The Institute and Faculty of Actuaries (IFoA) CDC Working Group welcomes the opportunity to respond to the publication of the **Occupational Pension Schemes (Collective Money Purchase Schemes) Regulations 2021.**

Should you wish to discuss any of the points raised in this submission in more detail please contact Caolan Ward, Policy Manager, (caolan.ward@actuaries.org.uk) in the first instance.

**Opening comments**

It is clear that DWP have completed a substantial amount of work to draft the regulations and we see that as a good thing for pensions in the public interest as it will enable the first tranche of CDC schemes including that designed by Royal Mail. It is a great endeavour to draft such regulations in such a short space of time, before any CDC schemes have been opened, and it is inevitable that over time, as experience emerges, the regulations will need to evolve to allow for learnings.

However from an actuarial perspective we see these drafts as being fit for purpose for initial regulations, subject to our thoughts below including **two in bold where in our view there is particular need for a change.** We would be happy to discuss our comments with DWP or assist further before the regulations are enacted.

**IFoA response**

***Q2: Are there any other characteristics that should be added to those that are already listed at regulation 4(1)?***

In discussing regulation 4(1), the consultation document refers to section 5 of the Act, but draft regulation 4(1) refers to section 3(8) of the Act. However, both sections refer to benefit characteristics triggering a separation of sections in a CDC scheme.

The essential characteristic of the operation of CDC for intergenerational fairness is the consistency of operation over time of the actuarial plan for converting contributions to benefits and making benefit adjustments. This is to avoid unfair cross subsidy between members.

The important point is that the accrual of new benefit of all members of a CDC section is done on the same actuarial terms, so that for all members in a pool, there is the same relationship between contributions payable and benefits accruing. The key trigger for a new CDC section is a change of actuarial plan such that the new and existing plans are incompatible.

The items listed in 4(1) are not sufficient on their own to warrant sectionalisation of a CDC scheme. For example, in a CDC scheme with a fixed accrual rate, if the accrual rate is changed and the contribution rate is also changed in proportion, there is no change to the actuarial plan for converting contributions to benefits and there is no need for a new section. A change of normal pension age has a broadly similar effect on a member’s pension to a change of accrual rate (e.g. increasing the NRA by two years and applying an early retirement reduction of 10% has much the same effect as leaving the NRA alone and reducing the accrual rate by 10%), so if the contribution rate also changes in proportion the NRA can change without disturbing the actuarial relationship between contributions and benefit accrual and there is no need for a new section.

It seems to us that 4(1) needs changing to remove the items listed and instead have one requirement that a change to a new actuarial plan which is incompatible with the existing actuarial plan triggers a new section.

***Q5: Do the proposed gateway and ongoing tests provide a sensible measure of whether a scheme’s design is sound, at initial application and going forward?***

There is no definition of "soundness" provided, although it must be considered by the actuary (Regulation 9(2)), the trustees (regulation 10 and part 2 of schedule 2) and the Regulator (regulation 11 and Part 3 of schedule 2).

**This is a problematic for scheme actuaries and trustees who will need to certify or report on soundness, and we would urge DWP to make a change in this respect.** Actuarial certifications in other areas (For example DB scheme schedules of contributions) relate to a statement of fact (for example, that £X is bigger than £Y). However as the regulations are drafted, the actuary would be certifying and trustees reporting that “the design of the scheme is sound”, without a clear definition of what “sound” means. That creates potential for inconsistency, which would also affect the reliability of the certificate. We can also see a risk that other stakeholders, with a different opinion of the meaning of “sound”, may legally challenge the actuary or trustees on the certification.

The consultation document (at section 57) refers to providing ‘indicators of soundness’. However, the Regulations provide only the list (in regulation 9(2)) of the matters to which the scheme actuary must have regard to when "providing a viability certificate and considering whether the design is sound". Those are simply matters to consider, they are not a list of indicators of soundness.

Trustees are referred to the same list in considering soundness – in paragraph 12 of schedule 2. The comments in Part 3 on the matters the Regulator must take into account in assessing soundness provide no further information on what soundness actually means.

Regulation 9(2) is therefore a crucial aspect of the regulations in defining soundness (in as far as is possible given the constraints of the Pension Scheme Act 2021 on what can be set out in Regulations) and we have several comments on the drafting.

* 9(2) (a) requires the actuary to have regard to whether the scheme rules meet certain legislative requirements regarding the calculation of benefits. This is a legal matter and outside the actuarial professional skillset. The actuary will therefore need to rely on advice from the scheme's lawyers. This should be made clear in the drafting – for example, the actuary might be required to have regard to "legal advice obtained by the trustees on whether the scheme rules meet [the various provisions], and shared with the actuary"
* 9(2) (b) requires the actuary to assess whether certain matters have been "accurately communicated" in the current member booklet and annual benefit statement. Member communication is a specialist area which will not necessarily be a specialism of the scheme actuary. In addition, a requirement for "accuracy" may lead to information which is not conducive to member understanding. These issues can be addressed by amended the text "Whether the trustees have accurately communicated… “With "Whether, in the actuary's opinion, the trustees have appropriately communicated… "".
* The tests set out in 9(2) (c) seem reasonable at outset, although we note that the legislation does not propose any stochastic tests to assess the range and variability of possible outcomes. We would expect such testing to form part of good scheme design.
* In 9(2) (d) (ii), the future service rates are to be calculated "in accordance with section 20 of the Act and regulations 17 and 19". However, these provisions do not appear to cover the calculation of future service rates. Perhaps the wording could be amended to read "in a manner consistent with the valuation of the required amount, in accordance with section 20 of the Act and regulations 17 and 19".

The drafting of regulation 9(3) (b) could prove unnecessarily problematic in circumstances where the certificate cannot be provided within 10 months of the reference date. As drafted, a short delay in sign-off could invalidate existing calculations, requiring the reference date to be changed and potentially major re-work. We suggest that this is reworded to read "Any subsequent viability certificate must be provided to the trustees no later than ten months after the date agreed between the trustees and scheme actuary as the reference date."

On regulation 10:

* Regulation 10(3) (b) envisages a document prepared by the scheme actuary to inform the trustees consideration of soundness. This is a new actuarial document not envisaged in the Act. We can see why the trustees would need it, but have a concern around the level of reliance on the scheme actuary – the trustees seem to be relying on the actuary for their assessment, and it isn’t clear to us that TPR will be independently assessing these matters. It is important that the judgements made on soundness have checks and balances outside of the scheme actuary’s opinion.Our comments above on the lack of a clear definition of soundness are again relevant. The reference in 10(3)(b)(ii) to the inclusion of "any testing or modelling being considered by the trustees…" does not appear to be consistent with the matters the actuary should have regard to when considering soundness, as set out in Regulation 9(2).
* We therefore suggest that Regulation 10(3) (b) (ii) should be removed, to avoid further obscuring what is meant by soundness. Instead, the contents of this report should reference the matters listed in regulation 9(2) on soundness (and which are also the matters the trustees are required to consider in assessing soundness under paragraph 12 of schedule 2).
* Regulation 10(4) (b) has a similar issue to our comments above on 9(3) (b). We suggest that this is reworded to read "Any subsequent viability report must be provided to the Regulator no later than ten months after the date chosen by the trustees as the reference date."

On schedule 2:

* Paragraph 11 – our comment on regulation 9(2) (a) above, in respect of non-lawyers (in this case trustees) being required to provide a legal view, are again relevant here. It should be made clear that the trustees can rely on explanations provided by their lawyers. For example, the opening text to 11(b) should be redrafted to read "an explanation as to why the trustee's legal advisers are satisfied that the scheme rules meet [the various provisions]"
* Paragraph 12 – as noted above, the trustees are provided with no indication of what constitutes soundness beyond the list provided in in Regulation 9(2).
* Paragraph 13 – The list provided for TPR (which may have been to most promising place to define soundness, given the constraints of the Act) provides no further illumination. In fact the reference in 13(e)(3) to the inclusion of "any testing or modelling used…" does not appear to be consistent with the matters the actuary or the trustees should have regard to when considering soundness, as set out in Regulation 9(2). We therefore suggest that paragraph 13(e) (3) should be removed, to avoid further obscuring what is meant by soundness.

***Q6: What back-stop should be provided in regulations which would require a CMP scheme to wind up rather than close to further accruals? What might constitute suitable evidence to support this decision?***

In general, we believe it is neither desirable nor practically possible to design objective triggers for when a CMP scheme should be wound-up. This is because CMP schemes by their nature are sustainable by being able to reduce the level of member benefits as far as is required to maintain sustainability.

There may be circumstances in which it is deemed to be in the best interests of members to wind-up (such as where the population is too low to allow the scheme to run cost effectively within the charge cap, or effective pooling of longevity risk) but the decision would need to be based on a subjective assessment, taking into account all the relevant facts, which are likely to vary from case to case.

***Q10: Are the regulations clear about how valuation and benefit adjustment is to take place?***

We have been pleased to work with you on this area in recent months; as it is unique to CMP schemes it has required much creative work and we consider that the resulting draft has shaped up well on the whole.

Regulation 17 does not appear to allow for any recognition of future service contributions or liabilities in setting the adjustment to the rate of the amount of benefits. In our view, the legislation should be more flexible:

* Under the proposed approach, of basing the benefit adjustment only on current assets and past service liabilities, there is likely to be an expectation of a surplus or deficit relating to current accrual, so the scheme is unlikely to be expected to be in balance by the time of the next valuation, even if assumptions are borne out in practice;
* For a scheme open to new members and new accrual, it might be preferable to allow for a year of contributions (perhaps as part of the "available assets of the scheme") and a year of additional liabilities (perhaps as part of the "required amount") so the scheme is expected to be in balance by the end of the year;
* For a scheme closed to new members but open to new accrual for existing members, it might be preferable to allow for contributions and liabilities for a longer period – perhaps for all future service– to reflected an expected increase in the cost of accrual might each year as the average age of active members increases. (This is referred to as the 'attained age method', which is used in DB schemes to address the related issue for closed DB schemes.)
* The aggregate actuarial method (a comparison of benefits for past and future service with assets and the present value of contributions) is appropriate for an employer sponsored CDC scheme aiming to provide an even accrual of benefits over time. We would like it to be possible within the regulations to use the aggregate method. As drafted, perhaps it is possible if use is made of 17(3) (a) and/or 17(4) (a) and the aggregate method is specified in the scheme rules (although that might be an odd thing to include in the rules) or if use is made of 17(5) that the trustees can adopt assumptions (and actuarial method?) on advice from their actuary, notwithstanding 17(3) and (4). Please would the DWP consider whether any alteration to the drafting is needed to permit use of the aggregate method?

Regulation 17 should be framed to allow the use of either method – perhaps by allowing the available assets of the scheme/required amount to allow for future contributions/service liabilities to the end of a chosen control period – which should be the same to assets and liabilities.

In addition, we have the following more detailed points in relation to this regulation:

* 17(4)(e) – this requires that the scheme rules require the trustees to determine whether an intended increase is funded by the assets, but it doesn’t say what must happen if it is not. Is it that the benefit adjustment that is to be made must satisfy the approach in (i) and (ii)? The word “sufficient” in (ii) implies that the increase could be lower than that funded by the assets, rather than equal to.
* 17(4) (e) requires the cost of funding and increase to be “measured relative to the projected change in inflation”. The legislation would be clearer if this comment was removed – any pension increase rate needs to be affordable, not just increases above inflation.
* 17(6) to (10) – we’re not sure whether this covers all scenarios, For example, where there is a multi-annual reduction followed by a very good year where no further reduction is needed at all (and planned multi-annual reductions could potentially be dropped), does “revise the planned reduction” under (9) include the scenario where no reduction is needed and in fact an increase is awarded?

In Regulation 18, the requirement for Scheme Actuaries to have regard to IFoA or TPR guidance is novel, but very much welcomed. Care will be required to scope this out properly in the context of future plans for regulation of the actuarial profession and the powers of the FRC and its successor.

On regulation 19:

On balance, we are of the view that the provisions of regulation 19(2) – which allow the scheme actuary to adjust the valuation results for post valuation experience should be removed, or, as a minimum, be significantly amended. Our justification is set out below:

* The prospect of allowing for post valuation experience will make the process of deciding on an appropriate increase rate more complicated than if decisions are made based on conditions at a fixed date (the valuation date) – there would be a choice between two sets of calculations (the second of which is a moving target as it relates to a changing "current" position)
* The current position is likely to be difficult to monitor from a practical perspective, and could potentially increase costs, often without any obvious benefit;
* Unlike DB scheme valuations, where the problem of addressing the moving target of the "current" position can usually be addressed by adding in a margin for prudence in post valuation experience, CDC schemes are based on best estimates – this makes the process (involving discussion with the trustees etc.) significantly more challenging as allowance for market movements up to the date of certification of the valuation, with no margins for prudence, would be required.
* Allowing a choice will also increase the scope for conflicts, with more pressure likely to be exerted on the actuary to allow for post valuation experience in years where such experience is favourable. This could be addressed by the legislation making it clear that schemes should always adopt the same approach and not change from year to year – but this seems to run counter to the most significant reason for including such a provision (which is that in a very extreme year, perhaps where there is a significant market crash after the effective date of the valuation, some allowance for the significantly changed financial circumstances would be reasonable).
* For CDC schemes there are annual valuations and so the post valuation experience from the current valuation will be allowed for in any case within 12 months.
* **On balance, our preference is for 19(2) to simply be removed but, if it is retained the following changes are essential in order to avoid problems relating to the actuarial discretion under the draft regulations:**
	+ The decision to allow for post valuation experience or not should be a decision for the trustees on actuarial advice, rather than the actuary (consistent with the other valuation decisions such as assumptions)
	+ It should be clear that allowance can be made for post valuation experience up to a chosen date (perhaps according to a trustee policy) between the effective date of the valuation and the date of certification – thus allowing the actuary to carry out the necessary calculations for discussion with the trustees, prior to certification – rather than chasing a moving target which could make it difficult to complete a valuation.
	+ The legislation should make it clear that the trustees should only adopt this approach where there are considered to have been material market movements after the valuation date – and that in most years there should be no need to allow for post valuation experience

In addition, we have the following more detailed points in relation to this regulation:

* 19(3) (e) - should this be the “amount” of benefits (i.e. £ pa pension), not an actuarial “value” of benefits, for each category of members, not just pensioners. This then tallies with other requirements in regulation 19 for numbers and average ages of members in each category.
* 19(3) (e) refers only to pensioners. It is not clear why non-pensioners are not included.
* 19 doesn’t appear to require any disclosure on future service. This may be related to our main comment on Regulation 17 above – we would expect to see future service reflected in the disclosures to the extent that it is reflected in the valuation methodology.

***Q12: Do you think that draft regulation 29 and schedule 6 meets the policy intent of providing a clear framework in which CMP schemes can be wound up and the interests of members protected?***

We did not find Schedule 6 clear around at which point the CMP benefits become individual drawdown pots. However we can see problems with both interpretations:

* If CMP benefits become drawdown pots as soon as wind up is triggered, that wouldn’t give the scheme enough time to adapt its administration system. Also there is a risk that over a 2 year wind up period, the oldest members run out of money (i.e. due to passing their life expectancy)
* If CMP benefits become drawdown pots at the point of wind up, that doesn’t give any time to allow for any member deaths which occurred before that point but which had not yet been reported to the scheme.

A solution would be to allow the trustees to designate the relevant date.

More generally, conversion from CMP to IMP would be a complex process that has never been done before, and without detailed analysis it isn’t clear to us whether it would be practical if in accordance with the draft. We suggest that the regulations are reviewed when the first live case is carried out.

***Q19: Do you think the changes we are making to the Occupational Pension Schemes (Charges and Governance) Regulations 2015 (see provisions in Annex A) will implement the charge cap in CMP schemes and protect members in the way we intend?***

Schedule 7, paragraph 8. Insertion of 5A (3) “Collective existing rights charge” is based on the value of a members’ rights. This doesn’t seem to be defined, and we would expect it to be based on the value of assets (available to pay member benefits).

***Wider comments***

Use of the word “value”. Recommend reviewing all regulations to check use of the word “value”. Confine it only to mean “actuarial value” or “share of fund”. Do not use “value” to refer to the “amount” of benefits or the amount of contributions. A few of the examples are listed below:

* Schedule 5, paragraph 4(a) – we think this should refer to the amount.
* Schedule 6, paragraphs 2(a) and (b), 5, 7(5), 8 – here “value” does seem to mean an actuarial value such as a transfer value but it is not clear.

Annex B paragraph 38 – in paragraphs 5, 6, 7, 9, 10 and 11 of inserted schedule 6A all referenced to value should be to amount (this is particularly confusing given "amount" is used (correctly) later in the same section.

**END**

**IFoA CDC Working Group**