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Collective defined contribution pensions

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Work and Pensions Committee

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Royal Mail deal could transform the pensions landscape

We congratulate Royal Mail and the Communication Workers Union on their ground-breaking agreement to pursue the creation of a collective defined contribution (CDC) pension scheme. As well as being a model of constructive industrial relations, it opens the door for CDC to move from abstract idea to practical reality. This could transform the UK private pensions landscape.

Potential benefits to employers and savers

That landscape is currently split. Defined benefit (DB) pensions are in decline as employers seek to reduce their exposure to ongoing funding obligations. Defined contribution (DC) saving is, by contrast, growing fast under automatic enrolment. DC pensions are more manageable for employers, but require individuals to shoulder the burdens of investment risk, volatility, uncertain life expectancy and purchasing a suitable pension income product on retirement.

CDC pensions, which are prominent features of highly successful pensions systems in Denmark and the Netherlands, offer advantages in the middle ground. These schemes offer a regular retirement income but in the form of a target benefit rather than a guarantee. Changes in the funding position of the scheme are addressed by adjusting the benefit rather than calling on extra contributions from the employer. CDC may well appeal to companies who want to offer good pensions to their staff without the risk of large long-term pension liabilities on their balance sheets. The prospect of a regular and relatively reliable income in retirement may be welcomed by those staff. Through the pooling of risk between scheme members, CDC may well also provide more generous pensions on average than standard DC saving. CDC would therefore be a good choice for some employers and some savers. To offer more good choices is entirely consistent with both pension freedoms and promoting retirement saving.

Legislating for CDC

The Government has indicated that it will seek to enable CDC for Royal Mail in a way which will allow other companies to follow suit. We very much welcome this and recommend the Government does so using its existing powers under the Pensions Act 2011. This method would have the added benefit of assuring employers that they will not face subsequent additional deficit funding obligations.

We further recommend the Government consult on the technical regulations necessary to create a CDC system to a swift timetable set out in response to this report. CDC schemes should be governed by a board of trustees and both authorised and supervised by a proactive Pensions Regulator. They should be required to publish their benefit calculation rules and funding position and strategy at least annually.

The consultation should also cover:

- benefit adjustment and risk sharing policies, including how to achieve intergenerational fairness within CDC schemes;
- the regime for transfers out of CDC, including whether they should be permitted once pensions are in payment and whether members transferring out should have to take financial advice; and
- whether CDC scheme trustees should be required to have a specific qualification.

The future of CDC

The initial impetus for CDC has come from a large employer and a major trade union seeking an alternative pension model. But establishing CDC schemes opens the possibility of more diverse and ambitious provision of collective pensions, across industries and professions and to self-employed and gig economy workers. We recommend that the regulations governing CDC should accommodate mutual, multi-employer and standalone schemes. The Government should seek to encourage such innovation, and its great potential gains, in establishing a framework for a new wave of collective pensions in the UK.

1 Introduction

The UK private pensions system

1. There are two main types of private pension in the UK:

   a) defined benefit (DB), which promises members a specified regular pension income in retirement paid from a collective fund; and

   b) defined contribution (DC), in which employer and employee contributions accumulate in an individual investment pot, which is used by the employee to purchase a pension product on retirement.

Defined benefit pensions

2. In DB schemes, the sponsoring employer takes the ongoing funding risk: if the scheme has insufficient assets to meet its pension promises, the employer must make additional contributions. DB pensions have been in steady decline. Sponsoring employers have found meeting their pension obligations difficult in the context of increased life expectancy, low interest rates and the decline of some traditional industries.[1] In 2016, 1.3 million employees were actively contributing to a private sector DB scheme, compared to 3 million a decade previously.[2] Many companies have sought to reduce financial risk by closing schemes to the accrual of further pension benefits.[3] Alan Rubenstein, former chief executive of the Pension Protection Fund (PPF), which pays reduced pensions in the event sponsoring employers become insolvent, said "we now all recognise that we are moving towards an endgame for defined benefit pensions".[4]

Defined contribution pensions

3. Closed DB schemes are typically superseded by DC arrangements, and new private pension schemes are now almost exclusively DC.[5] Membership of DC schemes has expanded dramatically in recent years following the introduction of automatic enrolment in 2012. Nearly 10 million employees have been automatically enrolled into pension saving.[6] Guy Opperman MP, the Minister for Pensions (the Minister) described this as a "success story on a level and a scale that is beyond anyone's wildest hope and aspiration"[7]—an assessment with which we agree.

4. In a DC scheme, the individual saver shoulders the risk that their investment falls in value or doesn't perform as hoped.[8] DC saving is also, in effect, a tax-advantaged

1 Written evidence from Mark Rowlinson (CDC0039)
2 ONS Occupational Pension Schemes Survey 2016, table 3
3 Written evidence from KPMG (CDC0016). The proportion of private-sector DB schemes that are closed to future accrual increased from 12% in 2006 to 39% in 2017. See PPF Purple Book fig 3.2 Distribution of schemes by scheme status and year, p11
4 Defined Benefit Pensions White Paper inquiry Q38 (Alan Rubenstein)
5 Written evidence from Barnett Waddingham LLP (CDC0032)
6 TPR Automatic enrolment declaration of compliance: monthly report June 2018
7 Q130 (Guy Opperman)
8 Written evidence from B&CE Ltd (CDC0041), Barnett Waddingham LLP (CDC0031)

individual savings vehicle rather than a pension.[9] When an individual decides to start drawing a retirement income they must identify a suitable retirement income product from a range of options. Those include:

- Annuity—an insurance product that offers the individual a guaranteed income, usually for the rest of their life.
- Drawdown—a product that enables the consumer to withdraw some income as cash while leaving the remainder invested in funds.

5. Individuals, many of whom will have been saving passively, can find making an appropriate choice of retirement income product difficult.[10] Drawdown options are currently twice as popular as annuities.[11] Annuities have offered poor value in recent years given low interest rates. The regular income generated is also dependent on the value of the pot at the point of purchase, which can leave it at the whim of market conditions.[12] Drawdown may provide higher total returns and the pot remains invested, meaning it is less dependent on market conditions at a single point in time. But the individual bears ongoing investment risk and could exhaust their pot, particularly if they live longer than they expect (this is known as longevity risk). Research suggests that a high proportion of DC savers aspire to a predictable, regular income in retirement—one survey found that over two-thirds of DC savers counted themselves as either "certainty seekers" or "steady spenders"—without having to manage risk on an individual basis.[13]

Collective defined contribution pensions

6. The UK pension system is therefore polarised between declining DB schemes underwritten by employers and offering guaranteed regular incomes, and growing numbers of individual DC savings pots subject to risk and uncertainty.[14] It is in the context of these challenges that we decided to examine collective defined contribution (CDC) pensions.

7. CDC pensions, which are not yet available in the UK, have received increasing interest as a means of retaining some of the benefits of DB and DC pensions while addressing some of the problems of each. The term CDC has been applied to a variety of existing and theoretical schemes with different characteristics.[15] Their shared fundamental features are:

- **Collective**: the risks that arise in any pension scheme (longevity, investment and inflation risk) are shared collectively among the scheme's members rather than being borne individually.

9 Q27 (Hilary Salt); Barnett Waddingham LLP (CDC0032)

10 Written evidence from B&CE Ltd (CDC0041) and Unite the Union (CDC0006). The reports published as part of our Pension Freedom and Choice inquiry contained recommendations aimed at ensuring that DC savers are equipped to make well-informed choices and are well served by the pensions marketplace.

11 Financial Conduct Authority (FCA), Retirement Outcomes Review Interim Report, July 2017, para 1.7

12 TUC blog (30 Oct 2017) "Workers must be protected from pension roulette, says TUC"; TUC blog (14 Nov 2017) "Pensions: the retirement lottery"

13 Aon (Dec 2014) In a brave new pensions world what will DC members really want? Aon DC Member survey. Cited in written evidence from Royal Mail Group (CDC0033) Also written evidence from TUC (CDC0019) and Unite the Union (CDC0006).

14 Written evidence from First Actuarial (CDC0018), KPMG LLP (CDC0016)

15 Written evidence from First Actuarial (CDC0018)

- **Defined contribution**: the respective contributions of employee and employer are defined in advance, with no ongoing liability to pay more to cover deficits.

CDC offers a target benefit rather than a promised benefit. The primary tool for addressing underfunding of the pension target is through reducing the benefits (through lower indexation or cutting pensions in payment) to ensure that the scheme's assets and liabilities remain aligned. As a result, risk is borne by the scheme's members without recourse to an external sponsor.[16]

International context

8. CDC schemes are a major part of the pensions landscape in the Netherlands and Denmark.

- **The Netherlands**: has around 260 CDC pension schemes, including 183 company pension funds, 58 industry-wide funds and 9 occupational funds.[17] Dutch pension schemes are characterised as CDC in that the contribution rate is fixed and the benefit is variable. Participation is effectively mandatory, meaning that around 95% of employees are members. Schemes are regulated by the Dutch central bank (De Nederlandsche Bank) which requires schemes to adopt a recovery plan (involving benefit reduction or deferral of indexation) if funding drops below 105% of target benefits.[18]

- **Denmark**: has a statutory pension fund, ATP (Arbejdsmarkedets Tillægspension, or "labour market supplementary pension"), which was created in 1964 to provide an earnings-related CDC-style pension to supplement the state pension.[19] Employers and employees make flat-rate contributions to ATP on a 2-to-1 ratio.[20] Enrolment is compulsory for all employees in Denmark. The ATP and state pension combined provide 80% of the total retirement income of Danish pensioners.[21] Employees are also typically enrolled in quasi-mandatory sector-wide pension arrangements.

The two countries are widely recognised as having among the best pension systems in the world.[22]

16 Vews differ as to whether CDC can be classed as a form of "defined ambition" scheme [eg KPMG CDC0016], in that it aims to pay out a target benefit but with no guarantee, or whether the two terms are mutually exclusive: The Pension Schemes 2015 Act categorises "defined ambition" as synonymous with "shared risk" schemes which share risk between members, sponsoring employers and potentially third parties. For the purposes of this report, and in line with the 2015 Act, the term "defined ambition" is not applied to CDC, as CDC involves risk-sharing among scheme members only.

17 De Nederlandsche Bank pensions statistics accessed June 2018

18 Pension reforms in the Netherlands this millennium; from DB via CDC to DC? Presentation by Bastiaan Starink (Tilburg University, Netspar and PwC) to Pensions Workshop at Cass Business School, 9 April 2018

19 InDepth: collective DC in action, David Rowley, PensionsExpert 3 April 2012

20 ATP contribution rates 2016–2018 from virk.dk website, accessed June 2018

21 "Around ATP Livslang Pension," atp.dk website, accessed June 2018

22 The most prominent global ranking of national pension systems, the Melbourne Mercer Global Pension Index, has placed Denmark and the Netherlands first and second in the last three editions (2015 to 2017). Both countries scored an 'A' grade in 2015 and 2016, meaning a "first class and robust retirement income system that delivers good benefits, is sustainable and has a high level of integrity." Denmark and the Netherlands also rank 2nd and 4th in the 2016 Allianz Pension Sustainability Index.

2 Arguments for and against CDC

9. In this chapter we examine the merits of enabling CDC pensions in the UK. We consider:

- the potential benefits for scheme members, employers and the wider economy; and
- whether CDC can be incorporated coherently into the UK pensions system.

Potential benefits

Benefits for members

10. Proponents of CDC argue that it can deliver higher retirement incomes for the same level of contributions as individual DC. The main reasons why CDC may produce better pensions are:[23]

- **Longevity pooling**: individuals cannot accurately predict how long they will live. Left to manage their own retirement funds, they must effectively act as amateur actuaries on their own behalf and are at risk of underspending (dying with funds unused) or overspending (running out of money). Pooling enables the efficient collective management of this risk, harnessing the "magic of averages" to pay a lifelong income to all members.[24] In this way, CDC mimics the key benefit of an annuity—the assurance of a regular income for life—without the cost of covering the insurer's capital buffer and profit margin.[25]
- **Investment outlook:** CDC investment strategy can be longer term and less defensive than in standard DC saving. A DC pension pot is typically de-risked (by shifting investment from riskier equities to safer bonds) in the years leading up to retirement.[26] This is to protect the individual against the risk of a sudden fall in their pot value at the point of retirement. CDC, however, can keep funds collectively invested in a balanced, return-seeking portfolio of assets for the long term.[27]

Removing the need to purchase a separate retirement income product may also reduce cost leakage to third-party providers and advisors.[28]

11. Various studies have attempted to model the potential benefits of CDC for scheme members. In 2013, Aon, an insurance company, found that the median outcome for CDC savers was one-third better (a pension of 28% of final salary compared to 21%) compared

23 For example, written evidence from RSA (CDC0009) and Philip Bennett (CDC0043)
24 HC Deb 25 May 1911 vol 26 col 509 [Winston Churchill, 2nd Reading of the National Insurance Bill 1911]
25 As mentioned by Willis Towers Watson (CDC0040) inter alia
26 Written evidence from Pensions Management Institute (CDC0008)
27 Written evidence from KPMG LLP (CDC0016) para 9.6, First Actuarial (CDC0018) Barnett Waddingham LLP (CDC0031) para 8, Philip Bennett (CDC0043) para 3.4,
28 Written evidence from Mark Rowlinson (CDC0039), Barnett Waddingham (CDC0031) para 9, and the Association of Member Nominated Trustees (CDC0032)

to individual DC pots that were de-risked and then invested in an annuity.[29] Other studies have showed improvements of similar magnitude: a 2009 Government Actuary's Department (GAD) study found that the median improvement in outcome offered by CDC "is as high as 39% for some members."[30] A 2012 paper by the Royal Society of Arts (RSA) indicated a 37% boost to outcomes through CDC.[31]

12. Those studies were all carried out before the pension freedoms reforms and assumed the saver would purchase an annuity at retirement. Since 2015, individuals have had greater freedom to choose drawdown or withdraw cash instead. Reflecting the new policy context, the Department for Work and Pensions (DWP) commissioned a study by the Pensions Policy Institute (PPI) which compared a CDC scheme similar to that modelled by Aon with various individual DC alternatives. This study found that CDC outperformed individual DC in terms of average income replacement rate in almost all the modelled scenarios. Outcomes for an individual DC pensioner adopting an "aggressive" drawdown approach of withdrawing 7% of their pot each year compared favourably with CDC at the outset, but carried a heightened risk of funds running out before death.[32]

13. CDC also promises less volatile outcomes between cohorts of members compared to individual DC. Even with de-risking investment strategies, the pots available to individuals in DC are dependent on highly unpredictable market performance in the period leading up to retirement. Market volatility can lead to very different outcomes for individuals with otherwise identical circumstances retiring only a few years apart.[33] The 2013 Aon study showed pensions for individual DC savers ranged from around 10% to 60% of pre-retirement income depending the year in which they happened to retire.[34] CDC, by contrast, delivered smoother, less volatile outcomes for successive cohorts of pensioners.[35] This greater predictability may well be considered both more desirable and more equitable by savers.[36]

29 Aon (Nov 2013) The Case for Collective DC: A new opportunity for UK pensions; also cited in RSA (Nov 2013) Collective Pensions in the UK II: Now is the time to act. Aon modelled successive cohorts of pensioners who had contributed 10% of pay over 25 years, over a 57-year timescale.

30 Government Actuary's Department (GAD, Dec 2009) Modelling Collective Defined Contribution Schemes: a summary of The Government Actuary's Department modelling of collective defined contribution schemes

31 RSA (July 2012) Collective Pensions in the UK

32 Pensions Policy Institute (PPI, Nov 2015) Modelling Collective Defined Contribution Schemes

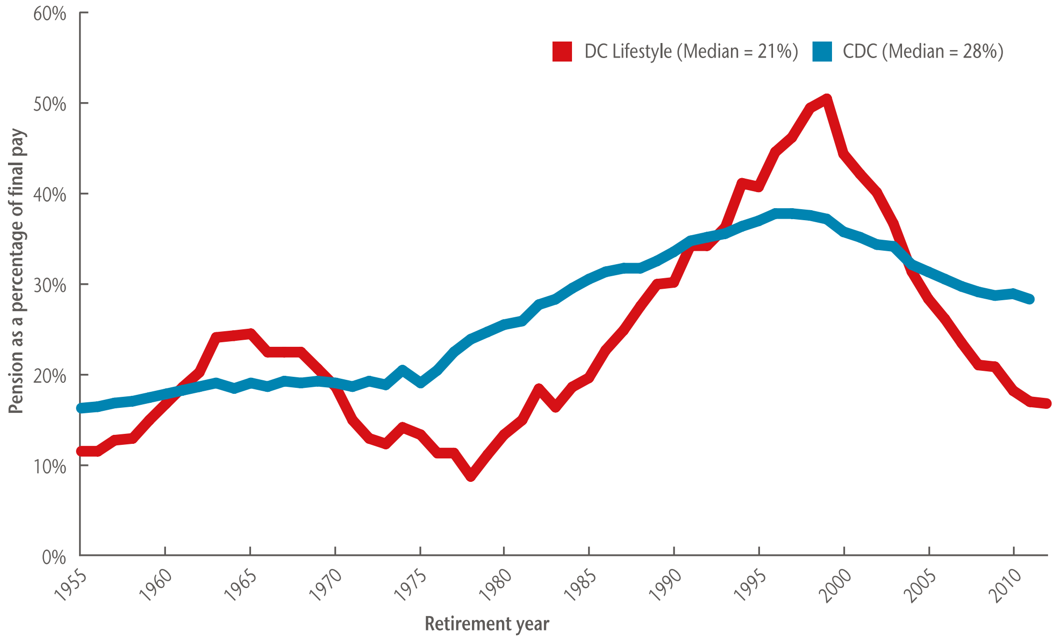
33 Written evidence from Willis Towers Watson (CDC0040) para 24; the TUC (CDC0019)

34 Written evidence from Barnett Waddingham LLP (CDC0031)

35 The PPI and GAD studies made similar findings.

36 Written evidence from Willis Tower Watson (CDC0040) paras 24–26; B&CE Ltd (CDC0041)

Figure 1: Aon modelling indicated that CDC could deliver less volatility and a better median outcome than individual DC



Source: Aon (2013), Collective defined contribution plans - a new opportunity for UK pensions?

14. The analyses cited above are based on assumption-based modelling rather than real world data.[37] The Pensions and Lifetime Savings Association (PLSA), an industry body and NEST, a major DC scheme set up by the Government, both told us that real-world CDC schemes tend to invest more cautiously than assumed in theoretical modelling. They argued that large-scale DC schemes can enjoy similar investment benefits to CDC.[38] Capital Cranfield, a professional trustee and governance firm, said however that:

> even if CDC does not offer significantly better benefits than DC it is unlikely to result in worse benefits overall and is therefore definitely worth considering further.[39]

Benefits for employers

15. The decline of DB pension schemes primarily reflects desire among employers to reduce their pension costs and potential liabilities.[40] These costs can be very substantial. In the year to 31 March 2018, defined benefit scheme sponsors made £13.5 billion in special payments in addition to their regular annual contributions.[41] As the risk of a CDC scheme being underfunded falls on scheme members rather than a sponsoring company, CDC carries the same benefit to employers as standard DC.

16. We heard that there are other potential benefits of CDC for employers:

37 Written evidence from Michael Johnson (CDC0044)
38 Written evidence from the Pensions and Lifetime Savings Association (CDC0017) and NEST (CDC0015)
39 Written evidence from Capital Cranfield Pension Trustees (CDC0007)
40 Written evidence from Philip Bennett (CDC0043)
41 ONS Investment by insurance companies, pension funds and trusts (MQ5), table 4.3 Self-administered pension funds income and expenditure (21 June 2018 release)

- Offering an attractive pension package may help them recruit and retain employees. APG Group, a major pension administrator and fund manager in the Netherlands, said research suggests that workers who can look forward to "more secure" retirement benefits may be more productive.[42]
- By providing greater predictability of outcomes compared with DC, CDC may reduce the likelihood of people needing to work beyond their preferred retirement date. This was identified as a risk to both savers and employers, with small and medium-sized businesses particularly concerned.[43]
- Employers may see it as their duty to help their employees achieve a decent pension.[44]

Benefits for the wider economy

17. We also heard that CDC may bring investment benefits to the wider economy. The long-term investment horizon and size of potential CDC schemes could enable them to invest in long-term assets. These might include providing capital for infrastructure projects or investing in innovative firms.[45] In turn, this could increase the productive capacity of the economy. The RSA pointed to the "much larger allocation to infrastructure of Dutch pension funds" compared with their UK counterparts.[46] Such benefits would be in keeping with the Government's desire to increase the supply of "patient capital" to the economy.[47]

Coherence with the UK pension system

Is it compatible with pension freedoms?

18. Several witnesses questioned whether the collective pooling of savings and risk characteristic in CDC was compatible with pension freedoms.[48] The Association of British Insurers (ABI), an industry body that represents annuity and drawdown providers, said that CDC may be seen as "a backward step" by "savers who value the flexibility of DC and are coming round to the idea of owning their own pension".[49]

19. In theory, individual CDC members could have rights to their own distinct pension within the scheme, which they could transfer out if they chose. This could increase the likelihood of selection bias in scheme membership: members who expect to die young would have an incentive to transfer out of the CDC scheme, leaving the membership

42 Written evidence from APG (CDC0010)
43 Written evidence from Philip Bennett (CDC0043) para 2.4, Association of Consulting Actuaries (CDC0027), B&CE Ltd (CDC0041), Q28 (Hilary Salt)
44 Written evidence from Communication Workers' Union (CDC0023)
45 Written evidence from the Department for Work and Pensions (CDC0029), PLSA (CDC0017), the Pensions Institute at Cass Business School (CDC0014, APG (CDC0010), Mark Rowlinson (CDC0039), Association of Member Nominated Trustees (CDC0032), TUC (CDC0019)
46 Written evidence from the RSA (CDC0009)
47 HM Treasury, Autumn Budget 2017 HC 587 (2017–19) page 49 box 4.1
48 Written evidence from NOW:Pensions (CDC0025); the Pensions Institute at Cass Business School (CDC0014) para 7
49 Written evidence from the Association of British Insurers (CDC0038) para 22

skewed towards people with long life expectancies, who are expensive to the scheme.[50] Some of the benefits of longevity pooling, which are greatest when there is a diversity of life expectancies in the pool, are lost.[51] Furthermore, CDC schemes would have to incorporate demand for transfers out into their approach to their funding position and investment strategy.[52] For example, they would need to hold sufficient liquid assets to accommodate possible transfers out.[53] The PLSA said that, while CDC could fit within the broader setting of pension freedoms, it would be "an imperfect match".[54]

20. It is already the case, however, that members of DB pension schemes—further removed from DC than CDC—can transfer their pensions out. The Communication Workers Union (CWU) told us there was "ample scope" for incorporating flexibility and freedom in CDC.[55] Kevin Wesbroom**,** consulting actuary at Aon, told us that transfer values could be calculated, "balancing the interests of the member who is leaving with the members who are remaining".[56] Indeed, it is conceivable that savers seeking a regular income in retirement could be allowed to transfer in to a CDC scheme.[57] Rather than being incompatible with pension freedoms, CDC is arguably completely consistent with it—it is an attractive choice for people seeking a regular pension in a low interest era in which DB pensions are in decline. Philip Bennett, a former partner at law firm Slaughter and May and an expert on CDC, said that CDC "enhances individual freedom and choice by providing an additional way of providing retirement income for individuals".[58]

Is CDC too confusing?

21. We heard concerns that introducing CDC would "create more complexity in an already complex market".[59] These focused on concerns that members would fail to understand that they, rather than their employer, bore the funding risk in CDC and would feel cheated if they faced reductions in indexation or pensions in payment. This could result in loss of trust in the system.[60]

22. The highest profile example of CDC schemes having to scale back their payments to pensioners was in the Netherlands, where scheme funding levels were severely affected by the 2008–09 financial crisis and subsequent recession. Having had no previous experience of cuts to their pension entitlements, members had come to see them as guaranteed and viewed the cuts with "considerable understandable dissatisfaction".[61] Despite the severity of the financial downturn, however, the reductions were relatively limited. Fewer than a quarter of schemes with recovery plans applied reductions, and the average reduction in these schemes was 1.9% in 2013 and 0.8% in 2014.[62] Those reductions compare favourably

50 People who know they have short life expectancies may of course choose not to join a CDC scheme in the first place.
51 Written evidence from the Association of British Insurers (CDC0038) para 19
52 Written evidence from Willis Towers Watson (CDC0040)
53 Written evidence from the Society of Pension Professionals (CDC0026)
54 Written evidence from the Pension and Lifetime Savings Association (CDC0017)
55 Written evidence from the Communication Workers' Union (CDC0023) para 26. See also written evidence from Philip Bennett (CDC0043).
56 Q74 (Kevin Wesbroom)
57 Q75 (Kevin Wesbroom), written evidence from PIMFA (CDC0028)
58 Written evidence from Philip Bennett (CDC0043) para 2.9
59 Written evidence from Association of British Insurers (CDC0038)
60 Written evidence from Hargreaves Lansdown (CDC0002), Pension and Lifetime Savings Association (CDC0017)
61 Written evidence from the RSA (CDC0009)
62 DNB assesses pension funds' recovery plan evaluations, De Nederlandsche Bank (DNB) press release, 25 April 2013; DNB completes its assessment of pension funds' recovery plan evaluations, DNB press release 1 May 2014

with changes in the cost of buying an annuity over the same period, and, unlike a fixed-income annuity, a reduced CDC income can be increased if economic conditions improve.[63] The reductions in the Netherlands also compare favourably with those for UK DB schemes that fall into the PPF, in which members not yet of pension age face 10% cuts to their starting entitlement.[64]

23. Other witnesses told us that CDC could alleviate existing complexity around pensions.[65] While many savers have welcomed the opportunity to consider the range of drawdown and cash withdrawal options at retirement, for others the decision is confusing and risky.[66] The Trades Union Congress (TUC) said that, given the pension options currently on offer "are not well understood" by many savers, CDC would "reduce current complexity".[67] The Association of Member-Nominated Trustees suggested that arguments that CDC would add unhelpful complexity to the system may come from "from people who are well served by providing the status quo".[68]

24. Crucially, CDC would combine the accumulation (saving) and decumulation (income) phases of a pension, providing both a savings vehicle and a regular retirement income.[69] In our report on pension freedoms, we argued that philosophical coherence in pensions policy would mean giving savers a simple, default decumulation option on retirement consistent with default accumulation in automatic enrolment.[70] The RSA told us that by meeting the "acute need" for such a default, CDC would serve as a "perfect complement" to pension freedoms.[71] The CWU said that the prospect of a clear target income in CDC would enable scheme members to plan better for the future and would increase confidence in saving.[72] The PLSA welcomed "the unambiguous focus that CDC places on the provision of an income"[73] which research has found is the priority consideration for savers accessing the pension freedoms.[74]

Why now?

25. Notwithstanding the potential advantages of CDC, we considered whether it was the right time to enable its introduction given major pension reforms such as automatic enrolment are still bedding in.[75] The Minister told us that the focus of the DWP "is on accumulation" and that decisions about decumulation, "of which CDC may be a part", are for a future date.[76] The saving and income phases of a pension are, however, mutually dependent. The CWU said that the prospect of a regular and predictable income through

63 Written evidence from Association of Member Nominated Trustees (CDC0032) and Barnett Waddingham LLP (CDC0031)
64 Pension Protection Fund website - Compensation (accessed June 2018)
65 Written evidence from B&CE Ltd (CDC0041), the RSA (CDC0009), Royal Mail Group (CDC0033), Redington (CDC0030), Association of Member Nominated Trustees (CDC0032)
66 Written evidence from Royal Mail Group (CDC0033) and the Communication Workers' Union (CDC0023)
67 Written evidence from the Trades Union Congress (CDC0019)
68 Written evidence from the Association of Member-Nominated Trustees (CDC0032)
69 Written evidence from the Trades Union Congress (CDC0019)
70 Work and Pensions Committee, Ninth Report of Session 2017–19, Pension Freedoms, HC 917, paras 11 and 22
71 Written evidence from the RSA (CDC0009)
72 Written evidence from the Communication Workers' Union (CDC0023)
73 Written evidence from the Pensions and Lifetime Savings Association (CDC0017); see also written evidence from Philip Bennett (CDC0043) para 3.2.
74 NAPF (Aug 2015) Pension Freedoms: Breaking the deadlock Understanding Retirement: Wave II Interim Report
75 Written evidence from the Association of British Insurers (CDC0038) para 25, Now:Pensions (CDC0025)
76 Q131 (Guy Opperman MP)

CDC could increase confidence in saving.[77] Rather than undermine the accumulation of pension savings, the introduction of desirable pension income options could promote greater participation.

Is CDC counter-cultural?

26. KPMG, a professional services firm, cautioned that the success of CDC in other countries "is as dependent on the social and labour market context in those countries as much as their legal and regulatory framework".[78] The Association of Consulting Actuaries echoed this, arguing that there is "no tradition in the UK of risk-sharing between pension scheme members" and that UK culture favoured "personal choice over social provision".[79] NOW:Pensions is a DC pension provider in the UK, but its Danish parent company ATP provides CDC pensions to nearly 5 million Danes. NOW:Pensions highlighted numerous cultural and structural differences between the UK and countries where CDC has been successful:

> Denmark and the Netherlands are both highly unionised countries, and have had mandatory or quasi-mandatory pension saving, with high levels of contributions, for many years. Crucially, they also already have big CDC arrangements in place. The UK on the other hand has a more fragmented workforce.[80]

27. While the UK does not have a history of CDC, it does have a tradition of collective pensions in the form of DB. DB schemes are relatively concentrated in longstanding companies with higher rates of unionisation. CDC in the UK may well be particularly attractive to large employers, especially those looking to close their DB schemes and find for their workers superior pension provision to individual DC.[81] We therefore considered whether there is evidence of demand for CDC.

Is there demand for CDC?

28. The Confederation of British Industry (CBI) told us:

> whilst the potential benefits of CDC pensions are evident, so too are the potential risks and there is not yet a clear picture of the appetite amongst employers to offer such schemes.[82]

The RSA told us, however, that "big companies, especially those closing DB plans […] have lobbied for change behind the scenes."[83] The Society of Pension Professionals told us that when the Pensions Act 2015 was under consideration there were around 10–20 large employers "with a serious interest in developing this type of provision".[84]

77 Written evidence from the Communication Workers' Union (CDC0023) para 31. See also written evidence from the Trades Union Congress (CDC0019).
78 Written evidence from KPMG LLP (CDC0016)
79 Written evidence from the Association of Consulting Actuaries (CDC0027)
80 Written evidence from NOW:Pensions (CDC0025)
81 Written evidence from B&CE Ltd (CDC0041) ,Royal Mail Group (CDC0033)
82 Written evidence from the CBI (CDC0024)
83 Written evidence from the RSA (CDC0009)
84 Written evidence from the Society of Pension Professionals (CDC0026)

29. Soon after we launched our inquiry, Royal Mail became the UK first company to commit itself publicly to CDC pensions. Royal Mail told us that, for industrial relations reasons, it had been unable to declare its interest in CDC sooner. Closing DB schemes was "very sensitive" and companies would risk "worrying their workforce" if they speculated about potential replacements. Royal Mail said that they believed there would be other companies privately considering CDC and that the absence of public expressions of interest should not be interpreted as indicating an absence of "significant latent demand" from businesses.[85]

30. We heard that there is also interest in CDC from pension schemes. The RSA told us that in the lead-up to the Pension Schemes Act 2015 they "took a delegation of eight pension funds to see the Minister privately" to argue for the introduction of CDC".[86] The PLSA said that "a group of large schemes and master trusts that see the potential for pooled decumulation products", particularly as a potential replacement for annuities.[87] Philip Bennett concurred that CDC could be attractive to NEST and other large DC schemes".[88]

31. The full extent and nature of demand for CDC will only become apparent once the regulatory framework is established. It currently remains "largely a theoretical concept" for which it is difficult to gauge demand.[89] Robin Ellison, a pensions lawyer and trustee, suggested that "many employers are keen to explore [CDC] when made aware of the possibility" but that few employers have the resources to turn theoretical options into practical proposals.[90] Mark Rowlinson, an actuary, told us "if you build it, they will come".[91]

Conclusion

32. **Through the pooling of risk, CDC offers scheme members the potential for better pensions than from standard defined contribution saving. It may be particularly appealing to people who desire a regular and reliable income in retirement. For employers keen to offer their workers decent pensions but reluctant to take on large potential liabilities, CDC is an attractive alternative to defined benefit schemes. CDC would therefore be a good choice for some employers and some savers that addresses limitations in their current options. To offer more good choices is entirely consistent with pension freedoms.**

33. **While the Government has rightly emphasised, and succeeded in, ensuring more people save for retirement, that focus should not preclude enabling new models of pension provision. The job of selling the benefits of retirement saving is made easier if the saver has a desirable pension to look forward to.** Impetus for enabling CDC schemes in the UK has been increased by the agreement to seek to introduce one for Royal Mail. We consider the Royal Mail proposals in the next chapter.

85 Written evidence from Royal Mail Group (CDC0033)
86 Written evidence from the RSA (CDC0009)
87 Written evidence from the Pensions and Lifetime Savings Association (CDC0017)
88 Written evidence from Philip Bennett (CDC0043)
89 Written evidence from Willis Towers Watson (CDC0040)
90 "Pension innovations should be optional", Letter from Robin Ellison to the Financial Times, 8 May 2018
91 Written evidence from Mark Rowlinson (CDC0039)

3 Royal Mail agreement

34. The profile of CDC was raised significantly in February 2018 by a pioneering agreement between the Royal Mail and the Communication Workers' Union (CWU) to pursue the creation of a CDC scheme for all employees of the company. This first concrete proposal for a CDC scheme in the UK was devised as a way of resolving a dispute over the future of pension provision in the company. The two sides wrote to us jointly in January "to underline our shared commitment to delivering such a scheme" which they believe "will provide employees with significantly better benefit outcomes than a traditional DC scheme, without the Company having to bear the balance sheet risks associated with a DB scheme".[92]

Table 1: Timeline of events leading to Royal Mail CDC agreement

2008	Royal Mail Pension Plan (RMPP), a DB scheme, closed to new members. Existing members could continue to accrue pension rights.
1 Apr 2012	Responsibility for historic pension liabilities were transferred out of the RMPP to the Government. This left RMPP fully funded. Royal Mail Group had ongoing responsibility for benefits accrued in the scheme from this date.
Jan-Mar 2017	Royal Mail consulted RMPP members about the future of the scheme.
13 Apr 2017	Royal Mail announced its decision to close the RMPP in March 2018 due to unaffordability. All future accrual was to move to a DC plan.
Late Oct 2017	Royal Mail and the Communication Workers Union (CWU) began negotiations on pensions, pay and working conditions, mediated by Acas.
28 Nov 2017	The Acas mediator's report recommended both sides commit to pursuing the introduction of a single CDC pension scheme for all employees offering a target wage in retirement plus a defined benefit cash balance lump sum.
1 Feb 2018	Royal Mail and the CWU formally announced their agreement on the pensions deal.
31 Mar 2018	RMPP closes to new accruals, with an actuarial valuation surplus of £143 million.
1 Apr 2018	A new DB cash balance scheme is put in place as a transitional arrangement until the CDC scheme can be established.

Source: Royal Mail Pension Plan, Commons Library Briefing Paper, 18 July 2013; Royal Mail Plc annual reports

35. Royal Mail is one of the UK's largest employers, directly employing around 142,000 people.[93] Royal Mail's DB scheme, the Royal Mail Pension Plan (RMPP), was closed to new members in 2008 but remained open to new accruals for existing members. On 25 March 2018, there were 83,000 Royal Mail staff actively contributing to the RMPP, while 47,000 employees were contributing to a separate DC plan.[94] Though the RMPP was in surplus,[95] the company expected that surplus to be "exhausted during 2018" and for ongoing costs to be unaffordable.[96] The company announced in April 2017 that it would

92 Letter from Jon Millidge, Group HR Director, Royal Mail Group and Terry Pullinger, Deputy General Secretary (Postal), CWU to Chair, 31 January 2018

93 Written evidence from Royal Mail Group (CDC0033)

94 Royal Mail Plc Annual Report and Financial Statements 2017–18, page 120

95 The RMPP (plus a smaller scheme for senior managers) had a £1.1 billion surplus as at 31 March 2017, but annual additional costs were estimated to be £1.26 billion.

96 Royal Mail plc Annual Report and Financial Statements 2016–17 page 31

"regrettably" and "very reluctantly" close its DB scheme to all new accruals from 31 March 2018, to be succeeded by an improved DC plan.[97] The CWU, which told us DC schemes lead to "uncertain outcomes" and "do not provide a decent standard of living",[98] pledged "the strongest possible opposition" to Royal Mail's "inadequate" plan.[99] The disagreement raised the prospect of industrial action in defence of DB accrual, as has been seen in many other workplaces.[100]

36. In October 2017, the two sides began negotiations over pensions, pay and working conditions and practices, mediated by Professor Lynette Harris of the Advisory, Conciliation and Arbitration Service (Acas). The mediator's report in late November recommended that the two sides commit to pursuing the creation of a single CDC pension scheme offering a target pension in combination with a defined benefit cash lump sum. On 1 February 2018, the two sides publicly confirmed their commitment to work together towards this goal. The proposed CDC scheme will be available to all Royal Mail staff, not just those who were members of the RMPP. CWU members voted in favour of the deal by margin of 9 to 1.[101]

37. The proposal was positively received by the Government. The Minister told us that the Royal Mail and CWU "seem to be on the same page absolutely and as joined up as any employer and union organisation that we have seen for a very, very long time".[102] The partnership between company and union could potentially act as a model for other schemes. Royal Mail stressed the importance of unions in explaining and promoting CDC, saying that CDC may be "particularly well suited to workforces with a high level of union membership.[103] Unite, the UK's biggest trade union, said the Royal Mail scheme could be "a flagship demonstration of a better form of DC".[104]

38. A CDC scheme is not yet, however, possible under UK legislation. The Government has challenged Royal Mail to develop a proposal and set out how it could be achieved with minimal change to the current legislative framework.[105] Royal Mail sent a first draft proposal to the DWP on 9 March 2018.[106] The Minister told us that, as the discussions were still in the "very early stages", he could not "give any cast-iron guarantees". He made clear, however, that the Government was "minded to assist".[107] Ronan O'Connor, Deputy Director of Private Pensions at the DWP, said that any legislation introduced as a result would not be limited to the Royal Mail scheme.[108]

39. **Royal Mail Group and the Communication Workers Union are to be congratulated for their remarkable unity of purpose in pursuing a CDC scheme for all the company's employees. As well as a model of constructive industrial relations, Royal Mail could act as a model for new collective pension schemes. The Government is rightly seeking**

97 Written evidence from Royal Mail (CDC0033)
98 Written evidence from Communication Workers' Union (CDC0023)
99 "CWU condemns royal mail pension closure", CWU press release, 13 April 2017 and written evidence from Communication Workers Union (CDC0023)
100 Recent examples of strike action over private-sector DB pensions include the Universities Superannuation Scheme (USS), Capita and BMW.
101 CWU (28 Mar 2018), "CWU votes yes to pay and four pillars agreement"
102 Q138 (Guy Opperman MP)
103 Written evidence from Royal Mail Group (CDC0033)
104 Written evidence from Unite the Union (CDC0006)
105 Q121 (Ronan O'Connor)
106 Q109 (Ronan O'Connor)
107 Q110 (Guy Opperman MP)
108 Q117 (Ronan O'Connor)

to support the Royal Mail agreement and to future-proof its legislation to enable the introduction of CDC schemes at other companies. In doing so, it is opening the door for CDC to move from abstract idea to practical reality. In the next chapter we turn to the legislative change necessary to effect that change.

4 Legislative change

Current legislation

40. There are two mutually-exclusive types of private pension benefits in existing UK law:[109]

- **Money purchase**: benefits are limited to whatever the individual can purchase with their own accumulated assets, and cannot be in funding deficit. Standard DC schemes fall in this category.

- **Non-money-purchase**: benefits are underwritten by the employer, who must pay them if the scheme is insufficiently funded.[110] DB pensions fall in this category.

Under this binary system, a sponsoring employer must bear the funding risk of providing collective benefits. CDC schemes are therefore not currently possible in UK law.

Pension Schemes Act 2015

41. The Pension Schemes Act 2015 was intended to promote greater innovation in pension provision, including to "enable, encourage and foster risk-sharing models".[111] Part 1 of the 2015 Act breaks the existing DB-DC dichotomy by introducing a new third category of risk-bearing arrangement, "shared risk" (sometimes known as "defined ambition"). This allows for risk to be shared between members, sponsors and potentially third parties such as insurance companies. Part 2 of the Act allows risk-pooling between individual scheme members through the payment of "collective benefits", the value of which can vary. This legislation, which was passed with cross-party support, could incorporate CDC pensions. Sandeep Maudgil, a partner specialising in pensions at law firm Slaughter and May, described the 2015 Act as a "seriously well thought through piece of work".[112]

42. Though the 2015 Act appears to offer a ready-made solution for CDC, it has not yet been implemented. The provisions that would enable CDC are embedded in wider changes to the legislative framework for all private pensions. Commencement of the 2015 Act would therefore depend on a "wholesale rewriting of pensions legislation", through regulations to support all existing and new forms of pension provision envisaged by it.[113] In October 2015, the Government announced that the implementation of the 2015 Act would be postponed indefinitely to enable Government and the pensions industry to focus on other pension reforms.[114] This remains the Government's position.[115] The DWP said that to implement the 2015 Act now would be complex, time-consuming and disruptive to tens of thousands of other pension schemes.[116] This would be an "unacceptable" price for enabling CDC schemes, especially given the "uncertain demand" for them.[117]

109 Pension Schemes Act 1993 section 181B, as added by Pensions Act 2011 section 29(2)
110 Qq 15-16 (Sandeep Maudgil)
111 HC Deb 2 Sep 2014 col 195 [Steve Webb]
112 Q18 (Sandeep Maudgil)
113 Written evidence from the Department for Work and Pensions (CDC0029)
114 Lords Written statement HLWS238, 15 Oct 2015 on Priorities on pensions [Baroness Altmann, Minister of State for Pensions]
115 Written evidence from the Department for Work and Pensions (CDC0029)
116 Written evidence from the Department for Work and Pensions (CDC0029)
117 Written evidence from the Department for Work and Pensions (CDC0029)

Pensions Act 2011

43. An alternative to implementing the 2015 Act to enable CDC schemes is to redefine money purchase benefits. This is possible by regulations under section 32 of the Pensions Act 2011.[118] Philip Bennett said that the definition could be changed to accommodate schemes where target obligations to members are kept aligned with scheme assets through adjustments to benefits. He said this redefinition could be as simple as adding that members' money purchase benefits can derive indirectly, as well as directly, from assets built up.[119] This was, he said, "substantially more straightforward than seeking to implement the Pension Schemes Act 2015 provisions".[120] The RSA agreed that the Government could quickly enable CDC schemes by introducing regulations under the current framework.[121]

44. Changing the definition of money purchase benefits may have the added benefit of reassuring employers about CDC. The Government has confirmed that it views a CDC scheme as one in which risks are shared between members but not with other parties such as the employer.[122] However, employers may nevertheless be worried about the prospect of "legislative creep" whereby such a commitment is imposed on them in future if pensions fall short of targets.[123] The Society of Pension Professionals warned that legislation had converted DB pensions from "good faith" arrangements into hard guarantees and cautioned against similar "gold-plating" of CDC pensions.[124] The Institute and Faculty of Actuaries told us that giving employers reassurance that they will not face balance sheet liabilities was necessary to create early "buy-in" for CDC schemes.[125] Philip Bennett said that classifying CDC pensions "unambiguously" as money purchase benefits under the 2011 Act would give employers the assurance they need.[126]

Consultation

45. While redefining money purchase benefits is relatively straightforward, establishing the detailed regulatory framework for CDC schemes will require substantial supporting secondary legislation. Part 2 of the 2015 Act has 28 sections which provide a ready-made guide to the technical aspects of collective schemes that would need to be addressed in regulations.[127] The DWP grouped these aspects into ten key themes:

a) the parameters within which schemes would set target benefit levels, and how those benefits are accrued;

b) contributions to the scheme;

c) investments;

d) valuation;

118 Pensions Act 2011 section 32 - Powers to make further provision.
119 Q73 (Philip Bennett)
120 Written evidence from Philip Bennett (CDC0043) para 1.6
121 Written evidence from the RSA (CDC0009)
122 Written evidence from the Department for Work and Pensions (CDC0029)
123 Written evidence from Association of Consulting Actuaries (CDC0027), Mark Rowlinson (CDC0039), Association of British Insurers (CDC0038) para 26
124 Written evidence from the Society of Pension Professionals (CDC0026)
125 Written evidence from the Institute and Faculty of Actuaries (CDC0020)
126 Written evidence from Philip Bennett (CDC0043) para 1.6
127 Written evidence from Philip Bennett (CDC0043) para 1.2

e) policies for dealing with under- and over-funding;

f) purposes for which payments can be made out of the collective fund, for example to pay levies;

g) transfers into and out of a collective fund;

h) winding up of the scheme;

i) duties of trustees or managers, for example information, reporting and professional advice requirements; and

j) enforcement.[128]

The DWP estimated that "regulations this complicated and technical would require up to two years to develop, consult on and implement".[129] The Minister said he was conscious that "Royal Mail and CWU are keen to progress this" but that it was important to take time to consult as "there is always a law of unintended consequences by Government action".[130]

46. **While commencing the Pension Schemes Act 2015 would enable the creation of CDCs as part of a coherent and redesigned pensions landscape, it would be disruptive. Action under the 2015 Act is not necessary for CDC schemes to be introduced. *We recommend the Government use its existing powers under section 32 of the Pensions Act 2011 to amend the statutory definition of money purchase benefits to incorporate collective benefits. This would have the added benefit of reassuring employers that they will not subsequently be held liable for funding scheme deficits. We further recommend the Government consult on technical regulations addressing each of the areas identified in Part 2 of the 2015 Act, to a swift timetable set out in response to this report.*** In the remainder of this chapter, we consider some key priorities for the CDC regulations.

Priorities for the legislative framework

Benefit policy

47. Each CDC scheme will need rules governing the accrual and payment of benefits, including how benefits are adjusted in response to changes in the funding position. Given the fundamental importance of these rules, numerous respondents told us that there should be substantial prescription in the regulations, covering factors including:

- the funding levels within which schemes could operate before needing to adjust benefits;[131]
- the circumstances in which price indexation may be reduced or benefit amounts cut;[132]

128 Written evidence from the Department for Work and Pensions (CDC0029)
129 Written evidence from the Department for Work and Pensions (CDC0029)
130 Q127 (Guy Opperman MP)
131 Written evidence from B&CE Ltd (CDC0041), Trades Union Congress (CDC0019), Institute and Faculty of Actuaries (CDC0020)
132 Written evidence from the Communication Workers Union (CDC0023), paras 11 & 38

- how investment approaches should respond to changes in scheme demographics;[133]
- the frequency with which schemes would be required to update and report their scheme valuations, benefit adjustment policies and actuarial assumptions;[134] and
- transparency and non-discrimination in risk allocation between membership categories, particularly between current employees, former employee and pensioner members.[135]

Willis Towers Watson, a risk management consultancy, told us that discretion in setting these rules was desirable to suit individual schemes and circumstances.[136] The ABI cautioned that "too many options" would result in "complexity for members and significant communication challenges."[137] Attempts to consolidate smaller DB schemes to achieve economies of scale have been complicated by the enormous inconsistency between scheme rules.[138]

48. An important consequence of scheme rules will be how risk is shared between generations.[139] There is a danger that trustees could seek to protect pensions in payment at the expense of sustainable long-term funding, to the detriment of younger scheme members.[140] At the extremes, we heard concerns that CDC schemes would rely on successive generations of new members to support the entitlements of older members, an arrangement "suspiciously like a Ponzi scheme".[141] Any perception that CDC unfairly transfers resources between generations risks undermining the collective basis of CDC and the participation of younger workers.[142] This issue has become central to the pensions debate in the Netherlands. While some Dutch schemes chose to cut pensions in payment in response to post-recession funding difficulties—to the consternation of the pensioners affected—other schemes chose not to and were criticised just as much for transferring risk to the younger members.[143] The Dutch government has acknowledged that CDC schemes have rewarded age groups differently for the same contributions and is consequently examining options for reform of its pension system.[144]

49. We were told, however, that intergenerational transfers are not an inherent feature of CDC and that difficulties experienced by Dutch schemes can be learned from.[145] Options

133 Written evidence from B&CE Ltd (CDC0041)
134 Written evidence from B&CE Ltd (CDC0041), Unite the Union (CDC0006)
135 Written evidence from Mark Rowlinson (CDC0039), John Ralfe (CDC0042)
136 Written evidence from Willis Towers Watson (CDC0040) para 31.
137 Written evidence from the Association of British Insurers (CDC0038)
138 Work and Pensions Committee, Sixth Report of Session 2016–17 Defined Benefit Pension Schemes, HC 828, paras 33–34
139 Written evidence from Pensions Management Institute (CDC0008), Redington (CDC0030) para 13a, Association of Consulting Actuaries (CDC0027); Willis Towers Watson (CDC0040) para 30
140 Written evidence from NEST (CDC0016), PLSA (CDC0017)
141 Written evidence from John Ralfe (CDC0042)
142 Written evidence from the CBI (CDC0024)
143 Q70 (Kevin Wesbroom)
144 CPB Netherlands Bureau for Economic Policy Analysis (28 Oct 2013) Eindrapportage 'Voor- en nadelen van de doorsneesystematiek' (in Dutch); Doorsneesystematiek in pensioenen onder druk? CPB Policy Brief 2014/01, 15 Jan 2014 (in Dutch); Written evidence from John Ralfe (CDC0042); Pension reforms in the Netherlands this millennium; from DB via CDC to DC? Presentation by Bastiaan Starink (Tilburg University/Netspar/PwC) and Intergenerational Risk Sharing in Dutch Pension Plans Presentation by Ed Westerhout (Tilburg University/Netspar/CBP) to Pensions Workshop at Cass Business School, 9 April 2018
145 Written evidence from B&CE Ltd (CDC0041), Mark Rowlinson (CDC0039),

include linking accrual rates to age (with a higher accrual rate for younger members),[146] containing risk-sharing within distinct age cohorts,[147] or periodically adjusting the investment strategy to reflect changes in scheme demography.[148] Furthermore, intergenerational fairness in pensions is not an issue restricted to CDC. The UK private pension landscape already exhibits major intergenerational disparity—between older generations of private sector employees for whom generous DB pension provision is common and younger generations who are largely restricted to DC schemes.[149] Risk and reward could be more fairly shared between generations through the introduction of well-designed CDC schemes.

50. **The Dutch experience has demonstrated that intergenerational fairness is a major issue for CDC schemes. Adoption of CDC in the short term, and the avoidance of difficulties in the long term, will depend in part on the extent to which people perceive that they will be fairly rewarded for the contributions they make at every stage of their working life.** ***We recommend the Government consult on achieving fair intergenerational risk sharing through CDC scheme design, learning from the experience in the Netherlands. This should be part of a wider consultation on benefit adjustment and risk sharing policies in CDC schemes.***

Transfers

51. We were told that it would be perfectly possible for an individual member of a CDC scheme to receive a cash-equivalent transfer value (CETV) of their entitlements before retirement, calculated as a proportionate share of the collective assets, without causing detriment to those remaining in the scheme.[150] Views differ however as to whether members should be able to cash out of a CDC scheme when they have already entered the payment phase. Henry Tapper, a pensions expert, told us that his vision for CDC was “one where even if the target pension is in payment, people still have the right to take their money away”.[151] By contrast, Philip Bennett told us that allowing such transfers would compromise the longevity pooling which is central to the benefit offered by the CDC model.[152] This is because members who have short life expectancies, and therefore lower pension cost to the scheme, would have the greatest incentives to leave the scheme.

52. DB scheme members can choose to take a CETV before they begin drawing their pension, providing they have taken financial advice first.[153] In our report on the British Steel Pension Scheme, we highlighted concerns that members of that scheme were being encouraged to take decisions against their best interest by dubious advisers incentivised by contingent fee arrangements.[154] A decision to transfer out of CDC would be of similar complexity to the decision to transfer out of DB. This has led some to suggest that transfers

146 Written evidence from Philip Bennett (CDC0043) para 1.20, Barnett Waddingham (CDC0031) para 15
147 Written evidence from NEST (CDC0015)
148 Written evidence from Philip Bennett (CDC0043) para 1.5
149 Written evidence from First Actuarial LLP (CDC0018)
150 Written evidence from Philip Bennett (CDC0043)
151 Written evidence from Henry Tapper (CDC0001)
152 Written evidence from Philip Bennett (CDC0043) para 2.8
153 Advice must be taken before making transfers worth over £30,000. Pension Schemes Act 2015, section 48 and The Pension Schemes Act 2015 (Transitional Provisions and Appropriate Independent Advice) Regulations 2015 (SI 2015/742)
154 Work and Pensions Committee, Sixth Report of Session 2017–19 British Steel Pension Scheme, HC 828

out of CDC into individual DC could be subject to a similar advice requirement.[155] However, CDCs do not promise pensions of a set value and many of CDC's proponents envisage the freedom to transfer in during the accumulation phase, which would mean a transfer out would not be irreversible. Given the novelty of the CDC proposition, more work is needed to determine whether extra protection is warranted for members considering transfers out of CDC.

53. **There is a strong pension freedoms case for members of CDC schemes who are still saving for their pension to be able to transfer out into alternative pension arrangements. The case for allowing transfers out in the decumulation phase is far less clear-cut, as this could erode the longevity pooling benefits of this model. Regardless of the point at which members choose to transfer out, the choice to do so is a major one. There is a strong case for members to be obliged to take financial advice on a transfer on a basis that does not involve a contingent fee.**

54. ***We recommend that the Government consult on:***

- ***the appropriate methodology for calculating cash-equivalent transfer values for CDC scheme members in the accumulation stage;***
- ***whether CDC scheme members should be allowed to transfer out in the decumulation stage and, if so, what methodology should be used to calculate transfer values to balance individual rights against collective longevity pooling benefits; and***
- ***whether transfers out of CDC should be subject to a financial advice requirement above a certain threshold.***

Communication

55. Communication is a major challenge for the entire pensions industry. Given the novelty and potential complexity of CDC, there was a broad consensus from witnesses that transparency and effective communications were vital.[156] The ABI said that mistaking target pension rates as guarantees, and therefore not understanding that members bore funding risk, was "arguably the greatest risk of CDC".[157] Unite said that clear communications were particularly important when benefits are adjusted below target levels, to provide assurance that decisions were justified and equitable.[158]

56. **Clear and effective communication will be vital to the success of CDC. Members need to understand that CDC schemes offer a pension target, not a pension promise.** ***We recommend that all CDC schemes be required to publish their rules for calculating and distributing member benefits in a standardised format, provide data for the pensions dashboard—the planned new digital platform intended to show all an individual's pension entitlements in one place—and to report publicly their funding position and strategy at least annually.***

155 Written evidence from Philip Bennett (CDC0043) para 2.7; Willis Towers Watson (CDC0040) para 46, Association of British Insurers (CDC0038) para 23.

156 Written evidence from the Communication Workers' Union (CDC0023), Philip Bennett (CDC0043), B&CE Ltd (CDC0041), the Association of Consulting Actuaries (CDC0027), Q12 (Hilary Salt), Q70 (Kevin Wesbroom)

157 Written evidence from Association of British Insurers (CDC0038)

158 Written evidence from Unite (CDC0006)

Governance and regulation

57. CDC entails complex and potentially contentious decisions about benefit adjustments, risk-sharing and investment strategy, meaning that careful consideration needs to be given to the appropriate governance model for such schemes. The UK has two governance regimes for pension schemes:

- **Trust-based schemes**, in which a board of trustees acts on members' behalf in accordance with trust law and occupational pension law.[159] These schemes are regulated by the Pensions Regulator (TPR).
- **Contract-based schemes**, in which individual contracts between the pension provider and members are overseen by an independent governance committee. These schemes are regulated by the Financial Conduct Authority (FCA).[160]

58. We heard that either approach could be used to operate a CDC scheme.[161] There was, however, a strong feeling among respondents that, given the stewardship of such schemes will involve discretionary judgement in assessing the funding outlook and balancing the competing interests of members, the trust-based approach was appropriate for CDC.[162] Royal Mail envisaged that its own CDC scheme will operate under similar trust-based governance (and TPR regulation) as DB schemes.[163]

59. The trustee role is crucial but trustee readiness is an area of significant concern. DB trustees vary greatly in their capability and rely heavily on advice from external consultants. In the case of a new and untested pensions model such as CDC, the requisite experience and expertise will initially be in short supply. Kevin Wesbroom told us that "CDCs should have the highest quality of governance available."[164] Dr Alwin Oerlemans, of APG, told us that trustees in the Netherlands have to be approved by the regulator.[165]

60. **The CDC model entails complex and sensitive decisions about benefits. There is therefore a strong argument that all CDC schemes should be subject to fiduciary governance by a board of trustees answerable to their members. Given the new and challenging demands that CDC places on trustees and their advisers there is a case for more stringent qualification requirements than currently exist.** ***We recommend that the Government consult on whether a specific qualification should be required for trustees of CDC schemes and their advisers. We further recommend that the Government consult on a framework to identify trustees who exemplify the very best practice in the emergent field of CDC pensions and to appoint these to an advisory panel of 'super-trustees' tasked with playing a capacity-building and trouble-shooting role among the broader trustee community.***

159 The Pensions Act 1995 and the Pensions Act 2004 together set out the specific duties of pension scheme trustees including the knowledge and understanding required of trustees, and the rules for appointing and removing trustees. The Pension Schemes Act 2017 makes specific provision for DC mastertrusts.
160 FCA/TPR (19 Mar 2018) Regulating the pensions and retirement income sector: our strategic approach
161 Written evidence from Institute of Faculty of Actuaries (CDC0020)
162 Written evidence from B&CE Ltd (CDC0041)
163 Written evidence from Royal Mail Group (CDC0033) para. 22
164 Q100 (Kevin Wesbroom)
165 Q96 (Dr Alwin Oerlemans)

61. The adoption of a trust-based model would place CDC schemes firmly within the remit of TPR, which already regulates DB pension schemes and multi-employer DC schemes (known as master trusts).[166] Aon told us that it would expect TPR to be able to intervene in CDC schemes if plans set by trustees were inappropriate.[167] Redington, an investment consultant to pension funds, told us that TPR should have "veto powers over target and pension in payment policies".[168] The Minister said that the Government was considering an authorisation regime for CDC schemes as part of discussions around Royal Mail's plans.[169] We were told that the regulatory framework for DC master trusts set out in the Pension Schemes Act 2017, which requires schemes to be authorised by TPR, would be suited to CDC.[170]

62. Regulation, supervision and authorisation of CDC schemes would be a further addition to the workload of TPR, which we have criticised as being timid and ineffectual in its regulation of DB schemes.[171] This raises the question of TPR's ability to oversee a successful launch of CDC. Ronan O'Connor told us putting TPR in charge of an authorisation regime for CDC schemes made him "nervous" as it would "put a lot of reliance" on that organisation.[172] TPR has, however, been allocated substantially increased funding by the DWP.[173] CDC schemes can also be expected to supersede DB schemes as that sector continues to decline. TPR has committed to a programme of cultural change under which it expects to be stronger and faster in intervening in schemes to protect member interests.[174]

63. **The Pensions Regulator is already responsible for reviewing the actuarial valuations and funding plans of defined benefit pension schemes. It is also responsible for authorising and supervising defined contribution master trusts. Regulatory coherence demands that these responsibilities should extend to CDC schemes. This will, however, place additional demands on an organisation which has underperformed in its defined benefit responsibilities.** ***We recommend that the Government's consultation include an assessment of The Pensions Regulator's suitability and readiness to regulate CDC schemes in terms of its skills, staffing and resource levels and what enhancements may be needed in order for it to perform this new function effectively.*** **We will continue to monitor closely the performance of the Pensions Regulator as part of work to assess whether the current split regulatory regime for pensions best serves the interests of scheme members.**

166 Written evidence from B&CE Ltd (CDC0041), Unite the Union (CDC0006) and First Actuarial LLP (CDC0018). See also Aon (CDC0013) para 3.6.2
167 Written evidence from Aon (CDC0013) para 3.6.3
168 Written evidence from Redington (CDC0030)
169 Q126 (Guy Opperman MP)
170 Written evidence from Philip Bennett (CDC0043) and Pension and Lifetime Savings Association (CDC0017) Pensions Management Institute (CDC0008), KPMG (CDC0016), B&CE Ltd (CDC0041)
171 Business, Energy and Industrial Strategy and Work and Pensions Committees Second Joint report of Session 2017–19, Carillion, HC 769
172 Q126 (Ronan O'Connor)
173 TPR's 2018–19 budget is £88.66 million, an increase of £4.34 million (+5.15%) compared with full-year spend of £84.32 million in 2017–18. Source: The Pensions Regulator (TPR) Corporate Plan 2018–2021
174 The Pensions Regulator (TPR) Corporate Plan 2018–2021; Letter from Mark Boyle, Chair of the Pensions Regulator (TPR) to Work and Pensions and BEIS Committee Chairs relating to TPR corporate plan and Chief Executive, 8 June 2018

Industry and self-employment CDCs

64. The initial interest in CDC has, in Royal Mail, come from an individual major employer. As CDC schemes, unlike DB schemes, do not require a sponsor to underwrite past accruals, they do not require employer sponsors in the traditional sense.[175] This opens the way for considerable diversity in the provision of CDC schemes. These could include:

- multi-employer CDC schemes, potentially with industry-wide coverage;
- schemes for members of professional associations or affinity groups;
- schemes catering for people who are self-employed, have irregular working patterns or work in the gig economy;[176] and
- standalone schemes open to the public enabling people to purchase a CDC income with savings built up elsewhere.[177]

65. **These are early days for CDC in the UK. The initial impetus has come from a major employer and trade union seeking an alternative to traditional defined benefit and defined contribution arrangements respectively. But establishing CDC schemes in the UK opens the possibility of more diverse and ambitious provision of collective pensions. These could include industry or profession-wide schemes. CDC may also be an opportunity to provide more attractive pension options to self-employed people and gig economy workers. The Government should seek to encourage such innovation, and its great potential gains, in establishing a framework for a new wave of collective pensions.** ***We recommend that regulations governing CDC should accommodate mutual, multi-employer and standalone schemes.***

66. **In many matters individuals want as much freedom and choice as possible. In other areas they crave collective security, particularly when the choices they face are likely to affect their livelihood over many decades. CDC not only provides the best means that we have seen so far of reconciling these aspirations in the pensions arena but also holds out the promise of reviving and sustaining the provision of company pensions for generations to come, at a time when the defined benefit model is coming slowly and not so peacefully to its close. We urge the Government to build on its initiative with the Royal Mail pension scheme to bring about the next great pensions revolution in this country and restore the UK to being among the very best pension systems in the world.**

175 Written evidence from Con Keating (CDC0005)

176 Written evidence from Con Keating (CDC0005)

177 Written evidence from First Actuarial LLP (CDC0018)

Conclusions and recommendations

Arguments for and against CDC

1. Through the pooling of risk, CDC offers scheme members the potential for better pensions than from standard defined contribution saving. It may be particularly appealing to people who desire a regular and reliable income in retirement. For employers keen to offer their workers decent pensions but reluctant to take on large potential liabilities, CDC is an attractive alternative to defined benefit schemes. CDC would therefore be a good choice for some employers and some savers that addresses limitations in their current options. To offer more good choices is entirely consistent with pension freedoms. (Paragraph 32)

2. While the Government has rightly emphasised, and succeeded in, ensuring more people save for retirement, that focus should not preclude enabling new models of pension provision. The job of selling the benefits of retirement saving is made easier if the saver has a desirable pension to look forward to. (Paragraph 33)

Royal Mail agreement

3. Royal Mail Group and the Communication Workers Union are to be congratulated for their remarkable unity of purpose in pursuing a CDC scheme for all the company's employees. As well as a model of constructive industrial relations, Royal Mail could act as a model for new collective pension schemes. The Government is rightly seeking to support the Royal Mail agreement and to future-proof its legislation to enable the introduction of CDC schemes at other companies. In doing so, it is opening the door for CDC to move from abstract idea to practical reality. (Paragraph 39)

Legislative change

4. While commencing the Pension Schemes Act 2015 would enable the creation of CDCs as part of a coherent and redesigned pensions landscape, it would be disruptive. Action under the 2015 Act is not necessary for CDC schemes to be introduced. *We recommend the Government use its existing powers under section 32 of the Pensions Act 2011 to amend the statutory definition of money purchase benefits to incorporate collective benefits. This would have the added benefit of reassuring employers that they will not subsequently be held liable for funding scheme deficits. We further recommend the Government consult on technical regulations addressing each of the areas identified in Part 2 of the 2015 Act, to a swift timetable set out in response to this report.* (Paragraph 46)

5. The Dutch experience has demonstrated that intergenerational fairness is a major issue for CDC schemes. Adoption of CDC in the short term, and the avoidance of difficulties in the long term, will depend in part on the extent to which people perceive that they will be fairly rewarded for the contributions they make at every stage of their working life. *We recommend the Government consult on achieving*

fair intergenerational risk sharing through CDC scheme design, learning from the experience in the Netherlands. This should be part of a wider consultation on benefit adjustment and risk sharing policies in CDC schemes. (Paragraph 50)

6. There is a strong pension freedoms case for members of CDC schemes who are still saving for their pension to be able to transfer out into alternative pension arrangements. The case for allowing transfers out in the decumulation phase is far less clear-cut, as this could erode the longevity pooling benefits of this model. Regardless of the point at which members choose to transfer out, the choice to do so is a major one. There is a strong case for members to be obliged to take financial advice on a transfer on a basis that does not involve a contingent fee. (Paragraph 53)

7. *We recommend that the Government consult on*:

- *the appropriate methodology for calculating cash-equivalent transfer values for CDC scheme members in the accumulation stage*;
- *whether CDC scheme members should be allowed to transfer out in the decumulation stage and, if so, what methodology should be used to calculate transfer values to balance individual rights against collective longevity pooling benefits; and*
- *whether transfers out of CDC should be subject to a financial advice requirement above a certain threshold.* (Paragraph 54)

8. Clear and effective communication will be vital to the success of CDC. Members need to understand that CDC schemes offer a pension target, not a pension promise. *We recommend that all CDC schemes be required to publish their rules for calculating and distributing member benefits in a standardised format, provide data for the pensions dashboard—the planned new digital platform intended to show all an individual's pension entitlements in one place—and to report publicly their funding position and strategy at least annually.* (Paragraph 56)

9. The CDC model entails complex and sensitive decisions about benefits. There is therefore a strong argument that all CDC schemes should be subject to fiduciary governance by a board of trustees answerable to their members. Given the new and challenging demands that CDC places on trustees and their advisers there is a case for more stringent qualification requirements than currently exist. *We recommend that the Government consult on whether a specific qualification should be required for trustees of CDC schemes and their advisers. We further recommend that the Government consult on a framework to identify trustees who exemplify the very best practice in the emergent field of CDC pensions and to appoint these to an advisory panel of 'super-trustees' tasked with playing a capacity-building and trouble-shooting role among the broader trustee community.* (Paragraph 60)

10. The Pensions Regulator is already responsible for reviewing the actuarial valuations and funding plans of defined benefit pension schemes. It is also responsible for authorising and supervising defined contribution master trusts. Regulatory coherence demands that these responsibilities should extend to CDC schemes. This will, however, place additional demands on an organisation which has underperformed in its defined benefit responsibilities. *We recommend that*

the Government's consultation include an assessment of The Pensions Regulator's suitability and readiness to regulate CDC schemes in terms of its skills, staffing and resource levels and what enhancements may be needed in order for it to perform this new function effectively. We will continue to monitor closely the performance of the Pensions Regulator as part of work to assess whether the current split regulatory regime for pensions best serves the interests of scheme members. (Paragraph 63)

11. These are early days for CDC in the UK. The initial impetus has come from a major employer and trade union seeking an alternative to traditional defined benefit and defined contribution arrangements respectively. But establishing CDC schemes in the UK opens the possibility of more diverse and ambitious provision of collective pensions. These could include industry or profession-wide schemes. CDC may also be an opportunity to provide more attractive pension options to self-employed people and gig economy workers. The Government should seek to encourage such innovation, and its great potential gains, in establishing a framework for a new wave of collective pensions. *We recommend that regulations governing CDC should accommodate mutual, multi-employer and standalone schemes.* (Paragraph 65)

12. In many matters individuals want as much freedom and choice as possible. In other areas they crave collective security, particularly when the choices they face are likely to affect their livelihood over many decades. CDC not only provides the best means that we have seen so far of reconciling these aspirations in the pensions arena but also holds out the promise of reviving and sustaining the provision of company pensions for generations to come, at a time when the defined benefit model is coming slowly and not so peacefully to its close. We urge the Government to build on its initiative with the Royal Mail pension scheme to bring about the next great pensions revolution in this country and restore the UK to being among the very best pension systems in the world. (Paragraph 66)

Formal minutes

Wednesday 11 July 2018

Members present:

Rt Hon Frank Field, in the Chair

Heidi Allen	Ruth George
Alex Burghart	Steve McCabe
Neil Coyle	Chris Stephens

Draft report (*Collective defined contribution pensions*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.
Paragraphs 1 to 66 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Sixteenth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 18 July at 9:15

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Wednesday 21 February 2018	*Question number*
Nathan Long, Senior Pensions Analyst, Hargreaves Lansdown, **Sandeep Maudgil**, Partner, Slaughter and May, **David Pitt-Watson**, Executive Fellow, London Business School, and **Hilary Salt**, Senior Actuary, First Actuarial	Q1–36
Jon Millidge, Group HR Director, Royal Mail plc, and **Ray Ellis**, National Officer, Communication Workers Union	Q37–56

Wednesday 14 March 2018

Philip Bennett, former partner, Slaughter and May; **Dr Alwin Oerlemans**, Head of Pension Strategy, APG; **Janice Turner**, co-chair, Association of Member Nominated Trustees; and **Kevin Wesbroom**, Senior Partner, Aon	Q57–105
Guy Opperman, Minister for Pensions and Financial Inclusion, DWP; **Ronan O'Connor**, Deputy Director, Private Pensions Policy, DWP	Q106–152

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

INQ numbers are generated by the evidence processing system and so may not be complete.

1 Aon (CDC0013)

2 APG (CDC0010)

3 Assn of British Insurers (CDC0038)

4 Association of Consulting Actuaries (CDC0027)

5 Association of Member Nominated Trustees (AMNT) (CDC0032)

6 B&CE Ltd (CDC0041)

7 Barnett Waddingham LLP (CDC0031)

8 Capital Cranfield Pension Trustees Limited (CDC0007)

9 Cardano Risk Management Limited (CDC0012)

10 Cass Business School (CDC0014)

11 CBI (CDC0024)

12 Communication Workers Union (CDC0023)

13 Department for Work and Pensions (CDC0029)

14 First Actuarial LLP (CDC0018)

15 Hargreaves Lansdown (CDC0002)

16 Head of Research Con Keating (CDC0005)

17 Institute and Faculty of Actuaries (CDC0020)

18 James Franklin-Adams (CDC0036)

19 John Ralfe Consulting (CDC0042)

20 Kevin Wesbroom (CDC0045)

21 KPMG LLP (CDC0016)

22 Mark Rowlinson (CDC0039)

23 Michael Johnson (CDC0044)

24 Mr Henry Tapper (CDC0001)

25 NEST (CDC0015)

26 NOW: Pensions (CDC0025)

27 Pensions and Lifetime Savings Association (CDC0017)

28 Pensions Management Institute (CDC0008)

29 Pensions Policy Institute (CDC0011)

30 Philip Bennett (CDC0043)

31 PIMFA (CDC0028)

32 Principles For Responsible Investment (CDC0034)

33 Professor Michael Otsuka (CDC0004)

34 Redington (CDC0030)

35 Royal Mail Group (CDC0033)

36 RSA (Royal Society of Arts (CDC0009)

37 Secure Pension Solutions (CDC0037)

38 The Society of Pension Professionals (CDC0026)

39 Trades Union Congress (CDC0019)

40 Unite the Union (CDC0006)

41 Utrecht University (CDC0022)

42 Willis Towers Watson (CDC0040)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website.

Session 2017–19

First Report	Universal Credit: the six week wait	HC 336
Second Report	A framework for modern employment	HC 352
Third Report	Protecting pensions against scams: priorities for the Financial Guidance and Claims Bill	HC 404
Fourth Report	PIP and ESA assessments: claimant experiences	HC 355
Fifth Report	Universal Credit Project Assessment Reviews	HC 740
Sixth Report	British Steel Pension Scheme	HC 828
Seventh Report	PIP and ESA assessments	HC 829
Eighth Report	European Social Fund	HC 848
Ninth Report	Pensions freedoms	HC 917
Tenth Report	Assistive technology	HC 673
Eleventh Report	Universal Credit: supporting self-employment	HC 997
Twelfth Report	Carllion	HC 769
Fourteenth Report	Appointment of Professor Sir Ian Diamond as Chair of the Social Security Advisory Committee	HC 971
Fifteenth Report	The Motability Scheme	HC 847
First Special Report	Child Maintenance Service: Government's Response to the Committee's Fourteenth Report of Session 2016–17	HC 354
Second Special Report	Self-employment and the gig economy: Government Response to the Committee's Thirteenth Report of Session 2016–17	HC 644
Third Special Report	Disability employment gap: Government Response to the Committee's Seventh Report of Session 2016–17	HC 652
Fourth Special Report	Victims of modern slavery: Government Response to the Committee's Twelfth Report of Session 2016–17	HC 672
Fifth Special Report	Employment Opportunities for Young People: Government response to the Committee's Ninth Report of Session 2016–17	HC 872

Sixth Special Report	Protecting pensions against scams: priorities for the Financial Guidance and Claims Bill: Government Response to the Committee's Third Report	HC 858
Seventh Special Report	A framework for modern employment: Government response to the Second Report of the Work and Pensions Committee and First Report of the Business, Energy and Industrial Strategy Committee	HC 966
Eight Special Report	PIP and ESA assessments: Government Response to the Committee's Seventh Report	HC 986
Ninth Special Report	British Steel Pension Scheme: The Pensions Regulator Response to the Committee's Sixth Report	HC 987
Tenth Special Report	Pension freedoms: Government response to Committee's Ninth Report	HC 1231
Eleventh Special Report	Carillion: Responses from Interested Parties to the Twelfth Report	HC 1392