

Impact Assessment (consultation stage)	
Title of measure	Introduction of legislative framework for Collective Defined Contribution (CDC) occupational pension schemes
Lead Department/Agency	Department for Work and Pensions
Planned coming into force / implementation date	N/A
Origin (Domestic/EU/Regulator)	Domestic
Policy lead	Julian Barker
Lead analyst	Luke Montgomery
Departmental Assessment	Self-certified

Summary Intervention and impacts
<p><u>Policy Background</u></p> <p>The existing UK workplace pensions legislative framework is, broadly speaking, binary in nature with employers enabled to offer only Defined Benefit (DB) and Defined Contribution (DC) type occupational pension schemes. The two models place all the risks and associated costs – economic, financial, and longevity - with either the sponsoring employer (in case of DB) or the individual member (in case of DC). Following an engagement with representatives from the pensions industry, and in particular a case that Royal Mail has presented, Government believes creating an option for the pensions industry to offer Collective Defined Contribution (CDC) type occupational pensions could, in certain cases, be beneficial to sponsoring businesses and individuals. In CDC type schemes, these risks would be with the members but collectively shared between them.</p> <p><u>Rationale for intervention and intended effects</u></p> <p>The objective is to introduce more flexibility in occupational pension provision so that the pensions industry may offer a new type of occupational pension scheme that is:</p> <ul style="list-style-type: none"> • more sustainable for sponsoring businesses than a DB scheme; and • has the potential to give an income in retirement that is more predictable than is currently available to members of DC schemes who do not wish to purchase an annuity. <p>The rationale for intervention is to establish a secure regulatory framework within which the pensions industry can create CDC type pension schemes with adequate governance and safeguards in place for members and for employers.</p> <p><u>Viable policy options (including alternatives to regulation)</u></p> <p><u>Option 1: non-legislative:</u></p> <p>Legislation currently on the statute book is insufficiently clear on where CDC schemes fit into the current pensions framework. This lack of clarity means employers see a clear risk that they might be liable for any shortfall in the funding needed to pay for the target benefits if the legislation does not state otherwise. Employers will not want to commit to</p>

this new pension arrangement if there is such a risk. Therefore, non-legislative options are not viable in making clear where CDC schemes fit into the current pensions framework.

Option 2: do nothing.

Our engagement with the pensions industry demonstrates a strong demand for the legislative changes that would enable CDC type pension schemes to be created. Based on the evidence and discussions to date, we believe that a well-designed CDC has the potential to offer a more predictable income in retirement for scheme members¹ than for DC members who do not wish to purchase an annuity. It achieves this by pooling risks and smoothing pensions payments out (incl. softening the impacts of ‘bad’ economic times when investment returns are relatively very low) whilst being more sustainable to sponsoring employers than DB. Doing nothing would mean the opportunity foregone and less choice and flexibility for both employers and workers.

Option 3 (the proposed option): introduce a legislative framework for Collective Defined Contribution (CDC) pension schemes.

Introducing a legislative framework will enable the pensions industry to offer a new type of occupational pension. As set out above – based on the arguments and evidence presented to us – we believe that well-designed CDC has the potential to offer a more predictable income in retirement for scheme members than DC can offer for those who do not wish to purchase an annuity, whilst being more sustainable to sponsoring employers than DB.

Initial assessment of impact on business/ Description and scale of key costs and benefits by ‘main affected groups’

In gross terms, businesses that choose to set up a CDC scheme will incur familiarisation, implementation, and scheme running costs. However, offering a CDC scheme will be optional – i.e. the legislative changes will create an option, but will not mandate it. We expect that businesses will only choose to offer CDC type pension schemes if, on balance, it is more beneficial for them than their best alternative - i.e. the benefits outweigh the costs when compared against the counterfactual. On this basis the proposal is classed as zero net cost to businesses.

In general, on the basis that CDC will be optional we assess that net benefit to businesses will be either cost neutral or negative cost (i.e. beneficial). Where the counterfactual is DC, we do not envisage fundamental differences in direct costs to sponsoring businesses as in both DC and CDC all the risks and associated costs – economic, financial, and longevity - are with the members. However, CDC potentially offers more flexibility and stability for employees through shared risk. This might make CDC more attractive as part of an overall employee compensation package, and result in a more stable and motivated workforce.

Where the counterfactual is DB, savings to sponsoring businesses may be substantial. However, where DB commitments already exist they cannot be broken and CDC will not alter this at all; and with regard to new / future pensions offer – businesses already have an alternative (in the form of DC) and strong financial incentives to pursue it. Hence the DB

¹ Scheme member – a current or future pensioner.

counterfactual may only be applicable in a very limited and specific way - *see more detail / discussion in the Evidence Base section.*

At this stage there is a significant uncertainty over the full impacts of the proposal, as costs and benefits will be determined by the details to be set out in subsequent legislation. The Department for Work and Pensions (DWP) will produce a full assessment of the Equivalent Annual Net Direct Cost to Businesses (EANDCB) in an updated impact assessment at the legislation stage, following a consultation with the pensions industry on how the framework should be designed and implemented.

Departmental Policy signoff (SCS): Ronan O'Connor Date: 16/10/18

Economist signoff (senior analyst): Rhys Cockerell Date: 15/10/18

Better Regulation Unit signoff: Prabhavati Mistry

Supporting Evidence

1. The policy issue and rationale for Government intervention

The existing UK workplace pensions legislative framework is, broadly speaking, binary in nature with employers enabled to offer only Defined Benefit (DB) and Defined Contribution (DC) type schemes.

DB schemes offer greater certainty and predictability for income in retirement for employees, but place significant risks and costs on the sponsoring employer - economic, financial, and longevity. Conversely, DC schemes place similar risks and costs on the individual scheme member.

Following an engagement with representatives from the pensions industry, and in particular a case that Royal Mail has presented, Government believes creating an option for the pensions industry to offer Collective Defined Contribution (CDC) type pensions could, in certain cases, be beneficial to sponsoring businesses and individuals. In CDC type schemes, the risks would be with the members but shared between them collectively.

The objective is to introduce more flexibility in occupational pension provision so that the pensions industry may offer a new type of occupational pension scheme that is:

- more sustainable for sponsoring businesses than a DB scheme; and
- has the potential to give an income in retirement that is more predictable than is currently available to members of DC schemes who do not wish to purchase an annuity.

The rationale for intervention is to establish a secure regulatory framework within which the pensions industry can create CDC-type pension schemes with adequate governance and safeguards in place for members and for employers.

2. Preferred Option

Option 3 (the proposed option): introduce a legislative framework for Collective Defined Contribution (CDC) pension schemes.

Introducing a legislative framework will create a provision to enable the pensions industry to offer a new type of occupational pension. We believe that well-designed CDC has the potential to offer a more predictable income in retirement for scheme members than DC can offer through an annuity whilst being more sustainable to sponsoring employers than DB. Current legislation is insufficiently clear on where CDC schemes fit into the current pensions framework. This legislation will need to:

- Amend parts of the Pension Schemes Act 1993 to create a new sub-set of money purchase benefits which will allow pooled pension arrangements (collective benefit pension schemes), and to define the nature and quality features of schemes which can provide them. The current definition of money purchase benefits provides for individual rather than pooled accumulation.
- Provide powers to flesh out the technical aspects of the new regime, for example how schemes with pooled benefits should undertake valuations of their assets and liabilities.
- Provide powers to apply (with necessary modifications) existing pensions legislation to enable the Pensions Regulator to register and oversee pooled schemes.

In a CDC scheme, financial contributions are invested in a collective fund. When the member retires, they are paid a pension based on their share of that collective fund. The value of this pension will be based on the total value of the pot, and will increase or decrease according to changes in investment performance or other risk factors. For example, the scheme may target an annual pension equivalent to 1/80th of an individual's annual salary per year of employment increased according to the Retail Prices Index (RPI) – but this value may increase each year by more or less than RPI, or may in extremis decrease, depending on the value of the total pension fund and expectations of future investment returns, longevity and other relevant factors. So in essence a CDC scheme will have a target pensions level it will be aiming to pay their members out based on their contributions. However, unlike in DB that target is not a promise and can be increased or decreased depending on social and economic outcomes (mainly investment returns and longevity).

As discussed in the Government's white paper 'Protecting Defined Benefit Pensions'², DB schemes are relatively expensive for the sponsoring businesses to run. The vast majority (c 90%) of DB schemes are now closed to new members. DB pensions are being replaced with DC, where all the risk is concentrated with each individual member. DC schemes, which are gradually replacing DB, are more sustainable for the sponsoring employers but more risky and uncertain for the scheme members.

In CDC, the risks are placed with the members but unlike in DC they are pooled and shared among the members, thus allowing to smooth pensions provision out during different economic times. Also, CDC differs from the traditional DC schemes in that it does not produce an individual "pension pot", which members then have to decide how best to use for their retirement, but pays out a regular retirement income from the collective fund. Thus, whilst

² Available at: < <https://www.gov.uk/government/publications/protecting-defined-benefit-pension-schemes>>

members are expected to be able to transfer out their share of the fund at any point before they start drawing a target pension, CDC schemes take the big central decision of pension freedoms out of retirement planning, and also much of the risk as members who stay in the scheme can rely on a regular, if variable, income in retirement.

A high level comparison of CDC against the existing forms of occupational pensions – DB and DC – is presented in table 1 below.

Table 1. A high level comparison of CDC, DB, and DC key principles.

	DB	DC	CDC
Longevity risk	With the employer	With the members, individually	With the members, shared collectively
Investment risk	With the employer	With the members, individually	With the members, shared collectively
Pension level	Promised level ³	A function of individual pot and decumulation strategy	Target level ⁴

Any lack of clarity in the current legislation brings the risk that a future court might rule that what was thought to be a CDC was in fact DB. It is concerns about this point which has lead the DWP to believe that the 2015 Act cannot be relied upon by employers and that we need fresh primary legislation to make the employer’s lack of liability for deficits unambiguous.

3. Expected level of business impact

3.1 Costs to businesses

Collective pensions are, in a broad sense, not a completely new concept, to the pensions industry. For example, the Pension Schemes Act 2015 includes provisions for collective pensions (albeit not stand alone and designed to operate within the wider Defined Ambition framework⁵). Consequently, we assume that businesses have a basic understanding of the concept of collective occupational pensions in the baseline, and their initial screening costs are negligible.

Furthermore, offering a CDC scheme will be optional. In gross terms, businesses that choose to set up a CDC scheme will incur familiarisation, implementation, and scheme running costs. However, we expect that businesses will only choose to offer CDC type pension if, on balance, it is more beneficial for them than their best alternative (which is the counterfactual here;

³ Depends on salary and years of contribution only; does not depend on longevity outcomes and investment returns.

⁴ Not a promise, actual pensions can be higher or lower depending on investment and longevity outcomes.

⁵ CDCs are one type of a Defined Ambition (DA) pension scheme. For more information on DA, see: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/323219/rr866-defined-ambition-consumer-perspectives.pdf, page 3.

depending on each case, it could be a DB scheme, a DC scheme, or a hybrid DB/DC scheme⁶) - i.e. the benefits outweigh the costs when compared against the counterfactual. On this basis the proposal is classed as zero net cost to business. The Department for Work and Pensions (DWP) will produce a full assessment of the Equivalent Annual Net Direct Cost to Businesses (EANDCB) following a consultation with the pensions industry on how the framework is to be designed and implemented.

3.2 Benefits to businesses

Firstly, policy detail, on which any impacts will directly depend on, is yet to be designed. Secondly, at this stage we do not know how many businesses will actually be offering CDC pensions. Any employer, should they wish to, will be able to offer CDC pensions within the legislative framework that will be introduced. At this point we are only aware of one business with very clear plans to deliver CDC (the Royal Mail Group). However, we have had signals in the past indicating that there might be more businesses interested in running CDC type schemes. For example, of the 737 delegates interviewed at the AoN Hewitt Pensions Conferences in 2013, 32% were in favour of CDC solutions⁷. Also, the Royal Society of Arts told the House of Commons Work and Pensions Committee that *big companies, especially those closing DB plans [...] have lobbied for change behind the scenes*; and the Society of Pension Professionals told the Committee 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'*⁸.

Where the counterfactual is DB, savings to sponsoring businesses may be substantial. New private sector DB schemes are no longer being created in practice. And where DB promises already exist employers cannot break them; however, they may choose to close their schemes to new members and/or future accruals. The introduction of CDCs will not alter this. However, in practice pension provision may be subject to negotiations between the employer and its workforce / labour union, and there may be situations where DC is not an acceptable alternative to DB for future accruals and / or new members but CDC is⁹.

In DB, all the risks and associated costs – economic, financial, and longevity – are with the sponsoring employer. Evidence shows that although the DB sector as a whole remains sustainable, the associated costs are high and higher than what was expected at the time the DB schemes were introduced, with longevity growing faster than expected and investment returns staying low for a sustained period of time – see figure 1 below for illustration.

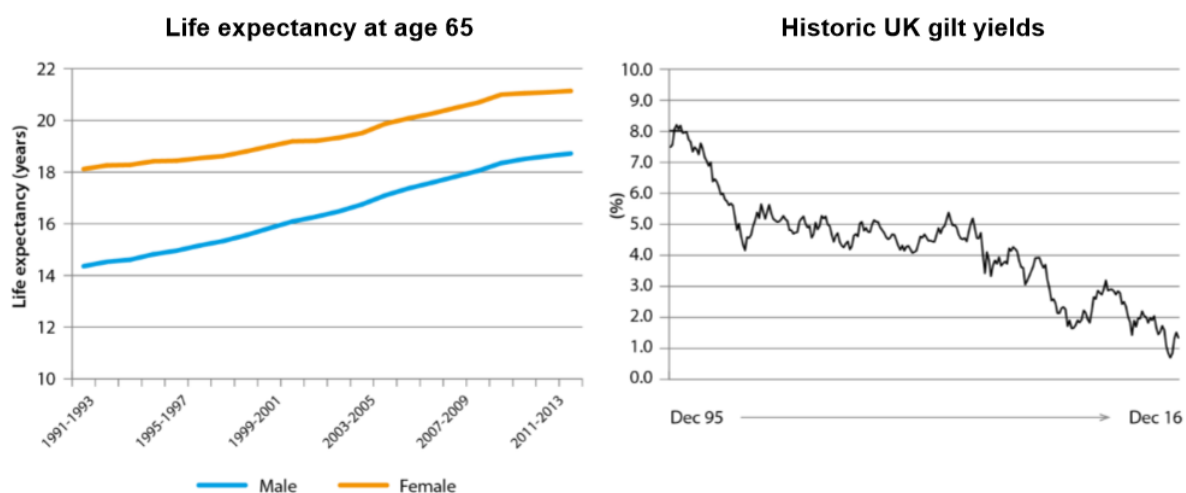
⁶ Note that due to the Auto Enrolment requirements offering no occupational pension is no longer an option for virtually all businesses.

⁷ Source: AoN Hewitt, The Case for Collective DC, Nov 2017. Available at: http://www.aon.com/unitedkingdom/attachments/aon_hewitt/dc/Aon_Hewitt_The_Case_for_Collective_DC_Nov13.pdf

⁸ Source: House Of Commons Work and Pensions Committee, Collective defined contribution pensions, Sixteenth Report of the Session 2017-19. Available at: <https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/580/580.pdf>

⁹ For example, a situation discussed in this publication: < <https://www.professionalspensions.com/professional-pensions/news/3025820/royal-mail-and-cwu-agree-to-introduce-uks-first-cdc-scheme>>

Figure 1. Social and economic environment – recently and c 20 years ago.



Source (secondary): Security and Sustainability in Defined Benefit Pensions, 2017¹⁰.

According to MQ5 data (table 4.3)¹¹, over the calendar year 2017, sponsoring businesses of DB schemes paid normal contributions worth around £20.8 billion, and special contributions¹² worth around £15.7 billion, in total. Over the same time period, DC scheme sponsoring businesses paid about £5.3 billion of normal contributions, and about £0.13 billion of special contributions (and there are more DC than DB schemes, and the number of members is broadly similar).

DB sponsoring businesses may also incur indirect costs associated with the natural uncertainties arising from their commitment to sponsor a DB scheme. For example, any changes in life expectancy and/or investment return forecasts would alter their estimated DB pension liabilities and thus their balance sheets, making them more uncertain and volatile, and in turn potentially making their business less attractive to potential investors or creditors. Replacing DB with CDC would result in a saving in this sense as well.

Where the counterfactual is DC, we do not envisage fundamental differences in direct costs to sponsoring businesses as in both DC and CDC all the risks and associated costs – economic, financial, and longevity - are with the members. Having said that, we acknowledge that there may be some differences, e.g. in CDC pension levels may need to be revalued more regularly, which may result in some differences in scheme running costs (e.g. actuarial), when compared against DC.

¹⁰ Available at:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/595103/security-and-sustainability-in-defined-benefit-pension-schemes.pdf

¹¹ Available at:
<https://www.ons.gov.uk/economy/investmentpensionsandtrusts/datasets/mq5investmentbyinsurancecompaniespensionfundsandtrusts>

¹² In simple words, additional payments needed to sustain their schemes.

In general, an occupational pension is part of an employee compensation package. More flexibility in its provision means that employers will be better able to optimise it given their individual circumstances and business strategies, potentially resulting in a more stable and motivated workforce.

4. Key assumptions/sensitivities/risks

At this stage there is a significant uncertainty over the full impacts of the proposal, as the costs and benefits will be determined by the details to be set out in subsequent legislation. Any figures derived in this Impact Assessment are indicative and for illustrative purposes only.

5. Wider Impacts

Impacts on the affected parties other than businesses, and wider economic impacts are discussed below.

5.1 Wider impacts - impacts on members

Again, impacts on members will directly depend on the exact design of CDC framework and its specific parameters. Publications by the pensions industry, albeit giving mixed messages in some cases, also appear to suggest that subject to being well designed it has a good potential. For example, according to Willis Towers Watson, *with fixed contribution rates and the merits of collective long-term investing, CDC schemes could offer attractive outcomes for both employers and employees. But a key challenge for CDC design is the framework for the variable allocation of the assets to provide member pensions; from our work so far we believe a robust framework is achievable*¹³.

Benefits to members.

Our assessment at this stage is that a well-designed, run, and regulated CDC can provide a more stable outcome for members at a lower cost than individual DC. This is expected to play out through the following forms and channels:

-Ability to smooth out shocks from the investment market to provide more stable pensions.

This is an inherent feature of CDC. The expectation is also supported by existing modelling-based evidence. For example, a study from the Netherlands 'Benefits of Collective Risk Sharing in Defined Contribution Pension Systems'¹⁴, suggested 'up to 15 per cent higher pension payments in 'bad' economic scenarios than the individual contract'.

¹³ WTW Corporate and Trustee Briefing, 08 July 2018. Available at: < <https://www.towerswatson.com/en-GB/Insights/Newsletters/Europe/UK-Corporate-and-Trustee-Briefing/2018/07/collective-defined-contribution-schemes>>

¹⁴ By Marcel Lever and Thomas Michielsen, Sept 2014. Available at: <https://www.netspar.nl/assets/uploads/P20161100_occ009_Lever_Michielsen.pdf>

-Ability for members to share their individual longevity risk with other members, so that they avoid the risks of either outliving their savings or being unnecessarily frugal with their savings.

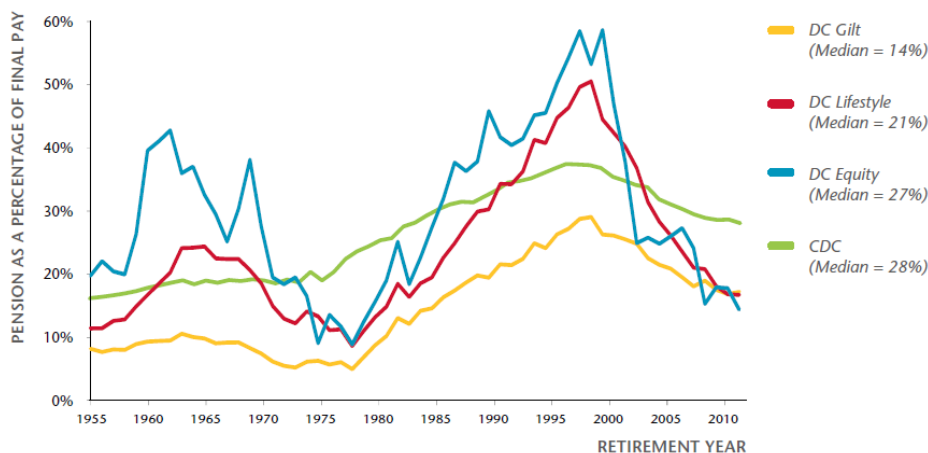
This potential benefit arises from the concept of longevity pooling. Individuals cannot accurately predict how long they will live. Those who turn out to underestimate their life expectancy risk outliving their savings by withdrawing too much / too fast from their pot, and those who overestimate may end up underusing their pensions pot. However, pooling means that those who would otherwise be outliving their savings and those being unnecessarily frugal with their savings balance each other out, at least to some extent.

-Potentially higher pensions overall (but not for all).

The primary underlying theoretical reason for the potentially superior performance of CDC (compared against DC) is that CDC schemes can invest a high proportion in growth assets (e.g. equities) throughout their whole lifetime, whereas typical DC schemes tend to move into safer, but lower-returning assets as the member approaches retirement. Also, de-risking in DC may mean purchasing annuity during 'adverse' times, e.g. when gilt yields are low; whereas in CDC, annuities are not necessary to provide a lifetime stream of pensions income.

AoN Hewitt have modelled the historic behaviour of an illustrative CDC plan compared with DC schemes over the period from 1930 to 2012. The outcomes of their modelling – as illustrated in Figure 2 below – suggest that eventually CDC reaches a better outcome than DC.

Figure 2 – Historic CDC and DC outcomes, based on AoN Hewitt's modelling.



Source: AoN Hewitt, The Case for Collective DC, 2013 (page 31)¹⁵

Based on a different set of assumptions and approach, Cass Business School's modelling¹⁶ suggested that a CDC scheme can generate a pension that is 30% higher, and volatility per unit of return in the CDC scheme is just 16% of that in the individual DC scheme. An additional

¹⁵ Available at: <

http://www.aon.com/unitedkingdom/attachments/aon_hewitt/dc/Aon_Hewitt_The_Case_for_Collective_DC_Nov13.pdf>

¹⁶ Independent Review of Retirement Income: Report, David Blake, March 2016. Available at: <

<http://www.pensions-institute.org/IRRIReport.pdf>>

study from the Royal Society of Arts' study in 2012¹⁷ showed an improvement of 37% in pension outcomes from a move to collectively.

Moreover, a DWP commissioned a study¹⁸ by the Pensions Policy Institute (PPI), which compared a CDC scheme similar to that modelled by Aon with various individual DC alternatives, found that CDCs outperformed individual DCs in terms of the average income replacement rate (in almost all the modelled scenarios).

The modelling outcomes depend on several assumptions, among them those associated with the design of the CDC plan. Also, investment behaviours are driven by a complex set of factors, and given that CDCs do not exist in the UK the underlying modelling assumptions are theoretical and / or foreign evidence based. We are not claiming that the framework we are going to introduce will result in the same outcomes. However, it helps strengthening our case that CDC, if well-designed, has the potential to deliver a higher level of overall pensions than individual DC.

-Converting DC pots into an income stream for members without the high costs of guaranteeing income through an annuity.

Annuities are insurance policies which pay an annual income for life in exchange for a lump sum. DC members can use their pension pot (or part of it) to buy an annuity and have a guaranteed stream of income for their whole lifetime. But buying an annuity may be costly as the price has to cover not only the insurer's costs of providing it but also the insurer's premium and other fees. For example, Logevidas¹⁹ say that 'an insurer in the UK will typically charge around 5% more than it expects the annuity to cost'. In CDC, a lifetime stream of 'target' level pensions could be provided without the need for the member to buy annuity, i.e. potentially an efficiency saving. However, again this will depend on the exact detail of the CDC framework to be introduced, and we will continue exploring whether this likely to be an efficiency saving in practice.

"Hands off" access to a professionally managed investment strategy.

On balance, DC members have more discretion and responsibility of managing their pension strategies. Depending on individual preferences, some may consider this to be in their best interest but some may prefer a "hands off" access to a professionally managed investment strategy, which CDC type schemes can offer. For example, the UK section of the 2013 Aon Hewitt Global Pension Risk survey received 241 responses, of which 46% mentioned 'members don't need to be involved in investment' when responding to the 'What do you see as the biggest positives of Defined Ambition plans' question²⁰. Also, this was among the key

¹⁷ Available at: <<https://www.thersa.org/discover/publications-and-articles/reports/collective-pensions-in-the-uk#>>

¹⁸ Modelling Collective Defined Contribution Schemes, PPI, 2015. Available at: <<http://www.pensionspolicyinstitute.org.uk/publications/reports/modelling-collective-defined-contribution-schemes>>

¹⁹ Available at: <https://www.longevitas.co.uk/site/informationmatrix/areannuitiesexpensiveenough.html>

²⁰ Available at:

<http://www.aon.com/unitedkingdom/attachments/aon_hewitt/dc/Aon_Hewitt_The_Case_for_Collective_DC_Nov13.pdf>, page 11.

arguments presented to DWP by the Communication Workers Union (CWU) for why their members want CDC.

Costs to members.

We do acknowledge that at least some members may incur costs associated with the introduction of CDCs. A summary of them is below – assuming a ‘well’ designed CDC framework as the legislative outcome and individual DC as the counterfactual. Where the counterfactual is DB most members are expected to be worse off under CDC given than all the risks and associated costs under CDC are with them rather than their employer as under DB.

-Not all members will gain from CDCs.

Any collective scheme will smooth, to a certain extent, outcomes between members. So whilst overall members might benefit (as discussed above), some will experience a worse outcome than under an individual DC. One reason for this is that the member may die at a young age. This is an inevitable consequence of pooling risk and happens in both DB schemes and annuities where those that die young subsidise the pensions of those that live longer. Again, it is important that members are communicated with in ways that ensure they understand the nature of the scheme they are in.

-Cases where there is an opportunity foregone for those that would rather have an individual DC.

A person’s preference between an individual and collection pension not only depends on objective expected outcomes, such as income level and risk / volatility, but also their subjective preferences with regard to degree of risk aversion and, more generally, their lifetime utility function. Following a ‘well’ designed CDC framework, certain employers who currently offer a DC scheme to its employees may choose to offer a CDC scheme. Although this may be preferred by the majority of the members, they may be individuals that prefer a DC scheme but would no longer have that option (other than moving jobs to an employer that would still continue offering a DC scheme). An example where this could occur is in a situation where, from the individual’s point of view, there are undesirable transfers and subsidies, for example, from young to old or from poor to rich.

5.2 Wider impacts - intergenerational fairness

In principle, CDC plan design involves risk sharing, which is likely to occur both between the members of the same cohort and between different cohorts. Critics of CDCs often claim that they are inherently unfair towards younger generations as older people may have first call on the pooled fund to pay their pensions and workers may have to make up any shortfall with increased contributions. The main lesson to be learned from abroad is the Dutch experience. The Dutch regulatory system for CDCs requires a very high level of certainty that target benefits and inflation increases can be paid by prescribing large funding buffers. Slow growth in asset values means that when the buffers were expended in the financial crisis, they could only be restored through increased contributions from younger workers²¹.

²¹ Available at: <https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/580/580.pdf>, page 22

We believe it is possible to design a CDC scheme model which eliminates these risks or at least mitigates them to reasonably low levels. A possible solution, as presented to us by Royal Mail, could involve ensuring that: (a) adjustments to benefits are not perfectly smoothed, (b) that adjustments to benefits required by under or over funding take place frequently (e.g. annually), and (c) that all cohorts of members are treated the same when adjustments are made. This means no funding buffers, and no need for additional funding from younger members to pay out pensions to older workers. In that case it is highly likely that members would see more volatility year on year than in the Dutch system, but an initial analysis and advice provided to us by Royal Mail suggest that in almost all years pensions in payment, and target pensions for those yet to retire, could increase by inflation plus or minus 1 or 2%²², per year.

Some other views from the pensions industry also seem to suggest the risk of intergenerational fairness is solvable. AoN Hewitt, for example, mention that *dealing with these issues of smoothing requires very careful communication to members and good actuarial processes*²³.

5.3 Wider impacts – wider economic and societal impacts

CDCs may possibly bring investment benefits to the wider economy. As mentioned above, CDC schemes are expected to be able to invest (over their lifetimes) a greater proportion in higher risk-return assets than DC. These might include, for example, investing in infrastructure projects or new firms. However, investment choices and their impacts on wider economy are always complex and hard to assess / predict, and we will continue exploring this.

5.4 Wider impacts - equality impacts with respect to the protected characteristics

The characteristics that are protected by the Equality Act 2010 are (in no particular order) age, disability, gender and gender reassignment, ethnicity, marriage or civil partnership, pregnancy and maternity, religion or belief, sexual orientation.

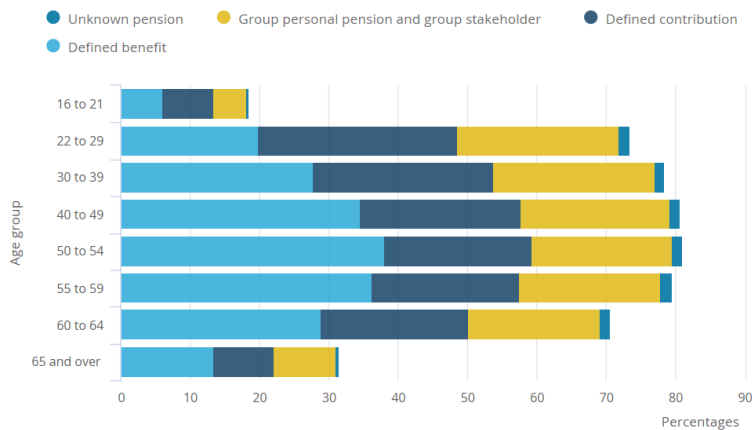
Under the proposed measures, any employer who meets the criteria in legislation will be able to set up or join a CDC scheme(s). As set out above, the counterfactual is members being in a DC or a DB scheme, depending on situation. Before we know more about which occupational memberships or memberships to be will be converted into CDC as a result of this legislation, any considerations of equality impacts therefore rest upon the demographics of the current occupational pension schemes in general. We welcome views of and inputs into our considerations of the protected characteristics through the consultation.

Age. As shown in the chart below, different age subgroups, except those below 21 and those aged over 65, have broadly similar workplace pension participation rates.

²² Based on internal debate and material provided to DWP by Royal Mail. To be treated as indicative and for illustrative purposes only.

²³ Source: AoN Hewitt, The Case for Collective DC, Nov 2017. Available at: http://www.aon.com/unitedkingdom/attachments/aon_hewitt/dc/Aon_Hewitt_The_Case_for_Collective_DC_Nov13.pdf

Figure 3. Proportion of employees with workplace pensions: by age band and type of pension.



Source: ONS, Annual Survey of Hours and Earnings ([link](#))

Gender. Historically a higher proportion of males than females were members of occupational pension schemes. For example, in DB schemes, which dominated the private occupational pensions landscape in the 1960s / 70s / 80s, about two thirds of members are males (based on the subset of all DB schemes that are managed by the Pensions Protection Fund) - see figure 4 below.

Figure 4. Gender of members in the Pensions Protection Fund (PPF)



Source: The Purple Book 2017^{24,25}.

Also, anecdotal evidence tends to suggest as well that there are more males than females in DB schemes. In the private sector DB schemes were (relatively) more commonly adopted by larger-scale employers in male-dominated industries²⁶ (such as engineering, manufacturing, formerly publically owned companies, finance, etc.). Also, as mentioned above many of DB schemes were set up in the 1970s / 80s, when the gender gap in labour market participation rates was higher than it is now.

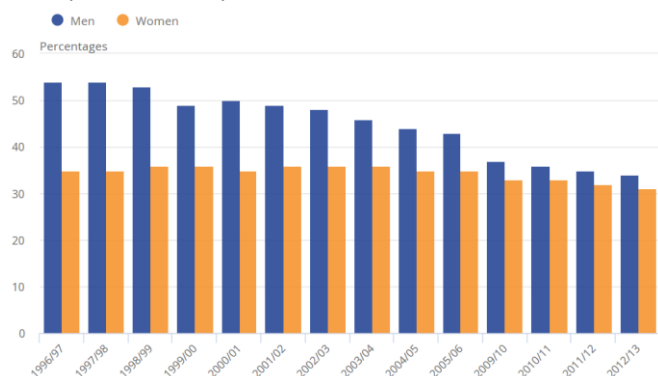
²⁴ Deferred member - a member of an occupational pension scheme who has accrued rights or assets in the scheme but is no longer actively contributing (or having contributions paid on his behalf) into the scheme.

²⁵ Available at < http://www.pensionprotectionfund.org.uk/About-Us/TheBoard/Documents/WEB_170407%20-%20PPF_Purple_Book_2017.pdf >

²⁶ Source: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220288/fas-eia-feb-2011.pdf

However, with changes in gender balance in the labour market, the rise of DC schemes, and the Auto-Enrolment, the balance is shifting towards much less gender inequality, with male and female participation rates now being broadly equal – see Figure 3 below.

Figure 3. Proportion of men and women aged 16 to 64 contributing to private pensions, 1996/97 to 2012/13.



Source: ONS Pension Scheme Membership²⁷

Disability. In general, the prevalence of disability rises with age. Around 8% of children are disabled, compared to 19% of working age adults and 45% of adults over State Pension age²⁸ (as at 2016/17). It is future pensioners that would potentially be affected by the proposed legislative changes. From the above we can infer that well over 20% of those affected may have a disability at some point over their lifetimes.

Marriage or civil partnership. According to Pensioner Income Series 2016/17²⁹, 62% of all pensioner units are in receipt of an occupational pension³⁰. Among single pensioners, the proportion is 54%; among pensioner couples the proportion (where at least one has an occupational pension) is 70%. It is not surprising that the proportion is higher for couples as the probability that at least one person has an occupational pension is naturally higher in dual than single pensioner households. Accounting for that, the proportions are very broadly similar and suggest no systematic bias.

Ethnicity. Research tends to suggest that minority ethnic groups are relatively less likely to be members of occupational pension schemes. For example, research by the University of

²⁷ Available at:

<<https://www.ons.gov.uk/economy/investmentpensionsandtrusts/compendium/pensiontrends/2014-11-28/chapter7pensionschememembership2014edition>>. This is an ad hoc publication and so has not been updated.

²⁸ Source: ONS Disability facts and figures. Available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/692771/family-resources-survey-2016-17.pdf

²⁹ Available at: <https://www.gov.uk/government/statistics/pensioners-incomes-series-financial-year-201617> Table 3_8.

³⁰ Note: may include personal pensions and Defined Contribution pensions. However, given that it is current pensioners it is not unreasonable to assume that the majority of them will be in receipt of a DB pension.

Southampton³¹, which used data from the UK Household Longitudinal Study, explores patterns of employment and the odds ratios of membership in an employer's pension scheme among working-age individuals from minority ethnic groups and the White British population. It concludes that people from ethnic minorities have a relatively lower probability of being a member of an occupational pension scheme.

Other protected characteristics. The proposed changes will impact on individuals as members of occupational pension schemes. The Government does not envisage any specific maternity or pregnancy, religion or belief, and sexual orientation equality impacts stemming from these changes.

³¹ *Ethnicity and Occupational Pension Membership in the UK*, Athina Vlachantoni et al, December 2015. Available at: <<https://onlinelibrary.wiley.com/doi/pdf/10.1111/spol.12137>>