Department
for Work &
Pensions

Government response to
the consultation

Reshaping workplace pensions for future generations

Presented to Parliament by the Secretary of State
for Work and Pensions by Command of Her Majesty
June 2014

CM 8883

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Foreword by the Minister of State for Pensions

This Government has already made fundamental reforms to the pensions' landscape. The introduction of the single-tier State Pension will provide a simplified foundation on which individuals can build their own private pension saving. The success of automatic enrolment means already over three million more savers have joined workplace schemes with another seven million still to be enrolled, and I am putting in place measures to ensure these workplace schemes will be high quality, delivering real value for money for consumers.

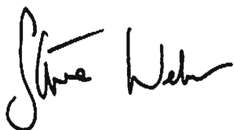
We have provided a once-in-a-generation stimulus to the pensions market and it has responded. We are seeing growth in high quality pensions' provision, and employers and the pensions industry are already thinking about future pension provision. Our defined ambition (DA) proposals are all about encouraging a flourishing and diverse private pensions' market by providing greater choice to employers and savers. DA pensions allow employers and providers to share risks more equably with savers while collective pension arrangements allow members to pool risks.

The very best defined benefit pension schemes are in decline and have been for decades, but many employers want to continue to offer good quality pensions that meet the needs of their employees. DA pensions will create the framework for new provision with greater risk-sharing opportunities to meet the needs of business and individuals.

I am therefore delighted to introduce legislation to make DA pensions a reality. I want to see new collective pension arrangements based on risk-pooling models that are successfully run in other countries now and recognised world-wide as being high quality – after all, why shouldn't the UK have access to pensions that are viewed as among the best across the globe?

This legislation is the combined result of extensive stakeholder engagement and research, including careful analysis of the responses to the Government consultation *Reshaping workplace pensions for future generations*[1] that ran from 7 November to 19 December 2013. There is a clear appetite from providers, employers and savers for new types of pensions that provide greater certainty, with a more equitable share of the risk.

These are exciting times. These reforms to the private pension legislation will provide greater choice and flexibility to reshape future pensions, tailored to the needs of employers and individuals.



Steve Webb MP
Minister of State for Pensions

1 Department for Work and Pensions, 2013, *Reshaping workplace pensions for future generations*, Cm 8710, TSO.

Executive summary

The time is right for a new regulatory framework for future private pension provision.

The market is steadily moving away from defined benefit (DB) schemes where the employer takes on the economic risks of funding benefits in retirement – and is swiftly moving towards a landscape where defined contribution (DC) predominates, moving the risk onto the member. The response to the consultation and our research findings are supportive of the Department's proposals to deliver a legislative structure that creates space and responds to demand for a middle ground, where risks are shared.

In November 2013 the Government published proposals for defined ambition (DA) or risk sharing pensions: *Reshaping workplace pensions for future generations*[2]. This full consultation was the culmination of extensive engagement with the pensions industry and stakeholders – on the demand and supply side. The aim of DA pensions is to encourage innovation in risk sharing and pension scheme design – providing more choice to employers and members. The 129 responses received have been insightful and thoughtful, and have contributed to the conclusion we have drawn in this paper.

Legislative approach

The consultation demonstrated a consensus that we should simplify the current legislative framework for risk-sharing schemes, by creating a specific DA pension space, in order to generate greater innovation in the design of pension schemes. The schemes that could develop in this space are those which will address the current concerns from providers and employers to look at new approaches to provide scheme members with greater certainty compared to traditional DC schemes.

2 Department for Work and Pensions, 2013, *Reshaping workplace pensions for future generations*, Cm 8710, TSO.

This will be the core of our DA package. Draft legislation sets out a new DA framework setting out three key categories of pension scheme determined by the presence of a promise – DB, shared risk (DA) and DC – enabling the introduction of collective schemes by defining collective benefits. It also delivers a new approach to governance and communications for DA schemes, and ensures current consumer protections apply to existing accrued rights and benefits.

Greater certainty for DC schemes

The consultation examined the appetite for greater certainty for DC schemes. The overall response to greater certainty was positive, with agreement to our assessment of specific new design proposals – that focus on promises about retirement income – being more popular than the money-back guarantee for example. We welcome the strong support for the pension income builder approach. This feedback provides us with a good understanding of how to take this work forward. We have set out the high-level legislative framework to enable all the models discussed, which will also encapsulate other current and new risk-sharing models to be delivered by the pensions industry. We will continue to work closely with industry on the detailed design of schemes to inform development of any future regulations.

Support for collective DC schemes

Our proposals for collective DC (CDC) schemes were widely welcomed by employers, advisers and trades unions who responded to the consultation. We have drafted legislation to enable collective schemes to operate in the UK.

There was a lot of support for schemes such as the pension income builder, which we explored under the DC with guarantee part of the consultation document. We will be ensuring that regulatory own funds can operate in a way to deliver these schemes.

Flexible DB schemes

We also consulted on a package of measures to give employers who provide DB schemes greater flexibility over the nature of benefits they might choose to provide, but without affecting past accruals. There was a lack of interest from employers about the proposed scheme designs around flexible DB –some of our separate research findings indicated that to make a real difference the measures would need to apply to accrued rights, which the Government does not support. Some of the ideas to reduce cost and volatility in DB schemes can already be achieved without the need for further legislation. Given that the overall response to these ideas was cautious and led to misunderstanding about the impact on current savers and pensioners, we have decided not to pursue these proposals.

Outcomes from the 2014 Budget

The Budget 2014 announced a significant set of reforms which will give individuals more choice on how they access their DC pension savings in retirement.

https://www.gov.uk/government/consultations/freedom-and-choice-in-pensions

Government wants to give individuals more freedom about how and when they draw-down their pensions, but recognises that a significant proportion of people want more certainty about their pension savings and income. DA and the Budget flexibilities together respond to demand from consumers.

Conclusion

We believe there is a broad consensus of support for the DA package. The proposals to develop a DA space will help encourage a flourishing private pensions' market that has the flexibility to respond to consumer needs and provide sustainable pensions for millions of savers in the future. Our focus is on the changes that are likely to make a real difference in reshaping workplace pensions for future generations – to enable the market to evolve in a way that includes possibilities for offering more certainty and stability of outcomes than traditional DC schemes, and a legislative framework that clearly reflects a risk-sharing space.

The demand for defined ambition – the consumer perspective

1

Chapter 2 of the consultation paper presented the consumer evidence on pensions. In order to feed into policy development, the Department for Work and Pensions (DWP) established a Consumer Perspective Group to consider potential defined ambition (DA) models from the points of view of employers and scheme members. We also commissioned some research on DA concepts, and planned to draw together a synopsis of wider research.

The consultation paper explained the early findings – that employers are generally positive about offering pensions to their employees; however, they want schemes that are simple to set up and not costly to run. Although many employers with defined benefit (DB) schemes see their pension arrangements as an important part of the employee benefits package they offer, some are reviewing them due to economic pressures and volatility of costs.

Employers with defined contribution (DC) schemes, or no scheme yet, would like to offer more than individual DC to their employees. However, these employers are concerned about generating a pension liability that would have an adverse impact on their business accounts. There is demand from some individuals for more certainty about what they get back for the money they put into their pensions compared to what DC can offer.

Government response

The findings from the further research and from the consultation responses support our proposals – that DA pensions are an opportunity to provide future generations of pension savers with more certainty about pension savings and retirement income than DC, and could lead to greater trust and confidence in pension saving from individuals. This could also encourage individuals to engage with pension saving, and also provide opportunities for more certainty about pension savings or income to enable people to consider their retirement age.

The views of the many respondents to our consultation who think certainty about savings and income in retirement will be of value to individuals, provides important evidence of demand for the DA concept. Research relating to individuals' attitudes to risk shows that they prefer certainty and guaranteed payments over the opportunity to receive a higher amount of money[3].

Further, as the majority of employers who responded to the consultation were positive about DA, we consider that the concept can gain traction if we facilitate it through legislative change. Our research shows that more than a quarter of employers are already interested in offering a pension involving greater risk sharing between members and employers, with a further quarter undecided[4]. In other responses to our consultation, six in ten employers thought that having a guaranteed pension income that builds up year by year would make a significant difference to the number of employees saving in a pension[5]. We acknowledge that for the vast majority of employers the key consideration is cost and that they would be most interested in risk-sharing arrangements that do not generate costs any greater than traditional DC. Our proposed measures take account of this approach.

Responses to the questions

Question (consultation question no. 1)
Do you agree that a greater focus on providing members with more certainty about savings or preferably income in retirement may increase confidence in saving in a pension?

Many respondents were of the view that providing greater certainty, and in particular certainty about pension income, would help increase confidence in pension saving. Individuals said they would like greater understanding of what their retirement income may be. Guarantees are popular in principle but tended to be disregarded due to an assumption that they would be costly to deliver. Individuals are willing to accept a lower return on their investment if they were guaranteed a minimum income in their retirement.

Question (consultation question no. 2)
As an employer, do you have experience of, or can you envisage any issues with, employees being unable to retire due to DC pension income levels or certainty about income levels?

A number of employers felt unable to comment on employees' ability to retire due to DC pension income levels or certainty of income levels. One reason given was that employees do not tend to spend all of their working lives with one employer, which makes it difficult for that employer to take a view on this. There were also respondents who commented that it is the level of contributions made to a member's pension that will have the greatest influence on their retirement income rather than the level of certainty.

However, of the respondents who answered this question, the majority envisage issues with employees' ability to retire. One made the point that this could lead to workforce management challenges where individuals feel compelled to continue in employment until such time as they can be sure of having sufficient retirement income, creating problems with staff management and restricting recruitment opportunities. Although the experience is not yet widespread because many people retiring now have some past DB to act as a cushion, this problem could grow in the future.

3 Department for Work and Pensions (2014) Defined Ambition: Evidence summary https://www.gov.uk/government/collections/dwp-ad-hoc-research
4 Department for Work and Pensions (2014) Defined Ambition: Evidence summary
5 Association of Consulting Actuaries (2013) The unfinished agenda: Growing workplace pensions fit for purpose http://www.aca.org.uk/files/ACA_2013_survey_report_-_the_unfinished_agenda-7_November_2013-20131107102735.pdf

Government wishes to encourage ongoing participation in the workplace for older workers. Greater certainty as to the outcome of pension savings could be an important part of the planning tool kit for individuals.

Question (consultation question no. 3)

Do you have any further evidence or research planned which might help inform the development of DA pensions?

We received a range of evidence and research to inform the development of DA pensions. We have considered the evidence received, alongside findings gathered through the Department's independently commissioned research. Together, this evidence has informed the further development of this policy.

In general the evidence we received on the consumer perspective shows that consumers welcome the DA proposals. Consumers – members and employers alike – appreciate ideas to enable greater sharing of risk. Employers tend to be attracted to proposals that will offer employees a guaranteed element to their pensions while limiting the employer's exposure to cost volatility. There are individuals who view pensions as risky and often misunderstand what they may provide, and see value in having a more certain pension than traditional DC pensions.

Other evidence and research

DWP has published further research on the consumer perspective on DA. This includes findings from an independently commissioned research study and a summary of evidence from consumers about their appetite and attitude to pensions and DA in particular. The findings from this research are available here:

https://www.gov.uk/government/collections/research-reports

Overall, this further research showed that the concept of DA was seen positively by consumers as an opportunity to reduce the costs of DB pensions for employers and provide greater certainty for individuals than in DC pensions. For employers, cost and affordability continue to be the priority. Employers providing DB schemes are generally seeking to reduce the cost of the risk they bear, but they argue that any of the flexible defined benefit ideas (as described in Chapter 3[6]) would need to have sufficient impact – for example, through including historically accrued benefits. However, this is not in scope as we were clear that the proposals set out would only relate to future accruals of benefit.

Employers with DC pensions remained wary of incurring additional risk or cost. The research suggests that the ideas for schemes providing more certainty than current standard DC schemes and for collective defined contribution (CDC) schemes (Chapters 4 and 5[7]) would work best if it is clear to employers what it means in practice and what the benefits are, including where the employer would not need to incur greater cost than traditional DC. Our proposals were clear that these schemes would not require any additional cost or risk to be borne by the employer.

6 Department for Work and Pensions, 2013, *Reshaping workplace pensions for future generations*, Cm 8710, TSO.

7 *ibid.*

In the absence of a legislative framework, employers tended to find the concept of CDC difficult to understand and, while there was recognition that, theoretically, investment pooling could smooth volatility and result in lower charges, there were concerns about how well the idea would work in practice. The research was conducted when the development of proposals for CDC was at an early stage and this is likely to have had an impact on the findings. However, research by the Institute for Public Policy Research[8], carried out at the end of 2013, found there was '*strong public support for a collective pension*'. In fact, it was the most popular of the ideas they tested and appealed across different income levels, life stages and ages.

For individuals, greatest appeal was in the concept of providing more certainty than traditional DC through the introduction of guarantees and income building.

8 http://www.ippr.org/publications/defining-ambitions-shaping-pension-reform-around-public-attitudes

Providing greater certainty for members in the defined contribution world

2

Our consultation paper proposed that there is space in the market for new types of provision, building on the good things provided by traditional defined contribution (DC) but with greater certainty for the consumer and without any funding liability on the employer's balance sheet.

We proposed types of defined ambition (DA) models that built on a DC, with a focus on guarantees that provide certainty, but which do not require high levels of consumer engagement to manage and understand any investment and longevity risks. We also wanted to ensure an appropriate trade-off of risk and reward between guarantees and investment return – for example, seeking to provide small guarantees and guarantees secured outside of the main provider. Offering consumers a greater level of certainty (at an appropriate cost) can reduce the anxiety sometimes induced by investments and prevent consumers viewing pensions as a gamble. Certainty may also encourage better planning and higher contributions.

In exploring the four models in the consultation our intention was to ensure proposals for the legislative framework create the right type of space for innovation, while also providing appropriate member protection.

Government response

The consultation responses and research provided a clear view that there is demand for new forms of DA which would look like DC pension but additionally provide more certainty for members about their pension, without increasing costs for employers. Our legislative measures set out a clear space for innovation to provide those types of models, including the pension income builder.

The consultation confirmed our assessment that, of the new models discussed, rather than focusing on guarantees that protect the value of the pension pot, the appetite from consumers is likely to be for forms of guarantee for retirement income starting in, for example, a member's 40s or 50s, increasing as they approach retirement and beyond. We also intend to ensure that the new legislative framework will facilitate development of models such as the pension income builder, a scheme that could provide a guaranteed pension income to members (as opposed to the traditional DC pot). Such models will complement the already existing models such as cash balance schemes which offer certainty about the accrual or the pension pot.

We will bring in the new legislative framework to set out a clear space in legislation for these types of scheme to develop. In the consultation paper[9] we identified some issues for further consideration but which are not material to the legislative space we are creating for risk-sharing schemes. We will continue to explore design issues such as: being able to hedge the guarantee, issues around achieving scale, and how to raise the working capital required to set up and operate schemes. Although the legislative measures we will introduce in the Pensions Bill will not include changes to the tax rules, the proposals under the Budget announcement in relation to decumulation are likely to have a beneficial effect on DA models. We will continue to work with Her Majesty's Treasury and Her Majesty's Revenue and Customs (HMRC) in that context as to how these models will be treated for tax purposes.

Model 1: Money-back guarantee

The money-back guarantee is intended to ensure the amount of the accumulated savings at retirement or at the point of transferring out of the scheme does not fall below the nominal value of contributions made to the scheme. In general the probability of such a low-level guarantee being exercised is small. However, when the guarantee is exercised, it could have real value for the individual.

In the consultation paper[10] we explored options for delivery by both the market or by the public sector and we rejected the latter. Consultation responses also confirm that the case has not been made to legislate for the regulatory enablers that have been suggested make market provision easier – such as including a safe harbour for trustees, employers and providers against mis-selling or compulsion, or money back as a default fund.

Our conclusion therefore is not to change legislation or bring in new legislation specifically to address these issues or offer public sector provision for this model. But a money-back model could operate within the new DA space if there was sufficient demand and supply appetite.

Model 2: Capital and investment return guarantee

This option is intended to offer guarantees at the mid-point of the pension life cycle: when a member has built up a sum and their primary focus shifts from protecting contributions to preventing loss of capital, while still maintaining a need to grow the fund further. The guarantee would be purchased by a fiduciary on behalf of the member to secure a guarantee against part of the capital, and possibly an investment return, for a fixed period. As there would be a medium-term lock-in period for the guarantee, this would create a new investment opportunity in illiquid assets.

The cost of the guarantee would be kept low by the ability of the scheme to purchase in bulk and a fiduciary would make the decision on when to purchase, minimising administrative costs.

9 Department for Work and Pensions, 2013, *Reshaping workplace pensions for future generations*, Cm 8710, TSO.
10 *ibid*.

In the consultation document we identified some design issues which included: the ability of the scheme to hedge the guarantee; the potential for this product to operate on a cohort basis; cost of the guarantee; and whether it would fit with the tax regime.

The intent is that the more detailed design features should be worked out within the legal parameters of the new legislative framework.

Model 3: Retirement income insurance

This option is intended to provide certainty about income in retirement before the member retires, to address the single event conversion risk associated with buying an annuity, and seeks to maximise the investment returns on the member's fund.

Each year from, for example, age 50, a fiduciary would use a portion of the member's fund to buy, on the member's behalf, an income insurance product that insures a minimum level of income, which grows each year as further insurance is purchased. At retirement, the saver draws their pension directly from their fund and only if their fund is reduced to zero does the income guarantee insurance kick in.

While this looks like an income drawdown product, it is also an annuity, because the insurance payouts will begin if the fund is exhausted, so there is no risk of the individual exhausting their fund and having to rely on other sources of income.

In the consultation[11] we identified some barriers to the adoption of this model in the UK which included: insufficient scale; incompatibility with HMRC drawdown rules; and insurers being willing to offer standardised and transparently-priced products. In light of these we said it was unlikely this model would be introduced in the short to medium term.

The intent is that the more detailed design features should be worked out within the legal parameters of the new legislative framework.

Model 4: Pension income builder

Under the pension income builder model, contributions are used for two different purposes. A proportion is used to purchase a deferred nominal annuity, payable from the current pension age. For every year of contributions, each individual has a pension made up of a series of these deferred annuities. Thus the individual can see their pension income increasing over time and has a degree of pre-retirement certainty over their retirement income.

The residual proportion of contributions is invested into a collective pool of risk-seeking assets along with the residual proportions of other scheme members. This could be done on a single collective basis or among smaller cohorts. This pool is used to provide future indexation on a conditional basis, with rights adjusted by way of bonus allowances based on the financial status of the scheme.

We presented modelling which shows that when compared with DC, the pension income builder: provides a smaller range of outcomes in comparison to DC and provides more protection than DC in the worst outcomes at the cost of reducing the potential for the upside in comparison to DC.

11 Department for Work and Pensions, 2013, *Reshaping workplace pensions for future generations*, Cm 8710, TSO.

We identified various issues for consideration. The biggest issue was achieving scale and we suggested the scheme could be run on a commercial basis or as a mutual. Other issues we identified were: how to raise the working capital required to set up and operate the scheme; how to ensure the model has intergenerational fairness; what level of governance would be appropriate; and who would hedge the scheme assets.

The intent is that the more detailed design features should be worked out within the legal parameters of the new legislative framework.

Responses to the consultation

Question (consultation question no. 25)
Do you think having more certainty than traditional DC would be welcomed by members, and help generate consumer confidence and persistency in saving?

Nearly half of respondents thought that more certainty would be welcomed by members with nearly half of those reiterating the points made in the consultation that guarantees should represent good value for money. This would contribute to increased confidence and persistency in saving.

> 'More certainty is probably essential for a viable and stable system.'
> **(Tempo Pension Services Limited)**

> 'Getting the future framework right for Defined Contribution will benefit millions and the government has made a good case for legislative change.'
> **(Long-Term Practical Perspectives Limited)**

Numerous respondents also highlighted that many individuals have a lack of understanding about pensions, which makes education about guarantees essential. Individuals need to be aware that they are trading the potential for higher benefits for more certainty during market downturns. This point is reflected in our proposals for fiduciary duties and additional communication requirements in Chapter 6[12].

> 'Yes, additional certainty would be of benefit to member perception and confidence. However the cost of this additional certainty is also important. In order to be effective, members would need to understand the value of the additional certainty they are being offered and how it differs from an alternative scheme which may be cheaper but is less certain. We believe that both provider appetite and consumer appetite exist for the various Defined Contribution plus models but the challenge is to find a price at which the provider is willing to provide and the consumer is willing to pay.'
> **(Prudential)**

A few respondents said that having more certainty than traditional DC would be welcomed by members and help generate consumer confidence and persistency in saving.

12 Department for Work and Pensions, 2013, *Reshaping workplace pensions for future generations*, Cm 8710, TSO.

There was very little support for the money-back guarantee: the majority of respondents thought it was an expensive option for the amount of certainty offered and said it was unnecessary, as members usually get back at least the contributions made into a scheme. Concerns were also raised about the ability of providers to offer this kind of model.

Question (consultation question no. 26)

As an employer, if these products mean there is no funding liability, only the requirement to contribute as for a traditional DC scheme, would you be interested in offering these products to employees?

The majority of respondents agreed there would be employer appetite if the product did not generate liability for employer funding. It was suggested that, as employers prepare for automatic enrolment, those with traditional DC schemes would be less interested in guarantees as it could be costly for the employer.

One employer group found that some companies were interested; however, others were reluctant to move away from traditional DC provision.

However, the majority of employers, providers and investment managers said that if the guarantees placed no further funding liabilities on the employer, then offering these products to members would be attractive and would give individuals more certainty over the size of their pension pot.

Question (consultation question no. 27)

In relation to medium- and long-term guarantees outlined in model 2 (capital and investment return guarantee), and model 3 (retirement income insurance), would removal of the legislative barriers be sufficient to stimulate the development of market-based solutions?

About a third of respondents thought that removal of the legislative barriers would be sufficient to stimulate the development of market-based solutions for the capital and investment return guarantee and the retirement income insurance guarantee. It was envisaged that some industry sectors would set up multi-million pound DC schemes offering risk sharing.

> ‘We think that greater simplification of the legislative framework could result in greater innovation and more willingness for providers and employers to consider looking at approaches to introduce greater certainty.’
>
> **(National Employment Savings Trust)**

The majority of respondents suggested that enabling the guarantees in legislation would not be sufficient to encourage market innovation and further issues needed to be addressed. Almost half of these respondents said that the market would not develop guarantees unless sufficient demand could be demonstrated. A small number of respondents thought that the guarantees may be too costly which would make them less attractive and discourage the development of Models 2 and 3.

> ‘Potential providers would also need to be confident that a market for the products would exist and that it would generate a suitable return.’
>
> **(Buck Consultants)**

Respondents also agreed with the points made in the consultation[13] that insufficient scale was also an issue, and a small number of respondents said that a number of insurers need to be willing to underwrite large quantities of guarantees.

Respondents agreed with what we said in the consultation about the current tax rules on decumulation. They suggested it was possible that a future government may change the rules surrounding guarantees which may impede the development of market-based solutions.

Question (consultation question no. 28)

As insufficient scale has been identified as a barrier to providing affordable guarantees, is there a role for the Government in facilitating different types of pension vehicles that would create greater scale for this purpose?

Just under a quarter of respondents said that government should not intervene to create scale. It was thought that the removal of legislative barriers would be sufficient to encourage the industry to set up pension vehicles with sufficient scale.

> ‘There is a question on whether enough scale could be achieved in the UK without significant Government or industry intervention. Nonetheless, the introduction of enabling legislation for these Defined Contribution options could encourage some industry sectors to set up multi-employer Defined Contribution schemes offering some of these risk-sharing or collective features.’
>
> **(Pensions Policy Institute)**

However, there was support from over three-quarters of respondents for some sort of government intervention to create scale.

> ‘We would support any Government proposals to provide greater scale in the occupational Defined Contribution market whether through traditional Defined Contribution schemes or the Defined Contribution Plus models outlined in this consultation.’
>
> **(Prospect)**

The majority were supportive of government facilitating different types of pension’s vehicles that would create scale. Some respondents suggested National Employment Savings Trust (NEST) or the Pension Protection Fund (PPF) would be suitable vehicles to provide guarantees as they already have the necessary scale of membership.

Other respondents thought that government’s role should be to support the facilitation of such vehicles rather than set them up. Respondents said government could promote the pension vehicles and promote education on the benefits of the large-scale schemes providing guarantees.

Some respondents suggested government could underwrite guarantees.

> ‘Any government role could range from providing help and support for those wishing to create such a vehicle to providing funding and state guarantees.’
>
> **(Hargreaves Landsdown)**

13 Department for Work and Pensions, 2013, *Reshaping workplace pensions for future generations*, Cm 8710, TSO.

However, there was a small body of respondents who said that government should not over-intervene in the market and were concerned that public money would be used to underwrite liabilities on a large scale.

Question (consultation question no. 29)
Are there any additional legislative barriers that stand in the way of innovation of products with guarantees?

Almost a third of respondents thought that no further legislative barriers beyond those we identified in the consultation stand in the way of the development of products with guarantees. However, the majority of respondents identified areas that should be clarified before products with guarantees could be introduced.

A small number of respondents were concerned that if government were to introduce a charge cap, insurers would be reluctant to offer products with guarantees, which could reduce competition in the guarantee market and increase the cost of purchasing a guarantee. The relationship between these policies and DA was explored in Chapter 6[14].

> ‘A charge cap on automatic enrolment schemes would be a legislative barrier to the innovation of products with guarantees as the presence of a cap would restrict the number of schemes that are able to access the guarantees. The extent of the issue would depend on the level of the charge cap and the cost of the guarantees which could be significant. This assumes a charge cap applies to such schemes and we believe that such a cap should apply to these schemes.’
>
> **(Scottish Life)**

Respondents also thought that the Government’s commitment to the ‘pot follows member’ initiative could be a barrier to innovation as a pot with a guarantee may be excluded.

Question (consultation question no. 30)
Do existing protection arrangements for DC products provide sufficient protection for members in the event of provider insolvency?

There were no new issues raised here other than concerns about protections which were discussed in the consultation[15].

Question (consultation question no. 31)
Would any protection mechanism need to apply in order to provide extra security for members and reassurance for the employer that it would not be liable in the event of any deficits arising?

The vast majority of respondents said that if products with guarantees were developed, the extent to which members are protected under existing protection arrangements for DC products would need to be assessed and a protection mechanism should apply for members in the event of provider insolvency.

> ‘The CWU considers that a protection mechanism will need to apply in order to provide extra security and certainty for members and reassurance for the employer that it would not be liable in the event of any deficits arising.’
>
> **(Communication Workers Union)**

14 Department for Work and Pensions, 2013, *Reshaping workplace pensions for future generations*, Cm 8710, TSO.
15 *ibid.*

The consultation suggested that a guarantor body similar to the PPF might need to be created; however, many respondents thought the Financial Services Compensation Scheme should protect members if the guarantee provider became insolvent.

> 'We believe it is very important that any Defined Ambition promises have the same protection as similar promises in other types of scheme. We therefore believe that where such promises are not being secured with the member by an insurance company with the protections of the Financial Services Compensation Scheme, the Pension Protection Fund or a similar organisation should provide support for the promises made.'
> **(Partnership)**

The majority of respondents thought that documentation should clearly state what happens in the event of insolvency, which should reassure employers that they will not incur additional liabilities for guarantees provided.

> 'We do not believe that an additional protection mechanism is required. However, it would be important for the wording of any participation agreement to put beyond doubt that employers had no liability for any deficits arising. In practice, we do not see employers being prepared to be the "back-stop" to such guarantees, but instead the guarantees being provided by the pension provider and/or inherent in the pension product or investment fund.'
> **(Association of Consulting Actuaries (ACA))**

The One Hundred Group, an employer representative body, said that employers are concerned that a future government may change regulations and impose additional liabilities on employers for guarantees. Several respondents thought that a safe harbour in legislation could make future governments reluctant to alter the legislative framework.

Question (consultation question no. 32)
Are these models likely to be an attractive option for employers and members?

About half of respondents thought that these models would be attractive to employers and members. A survey carried out by the ACA found that many employers think that having more certainty would encourage employees to save into a workplace pension scheme. Around a quarter of respondents think that the guarantees would be attractive for members if they represent good value for money.

The remaining respondents were unsure if employers and members would be interested in the models. It was suggested that the guarantees could be seen as expensive and confusing, and employers may be cautious about incurring any liabilities.

The majority of respondents thought that the capital and investment return guarantee would not be popular with members. Respondents said that it was expensive yet would protect only a small proportion of the pension pot. Some respondents said the model would require scale to work and there were mixed views on whether government should intervene to create scale.

On the other hand, most respondents thought that the retirement income insurance model would be popular, and employers and members would value the increased certainty. Some respondents said it was expensive but that the guarantee was valuable. Several respondents were concerned that insurance companies would not want to underwrite the longevity risk associated with this model and also said that it would work better with scale. A small number of respondents were concerned that members would draw all their income and rely on the insurance purchased.

Question (consultation question no. 33)
On model 4 – pension income builder – what are your views on this model in which members are in effect deploying their own capital to guarantee their own entitlements?

The pension income builder was the most popular model presented in the consultation document. Respondents thought it would provide more certainty for members while still allowing them to benefit from investments.

> ‘The pensions income builder offers an attractive, sustainable and well-communicated option.’
> **(J.P. Morgan)**

However, a number of respondents expressed concern that insurers will be reluctant to provide deferred annuities for younger generations as the longevity risk is unknown. Research from the Pensions Management Institute also showed that members were apprehensive about buying deferred annuities and thought this could be a stressful process. Some respondents said that scale was a hurdle to the development of this model.

Collective defined contribution schemes

3

In a collective defined contribution (CDC) scheme assets are pooled rather than being retained in an individual fund. When a member retires, they do not select an individual retirement income product; rather, the income is paid from the asset pool. The rights of the member in a CDC scheme are therefore not solely related to the contributions made by or on behalf of that member. A key feature for a CDC scheme is that it provides certainty for the employer who pays a fixed rate of contributions and has no liability to the scheme (unless they choose voluntarily to support it further) and no balance-sheet risk.

This arrangement can provide advantages to the member, since a CDC scheme, by virtue of the pooled nature of assets, can access a wider range of investment opportunities than individual defined contribution (DC). The operation of the pooling mechanism also smoothes the return: individual members are not exposed to downturns in the market in the same away as in individual DC so outcomes are more stable.

In one of the main models of this type of scheme, individuals are provided with a target pension income they might receive in retirement. This often includes a fluctuating conditional indexation payment. The actual pension income received is dependent on the available assets in the scheme. If the funding is not sufficient, there are a number of pressure valves to enable the scheme to continue to deliver benefits, such as not paying the conditional indexation element or reducing the target pension income for members, with a decision to be made on how the risks are shared between different classes of members.

One form of CDC scheme also includes the possibility of benefits in payment being reduced in certain circumstances.

In our consultation[16], we explained that our defined ambition (DA) principles include a criterion on intergenerational fairness. An alternative model for a CDC scheme would be to fix a core part of the pension which cannot be changed once it is in payment, so it would be only the conditional indexation payments that could be cut. However, the nature of the intergenerational risk transfer in this model would not necessarily be compatible with that principle.

Government response

Evidence suggests that collective schemes provide a greater degree of stability in pension incomes than individual DC, because demographic and financial risks are pooled across the membership. In recognition of this, the responses received during the consultation period were largely positive.

Collectives are not currently possible in the UK in practice because they are not catered for in either pensions or tax legislation. The Department for Work and Pensions has had discussions with Her Majesty's Treasury (HMT) and Her Majesty's Revenue and Customs (HMRC) to examine this issue. In order to enable collective schemes that are run safely and regulated appropriately, we propose to define benefits provided on a collective basis in primary legislation for the first time.

We will create a framework that draws on the experiences of other countries where collective schemes operate and places the interests of members firmly at the heart of that design, prioritising clarity and transparency.

Collective schemes are complex and can be opaque – because of the indirect relationship between contributions and benefits. This necessitates strong standards of communication and governance. We intend collective schemes to be overseen by experienced fiduciaries acting on behalf of members, taking decisions at scheme level and removing the need for individuals to make difficult choices over fund allocations and retirement income products.

We will also introduce a robust regulatory regime in respect of targeting benefits and internal accounting, providing regulators with the appropriate mandate and tools to supervise schemes properly. We believe it is crucial that members fully understand the risks associated with collective arrangements when they join the scheme, and while it is not for the state to determine the benefit design of these schemes, we will ensure that schemes set out clearly (to members) in advance how their rights are defined, what they can expect from the pool, and how positive and negative shocks will impact on their pension benefits.

Collective schemes, as with all DC arrangements, do not come without risk, but with proper standards of governance and a suitable regulatory regime, we believe that we can mitigate these appropriately. A definition of collective benefits and associated key requirements will be included in the Pensions Bill while secondary legislation is likely to include more detailed provisions in relation to areas such as benefit targeting, risk management, communications and governance.

The legislative measures we will introduce will not address tax rules; however we will continue to work with HMRC and HMT to consider how collective schemes would operate within the pensions tax regime.

16 Department for Work and Pensions, 2013, *Reshaping workplace pensions for future generations*, Cm 8710, TSO.

Responses to the consultation

Question (consultation question no. 34)
Do you agree that CDC schemes have the potential to provide more stable outcomes on average than traditional DC schemes?

The majority of respondents thought that CDC schemes have the potential to provide more stable outcomes on average than traditional DC schemes. Many respondents liked modelling by Aon Hewitt which found that CDC can produce better outcomes.

> 'Our modelling ... demonstrates that Collective Defined Contribution plans without guarantees can produce member outcomes that are one-third better on average than conventional Defined Contribution-lifestyle schemes at the same cost and scheme charges. Collective Defined Contribution fully meets the Defined Ambition aim of better member outcomes.'
>
> **(Aon Hewitt)**

Respondents discussed several reasons why CDC schemes have the potential to provide more stable outcomes. Many thought that the increased scale of CDCs and pooling of assets reduces risk and the impact of market volatility. It was also perceived to allow for greater diversification and higher investment returns.

> 'If set up and managed correctly, Collective Defined Contribution plans could provide better outcomes for employees due to lower operating costs (from economies of scale) and higher investment returns (through pooling of funds) without additional risk for employers. If this is possible, Collective Defined Contribution plans could provide a successful middle ground between current Defined Benefit and Defined Contribution schemes, as a sustainable Defined Ambition solution.'
>
> **(Ford)**

Respondents also noted that the diversity of membership in CDC schemes allows for outcomes to be smoothed in adverse market conditions. Very few disagreed and said that CDC schemes either produce equal or worse outcomes than individual DC.

The remaining respondents were uncertain on whether CDCs would provide more stable outcomes than traditional DC schemes.

> 'A badly designed Collective Defined Contribution scheme can be worse than a well-designed Defined Contribution scheme with guarantees (and the other way around). As discussed above the stability and value for money of Collective Defined Contribution schemes themselves depends a good deal on scale and the entry and exit rules. They are likely to be more appealing where there is participation across a large numbers of employers.'
>
> **(National Association of Pension Funds)**

One respondent thought that because pensions in payment were cut in the Netherlands, outcomes in CDCs may not be as stable as promoted. Another respondent said that more research into the possible outcomes from CDCs would be welcome.

Question (consultation question no. 35)

Given there is no tradition of risk sharing between pension scheme members in the UK, are individuals going to be willing to share the benefits of protection from downturns in the market and increased certainty of outcome, with the potential disadvantages of intergenerational risk transfer?

Almost two-fifths of respondents thought that individuals would be willing to risk share. Many respondents also added that there is a tradition of risk sharing in the UK insurance industry and the annuities market.

New consumer research from the Institute for Public Policy Research into what individuals want from a pension scheme found that a collective scheme was the most popular model tested.

> 'There is public appetite for a form of defined-ambition pension that minimises some of the risks associated with Defined Contribution. In particular, participants in our research preferred a Dutch-style collective scheme that shares the risk among all members and removes the need for an annuity, and that incorporates some form of smoothing into the accumulation phase.'
>
> **(Institute for Public Policy Research[17])**

Several respondents also said that intergenerational risk transfer in CDCs would be accepted by younger generations. The greater stability in outcomes and more certainty than provided in individual DC would be welcomed and would outweigh intergenerational risk sharing. In addition, several respondents thought that CDCs would be less intergenerationally unfair than current pension arrangements.

> 'New entrants are offered inadequate contributions to expensive, individual Defined Contribution pots and would welcome the possibility of joining a collective arrangement where flexibility made intergenerational fairness much easier to achieve.
>
> It is also worth noting that the higher benefit levels expected from Collective Defined Contribution vastly outweigh the level of intergenerational transfer that would have occurred for example over the last 50 years. With this in mind the focus should be on better outcomes for all when comparing Collective Defined Contribution with Defined Contribution rather than the intergenerational transfer that may be occurring under the bonnet.'
>
> **(First Actuarial)**

However, just over a quarter of respondents considered that individuals would not be willing to risk share because it is not part of the pension culture in the UK.

> 'There has been intergenerational risk transfer in the UK market for some time, and there still is (State pension, Defined Benefit schemes) but this has never been as explicit as it is in the Dutch model where this solidarity is heavily promoted. Given its different cultural background, it is unlikely that the UK's workforce would be as prepared to accept such an explicit sharing of risk.'
>
> **(B&CE)**

17 Imogen Parker, 2013, *Defining ambitions: Shaping pension reform around public attitudes*, Institute for Public Policy Research.

Several respondents were concerned that the intergenerational transfer of risk would be unfair on younger generations, although one respondent noted that if membership of a CDC was compulsory, each generation would complete the cycle of bearing the most risk, and subsequently the least. One respondent highlighted that people change jobs with increasing frequency, and so may be a member of a scheme for a short time only and therefore be unwilling to compensate other scheme members when the scheme has a funding deficit.

There were also respondents who were unsure whether risk sharing would be accepted by individuals. One respondent thought that the success of risk sharing would depend on education and clear communications on the benefits and risks of CDC schemes, and that it could take time for people to accept this cultural change.

Another respondent said that risk sharing would be popular when the scheme was well funded and in a position to pay out generous benefits, and less popular when low funding ratios meant benefits were lower.

It was also thought that a member's attitude to collective risk sharing would depend on their previous pension scheme. Members previously accruing defined benefits may be unwilling to shoulder investment risks, whereas members previously in an individual DC scheme may be relieved that risks are pooled and outcomes are smoothed.

Question (consultation question no. 36)

Is a CDC scheme designed to manage funding deficits by cutting benefits in payment going to be acceptable in the UK where traditionally maintaining the value of benefits in payment has been an overriding priority?

Almost half of respondents thought that managing funding deficits in CDCs by cutting benefits in payment would not be acceptable. Some respondents said that cutting benefits in payment would undermine confidence in saving and undermines the aim of DA to increase certainty for individuals.

> 'A long standing, and admirable, pillar of pension provision has been that pensioners should not be subjected to benefit reductions; as it is difficult for them to make up any loss.'
>
> **(GMB)**

However almost two-fifths of respondents thought cutting benefits in payment would be acceptable in the UK. This supports evidence submitted by the Institute for Public Policy Research which shows that participants thought a cut in benefits would be manageable.

> 'The fact that retirement income could fluctuate in a collective scheme was cause for concern. However, if the scheme was run by a non-profit organisation with proper governance arrangements, respondents felt that falls of 5 (or even 10) per cent could be manageable – particularly if the fall was being faced by all members. Because of the assumption that, on average, Collective Defined Contribution would provide a higher income in retirement in the first place, the possibility of an annual fall was felt to be worth accepting.'
>
> **(Institute for Public Policy Research[18])**

18 Imogen Parker, 2013, *Defining ambitions: Shaping pension reform around public attitudes*, Institute for Public Policy Research.

Many respondents, including trades unions and consumer groups, agreed that if the possibility that benefits could be cut is well communicated from the start, and the reason for decreases of pensions in payment are clearly explained, then cuts could be accepted. One respondent noted that if benefits were reduced, an individual's income would still be higher than if the member was receiving an income from an annuity.

Question (consultation question no. 37)

What levels of funding do you consider would be appropriate to ensure that a CDC scheme has sufficient capital to meet the liabilities and minimise the risk of benefits in payment being cut?

There were a number of suggestions on the levels of funding that would be appropriate to ensure that a CDC scheme has sufficient capital to meet the liabilities and minimise the risk of benefits in payment being cut. Suggestions included funding levels of 100–115% and 115–130% of the value of liabilities.

One respondent said that funding levels should be based on the approach taken in the Netherlands; however, another said that it is difficult to fund for market conditions and a best-efforts basis would be more appropriate. It was also suggested that the scheme actuaries could set the funding assumptions, which are used by the employer and scheme trustees who then decide on the level of funding required to ensure the scheme will have sufficient capital to meet its liabilities.

Several respondents thought that the appropriate level of funding would depend on the age of the scheme's members, whether the scheme will cut benefits regularly or only in extreme market conditions and whether the scheme has members with guaranteed benefits. It was thought that if the scheme offers guarantees, funding should be fully reserved to protect them.

It was suggested that The Pensions Regulator and Prudential Regulation Authority could ensure schemes have sufficient funds to protect against cutting benefits in payment; however, another respondent thought that existing scheme solvency requirements would be sufficient to ensure a CDC scheme has sufficient capital to meet its liabilities.

Question (consultation question no. 38)

Given the need for scale and an ongoing in-flow of new members to ensure the sustainability of a CDC scheme, will it be possible to set up a scheme without some form of Government intervention?

Over half of respondents thought that government intervention would be required to set up CDC schemes in the UK. Respondents said it would be necessary for government to market CDC schemes, encouraging people to join them and have confidence in the new type of schemes. It was also thought that, although some large companies may have the funding to set up a CDC scheme, it may be impractical to set up a scheme without government intervention.

Most respondents who supported government intervention said that CDC schemes would need a constant inflow of new members to be successful, and thought this would be difficult without Government assistance. There was also a body of support for making membership of CDC schemes compulsory.

There was support for government setting up and running CDC schemes and one respondent thought that government could have a role in assisting employers to convert their individual DC schemes to CDC and could also set up a framework for consumer protection.

> ‘Within the UK there may be an option to offer Collective Defined Contribution as an alternative, but specific, investment strategy within existing Defined Contribution schemes by means of a unit linked model. This would create a number of large Collective Defined Contribution “funds” accessible by existing schemes from current Defined Contribution pension arrangements. The unitised with profits model already in existence could form a framework for this option.
>
> The government could also help by putting in place some form of consumer and/or provider back up protection for accredited Collective Defined Contributions to give more confidence to consumers, while enabling the capital requirements to be kept sensible to encourage more industry product development.’
>
> **(Institute and Faculty of Actuaries)**

Nearly half of respondents thought that there was no need for government to intervene to create scale. The majority of these respondents said that, although scale makes CDCs more effective, a constant inflow of members is not necessary to make CDC schemes successful.

> ‘As we noted earlier the question of scale is relevant to the amount of risk-pooling gain to be captured. However, there is in fact no need for an ongoing inflow of new members to ensure the sustainability of a Collective Defined Contribution scheme; a Collective Defined Contribution can be managed with a closed membership as indeed some are in Holland. An open and ongoing scheme is however easier to manage and offers further risk management opportunities – in other words, it is a more efficient form of organisation. Government intervention, beyond facilitating through legislation this form of provision, should be unnecessary.’
>
> **(European Federation of Financial Analysts Societies)**

One stakeholder said that if legislation was introduced enabling the creation of CDC schemes, employers and industries would set them up, while another thought that government should not shape the market by creating artificial demand.

Question (consultation question no. 39)

As a mutual model, it has been suggested that CDC schemes might prove attractive to the trades unions and other social partners – might this be an option worth exploring?

The majority of respondents thought that there could be a role for trades unions and other social partners in facilitating the creation of CDC schemes and most trades unions were supportive of this idea.

Respondents said that trades unions have been pro-collective risk sharing and many have the scale of membership such that if they were to support CDC schemes, scale would not be an impeding issue.

Very few respondents were opposed to the involvement of trades unions and social partners. One respondent said that this could delay the introduction of schemes and another respondent thought that trades unions would strongly oppose cutting pensions in payment when the scheme is under-funded.

Flexible defined benefit – making it easier for employers to sponsor schemes where benefits accrue on a specified basis

4

The number of employers offering defined benefit (DB) pensions is in long-term decline. The consultation set out a number of ideas to reduce regulatory constraints on employers offering DB pensions while continuing to sufficiently protect members so they can have confidence in the pension promises made to them.

We put forward ideas for members to retain a significant pension promise but to bear more risk than in current DB, while employers would have greater design flexibility and the ability to reduce cost volatility. These ideas would be for future accrual of benefits only and not impact on those employers who wished to continue to offer traditional DB schemes. Three separate ideas were considered: ability to pay fluctuating benefits; automatic conversion to defined contribution (DC) when a member leaves employment; and ability to change scheme pension age.

Government response

It was clear that there are already flexibilities available to employers, such as linking the scheme's normal pension age with State Pension age, to reduce cost and volatility without the need for new legislation. We have therefore considered the consultation responses and have concluded that introducing new legislation, to make it easier to sponsor DB schemes, will not be our priority at the present time.

Separate research findings have shown that, to make enough of a difference to employers, the suggested changes would need to apply to accrued pension rights. We are absolutely clear that we will not be making changes that affect past accruals that could reduce the pension benefits that individuals have already built up with their employer.

The view most respondents expressed was that the greater prize was to deliver changes that enable collective schemes and greater ability to share risks in the DC world.

Scheme design 1: Ability to pay fluctuating benefits

What the consultation said

This design would have a revised minimum requirement for DB that removed, for future accruals only (including in existing DB schemes), the statutory requirements for the indexation of pensions in payment. The employer would continue to bear the risks associated with providing the new, simplified DB pension promise, while in future the member would bear the risks arising from future inflation.

Employers could choose to provide additional benefits above the simplified DB level when the scheme funding position allowed.

Responses to the consultation

Question (consultation question no. 4)
What are your views on the feasibility of this scheme design?

There were mixed views from respondents on the feasibility of this model. Overall almost half of all respondents were opposed to it.

There was general agreement among those who opposed the design that it could threaten the security of the funding for the non-discretionary benefits and would be complex to administer. Some respondents were concerned that in practice employers would not actually pay any discretionary benefits, and that if they were paid, older generations would receive higher payments than younger generations and deferred members.

There was some support from respondents in the pensions industry to remove requirements to index link future accruals only. However, there was also opposition from those worried that high inflation could cause pensioners to fall into poverty and force them to rely on the State. Many responses from individual members of the public were strongly opposed to removing minimum indexation requirements.

Question (consultation question no. 5)
Are employers likely to be interested in providing benefits in addition to a simplified flat-rate DB pension on a discretionary basis or otherwise?

Many respondents thought that employers would only be interested in providing discretionary benefits if they could be assured that future governments would not amend legislation to make the payment of discretionary benefits compulsory. There was also concern about the feasibility of employers determining whether to pay a discretionary benefit.

> ‘In order to determine the affordability of discretionary benefits, schemes would need to undertake regular, perhaps annual actuarial valuations. These will require quick turnaround times to ensure affordability is measured currently. This requirement will certainly lead to significant professional fees, which could discourage employers from pursuing such a design.’
>
> **(The Law Society of Scotland)**

There was an acknowledgement that certain employers would find this design attractive as it would allow them to reduce their liabilities going forward – while still offering their employees good quality pensions.

Question (consultation question no. 6)
What role do you see for scheme trustees in relation to discretionary payments?

We asked what the role of trustees should be when deciding whether a discretionary benefit should be paid, and how the benefit should be apportioned. The majority of respondents who expressed a view on this issue thought that trustees should have a role in making these decisions.

Of those who responded to the question, the majority thought that an employer should consult trustees when deciding whether a discretionary payment will be made. There were also suggestions that employee representatives should be consulted when a company is deciding whether to make a discretionary benefit, and that the decision should be solely down to the trustees. Most felt that trustees should be involved in deciding how discretionary payments would be apportioned.

Question (consultation question no. 7)
Do you agree that our starting point should be to keep regulatory requirements around discretionary benefits to a minimum?

The majority of respondents agreed that regulatory requirements around discretionary benefits should be kept to a minimum and most were in favour of light-touch regulation, while the remaining few thought that more detailed regulations would be more appropriate.

Question (consultation question no. 8)
How do you see funding for the non-discretionary DB element being sufficiently protected while allowing for extra discretionary benefits?

We asked how funding for the non-discretionary DB element could be sufficiently protected while allowing for extra discretionary benefits. It was suggested that the non-discretionary assets could be ring-fenced or held in a trust fund.

Many respondents considered the risk that paying discretionary benefits could threaten the funding for non-discretionary DB benefits. There were concerns that this would have a disproportionate impact on younger scheme members.

Scheme design 2: Automatic conversion to DC when a member leaves employment

What the consultation said
In this model the employer promises that during the period of employment, they will provide the employee with pension benefits that accrue at a specified level and will bear the investment risk associated with providing what is, in effect, a DB scheme.

However, if the employee leaves their employment before retirement, the amount of pension benefit they have accrued in the scheme is crystallised and the cash value transferred to a nominated DC pension fund. Where they die in service or retire, normal scheme rules would apply.

Our intention was that such an arrangement would only apply to future benefits that accrue after the implementation of this scheme design.

Responses to the consultation

Question (consultation question no. 9)
What are your views on the feasibility of this scheme design?

The majority of respondents thought that this design was complex and unfeasible. Half of respondents were opposed to the automatic conversion design, with a few highlighting concerns and challenges that Government, employers and scheme members would face with the model. There was some support for the model and several respondents noted it would be attractive with employers.

Question (consultation question no. 10)
If employers are able to use scheme designs 1 and 3, do you think it is still helpful for legislation to allow for this scheme design?

Of the respondents who addressed the issue, over half thought legislation should not allow for this scheme design. The model was more popular with employers, investment managers and some advisors.

Question (consultation question no. 11)
Do you think this scheme design could be extended to permit employers to automatically transfer members out of the scheme at retirement?

Of the small number of respondents who answered this question, half thought the design should not be extended to permit employers to automatically transfer members out of the scheme at retirement.

Question (consultation question no. 12)
12. What would be the most suitable way for benefits to accrue under this model? And how might this best be communicated to ensure members understand the value of their pension benefits?

One-third of respondents thought that benefits should accrue in a cash balance arrangement. Although one respondent opposed this, benefits accruing under a cash balance provision was the most popular suggestion.

> 'The idea of longevity, inflation and investment risk falling on the employer while the employee is in employment but not thereafter is a coherent actuarial idea, which can be delivered via cash balance provision.'
>
> **(Mercer)**

Some respondents expressed the view that government should not prescribe how benefits accrue and instead should allow employers to choose a design.

Some consumer groups were concerned that members would not understand how benefits accrue under the automatic conversion model. However, others thought that it would be possible to clearly communicate how benefits accrue if a cash balance design was used.

There was a body of support for introducing a statutory requirement for employers to provide annual financial statements or statements when requested by the member.

Question (consultation question no. 13)
Assuming a cash equivalent transfer value (CETV) would not represent 'fair value' for the accrued rights when the member leaves or retires, how might it best be calculated? Should the basis for calculation be different when the transfer is initiated by the employer (for example on redundancy)?

There were divergent views on this issue. Several respondents thought that if it was clearly explained to members when they join the scheme that a CETV would be used to calculate accrued rights if the member leaves or retires, then it is fair value. However, other respondents said that, in this scheme design, CETV could be open to manipulation by employers. Many were concerned transfer values might be reduced when the scheme is not fully funded.

We also asked whether the basis for calculation should be different when the transfer is initiated by the employer. Over three-quarters of respondents who expressed a view on this issue thought the basis for calculation of accrued rights should be the same regardless of whether the transfer is initiated by the employer or if the member decides to leave employment.

However, a third of respondents thought that, although the basis of calculation should be constant, the employer should have some flexibility to determine redundancy arrangements and could uprate the benefits provided.

> 'The basic calculation should remain the same, as a minimum, with a discretion for the employer to enhance the arrangement as part of any settlement agreed. For example, bring the payment date forward from the NPA [normal pension age] to 55.'
>
> **(National Federation of Occupational Pensioners)**

Question (consultation question no. 14)
For schemes providing a lump-sum benefit, what are your views on how the cash value should be calculated for members who leave before retirement? Should the net present value of the lump sum be calculated on how many years away from pension age they are?

Almost two-thirds of respondents thought that if a member leaves the scheme before retirement, the net value of the lump sum should be calculated on how many years from pension age they are.

Almost a quarter of respondents thought that employers should be given the flexibility to choose how cash value should be calculated for early leavers.

> 'Employers should be allowed to design a scheme based on providing a lump sum benefit, and should have flexibility in how that is delivered. A sensible approach would be to provide benefits on a net present value basis, but we do not think this should be prescribed. It is more important that employers should be able to design an appropriate scheme, and that regulations ensure that it is fairly and clearly communicated to members.'
>
> **(Pensions Management Institute)**

Question (consultation question no. 15)
Could the accrual rate and pension value be along similar lines to existing cash balance arrangements?

There was a group of respondents who agreed that, if it were decided to permit this scheme design, the design could be implemented within the current cash balance regulatory framework. However, there were respondents who thought that many of the benefits of this scheme could be enjoyed using the cash balance models already allowed within the existing legislative framework.

Question (consultation question no. 16)

What forms of regulatory requirements would be needed to:

- prevent avoidance activity?
- ensure the scheme has access to sufficient funds to enable a transfer when a member leaves?

Almost half of respondents who answered this question thought that there should be regulations imposing a time limit for funds to be transferred.

It was also suggested that The Pensions Regulator should be given additional powers to monitor schemes adopting this scheme design. Several respondents thought that the scheme actuary should be satisfied that transfers are fair for both leaving and remaining members and do not negatively impact on the scheme funding.

We asked what forms of regulatory requirements would be needed to ensure the scheme has access to sufficient funds to enable a transfer when a member leaves. Over a third of respondents thought that current funding and transfer value regulations would be appropriate and no additional rules would be necessary.

There was a strong body of support for this being the responsibility of the trustees and that they take actuarial advice before making a decision. One respondent suggested introducing mandatory financial training for trustees so they can ensure the scheme has sufficient liquidity to pay transfer values.

Some respondents thought that the scheme would have to be fully funded at all times. Several respondents made suggestions on what should happen if the scheme has insufficient funds to enable a transfer when a member leaves.

Scheme design 3: Ability to change scheme pension age

What the consultation said

To provide employers with greater flexibility to manage longevity risk we proposed adjusting their schemes' NPA. From the date the model is implemented, the scheme pension age could be adjusted in line with changes to longevity assumptions, so that members would be expected to spend broadly the same length of time in retirement, regardless of changes to life expectancy.

Ideas included:

- making it easier for schemes to link their NPA with changes to State Pension age if they so choose; and
- requiring the Government Actuary's Department (GAD) to publish, at predetermined intervals (say every three years), an objective index on pension ages based on the latest longevity assumptions. Schemes would then be able to increase their NPA in line with any increases in this index.

We proposed that any accruals earned after the date the scheme implemented this adjustment would be affected. We would consider whether there was a need for a statutory override to enable schemes to change their rules.

Responses to the consultation

Question (consultation question no. 17)
What are your views on the feasibility of this scheme design?

Respondents generally agreed that the design was feasible. There was broad support for this model. However, numerous respondents considered that it was already possible to adopt this scheme design under current legislation – for example, linking the scheme's pension age to the State Pension age – so further legislation to make it easier for employers to change the scheme pension age would be unnecessary.

Almost all of the respondents believe an employer should not be able to adjust the retirement age of people within a set period before retirement. While one respondent thought that five years would be an adequate period, an overwhelming majority said employers should be prevented from adjusting the NPA of anyone within ten years of the existing NPA in the scheme.

Question (consultation question no. 18)
It could lead to more schemes having proportions of accrued pension payable at different pension ages. Would this further complexity outweigh the benefits?

Three-quarters of respondents felt that having proportions of accrued pension payable at different pension ages was manageable and the complexity of this did not outweigh the benefits.

Question (consultation question no. 19)
What role do you see the scheme trustees playing? Should they be involved in setting a new NPA, or should this be down to the employer and the employer's actuary?

Over half of the respondents said trustees should have a role in setting a new scheme pension age and the rest thought this should be set by the employer and the employer's actuary.

> 'Setting a new NPA should be a matter for the employer and its actuary ... However, trustees do have a responsibility to safeguard accrued rights, which could suggest a role in ensuring that members close to retirement do not have their NPA adjusted unfairly.'
>
> **(SPC)**

Question (consultation question no. 20)
What are your thoughts on how future pension ages are set?

- For GAD to publish a standard index based on longevity assumptions?
- Or do you prefer schemes linking their NPA with the State Pension age, so that when the latter changes, the scheme's pension age automatically changes in line with this?

About a third of respondents were interested in the idea of the scheme pension age following an index set by GAD.

Some trades unions and consumer groups thought scheme pension age should be set by the sector or trades unions.

> 'Many of our members work in physically demanding jobs where it may not be possible to work into their late sixties or beyond and so we believe NPAs should reflect the specific characteristics of the workforce and be negotiated with trades unions.'
>
> **(The Communication Workers Union)**

Question (consultation question no. 21)
How might the decision to change the NPA work in multi-employer schemes?

Around one-fifth of respondents expressed a view on how the decision to change the NPA could work in multi-employer schemes. Of these, just under half thought that each employer should be able to determine the scheme pension age for their cohort.

There was some support for having a standard formula so that all employers use a uniform method to decide and implement changes to their scheme's NPA.

> 'A standard index would make this easier; even within one employer there could be vast differences in life expectancy due to location and job.'
>
> **(ATL)**

Several respondents thought that multi-employer schemes should not be able to change the NPA without the consent of all the employers.

Three respondents thought that government should not specify how the decision to change the NPA should work in multi-employer schemes.

Amending an existing scheme or creating a new one? Including past accruals

What the consultation said

Government believes that employers should not have the power to transfer or modify accruals built up under previous arrangements into new arrangements, beyond what is allowed under current legislation, otherwise there is a risk that members could lose out on their legitimate expectations. This means that deferred and pensioner members, and the past accrued benefits of active members, would not be affected as a consequence of introducing these scheme designs. We were, however, open to enabling employers to alter their existing DB scheme in relation to future accruals, rather than needing to open a new scheme.

Responses to the consultation

Question (consultation question no. 22)
As an alternative to opening a new scheme, do you agree it should be possible for an employer to modify the rules of an existing scheme so that it can be re-designed as a flexible DB scheme in relation to new accruals?

The majority of respondents who commented on this issue thought that employers should be able to modify a scheme's rules to change it to defined ambition (DA).

> 'As setting up a new scheme would be costly, we agree that it should be possible for an existing employer to modify the rules as proposed. These proposals recognise that employers are most likely to allow Defined Benefit accrual in future if they already have a Defined Benefit arrangement, and they have the powers to adapt it.'
>
> **(Mercer)**

Trades unions and consumer groups generally said that employers should not be able to modify their schemes to include the flexible DB designs and were opposed to a statutory override to allow schemes to change to DA.

Question (consultation question no. 23)
Do you agree that employers should not have the power to transfer or modify accruals built up under previous arrangements into a new arrangement, beyond what is allowed under current legislation?

Of the respondents who answered this question, most agreed that employers should not be able to convert accrued rights into a DA scheme.

The remaining respondents thought that accrued benefits could be reshaped as long as they were fairly converted and converted on an actuarially neutral basis.

Question (consultation question no. 24)
Should there be a requirement to provide independent financial advice in all cases where an employer offers to transfer a member's accrued rights from a traditional DB scheme to a new arrangement?

There was general consensus among respondents that an employer should be required to provide independent financial advice if they offer to transfer a member's accrued rights from a traditional DB scheme to a new arrangement.

> 'Whilst we would support the requirement to provide independent financial advice in these circumstances it should be made clear that the cost of this should be borne by the scheme and not the member. Advice on such matters is also very complex and so consideration should be given to how to ensure that members get advice only from suitable experienced and qualified advisers.'
>
> **(Age UK)**

Enabling innovation – legislative approach

5

Chapter 6 of the consultation paper[19] stated that our aim was to create a specific defined ambition (DA) space in legislation, taking the opportunity to move away from the polarity created by the existing broad classification of pension schemes as money purchase or non-money purchase, and giving explicit recognition in legislation to the potential for innovation in risk sharing.

We proposed defining defined benefit (DB) schemes in their own right and creating a new definition of DA scheme, distinct from each other and money purchase schemes. We envisaged that primary legislation would be used to set out the new definitions, with the specific requirements attaching to the different types of schemes being set out in regulations.

The objectives would be to:

- enable schemes to evolve and innovate;
- ensure proportionate regulation of different types of schemes;
- make the extent of their obligations clear for employers and providers;
- avoid being overly prescriptive.

Defining the different types of scheme

A DA scheme would be a scheme under which members are given some form of guarantee in respect of their pension, but not complete certainty over the level of income they will receive from it in retirement, or when paid.

19 Department for Work and Pensions, 2013, Res*haping workplace pensions for future generations*, Cm 8710, TSO.

A DB scheme would be one in which the member is given complete certainty about the level of benefit they will receive in retirement. It is important to note that a scheme may be DB regardless of its status as an occupational or personal pension scheme and regardless of who stands behind the promise made by the scheme.

Subject to one exception, a money purchase scheme would be one in which all benefits in the scheme are money-purchase benefits. The exception relates to situations in which a guarantee is obtained on behalf of the member, but the liability for meeting that guarantee does not fall on the scheme. We agreed it would be important to ensure it is relatively straightforward for schemes to evolve in relation to future accruals and change status under the proposed new definitions.

Collective defined contribution schemes that provide a promise or guarantee

We proposed that collective defined contribution (CDC) schemes that provide the member with some form of promise or guarantee operate within the proposed DA regulatory framework. In relation to funding requirements, we said the primary option for this would be a vehicle set up as a Regulatory Own Fund, which already exist within the terms of Article 17 of the Institutions for Occupational Retirement Provision (IORP) Directive where the scheme and not the employer underwrites biometric risks, and/or provides guarantees. We acknowledged that there might be other vehicles which could also provide this type of collective arrangement.

We considered whether the framework should include other requirements to enable CDC schemes to provide the high levels of governance that would be needed to protect member interests. For example, we asked whether schemes would need to have a formal approval arrangement such as licensing by a regulator, as well as being subject to oversight of funding levels.

CDC schemes that do not provide a promise or guarantee

We agreed to explore where CDC schemes that do not underwrite biometric risks or provide any guarantees should sit within our legislative framework, and the extent to which legislation would be needed to enable this type of scheme to operate in the UK.

Exploring the detailed legislation governing DA schemes

As already outlined, defining DA schemes in their own right would enable us to set out cross-cutting requirements that would apply to all such schemes. We identified as potential areas: governance; member communications; and funding.

Governance

Where models involve discretion over the level of benefits to be provided, we said that while we should avoid prescribing conditions about how that discretion be exercised, there could be a case for introducing requirements to ensure that, where there is discretion in a scheme, trustees or scheme managers give proper and regular consideration to the exercise of that discretion. We also said there was a case for imposing different requirements in relation to the levels of knowledge and understanding required and for internal controls and processes.

Member communications

We noted that, given DA schemes would offer members some degree of guarantee but not absolute certainty about their pensions, the nature of the pension promise might be harder to understand and more complex to communicate. We said we would consider the need to set out specific disclosure and information requirements for DA schemes to ensure that members receive clear and consistent explanations of their pension rights.

Scheme funding

We envisaged that schemes which make a promise in relation to the benefit would need to be funded to be able to meet that promise, but funding requirements should only apply to the extent of the promise or guarantee, and the nature of the funding obligation, which will depend on who is standing behind the promise.

Changing scheme status

We said that where employers and providers choose to change scheme shape and this, results in a change in scheme status – for example, from DB to DA – any DB-specific requirements will cease and the scheme become subject to DA-specific requirements on information and governance instead.

The relationship between DA schemes and ongoing initiatives on defined contribution pension quality, automatic transfers and automatic enrolment

We said that requirements that might be applied to money purchase schemes, such as the restrictions on charges then being consulted on, would not necessarily be appropriate for DA schemes in the same way, reflecting the fact that DA schemes providing guarantees may be more complex and involve additional cost. We also said we would not necessarily impose the same quality standards on DA schemes as those on which government issued its call for evidence in July 2013, since some aspects (such as governance) would be covered under specific DA requirements.

It was also our intention that DA schemes would be outside any system of automatic transfer (pot follows member) since this would involve transfers of incommensurable benefits. However we would need to ensure that DA schemes were able to be qualifying schemes for automatic enrolment purposes, which may require amendments to the automatic enrolment legislation, certification guidance and regulations.

Managing regulatory expectations for the future
We considered that it was not apparent that we could make any statutory provision to future-proof legislation for DA schemes.

Government response

Further to the ideas outlined in the consultation paper[20] and responses received during this period, we consider the design of a new legislative framework crucial to the success of the DA project. The consultation exercise and the streamlining of our plans for DA (as detailed in previous chapters) have confirmed we need a framework that will create a clear DA space with its own regulatory protections to encourage innovation in risk sharing and enable new kinds of collective models.

We intend to retain the overall approach and principles set out in the consultation document, with some refinements. We will continue, as intended, to establish mutually exclusive definitions for scheme type based on degrees of certainty for members. We will also ensure proportionate regulation by applying requirements to certain features – where there is a promise, for example, ensuring it is funded – while still maintaining transparency in the law so that employers are clear on the extent of their obligations. We are committed to avoiding legislation that is overly prescriptive; instead, we want to allow schemes to evolve and innovate.

Where we have deviated from the ideas set out in the consultation, we have put additional safeguards in place to ensure the new schemes work to their full potential. We are introducing a new definition of collective benefit, which could be offered under DA or defined contribution (DC) schemes. We will refine the definition of DB scheme to take account of certain discretionary features which already exist in some DB schemes and broaden the definition of DC to cater for self-annuitising and CDC schemes (that do not provide a promise or guarantee during the accrual phase). Money purchase schemes will fall within the DC scheme definition.

The legislation contains further detail on practical implications for how the definitions will apply and to avoid unintended consequences – for example, how to deal with schemes which have different sections, discretions and general augmentation powers. We have also given additional consideration to consequential legal changes, and where appropriate, we have taken regulation-making powers to be able to set out more detailed provisions in secondary legislation.

Responses to the consultation

Question (consultation question no. 40)

Do you agree that creating a unified and identifiable legislative framework that brings together the legislation relating to DA schemes would be preferable to simply amending existing legislation?

The majority of respondents agreed there is a need for legislative changes, rather than amending existing legislation. A few of those that responded agreed that we should legislate for DA but they had some concerns around implementation and whether the legislative changes should only apply to certain aspects of DA. Most were keen that DC should have its own legislation, and some thought that DA should work within the current legislative framework.

20 Department for Work and Pensions, 2013, *Reshaping workplace pensions for future generations*, Cm 8710, TSO.

> 'To avoid complexity, we agree that it would be better to create new legislation rather than amend existing legislation. While we support the proposal for legislation defining Defined Benefit, Defined Ambition and Defined Contribution, we think that if Defined Benefit legislation is left unchanged, there could be a rush from Defined Benefit to Defined Ambition or Defined Contribution to avoid remaining with the onerous Defined Benefit requirements. Therefore, it may be expedient to revisit ... We think that the number of choices should be restricted, to avoid complexity and to keep a definition as simple as possible.'
>
> **(Pensions Advisory Service)**

Those that were opposed were concerned that it could further complicate private pensions. They felt that keeping legislation as it is could work. Schemes are already able to use some DA ideas especially for DB schemes. It was felt that further promotion (that they can already use DA) rather than legislative changes are all that could be required.

> 'No. For simplified Defined Benefit, it seems more sensible just to redefine the requirements for Defined Benefit going forward. This seems to be what is being suggested in any case. The various flavours of Defined Contribution-plus-guarantee occupy a continuum that starts with "pure" Defined Contribution. It seems arbitrary to add a new classification that divides this continuum rather than simply extending the scope for Defined Contribution plans.'
>
> **(J.P. Morgan)**

Question (consultation question no. 41)

Do you have any comments on how to characterise the defining characteristics of DA pensions?

Nearly half of the responses to this were supportive of a DA concept and felt that defining the characteristics of DA was necessary. Those in favour felt that the characteristics of DA would need to be clear, concise and simple to ensure that it would be seen as a scheme option in its own right.

> 'In order to ensure that Defined Ambition is seen as an option in its own right and not simply a watered down Defined Benefit or more certain Defined Contribution option it is important to be crisp in the articulation of the concepts at play ... Without a clear framework that also acknowledges the bifurcation between trust and contract there is a danger of merely adding additional layers of complexity.'
>
> **(PMI)**

Those that were not supportive commented that it would be unnecessary to define the characteristics of DA due to the current definitions of DC and DB – money purchase and non-money purchase. It would be simple enough to suggest that DA would simply fall into the space in-between those types of schemes. One response suggested that defining DA would not guarantee certainty and could make pensions scheme types complicated.

> 'We do not consider it to be necessary to define the characteristics of Defined Ambition pensions other than for marketing purposes. If Defined Ambition pensions are defined then suggesting that a Defined Ambition pension offers a form of guarantee, but not complete certainty gives the impression that a guarantee is not guaranteed. The definition itself will increase uncertainty.'
>
> **(Hargreaves Lansdown)**

Question (consultation question no. 42)
Do you agree that it makes sense to define DB schemes in their own right rather than simply by contrast to money purchase?

The majority of respondents felt that there is a persuasive case to define DB schemes and this would/could provide precision in legislation, which would be desirable. They felt it was not enough to simply say that the definition of DB scheme equates to a non-money purchase scheme.

> 'Yes, we support clearer definitions in order to facilitate precision in the regulation of the different schemes, as well as to enhance consumer confidence in and certainty around products.'
>
> **(Which)**

A few respondents disagreed with this, suggesting that current definitions are sufficient and no further legislative definition required. Non-money purchase was considered to be definition enough.

> 'Although Defined Benefit schemes are defined as being "not money purchase", the definition of money purchase means that effectively Defined Benefit schemes are defined as being schemes which could develop a funding deficit. We see no reason why any further definition is required.'
>
> **(Hargreaves Landsdown)**

Question (consultation question no. 43)
Do you agree that defining DA, DB and money purchase schemes should facilitate clear and proportionate regulation according to scheme type?

There were mixed views with this question, as with the previous questions. Some felt that it would be necessary to define all three of the different types of schemes while others simply stated that the current definitions already give them clear meaning. However, the majority of respondents want to see a clear definition in the types of schemes which would, importantly, aid clarity for members.

> 'Responsibility for definition, categorisation and supervision puts an onus on Regulatory oversight to ensure that innovation is reflected in appropriate future categorisation. We would like to see some flexibility to allow the Regulator to assign schemes that develop in the future appropriately and to revise categorisations accordingly.'
>
> **(TUC)**

Those that were opposed to separate legislative definitions for DB, DA and money purchase schemes (because of current definitions) did however feel that there would be a need to define DC and that this would be of more importance. Some felt that having a definition for scheme type would not support clarity for members.

> 'In our view, there need not be a distinction between Defined Benefit and Defined Ambition schemes of the type that is Defined Benefit with a policy for discretionary benefits. All Defined Benefit schemes have the potential to have a discretionary benefit policy and whether they have a discretionary benefit policy or not does not currently result in any distinctions in law, and nor, in our view, should it. As we see it, the legislative distinction which is required to be created is to distinguish collective Defined Contribution from individual Defined Contribution (i.e. money purchase).'
>
> **(First Actuarial)**

Question (consultation question no. 44)
Do you have any comments in relation to the suggested definitions of DA, DB and money purchase schemes?

There were equal thoughts on whether the suggested definitions were needed. Some felt that it was too little too late, while others felt that there was no need to make changes to the current definitions.

> 'It is arguably too late now, because of the recent retrospective change to the nature of "money purchase benefits" – there will be little appetite for further tinkering.'
>
> **(Wragge)**

Those that agreed with the suggested definitions were supportive and clear that the definitions were required in order for DA to be used within industry. Some commented that language was key, as are the attributes, so as not to become misleading.

> 'The examples, particularly of Defined Contribution plus schemes seem to hinge on the scheme offering a benefit promise rather than the investment under a scheme offering a promised outcome. This would seem to mean that personal pension schemes would find it difficult to become Defined Ambition schemes, and subsequently suffer a competitive disadvantage. It is important that both personal pensions and trust based schemes, including master trusts, are given a level playing field. If this does not happen then there will be market distortions.'
>
> **(AVIVA)**

Question (consultation question no. 45)
Are you aware of any schemes operating in the UK under the Regulatory Own Fund provisions?

All of the responses to this question stated that they were unaware of any other schemes operating under regulatory own fund provision.

Question (consultation question no. 46)
Aside from Regulatory Own Funds vehicles, are there any other vehicles which might be appropriate for the provision of CDC which offers some form of guarantee or promise?

There were few responses to this question; those that did respond felt that there were no other vehicles which could be appropriate for the provision of CDC.

> 'Master trust arrangements might be appropriate for the provision of Collective Defined Contribution although it's not clear whether a master trust arrangement could achieve the necessary scale needed for such schemes quickly enough.'
>
> **(Scottish Life)**

Question (consultation question no. 47)
Do you think that setting up a CDC scheme should be subject to formal approval, for example licensing by a regulator?

Around half of respondents felt that licensing CDC would be the preferred way to gain public confidence and assure that schemes followed scheme rules. Due to the different way that CDC is funded it was clear that those who supported a licensing regime felt that this would ensure schemes were transparent in decisions for funding.

> 'Notwithstanding the general premise that regulation should be "light touch", we believe that in order to ensure public confidence in a new system, there might well be merit in this.'
>
> **(Slaughter and May)**

However, just under half of respondents felt that CDC should be treated in the same way as other schemes and that The Pensions Regulator should and could monitor them, subject to some further requirements that do not currently exist in other schemes. One respondent felt that CDC should be subject to formal approval at start up, and then be monitored by the Regulator in the way that other schemes are run.

> 'We believe that in order to create reform, prescription and regulation should be kept to a minimum and be sufficiently flexible to allow employers that want to create innovative schemes to do so. We do not believe it to be a necessary requirement for Collective Defined Contribution schemes to be subject to formal approval such as licensing by a regulator. The existence of pension liberation scams shows, however, that there is a need for new schemes to be properly checked as having a genuine purpose before HMRC registration. If the DWP has set up a sound legislative framework within which all schemes have to operate, we do not believe licensing is necessary.'
>
> **(First Actuarial)**

Question (consultation question no. 48)

Do you think that CDC schemes which do not provide a guarantee or promise should also be licensed?

There were fewer responses to this question than there were to Question 47. Of those that did respond half expressed agreement that CDC without guarantee or promise should be licensed. The remaining half were either in disagreement, as they felt that these schemes could and should also fall under the Regulator, or felt they could make no comment. One response commented that the UK was not ready for CDC.

> 'We suggest that consideration is given to some form of kite-marking, or similar, of Collective Defined Contribution schemes. This would ensure that all such schemes meet a minimum set of criteria in areas such as governance, communication, charges, etc. and is similar to the arrangements for Stakeholder schemes and those under consideration for Master Trusts.'
>
> **(IFoA)**

Question (consultation question no. 49)

Do you agree that such CDC schemes should also be subject to DA requirements on governance and member communications?

All of the respondents to this question expressed a view that all CDC schemes should be subject to at least the same level of governance and communications as set out for all DA schemes. Most responses were that these areas would be key in relation to setting up CDC in the UK. All agreed that, given the exact nature of CDC, the requirements would need to be transparent with frequent communication to members, adding that trustees would and should need more knowledge to manage the scheme.

One respondent argued that this could depend on the type of CDC scheme and whether this should actually fall under the same requirements as DA (to be described) or whether they should follow the same requirements made for DC schemes.

Question (consultation question no. 50)
Should there also be an option for schemes that currently offer DC to convert to CDC?

All respondents agreed that they could not see why we should not/could not allow the transfer of DC to CDC. One respondent pointed out that this would need to be communicated clearly to allow members the opportunity to fully understand what that would mean for them personally for funding and benefits at retirement. It would also need to be optional with member approval.

Question (consultation question no. 51)
In the absence of both a guaranteed pension entitlement and an individually defined pool of assets, how should assets in a CDC scheme be apportioned such that pension accruals can be measured for tax purposes against the Annual Allowance and the Lifetime Allowance?

There were few responses to this question; some respondents made the suggestion that tax implications should not drive scheme designs. Another respondent said that restricting lifetime accruals would not make sense and that annual allowances should be based on the amount of money actually paid into the scheme by the member. It was suggested that perhaps a fundamental rethink of lifetime allowance and annual allowance could be required.

Question (consultation question no. 52)
What specific areas should we address in relation to governance and member communications for DA schemes?

A large majority of respondents had ideas of which specific areas for governance we should address for DA schemes. The rest of the respondents to this question felt that there was no need to add more governance and that current requirements for other types of scheme should be used.

> ‘We do not believe there are any special considerations. Governance should be similar to that in current occupational schemes with employees making up 50% of the trustee board (as there is no risk to the employer). Legislation should require schemes to provide member communications but should not be prescriptive on what should be provided.’
>
> **(First Actuarial)**

Those that did agree felt that one area that might need to be considered for governance of DA could be the risk that perhaps we should look into creating a new set of knowledge and understanding control processes for trustees, developing detailed criteria for making payments. There were also thoughts that governance and communication would need to be of a higher standard than that for DC and DB schemes.

Most agreed that there needed to be careful communications to members, due to the funding requirements being different to that in DB and DC. Most thought that communication would need to be clear, transparent and careful.

Question (consultation question no. 53)

53. Do you have any comments on the assumptions in relation to scheme funding requirements?

We received fewer responses to this question than many others. There was a feeling that scheme funding for DA should match the requirements of DB. There was also mention of past issues with scheme funding and that the Pensions Act 2014 should apply to DA.

Annex 1
Organisations that responded to the consultation

Aberdeen Asset Management
Aegon
Age UK
Aon Hewitt
Aquila Heywood
Association of British Insurers
Association of Consulting Actuaries
Association of Pensions Lawyers
Association of Teachers and Lecturers
Aviva
B&CE
Barclays
BT
Buck Consultants
Capita
Cardano
Charlton Frank
Committee of Unilever Pensioners
Communication Workers Union
Confederation of British Industry
Dr Ross Altmann
EDF Energy
EEF
Esso
European Federation of Financial Analysts Societies
Eversheds
Federation of Small Businesses
Fidelity
Financial Conduct Authority
First Actuarial
Ford Motor Co Ltd
Friends Life
GMB
Hargreaves Lansdown
Hymans Robertson
ICAEW
ICAS
ILAG
IMA
Institute and Faculty of Actuaries
Institute for Public Policy Research
Institute of Directors
JLT
J.P. Morgan
KPMG

Legal and General
Legislative and Parliamentary Subcommittee of the Association of Pension Lawyers
Lloyds
Long Term Practical Perspectives Ltd
Marks and Spencer
Mayer Brown
Mercer
NASUWT The Teachers' Union
National Association of Pension Funds
National Employment Savings Trust
National Federation of Occupational Pensioners
National Union of Rail Maritime and Transport Workers (RMT)
Northern Power Grid
Occupational Pensioners Alliance
Partnership
Pension PlaypenPension Protection Fund
Pensions Advisory Services
Pensions Management Institute
Pensions Policy Institute
Price Waterhouse Coopers
Prospect
Prudential
Public and Commercial Services TU
Royal Society of Arts
Sackers
Saul Trustee
Schroders
Scottish Life
Scottish Power Trustees
Scottish Widows
Shell Pensioners Association
Slaughter and May
Société Générale CIB
Society of Pension Consultants
Standard Life
Tax Incentivised Savings Association
Tempo Pension Services
The Hundred Group Pensions Committee
The Law Society of Scotland
Towers Watson
Trades Union Congress
Transport for London Pension Fund Council
Unite the Union
Universities Superannuation Scheme
University of Bath
Which?
Wragge

There were 38 responses from individuals.

This publication can be accessed online at:
www.gov.uk/government/consultations/reshaping-workplace-pensions-for-future-generations

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