Unite response to the Department for Work and Pensions consultation on Extending Opportunities for Collective Defined Contribution Pension Schemes – 26th March 2023

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 is supportive of Collective Defined Contribution (CDC) and the legislation to support it.

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 as a means 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: Do you agree with the key principles we have identified as necessary for the new types of CDC schemes and in particular whole-life multi-employer CDC models? If not, please set out why.

Unite agrees that CDC benefits should be classified in legislation as a type of money purchase benefit.

A CDC scheme is a particular form of defined ambition scheme where no level of benefit is guaranteed. It is distinguished from other forms of defined ambition schemes where a part of the benefit is guaranteed e.g. a scheme where a defined minimum level of benefit is guaranteed but benefits can be adjusted down to or up from that minimum level.

This distinction is critically important as with CDC the employer contribution can be fixed and the employer has no funding liability beyond that fixed contribution and does not have to reference any pension liability in its balance sheet.

Unite also supports the development of defined ambition schemes with a DB element subject to the proviso that they extend only to future service benefits. Unite would oppose any change in the law as would allow currently guaranteed benefits to be subject to alteration without member consent.

Question 2: Do you agree with our thoughts on what requirements might need amending to accommodate these new CDC designs? What new triggers for sectionalisation other than a change to the actuarial plan do you envisage might be appropriate in these new schemes?

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 actually hold, with a margin for prudence, rather than a gilts-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.

Question 3: Should the definition of "operates" at section 7(5) of the 2021 Act be amended for whole-life multi-employer CDC schemes? If you agree, please set out how.

Unite agrees that legislation shouldn't restrict employers in this area. There is a strong case for such detail to be negotiated between employer and workforce. Different workforces will suit different arrangements and it is unwise for government to remove options from the table.

Many providers are currently quoting staggering set-up and authorisation costs, which has scared off 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.

Question 4: How might legislation capture persons performing the functions listed at paragraph 39 in commercial and sectorial schemes so that they are within scope of the fit and proper persons test? Are there other persons that should be brought within scope of the fit and proper persons test for these new schemes?

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. 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 over time 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 5: Do you agree that those marketing and promoting CDC schemes should be within scope of the fit and proper persons test where certain conditions apply, and if those conditions should be similar to those in Master Trust schemes?

Yes. 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.

Question 6: Are any changes or additions needed to Schedule 1 of the 2022 Regulations in respect of matters to be taken into account by TPR, as part of the fit and proper test to reflect the new roles envisaged to exist in sectorial and commercial schemes?

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 pensions 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 7: Are the current scheme design requirements including the tests still appropriate for assessing soundness in the new whole-life multi-employer schemes? Are there any additional soundness considerations or tests needed in light of the new designs?

On first glance 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 in excess of the 8% AE total contribution requirement as at 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 8: If a scheme funder equivalent is introduced for the new whole-life multi-employer CDC schemes including Master Trusts, should similar scheme funder requirements to those in the DC Master Trusts regime apply? Are there any changes needed to ensure there is a clear focal point for TPR's scrutiny and liability for meeting the relevant costs?

Yes, 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.

Question 9: Should business plan requirements, similar to those for Master Trusts, be introduced for commercial and sectorial CDC whole-life multi-employer schemes? What, if anything, should change? Who should be responsible for preparing the business plan?

Yes, they should be introduced.

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.

Question 10: Do you agree that the existing requirements should apply to new whole-life multi-employer schemes and are additional requirements needed to help ensure that communications used in promoting and marketing the scheme are not misleading? How might Schedule 4 of the 2022 Regulations be amended to achieve this?

Yes, existing requirements should apply.

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 so as 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 11: Are any changes or additions needed to the requirements in Schedule 5 of the 2022 Regulations to reflect the new designs and relationships anticipated in the new whole-life multi-employer schemes?

Trade union access to information on behalf of members.

CDC schemes added to the statutory pension consultation regulations if any detrimental change is proposed.

Question 12: Do you agree that it is reasonable for the existing requirements in regulations 15 and 16 of the 2022 Regulations to apply to the new whole-life multi-employer CDC schemes, and that the continuity strategy should include an aspiration to operate the scheme as a closed scheme?

Agree as long as a closed scheme wouldn't mean a more conservative investment strategy.

Question 13: Do you agree that most of the existing requirements can read across to the new whole-life multi-employer schemes? What changes including the one proposed above do you think should be made to the existing requirements and why?

Agree that most of the existing requirements can read across to the new whole-life multi-employer schemes.

Question 14: Do you think that the list of events in regulation 23 of the 2022 Regulations needs amending for the new whole-life multi-employer CDC schemes? If so, why? Are there new events that should be added or current events that should be removed?

Think that the list of events in regulation 23 of the 2022 Regulations needs amending for the new whole-life multi-employer CDC schemes are sufficient.

Question 15: Do you agree that the list of triggering events that apply to single or connected employer CDC schemes needs some revision to accommodate whole-life multi-employer CDC schemes? Are there new events that should be added or current events that should be removed?

Yes, agree that the list of triggering events that apply to single or connected employer CDC schemes needs some revision to accommodate whole-life multi-employer CDC schemes.

Question 16: Is a similar approach to the wind up commencement time (and the cessation of contributions/accruals) appropriate in respect of the new whole-life multi-employer schemes? If not, why not? Given AE obligations, how might participating employers be provided with sufficient opportunity to make alternative arrangements, before contributions are prohibited in the whole-life multi-employer CDC scheme being wound up, whilst managing risks to members?

The same framework to the wind up commencement (and the cessation of contributions/accruals) is appropriate in respect of the new whole-life multi-employer schemes. However with these being multi-employer schemes, the time element could be potentially extended depending on the situation.

Participating employers should be given some time to provide alternative arrangements but this shouldn’t exceed the normal statutory limits for establishing an AE scheme.

Question 17: Are the current default and alternative discharge options sufficient for the new whole-life multi-employer CDC schemes?

Unite believes that the current default and alternative discharge options are sufficient for the new whole-life multi-employer CDC schemes.

Question 18: Do you agree that the existing framework for the wind up of a CDC scheme can read across to the new whole-life multi-employer schemes? What changes, other than the ones mentioned above, do you consider should be made for these new schemes?

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.

Allow CDCs into the Pensions Protection Fund.

Question 19: Do you agree that the existing requirements, outlined in Chapter 10, which apply to single or connected employer schemes can be read across to the new whole-life multi-employer CDC schemes, other than where a modification has been highlighted?

Yes, Unite agrees that the existing requirements, outlined in Chapter 10, which apply to single or connected employer schemes can be read across to the new whole-life multi-employer CDC schemes, other than where a modification has been highlighted

Question 20: Who would be responsible for meeting the costs of establishing the arrangement and the short-medium term operating costs?

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.

Allow CDCs into the Pensions Protection Fund.

Question 21: How could such arrangements establish scale and what evidence is there to support this? In addition, until such schemes achieve and maintain scale do commercial providers envisage providing the funding needed to smooth volatility and deliver the aspired to pension benefits? How would the potential issue of small pots be addressed?

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.

There isn't an easy solution to the small pots issue. Master Trusts don't want to house them because the servicing required affects their bottom line. Industry suggestions of the pot follows member or the Government stepping in with NEST becoming the default home are possibilities.

However the real challenge of turning small pots into bigger ones will remain.

Question 22: What mechanism should be used to determine the price at which people might buy into a decumulation only CDC arrangement and what can be done to ensure individuals are treated fairly? In addition, should mortality underwriting be a feature of these arrangements, and how would this best be done?

Unite is keen that the definition of a money purchase benefit is drawn more broadly than it currently is to allow for greater innovation in the at-retirement space that could improve the service offered to members. We would like to see greater scope for mortality protection in the retirement phase. This could potentially be delivered through a mortality pool, in which a proportion of members' assets are pooled between certain ages. Within the pool, deceased members' assets would be allocated to living members, increasing the size of the annuity they could purchase later on. Currently such a scheme would fall foul of the emphasis on "payments" in Section 181 of Pension Schemes Act 1993. Without an expanded definition we fear that schemes may be unwilling to explore changes to their retirement offering because they worry about no longer being classified as money purchase and incurring a funding risk.

Question 23: What steps can be taken to ensure communications to members help them understand how these new arrangements will work and how can consistent standards be achieved in the way commercial arrangements market their products to prevent over-promising?

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 so as 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 24: What other changes in addition to those set out in this document, do you think need to be made to ensure the effective and fair operation of decumulation only CDC arrangements?

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.

Pension Protection Fund (PPF)
Allowing CDC schemes into the PPF could be one way of mitigating risk.

Transfers
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 actually drive up opt out rates. However, with the right scheme design and investment approach CDC schemes should be able to run in such as a way that they are compatible with pension freedoms, just as DB schemes currently do.

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John Neal – National Pensions Officer, Unite the Union 26th March 2023