



Unite response to the Department for Work and Pensions consultation on Retirement Collective Defined Contribution pension schemes

Introduction

This response is submitted by Unite the Union, the UK and Ireland's largest trade union representing over one million members across all sectors of the economy including transport, manufacturing, financial services, food and agriculture, construction, energy and utilities, information technology, service industries, health, local government and the not-for-profit sector. Unite also organises in the community, enabling those who are not in employment to be part of our Union.

Unite has facilitated and negotiated pension benefit changes, agreed between members and employer, for many schemes. It is a key part of our role to balance the benefits provided, cost of that benefit provision and the risk that the scheme can afford to take, recognising the impact that this has on the funding level, investment strategy and affordability.

The most important consideration is pensions adequacy, which should drive decisions relating to pensions investment. The government should enact policies to support the re-opening of Defined Benefit (DB) schemes (and the reinvigorating of DB provision) which in turn would affect their investment strategies. Workers must have at least equal representation to employers in the governance of all pension funds.

Unite is supportive of Collective Defined Contribution (CDC) and the legislation to support it but not instead of Defined Benefit Schemes.

Unite believes CDC schemes have the potential to deliver much better benefits for employees than the individual DC schemes that are becoming the norm. Once established, we believe they could grow rapidly in the UK as their advantages are demonstrated both to employees and to employers.

It is vital this is taken forward in the interests of DC contributors as the main beneficiaries of current DC arrangements are the 'pensions industry' and CDC will intensify competitive pressure driving increased efficiency and value for money for members in DC schemes generally.

Unite welcomes the commitment of the Royal Mail to introduce a CDC scheme. Such a scheme, potentially with up to 140,000 members, could be a flagship demonstration of a better form of DC.

Unite believes that CDC shouldn't be limited to single employer schemes. CDC should be made available to workers in as many workplaces as possible where the only option currently is conventional defined contribution with few cost-effective means of generating a lifelong income in retirement. In some sectors this might mean that an industry-wide scheme is the most effective way of delivering retirement benefits.

Unite also believes that we shouldn't prohibit defined contribution master trusts from using CDC approaches. Unite thinks that this could be of particular use in the near or at-retirement phase where greater certainty of returns could be beneficial, but savers could still benefit from continued exposure to return-seeking assets to ensure that their pot grows ahead of inflation.

Although this consultation doesn't focus on converting DB schemes to CDC it is beneficial to make the point that the notion that current DB schemes can or should be converted to a CDC format is neither acceptable in principle nor realistic in practice. The main effect of such an initiative would not be to breathe life into CDC but to discredit the concept.

The idea is a red herring promoted with a view not to benefit scheme members but rather to allow employers to escape from their legal obligations to fund DB schemes. While some employers who currently have DB schemes might be interested in adopting CDC as an alternative to moving to DC, this should not and need not mean that a closed DB scheme should be linked to the CDC.

CDC should be of interest and be promoted solely as a way of providing better outcomes for members in respect of their pension for future company service and not to reduce benefits for past service.

The only exception to this is where members agree to a transition of benefits under which they specifically give consent to a change in the form of their past service benefits. A change through this means would not compromise the legal protection which the law gives to members' accrued rights in DB schemes, and specifically the general ban on converting DB benefits to DC without member consent.

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Question 1: How do you anticipate Retirement CDC investment strategies will need to differ from those of whole-life CDC schemes?

Unite agrees that unlike whole-life CDC schemes, Retirement CDC schemes will be paying out benefits as soon as they start running. As a result, their investment strategies will inherently differ, as greater liquidity will be required from the outset in order to pay out the required benefits. This really is a question of scale and the economies of scale need to be big enough to generate sufficient returns during periods of market fluctuations.

Question 2: What do you estimate the establishment and running costs of an r-CDC scheme to be? Please outline one-off and ongoing costs.

Many providers are currently quoting staggering set-up and authorisation costs, which has scared some employers from considering a CDC scheme. So, if set-up and authorisation costs were met by the provider, who ultimately are going to be the ones profiting from a CDC scheme's launch. Then this would help establish better conditions to establish further CDC schemes. A scheme funder equivalent should be introduced.

For multi-employer schemes, certainly trade unions are signatories to many sectoral agreements with employers and obviously have a previous and current history with regards to providing pension provision via these frameworks. So, any developments in this area should allow for sector agreements to be able to facilitate this.

The employer/employers should be responsible for meeting the costs of establishing the arrangement and the short-medium term operating costs

In addition, employer/employers' pledges to meet the winding-up costs themselves will help in the first instance.

An expenses reserve, similar to the pension protection fund levy for DB schemes, is an idea worth exploring as long as it doesn't detract from members' outcomes.

Valuations and the normal oversight from the Pensions Regulator will help.

As will allowing CDCs into the Pensions Protection Fund.

Question 3: Should all business plan requirements that would apply to whole-life unconnected multiple employer CDC schemes also apply to Retirement CDC schemes? What, if anything, should change or be added?

The scheme funder should prepare the plan, be that an actual employer for an in-house CDC scheme or the Master Trust as they do now with their current DC provision.

Again, for multi-employer schemes, certainly trade unions are signatories to many sectoral agreements with employers and obviously have a previous and current history with regards to providing pension provision via these frameworks. So, any developments in this area should allow for sector agreements to be able to facilitate this.

Trade union access to information on behalf of members should be a requirement.

CDC schemes should be added to the statutory pension consultation regulations.

Question 4: What numbers of member onflows, and at what pot sizes will be needed to achieve stability in Retirement CDC, given there are no ongoing contributions, and what allowances need to be made for members who opt-out of their default pension benefit solution?

Unite does believe that membership size of a CDC scheme is important in increasing the likelihood of effectively pooling longevity risk to the benefit of the membership.

Unite believes that Royal Mail's membership size of 140,000 makes this the ideal place for a CDC to start.

Beyond this, Unite's discussion with actuaries on the minimum membership size question is that smaller sized CDC schemes can work. Some actuaries have said about 3,000 members would be the right number, with a minimum of 1,000. Another actuary has told Unite that a CDC scheme with as little as 200-300 members would work.

Providers we have spoken to have said 4,000 - 5,000 is the scale that is needed to make the administration and infrastructure investment required to work from a commercial perspective

Question 5: What do you think the effects of the proposed adaptation to promotion and marketing criteria, including a prohibition on member marketing, would be? & Question 6: How would an approach to allow access to Retirement CDC via a guided retirement default or formal partnership between trustees, protect members, and impact a developing market? Would there be any unintended consequences?

The government should ensure that the member perspective is represented in the management of CDC schemes. Requirements aimed at ensuring trustees are competent should not exclude member trustees, especially given the difficult decisions likely to be made by trustees. Given that risks are pooled between members and the employer responsibility ends with the provision of contributions, Unite believes it would be appropriate to require trustee boards to comprise 50 per cent member nominated trustees. Unions should also have access to scheme documents.

Membership will be encouraged by a clear target benefit being specified. While this is a soft promise, the flexibility of the pension promise, though it has a down-side, can also be portrayed as an up-side in that it allows schemes to be managed in a manner which adds value by allowing more efficient accumulation and decumulation (or investment and accessing of benefits).

This commitment will need to be demonstrated through clear and transparent communications. These will be critical at times when benefits may need to be adjusted away from target levels to provide reassurance that decisions are being made both for good reason and equitably as between different sections of the membership.

The importance of member communication means that there should be a requirement that workers and their unions should be involved in the creation of schemes. It is important that trade unions have the same rights to obtain information about schemes as they do with trust-based schemes at present. They will present an important safeguard that schemes are operating in members' interests.

Question 7: What are your views on the risks, benefits and potential protections for members of FCA-regulated pension schemes being transferred to a Retirement CDC to access their pension savings?

Allowing CDC schemes into the PPF could be one way of mitigating risk.

Question 8: What matters should we consider in developing an actuarial equivalence requirement for transfers into the scheme, and are there other factors to address regarding member entry?

The DB approach would be the most appropriate approach to handling transfers out of or into CDC pension schemes. CDC schemes would have to incorporate demand for transfers out into their approach to their funding and investment strategy. For example, they would need to hold sufficient liquid assets to accommodate possible transfers out.

CDC schemes may have to be restrictive in some way. Schemes could possibly offer set times at which members could transfer out of the scheme, although research suggests that this may drive up opt out rates. However, with the right scheme design and investment approach CDC schemes should be able to run in such a way that they are compatible with pension freedoms, just as DB schemes currently do.

Question 9: What mechanisms should be introduced to ensure that quotations are accurate and not misleading? & Question 10: What are your comments on a 'cohorting' approach to helping well-performing schemes remain affordable for members and are there alternative approaches you would recommend? What should scheme rules on cohorting include? And does the illustrative drafting capture the policy intent and would this drafting work in practice?

Unite supports the use of a best estimate basis.

A clear illustration of the impact of a more enlightened approach to funding and investment can be found by comparing the PPF's assessment of the general level of scheme funding (of FTSE350 companies DB Schemes) on a bond-based investment approach, which shows a large aggregate deficit, and the First Actuarial FAB Index, which adjusts to allow for best estimate investment returns and shows an aggregate picture of a large surplus.

The irony is that this was once the investment approach of Defined Benefit (DB) schemes.

Actuarial and accounting practices compounded by misguided regulation have compounded the economic and demographic challenges rather than helping DB schemes and employers to manage them. In particular, the drive to de-risk investments has inflated pension deficits and hugely increased the cost of future service benefits.

This situation has been developing over many years with notable factors being the change to mark to market accounting and valuation of pension schemes on current market values, denying the opportunity to take a long-term view, through to the current approach of gilts-plus methodology to determine investment returns, regardless of that market being grossly distorted.

If decent levels of pensions are to be provided, then schemes necessarily must invest contributions in return-seeking investments over the long term. Without taking some risk there will be little reward and pension saving ceases to be viable. Yet all the pressure on DB schemes has been to reduce risk.

Too great an orientation towards bond-based investment strategies results in excessive prudence and guarantees that the cost of benefits will be high. It represents a 'solution' which crystallises a problem rather than solving it.

The whole point of DB schemes is that they are collective schemes which can and should be able to take more risk than an individually invested pension and so deliver better value. This, just as much as the employer underwriting them, is what makes schemes viable. The effect of de-risking makes the employer the first resort for additional pension funding rather than the last resort.

What is needed is a greater emphasis on the long-term funding position as will allow greater investment in return-seeking assets. Discount rates should be based on the expected returns which schemes hold, with a margin for prudence, rather than a gilt-plus methodology. This is particularly important now as the margin between expected returns on gilts and on other assets has widened markedly.

Trade unions' support for CDC shouldn't be seen as a green light for employers to give up on DB schemes that are sustainable and give members guaranteed outcomes opposed to targeted with CDC.

A money purchase type approach might be perceived to be the logical fit for a CDC scheme given the intention is to categorise CDC benefits as a type of money purchase benefit.

However, the collective nature of the CDC scheme makes the DB scheme 'cost of accrual' AE test more appropriate in Unite's opinion.

On a wider point Unite believes there is also a scale argument with regards to the level of contribution that should be required for a CDC scheme. Unite believes this needs to be more than the 8% AE total contribution requirement as of 6th April 2019, which would potentially deliver a target of a 160th accrual rate in a CDC scheme, which wouldn't be enough for people to live on in retirement.

Question 11: What issues would removal of the upper threshold and allowing the spreading of cuts over the lifetime of the scheme, for schemes using cohorting create, and how might these be mitigated?

Intergenerational - CDC has raised important questions about intergenerational fairness, especially in the Netherlands. It is all too easy to create a system which carries unintended consequences, or to change the rules later in a way that benefits one cohort over another. In the UK, where intergenerational inequity is already a very real issue, government and scheme decision-makers will need to tread with caution.

Unite believes that it is vital that any CDC schemes deliver inter-generationally fair benefits – i.e.:

- The same pension level is provided to all members, regardless of age, adjusted for the increases which the assets fund at that time.
- There cannot be material inherent 'bias' in the increases each generation of members receives.
- Increases should not be materially affected by Section population changes, for example, closure to new accumulations.

CDC Death in Service and Death in Retirement Benefits

- Its important that the legislation is drafted in such a way that it would preclude CDC scheme design from offering Death in Service and Death in Retirement Benefits.
- Defined Benefit schemes have for a long time offered benefits for Death in Service as a multiple of salary, which is 4 times in most schemes.
- In addition, most Defined Benefit schemes offer a 50% spouse pension for Death in Retirement.
- These would be welcome additions to CDC scheme design.

Question 12: Is there any further information that Retirement CDC schemes should be required to provide to new and prospective members?

Again, membership will be encouraged by a clear target benefit being specified. While this is a soft promise, the flexibility of the pension promise, though it has a down-side, can also be portrayed as an up-side in that it allows schemes to be managed in a manner which adds value by allowing more efficient accumulation and

decumulation (or investment and accessing of benefits).

This commitment will need to be demonstrated through clear and transparent communications. These will be critical at times when benefits may need to be adjusted away from target levels to provide reassurance that decisions are being made both for good reason and equitably as between different sections of the membership.

The importance of member communication means that there should be a requirement that workers and their unions should be involved in the creation of schemes. It is important that trade unions have the same rights to obtain information about schemes as they do with trust-based schemes at present. They will present an important safeguard that schemes are operating in members' interests.

RPI should be used as the target measure of inflation. It's the one that most closely matches retired people's real living costs.

Question 13: Are there practical or operational challenges in delivering Retirement CDC communications through DC scheme trustees, and how might these be addressed?

CDC schemes should be controlled by Trustees, including member trustees, employer trustees and professional trustees. The number of member trustees should be not less than the number of employer trustees.

The trust model is the most appropriate model for CDC given the obligation it places on trustees to act in the member interest.

Unite sees no justification for more onerous requirements for trustee knowledge and understanding than are required for other forms of pension schemes. Unite agrees that trustees of CDC schemes would have important and sometimes complex decisions to make but the same is often true in other parts of the pension's universe, notably for defined benefit schemes.

It would be worrying if additional requirements, for instance on knowledge and understanding, were to exclude lay trustees. Unite believes that member-nominated trustees bring important and varied perspectives from outside the pensions industry, as well as contributing a knowledge of scheme members. This latter aspect will be very important when schemes have to consider the communication of scheme aims and decisions.

For single employer schemes, Unite would like to see half of the trustee board made up of member-nominated trustees. After all, members are bearing the risks such as investment risk and longevity risk, while the employer's responsibility ends with the payment of contributions.

If there are concerns that lay trustees lack sufficient knowledge, this should be addressed in post-appointment training, not by installing a cadre of professional trustees with similar backgrounds and assumptions.

Question 14: What additional costs might a Retirement CDC illustration create, and what considerations should be taken into account to ensure illustrations are realistic, consistent, and not misleading?

Unite are unaware of the costs involved but do support members having access to the two different illustrations be that the statutory money purchase illustration (SMPI) and the Retirement CDC illustration. It's important that members receive the right information and providing one runs the risk of not presenting the full picture to the membership.

Question 15: What charging structure/what charge levels is your organisation considering levying on members? If implemented, at what level should a Retirement CDC charge cap be set?

Unite support the introduction of a Retirement CDC charge cap. Unite agrees it will provide a safeguard for those who have not actively considered their retirement options under Guided Retirement, but we would also expect trustees to take administration charges into account when designing their pension benefits strategy.

Question 16: Do you foresee any areas of potential arbitrage, and how should Government and regulators seek to mitigate this? & Question 17: Are there any other matters you wish to raise in relation to the possible extension of the CDC authorisation and supervisory framework to include Retirement CDC schemes?

Like all trust-based schemes they should come under the general supervision of the Pensions Regulator.

CDC schemes should be subject to a general duty to provide overtime an equitable distribution of investment returns and benefit outcomes between different classes of members. There should also be a requirement that there is consistency between any target benefits communicated to members and the investment policy, funding strategy and the policy on discretionary decisions on benefit adjustments.

CDC schemes should be required to have an annual review/valuation to ensure its objectives and performance remains in reasonable alignment. There should be full disclosure/publication of its policies on investment, funding and benefit outcomes/discretionary benefit adjustments.

Question 18: Do you have any comments on the proposed amendment to Regulation 12 of the Preservation of Benefit Regulations 1991?

No comment.

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John Neal – National Pensions Officer, Unite the Union

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