consultation document below.

Q1. 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?

8. It is vital that the different impacts on individuals in relation to protected characteristics of any pension scheme design are clearly explained to all members and potential members. However, when talking about different impacts, it is important to make a clear distinction between risk sharing and cross-subsidisation. It is also extremely important to acknowledge that there a number of different ways of defining and determining "fairness".

9. The consultation document outlines potential inter-generational impacts of CDC schemes. However, for target benefit CDC schemes, these impacts will simply mirror those in DB schemes that guarantee equivalent levels of benefit. There is no reason that the Equality Act (Age Exceptions for Pension Schemes) Order 2010[1] exemptions for Defined Benefit pension schemes could not be replicated for CDC schemes. There will have to be some thought given to whether CDC schemes require any additional exemptions.

10. If CDC schemes use gender neutral actuarial factors there will be different impacts on individuals in relation to gender.

11. Research from Prospect[2] shows that the gender pension gap is significantly higher than the gender pay gap and arises, in part, due to the impact of pregnancy and maternity. It is important that regulations underpinning CDC schemes ensure, as far as possible, that scheme members are not adversely impacted by pregnancy or maternity.

Q2. Do you agree that CDC benefits should be classified in legislation as a type of money purchase benefit?

12. Yes. There are many potential hybrid pension scheme designs but they have not generally seen great take-up due to the funding risk placed on employers and the regulatory requirements around accounting for that risk. One of the main advantages claimed for CDC schemes is that they place no risk on employers and hence are more likely to see greater take-up. To ensure this is the case in practice, they need to be classified in legislation as a type of money purchase benefit.

Q3. Are there any other areas there the current money purchase requirements do not fit, are inappropriate or could cause unintended consequences?

13. There may need to be different statutory provisions for, and regulatory guidance on, the handling of transfers out.

14. As noted above, provision would have to be made for exemptions from age discrimination regulations under the Equality Act 2010.

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[1] http://www.legislation.gov.uk/uksi/2010/2133/contents/made
[2] https://library.prospect.org.uk/download/2018/01522

15. We welcome the commitment to consider whether further legislation is needed for tax purposes and how best to fit CDC schemes into the current Finance Act 2004 framework.

16. It would not be appropriate to be overly restrictive on the options CDC schemes can offer member at retirement. It might be necessary to review the relevant money purchase requirements to ensure they do not prevent schemes from allowing acceptable forms of risk-sharing between members.

Q4. Do you agree that the initial CDC schemes should be required to meet the conditions described above?

17. Some of the conditions are sensible but others could unnecessarily restrict the potential for trade unions and employers to reach agreement on the introduction of CDC schemes in certain companies and industries.

18. CDC schemes should be occupational trust-based pension schemes with their main place of administration in the UK. They should also be registered by HMRC for tax purposes. Requiring authorisation by The Pensions Regulator might enhance confidence in CDC schemes but it should not be overly onerous. The Pensions Regulator must be adequately resourced to operate an authorisation regime so that this requirement does not become an administrative barrier to introducing CDC schemes.

19. Prospect represents members in a number of sectors and industries that have a tradition of industry-wide pension provision (including, for example, the Electricity Supply Pension Scheme). Industry-wide schemes do not present significantly different issues to schemes for single or associated employers. Given the potential benefits of industry-wide schemes, including greatly increased scale and potential provision for the increasing numbers of workers who find themselves outsourced, it would seem sensible to also allow industry-wide CDC schemes initially. Indeed, not doing so could result in the future CDC landscape being more fractured and having more limited coverage than might otherwise be the case.

Q5. Is there a minimum membership size for CDC schemes below which a scheme could not be viewed as having sufficient scale to effectively pool longevity risk to the benefit of membership?

20. Yes. In general there are significant returns to scale for CDC schemes through a bigger pool of risk and the ability to drive costs lower for scheme members. The flip side to this is that there will be a minimum membership size below which the risk pool is too small and costs will likely to be too high for a CDC scheme to deliver good outcomes for its members.

21. The precise number of members that might be considered an appropriate minimum level for a CDC scheme will depend on factors such as the tolerance for variations in outcomes and the diversity of scheme membership. It will be important for confidence in CDC schemes as a concept that any minimum membership size specified in regulations is set with a margin of prudence initially.

Q6. Do you agree with the proposed approach to TKU for CDC schemes?

22. Yes.

23. While not specific to TKU, it is important that lay member nominated trustees are given an important role in the governance of CDC schemes. This will enhance member confidence in CDC schemes as well as ensuring accountability to members. There is no reason why at least 50% of trustees or trustee directors should not be lay member nominated trustees.

Q7. Are there any additional TKU requirements that should be placed on the trustees in CDC schemes?

24. No.

Q8. Are there any TKU requirements that should be relaxed for the trustees in CDC schemes?

25. No.

Q9. 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?

26. A 'cost of accrual' AE test would seem to be the best fit for the type of CDC scheme discussed in the consultation document. However there should be a minimum proportion of the cost attributable to the employer. There is also a case for ensuring that this test is set prudently as AE requirements evolve in the future in order to protect against the possibility of CDC schemes becoming a cheaper alternative for any employers.

Q10. What issues might arise from having no in-built capital buffers in the scheme design?

27. Having no in-built capital buffers will result in greater variability of outcomes and therefore a greater likelihood of benefits in payment being cut. This in turn could undermine the confidence of members in CDC schemes and incur reputational risk for the sponsoring employer(s) and any other groups associated with the establishment of a CDC scheme (eg a recognised trade union).

28. However, not having in-built capital buffers should also be a more efficient scheme design and should deliver better overall outcomes for members. It will also avoid the risk of contributions in respect of any particular group of members being used to build up capital buffers rather than deliver their benefits.

29. The risk of benefits in payment being cut can be mitigated by a requirement for CDC schemes to allow for generous revaluation and pension increases. In the event of assets being lower than expected, the ability to reduce revaluation and pension increases could often avoid the need to cut benefits in payment.

Q11. 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?

30. There will need to be a clear communication to all members that explains that the target level of benefits is not guaranteed and that benefits in payment can be cut. A statement to this effect should be included in all scheme literature as well as in a specific communication to all members who join the scheme and in annual scheme statements.

31. It is important that the explanation that benefits in payment can be cut but put in context. It might be helpful for annual scheme statements to state how often a cut to benefits in payment might be expected under the assumptions used in the latest scheme valuation or what reduction in the value of scheme assets would be required before benefits would have to be cut.

32. Similarly, the possibility of a cut in benefits in a CDC scheme should be compared to the downside risks of other forms of scheme design.

33. Finally, scheme members must be reminded of the value of tax relief and employer contributions so that messages about the possibility of benefits in payment being cut do not result in higher opt-out rates.

Q12. What additional issues may arise from using a best estimate basis for valuation, and how should these issues be addressed?

34. The issues in relation to using a best estimate basis are the same as for having no in-built capital buffers.

Q13. Should we restrict CDC scheme designs to those schemes which would be sustainable without continuing employer contributions?

35. It is certainly important to address any concern that CDC schemes would be dependent on future contributions in relation to new entrants in order to sustain benefit levels for current pensioners. Such an arrangement would be an unjustifiable inter-generational transfer.

Q14. We would welcome feedback on how best to manage risk generally going forward.

36. An authorisation regime for CDC schemes could potentially ensure higher standards and help manage operational risks such as inadequate administration systems.

37. Appropriate levels of representation for lay member-nominated trustees would help improve governance.

38. As well as peer-review and TPR scrutiny of the underlying actuarial assumptions before authorisation of a CDC scheme there should be a requirement for regular ongoing review of actuarial assumptions.

39. Similarly there should be appropriate peer-review and TPR scrutiny of the scheme’s asset allocation.

40. There should be a requirement to publicly disclose relevant scheme information and assumptions used in actuarial valuations.

41. There should be a bias in favour of automatic, rules-based decision making in preference to reliance on discretion.

Q15. Does the proposed CDC scheme framework, as set out in the consultation document, address concerns about risk transfer between generations? We welcome thoughts on any other measures that could also address this.

42. Yes.

Q16. We would welcome thoughts on appropriate wind up triggers and how best to manage associated risks.

43. The scheme's trustees or The Pensions Regulator should be able to instigate the winding up of a CDC scheme if doing so is necessary to protect the interests of scheme members.

44. It is not common for employees to have a contractual or other legal right to ongoing pension accrual at any given level so the sponsoring employer will also usually have an implicit right to stop future accrual in a CDC scheme (subject to the consultation requirements that may apply).

45. On wind up, each member should be given their share of scheme assets.

Q17. Are there any elements of the proposed regime that it is not appropriate to apply to CDC schemes?

46. Nearly all elements of the proposed regime are appropriate to apply to CDC schemes.

47. Additional powers for the Pensions Regulator in relation to CDC schemes should only be granted if absolutely necessary to ensure confidence in the future operation of these schemes.

Q18. Are there any additional authorisation requirements that should be placed on CDC schemes?

48. Issues addressed in responses to Questions 10, 13 and 14 above might have to be addressed in any authorisation regime for CDC schemes.

Q19. Are there any other investment requirements that should be required in addition to those proposed above?

49. No.

Q20. Are there any other disclosure of information requirements that should be required in addition to those proposed above?

50. No.

Q21. 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?

51. Yes.

Q22. Do you agree that CDC benefits should be subject to a similar cap to the automatic enrolment charge cap?

52. Yes.

Q23. Do you agree with the proposal that charge cap compliance should be assessed on the value of the whole scheme's assets?

53. Yes.

Q24. What would be an appropriate approach to handling transfers out of or into CDC pension schemes?

54. Transfers out should generally be permitted for any active or deferred members. There is a greater potential risk of selection against other members of the scheme if pensioner members were allowed to take a transfer out so more consideration would have to be given to a regime that allowed this.

55. Transfers out should be based on each member's share of the assets calculated on a best estimate basis.

56. Consideration should be given to whether it should be necessary to get financial advice before being allowed to proceed with a transfer out from a CDC scheme.

57. There should be no statutory requirement on a CDC scheme to accept a transfer in. However there would be advantages from a public pension policy perspective to allowing CDC schemes to accept transfers in. Transfers in should only be accepted on a basis that ensures there is no detriment in relation to the accrued rights of existing members.

Q25. Should transfers be restricted in any way – for example to take account of the sustainability of the fund?

58. There should be no additional restrictions other than those mentioned in the answer to Question 24 above.

SUMMARY

59. Prospect welcomes the government's consultation on delivering CDC schemes and the cross-party support for their introduction. Prospect representatives demonstrated their support for an alternative scheme design that is an improvement over traditional defined contribution schemes when overwhelming backing a motion on this subject at our National Conference last year. It is necessary to provide a legislative framework to allow the agreement between the CWU and the Royal Mail to be brought into effect at the earliest possible opportunity. That legislative framework should be flexible

enough to allow other trade unions and companies to introduce CDC schemes for other groups of members where there is agreement to do so.