Unite response to the Department for Work and Pensions consultation on draft legislation to extend Collective Defined Contribution (CDC) provision to whole-life unconnected multiple employer schemes and other related provisions – 19th November 2024

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: Do you think draft regulation 25 delivers the policy intent for the opening of a new section for unconnected multiple employer CDC schemes? & 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?

Yes, we agree.

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 3: Do you have any comments on the draft regulations on the fit and proper person requirements? & Question 4: Do you agree with the functions we have identified for the role of the Chief Investment Officer?

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.

Yes, we agree with the functions that have been identified for the role of the Chief Investment Officer.

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? & 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?

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

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

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).

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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 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?

We agree it is necessary to protect members in any new unconnected multiple employer CDC schemes. So, we strongly support the additional significant events to cover the potential for commercial unconnected multiple employer CDC schemes and their promotion or marketing activities.

Question 12: Do you have any comments on the draft regulations that provide for ongoing supervision of unconnected multiple employer 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 13: Do you agree with the changes in Part 6 of the draft regulations?

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

Unite agrees with the changes in the Miscellaneous Amendment CDC Regulations 2025.

However, it is vital that this change doesn’t get misinterpreted, and members continue to receive the required benefit illustration of the member’s projected retirement pension.

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. & 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.

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

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.

Allow CDCs into the Pensions Protection Fund.

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 & 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?

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 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

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.

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 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.

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John Neal – National Pensions Officer, Unite the Union 19th November 2024