Sackers

Collective DC Schemes get the go-ahead

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Introduction

The DWP published its response to consultation on "Delivering collective defined contribution schemes" on 18 March 2019. This gives the green light for a particular model of trust-based, collective defined contribution (CDC) scheme, as proposed by Royal Mail and the Communication Workers Union.

Key points

- The DWP's response sets out its commitment to legislate for a model of CDC scheme involving single or associated employers.
- Further work is being undertaken, in conjunction with TPR, HMRC and others, to ensure that the existing legislative and regulatory frameworks are adapted to the extent needed to accommodate CDC.
- While its initial priority is to legislate for the Royal Mail CDC model, the DWP was impressed by the "genuine, strong appetite for CDC benefit provision in the UK" demonstrated by the responses to its consultation. The DWP will therefore structure the legislation to allow it to "move promptly to other forms of CDC benefit provision", in particular, decumulation-only vehicles and DC master trusts.
- CDC schemes will be subject to authorisation and ongoing supervision by TPR, with the introduction of a bespoke regime drawing on TPR's experience in relation to master trusts.

What is a CDC scheme?

In a CDC scheme, financial contributions are invested in a collective fund, with members receiving a regular pension from the fund at retirement. A key principle underpinning CDC is that "the benefit level offered can only ever be an estimate based on current facts".

Broadly, an individual member's pension would be calculated by:

- estimating how much money is needed to provide the benefits already credited to each member
- adding up the values for each member to determine the total assets available to meet the benefits credited to all members

- if the assets available are higher or lower than the estimated money required to meet credited benefits, make corresponding adjustments to (i) the current payment of benefits to each pensioner member and (ii) the prospective pensions payable to active and deferred members

- adjusting the future target level of benefits so that the total value of benefits is equal to the total value of assets.

The collective nature of a CDC scheme, and the way it adjusts the level of pensions and prospective pensions, should mean that the overall membership will enjoy an element of cushioning from volatility, as investment risk is adjusted for over time and longevity risk is pooled across the membership. And because the fund is administered and managed on a collective basis, there is also no need for members to make choices about investments or the options for converting funds into an income stream in retirement.

Overview of the new legislative framework

For more than a decade, CDC schemes have been on successive government agendas (our Alert on the DWP's November 2018 consultation sets out a brief history). But, as thinking has "moved on considerably" since the Pensions Schemes Act 2015 first provided a framework for CDC, the Government recognises that fresh law is needed "to deliver an appropriate legislative and regulatory framework". Highlights include:

CDC benefits are "money purchase"

CDC benefits will be defined in legislation as a type of money purchase benefit. The DWP sees this as key to ensuring employers have confidence in the proposals, as it will clarify their responsibilities and provide assurance that there is no obligation on them "to make additional contributions should the funding level fall short". However, some of the existing legislation for DC schemes will need to be adapted to cater for CDC arrangements, such as the default fund charge cap and the DC chair's statement.

Member communications

Communication throughout a member's pension journey is important for any scheme, helping members understand their benefits and engage with their pension savings. But, as CDC schemes are new in the UK, ensuring members understand how they operate will be central to any such arrangement.

Risk warnings, designed to be repeated at key stages, are therefore likely to be an essential element, addressing features such as:

- the fact that projected benefits are a not guarantee
- benefits (including pension payments) can go down as well as up
- the scale of potential fluctuations
- the distribution of risks between members
- the fact that risks are borne by members rather than the employer, and
- that ultimately, members have limited control over the attribution of losses and surpluses.

Tax

Work is underway with HMRC "currently determining how CDC schemes can best be slotted into the tax framework". We can expect a consultation "in due course" on any changes required here.

Trustee duties

The DWP considers general trust law provisions and the existing TKU requirements to be sufficient and flexible enough for the single employer CDC model. It notes that a good trustee board should be looked at in terms of collective expertise, as well as its systems and processes, which should be suitable for the scheme's purposes, and not pose an unreasonable risk of member detriment. At present, the DWP considers it inappropriate to require CDC schemes to appoint professional trustees.

Actuarial

Annual actuarial valuations (which will need to be submitted to TPR) will be used to determine whether benefit adjustments are required, and to specify the principles that will apply to those valuations.

Any increase or decrease (in benefits payable to pensioner members and those credited to non-pensioner members) resulting from scheme performance or changed assumptions should be applied on a uniform basis across the entire membership. The approach used for adjusting benefits must be clear and unambiguous in scheme rules, be communicated clearly to members, and "should be based on a mechanism set out in scheme rules, rather than trustee discretion".

Member representation

Although some respondents to the consultation called for a higher proportion of MNTs/MNDs in CDC schemes (50% rather than the existing one third threshold), the DWP is not currently minded to change these requirements.

Transfers

Members will have a statutory right to transfer out before retirement, giving them the same access to pensions freedom and choice as their counterparts in other private sector DB and DC schemes.

Whether CDC members should be required to take independent financial advice before transferring their benefits remains under review. This is because the DWP considers that "suitable financial advice may be very difficult to find before CDC schemes become fully established in the UK pension landscape".

Transfers into a CDC scheme will be a matter for scheme discretion.

Automatic Enrolment

A cost of accruals test (based on the cost to the scheme of the future accrual of active members' benefits, applied at benefit scale level, rather than scheme level) is the DWP's preferred option for determining how CDC schemes can meet the legal quality requirements for automatic enrolment purposes. It is currently in discussion with GAD as to what an appropriate accrual rate might be for this purpose. However, the DWP intends the legislation to be flexible enough to encompass alternative tests (for example, based on minimum contributions), as future CDC models may warrant a different approach.

Winding-up

Scheme rules must be clear on what will prompt the winding-up of a CDC scheme, with a requirement to include a trigger relating to scheme sustainability. CDC schemes will also need a strategy explaining how the winding-up process will work, including how members will receive a share of the pooled fund.

A new regulatory regime?

CDC schemes will be subject to a new authorisation regime and ongoing supervision by TPR. As part of this process, schemes will need to be able to demonstrate that they are sustainable without continuing employer contributions (as they will have no recourse to the PPF). The new master trust framework is seen as a useful starting point, although it will be adapted "to better encompass the risks and considerations appropriate to CDC and non-commercial provision".

The DWP will work with TPR to ensure that its supporting guidance (in the short-term) and codes of practice (longer term) fully support CDC scheme trustees in delivering effective communications. Similarly, TPR will review its TKU guidance as CDC develops.

Next Steps

Using a now common refrain, the Government intends to move forward with legislation to facilitate CDC schemes "as soon as Parliamentary time allows".

Much of the detail will be set out in regulations, as this will allow the DWP "to focus carefully on precise technical issues". It will also give the DWP "the flexibility to adjust the provisions more easily as CDC schemes bed-in" and it learns from early experience.

The DWP's immediate priority is to get the Royal Mail scheme established "as a first test of CDC provision". Once that is in operation, the DWP will work with interested parties to develop a framework for other CDC arrangements, such as decumulation-only vehicles and DC master trusts.

If you have any questions on any of the above, please speak to your usual Sackers contact.

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