Department for Work & Pensions	**Impact Assessment (Final)**	
Title of measure		The Occupational Pension Schemes (Collective Money Purchase Schemes) Regulations 2022
Lead Department/Agency		Department for Work and Pensions
Planned coming into force /implementation date		1st August 2022
Origin (Domestic/EU/Regulator)		Domestic
Policy lead		Nada Balasingham
Lead analyst		Matt Parkinson and Grace Cassidy
Departmental Assessment		Self-certified
Total Net Present Social Value (over 10-year period): -£3.0m	**Equivalent Annual Net Direct Cost to Business (EANDCB) (over 10-year period:** £0.4m	**Business Impact Status:** Non-Qualifying Regulatory Provision

Summary - Intervention and impacts

Policy Background – Issue – Rationale for Intervention – Intended Effects

Until the Pension Schemes Act 2021 (the 2021 Act)[1], the UK's workplace pensions legislative framework was, broadly speaking, binary in nature with employers enabled to offer either Defined Benefit (DB) or Defined Contribution (DC) occupational pension schemes. The two models place the majority of the risks and associated costs – economic, financial, and longevity - with either the sponsoring employer (DB) or the individual member (DC). Following engagement with representatives from the pensions industry, Government decided to introduce a further option for the pensions industry called Collective Defined Contribution (CDC) schemes. CDC schemes could be beneficial to sponsoring businesses and individuals in certain cases. The legislative term for CDCs is Collective Money Purchase (CMP), but we will refer to CDCs in this document.

The 2021 Act provides the legislative framework to establish and operate CDC schemes. Secondary legislation will establish a secure regulatory framework within which single or connected employers can create CDC type pension schemes with adequate governance and safeguards in place for members and for employers. This sets out what CDC schemes must do to become authorised, to operate effectively in the market under regulatory oversight, and what happens if changes need to be made to schemes.

The authorisation regime is designed to protect members and to build confidence in this new form of money purchase occupational pension provision by ensuring only well designed and run schemes are able to operate. This should therefore provide protection to members' savings and future retirement income by ensuring only well-run and designed CDC are established. These regulations do not mandate CDCs but provides a framework if an employer wants to set up a CDC scheme. We only expect businesses to incur any gross costs if the expected benefits outweigh the additional costs.

Rationale for intervention

The rationale for intervention and therefore the introduction of CDCs is to create more flexibility in occupational pension provision so there is a new type of scheme that is:

- more sustainable for sponsoring employers than a DB scheme because it does not place any unpredictable future liabilities on them;
- and has the potential to give an income in retirement to members without the high cost of guarantees and is more predictable than is currently available to members of DC schemes who do not wish to purchase an annuity.

[1] https://www.legislation.gov.uk/ukpga/2021/1/contents/enacted/data.htm

Brief description of viable policy options considered (including alternatives to regulation)

As the Bill Stage Impact Assessment[2] did not monetise the impacts of any provisions made in the 2021 Act; we are treating Option 0 as the counterfactual where primary legislation was not enacted. Therefore, the counterfactual is a pensions market where CDC schemes do not exist and businesses must provide either a DB, DC, or hybrid workplace pension scheme for eligible employees.

Policy Option 0: Do nothing - As if no provisions of the 2021 Act had been enacted

Do nothing is the basis of our counterfactual. All businesses are required to enrol their eligible employees into a workplace pension so there would still be running costs associated with their current pension scheme. However, this option would mean less opportunity, choice, and flexibility for both employers and workers. A well-designed CDC scheme has the potential to offer a more predictable income in retirement for scheme members than for DC members who do not wish to purchase an annuity. It achieves this by pooling risks and smoothing pensions payments (for example softening the impacts during periods when investment returns are relatively low, and benefits may need to be reduced) whilst being more sustainable to sponsoring employers than DB.

Policy Option 1: Guidance around authorisation and scheme design

This is a non-regulatory policy option and involves issuing guidance to businesses and CDC trustees about member protections and ongoing supervision. This would encourage trustees to consider the risks of scheme design and financial sustainability whilst outlining how best to safeguard members and their savings. However, this option provides no regulatory protection for members and their savings. This could put them at risk of being enrolled in a poorly designed pension scheme. Without regulation, trustees are unlikely to fully consider the wide-ranging impacts that CDCs may incur that may negatively impact the interests of members. Without the full legislative framework, employers and potential members are unlikely to commit to CDC due to legal uncertainty in the face of challenge. Within legislation CDC schemes cannot be fully implemented and within the current automatic enrolment provisions trustees would be limited in what actions they could take.

Policy Option 2: Introducing secondary legislation to outline the authorisation and supervision regime (preferred option)

This option establishes the authorisation and supervision regime for CDCs as well as the relevant consequential amendments. The novelty and potential complexity of CDC models requires specific and targeted supervision to ensure they maintain the confidence of employers and scheme members. The authorisation and supervision regime is designed to protect members and to build confidence in this new form of money purchase occupational pension provision by ensuring only soundly designed and well-run schemes can operate. Therefore, members should be safeguarded from paying into poorly designed or managed schemes.

This option is likely to incur costs to businesses who choose to set up a CDC scheme because they must meet the authorisation criteria and ongoing supervisory requirements. However, businesses and employers should already have an established pension scheme to meet their automatic enrolment duties. Any new costs associated with setting up a CDC scheme would be voluntary as they could use the existing DC or DB provisions they currently provide to meet their automatic enrolment obligations.

Preferred option: Summary of assessment of impact on business and other main affected groups

<u>Impact on business</u>

These regulations do not mandate CDCs but provides a framework for if an employer wants to set up a CDC scheme. We only expect businesses to incur any gross costs if it were beneficial to do so compared to their next best alternative. **Therefore, we assume businesses will only incur costs if the benefits are greater than the costs.**

All businesses who choose to set up a CDC scheme will incur costs associated with:

- One-off familiarisation for trustees to read the relevant legislation and guidance
- One-off costs associated with meeting the criteria to be authorised
- Ongoing costs associated with meeting the supervisory regime

Depending on the scheme design some employers may also incur additional ongoing scheme running costs compared to their counterfactual.

[2] https://publications.parliament.uk/pa/bills/lbill/58-01/004/5801004-IA-Annex-G.pdf

Businesses may experience some benefits from adopting a CDC scheme including:

- more sustainable and predictable running costs for sponsoring employers
- having more flexibility in the pension provision they can offer

These costs are therefore as a result of a commercially viable decision, the regulatory framework is a marginal cost on top of that. The previous impact assessment[3] published in January 2020 did not quantify an Equivalent Annual Net Direct Cost to Business (EANDCB) for a few reasons. Specifically:

- The **costs and benefits depend on the counterfactual** (whether a firm's employees would in future be enrolled in a DB scheme, a DC scheme, or a hybrid DB/DC scheme**) which is not possible to predict**. Particularly in the case for DB employers, there are uncertainties as to whether they would switch to DC in the absence of CDC legislation.
- Consultation responses illustrated further interest in CDC amongst the wider pensions industry but did not identify new plans to deliver CDC. Consequently, **the potential take-up of CDCs from employers is currently an unknown with only the Royal Mail Group having clear plans to deliver CDC**. Therefore, on the grounds of commercial sensitivity, we were not able to set out the direct impact to business.

We still believe both these points are relevant. It is still not possible to predict the counterfactual or whether an employer would switch schemes in the absence of CDC legislation. We are also not aware of any other businesses having clear plans to deliver a CDC scheme.

Many of the regulations specify clear minimum standards that must be met by CDCs in order to gain authorisation but are not overly prescriptive on how the CDCs should meet them. This adds to the uncertainty around any estimates of the costs of this policy. Some detail about how schemes can demonstrate that they meet these requirements will be set out in the Pension Regulator's Code which will be published, following consultation and approval by Parliament, after this impact assessment.

At this stage there is still considerable uncertainty over the full impacts of the proposal, and the exact content of the Regulator's Code of Practice (Code) is yet to be finalised. Some impacts will depend on specific features of the CDC schemes applying for authorisation, of which there are a wide variety, which creates some uncertainty about the costs.

Departmental Policy signoff (SCS): Joanne Gibson	Date: 15/11/2021
Economist signoff (senior analyst): Joy Thompson	Date: 12/11/2021
Better Regulation Unit signoff: Prabhavati Mistry	Date: 12/11/2021

Additional detail – policy, analysis, and impacts

Policy options considered, including alternatives to regulation

The Policy Background

Background

Until the Pension Schemes Act 2021[4], the UK's workplace pensions legislative framework was, broadly speaking, binary in nature with employers enabled to offer only Defined Benefit (DB) or Defined Contribution (DC) occupational pension schemes.

[3] https://publications.parliament.uk/pa/bills/lbill/58-01/004/5801004-IA-Annex-G.pdf
[4] https://www.legislation.gov.uk/ukpga/2021/1/contents/enacted/data.htm

DB schemes offer greater certainty and predictability of income in retirement for employees but place significant risks and costs on the sponsoring employer because of the guarantee to members involved with such schemes. Conversely, DC schemes place the majority of the risks and costs on the individual scheme member. This is set out below in Table 1:

Table 1: High level comparison of DB, DC, and CDC key principles

	Defined Benefit (DB)	**Defined Contribution (DC)**	**Collective Defined Contribution (CDC)**
Longevity Risk	With the employer	With the members, individually	With the members, shared collectively
Investment Risk	With the employer	With the members, individually	With the members, shared collectively
Pension Level	Promised level[5]	A function of individual pot and decumulation strategy	Aspired to level[6]

Following engagement with representatives from the pensions industry[7,8], and in particular the Royal Mail Group, Government believes creating an option for the pensions industry to offer CDC pensions could be beneficial to sponsoring businesses and individuals. In CDC schemes, the risks would be with the members but shared between them collectively.

The rationale for intervention and therefore the introduction of CDCs is to create more flexibility in occupational pension provision so there is a new type of scheme that is:

- more sustainable for sponsoring employers than a DB scheme because it does not place any unpredictable future liabilities on them;
- and has the potential to give an income in retirement to members without the high cost of guarantees and is more predictable than is currently available to members of DC schemes who do not wish to purchase an annuity.

Secondary legislation will establish a secure regulatory framework within which single or connected employers can create CDC type pension schemes with adequate governance and safeguards in place for members and for employers. This sets out what CDC schemes must do to become authorised, to operate effectively in the market under regulatory oversight, and what happens if changes need to be made to schemes.

Collective Defined Contribution schemes

In a CDC scheme, the contributions of employers and employees are invested in a collective fund. When the member retires, they are paid a pension based on their share of that collective fund. The value of this pension

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

[6] Not a promise, actual pensions can be higher or lower depending on investment and longevity outcomes and will be adjusted by a formula in the scheme rules so that liabilities match assets.

[7]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/756275/delivering-collective-defined-contribution-pension-schemes.pdf

[8]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/786395/response-delivering-collective-defined-contribution-pension-schemes.pdf

will be based on the total value of the collective fund and will increase or decrease according to changes in investment performance or other risk factors.

CDC schemes will have an aspired to pensions level it will aim to pay members based on their share of the collective fund. Unlike DB schemes, that aspired level of pension income is not a promise and can increase or decrease depending on social and economic outcomes (mainly investment returns and longevity).

As discussed in the Government's White Paper 'Protecting Defined Benefit Pensions'[9], evidence shows that although the DB sector generally remains sustainable, the associated costs are high and higher than what was expected at the time the DB schemes were introduced. Currently, only 11% of all DB schemes (including hybrid schemes) are open to new members, down from 43% in 2006[10]. DB pensions are gradually being replaced with DC, where the risk is concentrated with each individual member, making them more sustainable for the sponsoring employers but riskier and more uncertain for the scheme members.

In CDCs, the risks are placed with the members, but they are shared among the members, thus allowing pensions provision to be smoothed out during different economic times. CDCs differ from the traditional DC schemes because it does not produce an individual "pension pot" which members then must decide how best to use to fund their retirement. Instead, CDCs pay out a regular retirement income from the collective fund taking away the need for members to make complex financial decisions. Whilst members of CDC schemes are able to transfer out their share of the fund at any point, CDCs take the big central decision of having to choose the right financial product out of retirement planning, as well as much of the risk, as members who stay in the scheme can rely on a regular, if variable, income throughout retirement.

Description of options considered

Option 0 - Do Nothing

This is the basis of our counterfactual. As the Bill Stage Impact Assessment[11] did not monetise the impacts of any provisions made in the 2021 Act; we are treating Option 0 as the counterfactual where Primary legislation was not enacted. Therefore, employers would still have to enrol eligible employees into either a DB or DC workplace pension scheme.

Doing nothing would mean there would be no additional cost to businesses or employers beyond running their current pension scheme. However, no business would be able to create a CDC scheme. Therefore, it would mean less opportunity, choice, and flexibility for both employers and workers. Not providing the option of CDC would prevent employers and workforces from being able to select a pension arrangement that may better suit their circumstances and would present an opportunity cost.

Previous engagement with the pensions industry via consultations[12,13] demonstrated strong support for legislative changes that would enable CDC schemes to be created. As previously explained, a well-designed CDC has the potential to offer a more predictable income in retirement for scheme members than for DC members who do not wish to purchase an annuity whilst being more sustainable to sponsoring employers than DB.

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[9]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/693655/protecting-defined-benefit-pension-schemes.pdf

[10] https://www.ppf.co.uk/sites/default/files/2020-12/PPF_Purple_Book_20.pdf

[11] https://publications.parliament.uk/pa/bills/lbill/58-01/004/5801004-IA-Annex-G.pdf

[12]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/756275/delivering-collective-defined-contribution-pension-schemes.pdf

[13]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/786395/response-delivering-collective-defined-contribution-pension-schemes.pdf

Option 1 - Guidance around authorisation and scheme design

This is a non-regulatory policy option and involves issuing guidance to employers and CDC trustees about member protections and ongoing supervision. This would encourage trustees to consider the risks about scheme design, financial sustainability and how best to safeguard members and their savings.

The main costs of this option are:

- One-off familiarisation for trustees to read the guidance

However, this option provides no regulatory protection for members and their savings which could put them at risk of being enrolled in a poorly designed scheme. Without regulation, trustees are unlikely to fully consider the risks and benefits to members of CDCs. It also gives businesses significant freedom to design a CDC in any way without considering the relevant risks. This option could result in the creation of very large schemes which pose a high risk to members or to particular cohorts of members. Without the necessary protection these schemes may be unsustainable and more likely fail, thus incurring greater costs to members and employers in the long term. This option risks damaging confidence in CDC and its potential to offer an attractive alternative to existing pension saving options.

Option 2 – Introducing secondary legislation to outline the authorisation and supervision regime

Option 2 is our preferred option. These regulations set up the framework for authorisation and supervision of CDC schemes, which includes:

a) a requirement on CDC schemes to be authorised before they can operate – i.e., before the scheme can start to receive contributions.
b) a system for CDC schemes to apply, be assessed for and be granted authorisation by the Regulator, and for the withdrawal of authorisation if the Regulator decides a scheme is no longer meeting the authorisation criteria on an ongoing basis.
c) provision for appeals if a CDC scheme is not content with the Regulator's decisions.
d) the six criteria that schemes must meet in order for the Regulator to be satisfied that they can be and remain authorised:
    i. that the persons involved in the scheme are fit and proper persons
    ii. that the design of the scheme is sound
    iii. that the scheme is financially sustainable
    iv. that the scheme has adequate systems and processes for communicating with members and others
    v. that the systems and processes used in running the scheme are sufficient to ensure that it is run effectively, and;
    vi. that the scheme has an adequate continuity strategy

Authorisation Criteria

The 2021 Act did not specify the detailed standards for each authorisation criteria. Setting out the details in secondary legislation is more appropriate and can provide the flexibility needed for the implementation of a proportionate regime - for example, providing a route to respond to a changing market in the future.

Costs and benefits to businesses

Counterfactuals

The counterfactual is the 'do nothing' option. As stated, whilst this regulatory framework is a marginal additional cost incurred over and above the costs which firms choose when opting to set up a CDC. For

completeness, as no estimates were made of costs, the counterfactual assumes there could be no CDC without this change. Therefore, this is where a business must enrol eligible employees into either a DB or DC workplace pension scheme in order to fulfil their automatic enrolment duties. Depending on whether a business offers a DB or DC scheme there may be different costs and benefits as discussed below. Regardless of the counterfactual, we only anticipate these direct costs to be incurred if the business expects the benefits to outweigh the costs.

DB Counterfactual

Where the counterfactual is DB, savings to sponsoring businesses may be substantial. New private sector DB schemes are no longer being created in practice and where DB promises already exist employers cannot break them. However, they may choose to close their schemes to new members and/or future accruals.

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

There is a strong financial incentive for DB sponsoring businesses to switch to a CDC scheme, but it is not possible to know how many of these would have switched to DC if there was no CDC option.

DC Counterfactual

Where the counterfactual is DC, there may be some differences in direct costs to sponsoring businesses. CDC schemes are likely to incur greater costs in the running and set up of the scheme in comparison to a conventional DC scheme. For example, employers who decide to use Nest or another Master Trust to fulfil their automatic enrolment duties have minimal costs. Larger employers who run their own DC scheme may see more comparable costs with CDC schemes although we acknowledge that there may be some differences such as the actuarial input needed in CDC schemes. For example, CDC schemes are required to undertake an annual valuation of the collective funds, which may result in some differences in scheme running costs, when compared against DC.

Where the counterfactual is DC, we do not envisage fundamental differences in direct costs to sponsoring businesses so there are no anticipated savings to business in terms of lower pension scheme costs. It is possible that moving from DC to CDC would result in benefits to employers in terms of improved employee retention, but we do not have any robust evidence to estimate this.

Expected level of business impacts

These regulations do not mandate CDCs but provides a framework if an employer wants to set up a CDC scheme. We only expect businesses to incur any gross costs if it were beneficial to do so compared to their next best alternative. **Therefore, we assume businesses will only incur costs if the benefits are greater than the costs.**

DWP produced a consultation stage impact assessment (IA)[14] and final stage impact assessment[15] (IA). In these, DWP set out its intention to calculate an Equivalent Annual Net Direct Cost to Business (EANDCB). Specifically:

- The costs and benefits depend on the counterfactual (whether a firm's employees would in future be enrolled in a DB scheme, a DC scheme, or a hybrid DB/DC scheme) which is not possible to predict. Particularly for DB employers, there are uncertainties as to whether they would switch to DC in the absence of CDC legislation. In any counterfactual all employers with eligible employees will be required to set up a workplace pension and automatically enrol eligible employees. We have good data on how many employers currently offer DB, DC, and hybrid schemes, but we do not know what employers will choose to do in the future in relation to their scheme choice for occupational pensions.

- Consultation responses[16] illustrated further interest in CDC amongst the wider pensions industry but did not identify new plans to deliver CDC. Consequently, the potential take-up of CDCs from employers is currently an unknown with only the Royal Mail Group the only employer to commit to establishing a CDC scheme for its employees. Therefore, on the grounds of commercial sensitivity, we are unable to quantify any potential net direct cost to business.

We still believe both these points are relevant. It is still not possible to predict the counterfactual or whether an employer would switch schemes in the absence of CDC legislation. We are also still aware only the Royal Mail Group having clear plans to deliver a CDC scheme.

At this stage there is still considerable uncertainty over the full impacts of the proposal, and the exact content of the Regulator's Code is yet to be finalised. Some impacts will depend on specific features of the CDC schemes applying for authorisation, of which there may be a wide variety, which creates some uncertainty about the costs.

We have discussed the direct costs to business arising from the secondary legislation. All businesses who choose to set up a CDC scheme will incur costs associated with:

- One-off familiarisation for trustees to read the relevant legislation and guidance
- One-off costs associated with meeting the criteria to be authorised
- Ongoing costs associated with meeting the supervisory regime

Depending on the scheme design some employers may also incur additional ongoing scheme running costs compared to their counterfactual.

Many of the regulations specify clear minimum standards that must be met by CDCs in order to gain authorisation but are not overly prescriptive on how the CDCs should meet them. This adds to the uncertainty around any estimates of the costs of this policy. Some detail about how schemes can demonstrate that they meet these requirements will be set out in the Regulator's Code, which is likely to be published after this impact assessment.

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[14] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/754329/impact-assessment-delivering-collective-defined-contribution-pension-schemes.pdf

[15] https://publications.parliament.uk/pa/bills/lbill/58-01/004/5801004-IA-Annex-G.pdf

[16] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/786395/response-delivering-collective-defined-contribution-pension-schemes.pdf

There is some overlap with Master Trust Authorisation and DB schemes, and we will refer to this where possible. We have also gathered consultation responses, engaged with industry, and have used qualitative evidence to provide context to some of our costs or reasons for uncertainty.

If a business decided to set up a CDC scheme as soon as the relevant legislation was laid, the 10-year appraisal is outlined in Table 2. As more schemes are established, the timings and costs associated with the creation of a CDC scheme may be reduced as lessons are learnt and shared across the industry.

Table 2: 10-year appraisal period for activities and costs associated with adopting a CDC scheme

Year	2021/2022	2022/2023	2023/2024	2024/25-2030/31
Appraisal period year	**1**	**2**	**3**	**4-10**
Event	Pension Schemes Act 2021 passed January 2021 Secondary legislation laid December 2021	The Regulator's code and guidance is published Authorisation comes into force August 2022 First CDC schemes can apply for authorisation	CDC schemes can apply for authorisation First CDC schemes begin operating	Steady market state Authorised schemes begin operating Other businesses may set up CDCs
Activity	Familiarisation with primary legislation Familiarisation with secondary legislation	Familiarisation with code and guidance Initial scoping work Application fee Fit and proper persons Financial sustainability Scheme design Communication requirement Systems and processes Continuity strategy	Valuation and Benefit Adjustment Supervisory return	Valuation and Benefit Adjustment Supervisory return

Familiarisation

Businesses who decide to set up a CDC scheme will be required to familiarise themselves with:

- the primary legislation
- the secondary legislation[17]
- the Regulator's code and guidance.

If we assume two senior managers and eight trustees are required to familiarise, based on the average reading speed of around six minutes per page[18], the total cost of familiarisation is estimated to be £37,800[19] per business with £15,400 in the 1st year of the appraisal period and £22,500 in the 2nd year of the appraisal period. Regardless of whether a business has an existing DB or DC scheme, if they transition to a CDC, they will incur this additional cost. We believe they will only incur this cost if the benefits outweigh it.

Our initial assumptions for these costs are outlined below[20]:

Familiarisation with primary legislation (entire Act)

(199 pages x 6 minutes reading time per page) x 2 senior managers x £28.87 hourly wage = £1,100

(199 pages x 6 minutes reading time per page) x 8 trustees x £100.78 hourly wage = £16,000

Familiarisation with primary legislation (only CDC regulations)

(102 pages x 6 minutes reading time per page) x 2 senior managers x £28.87 hourly wage = £600

(102 pages x 6 minutes reading time per page) x 8 trustee x £100.78 hourly wage = £8,200

Familiarisation with secondary legislation

(76 pages x 6 minutes reading time per page) x 2 senior managers x £28.87 hourly wage = £400

(76 pages x 6 minutes reading time per page) x 8 trustee x £100.78 hourly wage = £6,100

Familiarisation with the Regulator's code and guidance[21]

(260 pages x 6 minutes reading time per page) x 2 senior managers x £28.87 hourly wage = £1,500

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[17] Including affirmative and negative packages of legislation
[18] Based on assumptions used in previous pensions-related impact assessments.
[19] Assuming familiarisation CDC specific sections of Act rather than the whole Act.
[20] Costs may not add up due to rounding.
[21] Based on Master Trust authorisation guidance as a proxy.

$$(260 \text{ pages x } 6 \text{ minutes reading time per page}) \text{ x } 8 \text{ trustee x } £100.78 \text{ hourly wage} = £21{,}000$$

Scoping

The regulations have flexibility for businesses to adapt and design a CDC scheme that suits their needs and desired outcomes. Businesses may decide to take time determining the type of scheme they want to offer members. This may include the scoping and testing of scheme designs, investment strategies, contribution rates and accrual rates.

These activities may incur costs such as actuarial, legal and investment advice depending on whether they want to develop a scheme within the parameters of the regulations, a bespoke scheme or something beyond the regulations. However, it is at the discretion of the employer how much time, money, and resource they spend, and it is not considered an additional cost to business.

Preparing an application

Until an employer's CDC is authorised by the Regulator, they cannot start to receive any contributions. When an employer makes an application for authorisation, they will have to:

a) prepare and submit the relevant products and information to support their application which will be considered by the Regulator (discussed in more detailed later)

b) pay an application fee to the Regulator to cover the cost of assessing and processing the application

The exact amount of the application fee is yet to be finalised, but we estimate in our consultation response[22] that the maximum level of the fee will be £77,000 per scheme from the second year of the appraisal period. Regardless of whether a business has an existing DB or DC scheme, if they transition to a CDC, they will incur this additional cost. We believe they will only incur this cost if the benefits outweigh it.

Sectionalisation

Should a business operating a CDC scheme wish to offer, for example, new employees a different contribution rate the regulations require that they can only do this by opening a new section for those employees. The new section will need to be authorised by Regulator before it can begin operating. The level of the application fee for authorisation of the new section, which cannot exceed the maximum level, will be determined by the Regulator who will take into account factors such as the degree to which the original scheme and the new section share IT systems, trustees etc. It is at the discretion of the employer if they decide to open a new section and it is not considered an additional cost to business.

Fit and Proper

As a part of their application for authorisation by the Regulator, persons undertaking key functions[23] in the CDC scheme will have to meet the fit and proper persons requirement. The is intended to protect members by ensuring that persons who establish and make key decisions in respect of a CDC scheme demonstrate appropriate standards of integrity and understanding to act in the capacity specified in the 2021 Act.

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[22]

[23] The roles included in the need to complete a fit and proper person test may include; a person who establishes the scheme, a trustee, any person who has the power to appoint or remove a trustee, a person who has the power to vary the terms of the trust under which the scheme is established, a person who has the power to vary the scheme, and anyone else specified in the reg.

It is expected that in the first tranche of schemes, the persons acting in relation to the scheme in the capacities mentioned will be either the employer, the trustees, or a combination of both[24]. The relevant persons will have to supply their information to the Regulator to meet the requirements.

This requirement consists of three matters:

a) Conduct

b) Integrity

c) Competence

The Regulator will outline what is expected, in its forthcoming Code, in terms of the knowledge and experience deemed sufficient for individual trustees and for the board as a whole. Therefore, we have used the existing Master Trust fit and proper authorisation criteria as a proxy.

Conduct and Integrity

The matters to be considered by the Regulator are similar to those it considers when authorising Master Trusts. These include:

a) bankruptcy

b) unspent criminal convictions

c) settlements and findings in civil proceedings

d) disqualification of directors

e) prohibition of trustees

f) contravention of the rules of any other regulatory authority

The Master Trust authorisation impact assessment estimated that sixteen people at each Master Trust would have to complete the integrity and conduct tests[25]. Given that CDCs do not have scheme strategist or funders we have assumed that half the number of people will need to carry out the tests for CDC authorisation.

The FCA has a fit and proper test for those carrying out a 'senior managers' function within the scope of their authorisation regime. In the cost benefit analysis[26] for this change, they estimated that each individual that would need to be checked would spend 45 minutes preparing their information. For Master Trust authorisation because there were fewer elements than the FCA's tests, it was assumed that for the Regulator's tests individuals will spend 30 minutes collecting the required information.

Although the Regulator's code and tests are not yet available, we have assumed that for the Regulator's tests individuals will spend 30 minutes collecting the required information.

Cost of conduct and integrity tests

$$8 \text{ people in each CDC scheme x } 0.5 \text{ hours to collect information x } £100.78 \text{ hourly wage rate} = £400$$

[24] We have used the trustee wage in our calculations, but this cost may be lower if undertaken by the employer or a senior manager.
[25] https://www.legislation.gov.uk/ukdsi/2018/9780111169261/pdfs/ukdsiod_9780111169261_en.pdf
[26] https://www.fca.org.uk/publication/research/cba-extension-senior-managers-certification-regime.pdf

Competence tests

Given the additional complexity of CDC schemes, the trustees must have appropriate experience, knowledge and understanding to properly discharge their duties. The Regulator will outline what is expected, in its forthcoming Code, in terms of the knowledge and experience deemed sufficient for individual trustees and for the board as a whole.

It is expected a board of trustees will be competent as a whole to carry out the functions required of it at the point of application, and on an ongoing basis, and to show how they will meet and continue to meet those requirements.

The Master Trust authorisation impact assessment estimated that six people at each Master Trust would have to complete the competency tests[27]. We have accordingly estimated that six people in a CDC scheme that apply will have to complete this test.

One way of demonstrating compliance could be completing the Trustee Knowledge and Understanding[28] (TKU) through the Regulator's Trustee Toolkit[29]. Under CDC it is envisaged that trustees will need to have sufficient knowledge upon application. What this means for individual trustees and how this is balanced with the knowledge and understanding expected across the trustee board will be set out in the Regulator's forthcoming code.

The Regulator's 2016 governance survey of schemes found that 75% of trustees of Master Trust schemes had adequate levels of knowledge and understanding[30]. We accordingly assume that 75% of trustees will be able to complete the competency test with no extra work, and that 25% will need to spend time studying to pass the test.

We have assumed that 75% (4) of these people will not need any further preparation, and 25% (2) of them will need to do a large amount. Each of the 6 people will also need to spend time completing the tests; the TKU suggests that the tests will take 165 minutes to complete, so we have assumed at this stage that the competence tests will take the same amount of time, in the absence of any evidence to suggest that the tests will be materially different at this stage.

Competence test (prepared)

$$4 \text{ people completing these tests x } 2.75 \text{ hours taken to complete the tests x } £100.78 \text{ hourly wage} = \mathbf{£1,100}$$

Competence test (unprepared)

$$2 \text{ people completing these tests x } 20.75 \text{ hours prepare for and complete the tests x } £100.78 \text{ hourly wage} = \mathbf{£4,200}$$

The Regulator will consider the evidence provided when deciding whether an individual meets the fit and proper requirement. It is possible that someone might not meet this requirement and will need to be replaced. Evidence suggests, however, that few people fail the FCA's Approved Persons Regime[31]. We do not therefore believe that there will be a significant failure rate for the Regulator's fit and proper tests, given the relatively low number of people that will be checked in this policy option compared to under FCA's regime. In addition, the Regulator's Code of Practice will make clear what checks will take place.

[27] https://www.legislation.gov.uk/ukdsi/2018/9780111169261/pdfs/ukdsiod_9780111169261_en.pdf
[28] https://www.thepensionsregulator.gov.uk/en/document-library/regulatory-guidance/trustee-knowledge-and-understanding
[29] https://trusteetoolkit.thepensionsregulator.gov.uk/
[30] http://www.thepensionsregulator.gov.uk/docs/dc-research-summary-report-2016.pdf
[31] http://uk.reuters.com/article/uk-fca-appointments-idUKBRE93B06P20130412

Competency tests will be a one-off cost to business in the second year of the appraisal period which we estimate will be £5,300.

The total cost of meeting the 'fit and proper' requirements for authorisation is estimated to be £5,700 in the 2nd year of the appraisal period. Regardless of whether a business has an existing DB or DC scheme, if they transition to a CDC, they will incur this additional cost. We believe they will only incur this cost if the benefits outweigh it.

Scheme Design

This authorisation criterion aims to protect members from being enrolled in ill-considered and poorly designed CDC schemes, which are unlikely to remain viable over the long-term. It requires the Regulator to be satisfied that the design of a CDC scheme is sound.

The regulations seek to set out sensible parameters to weed out applications in respect of poorly designed schemes whose members may be better off saving for retirement elsewhere, or to highlight emerging threats in live schemes, such as an increasing risk of intergenerational unfairness, which suggest it should close to new accruals.

A viability report and viability certificate produced by the scheme's trustees and scheme actuary respectively must be submitted to the Regulator on application for authorisation. These products must be kept under review by the scheme actuary and trustees over the course of scheme's lifetime to ensure it remains sound.

It is difficult to estimate the exact timings and cost of the creation of the scheme design, viability report and certificate. It is likely some of the work undertaken in the scoping activities could be adapted to support this authorisation criterion and therefore schemes may off-set or pre-empt some of the costs in preparing the initial application. The annual valuation process will also help to inform the annual review and certification of soundness by the scheme actuary.

Due to an absence of other evidence, we have used the typical actuarial costs associated with running a DB scheme as a proxy for the cost of actuarial input required for the scheme design criterion and assumed this would cover the actuarial input required for the creation of viability report and signing off of the viability report. The Regulator collected data on the typical yearly running costs, excluding triennial valuation, of DB schemes[32], shown below in Table 3:

Table 3: Typical yearly actuarial costs for the scheme and per member excluding triennial valuation costs, by scheme size[33]

	Small scheme (12-99 members)	Medium scheme (100-999 members)	Large scheme (1000 - 4999 members)	Very large scheme (5000+ members)
Scheme cost (median)	£5,000	£26,608	£71,801	£260,502
Scheme cost (mean)	£8,759	£37,703	£83,890	£287,730

[32] https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/db-scheme-costs-research-2014.ashx

[33] https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/db-scheme-costs-research-2014.ashx

If we assume only larger employers will open a CDC scheme, then the very large scheme estimate may be the most suitable although this is likely to be an overestimate. This information was collected in 2012 so this has been uprated to 2021 prices using data from the Office of National Statistics[34], the cost in 2020/21 prices is therefore £303,300.

Our engagement with the Regulator suggests there may some work undertaken at this stage accounting for the valuation of the scheme. In the absence of other evidence, we have used the triennial valuation of DB schemes as a proxy. The Regulator collected data on the cost of triennial valuation, of DB schemes[35], shown below in Table 4:

Table 4: Cost of triennial valuation, by scheme size[36]

	Small scheme (12-99 members)	Medium scheme (100-999 members)	Large scheme (1000 - 4999 members)	Very large scheme (5000+ members)
Scheme cost (median)	£15,000	£32,440	£62,248	£286,986
Scheme cost (mean)	£16,694	£39,556	£102,860	£240,858

If we assume only larger employers will open a CDC scheme, then the very large scheme estimate may be the most suitable. This information was collected in 2012 so this has been uprated to 2021 using data from the Office of National Statistics[37], the cost in 2021 prices is therefore £337,700.

Where trustees have a role in this criterion, it is likely they will be very reliant on advice and input from their actuary. Therefore, we have assumed it may take two trustees around two weeks to write and clear the viability report.

Writing, clearing, and submitting the viability report and certificate

$$2 \text{ trustees x } (37.5 \text{ hours a week x } 2 \text{ weeks}) \text{ x } £100.78 \text{ wage rate} =$$

$$\mathbf{£15{,}100}$$

We therefore assume that the cost will be £656,100 in the 3rd year of the appraisal period. Regardless of whether a business has an existing DB or DC scheme, if they transition to a CDC, they will incur this additional cost. We believe they will only incur this cost if the benefit outweighs it.

Financial Sustainability

34 https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/d7bt/mm23
35 https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/db-scheme-costs-research-2014.ashx
36 https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/db-scheme-costs-research-2014.ashx
37 https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/d7bt/mm23

This authorisation criterion aims to ensure CDC schemes have sufficient financial resources and well considered strategies to meet the costs of setting up and running a CDC scheme, as well as costs associated with the occurrence of a triggering event.

The Regulator will require evidence to enable it to decide whether it is satisfied that a CDC scheme is financially sustainable, including:

- the estimated costs of setting up and running the scheme
- details of the scheme's sources of income, and
- the trustees' strategy for meeting any shortfall between its income and costs including the cost of resolving any triggering event (discussed below)

A CDC scheme will need to have key elements in place before it can be authorised and begin to operate. In deciding whether it is satisfied about a scheme's financial sustainability, the Regulator must take into account various matters in making its decision.

The Regulator will provide more practical guidance to trustees seeking to evidence this requirement in its forthcoming Code. However, the approach set out is similar to that taken in the authorisation of master trusts and therefore we will use the costs and requirements associated with Master Trust authorisation as a proxy.

Financial resources

Each CDC scheme will have to hold or be able to access a different amount of money for the financial sustainability requirement, which will be heavily dependent on a variety of factors, including scale, but the baseline is that trustees should have access to sufficient funds to meet the relevant costs at the point they are needed. Schemes will have to spend time assessing and reviewing the initial and on-going cost of running the scheme and the estimated cost of resolving potential triggering events, such as the need to wind up the scheme. The CDC regime does provide flexibility to accommodate a range of financing arrangements. The Regulator's forthcoming code will provide further information on these and other matters.

If a scheme is unable to meet relevant costs from member-borne charges, then the establishing employer may need to help out. It is important that any guarantee from an employer to meet relevant costs is credible and realisable. This does require assessment based on detailed information about the employer. Once again, the Regulator's forthcoming code will provide further information on these matters.

These estimates carry with them a significant degree of uncertainty, as the running costs of a scheme depend heavily on a number of different factors, such as whether the scheme uses a third-party administrator, or does the work in-house, and scale. Much of this is commercially sensitive so we have assumed it may take two trustees around eight hours to gather the relevant evidence required for this criterion.

Collecting information for financial resources

$$2 \text{ trustees x } 8 \text{ hours taken to gather financial information x } £100.78 \text{ wage rate} =$$

$$\mathbf{£1{,}600}$$

The former Department for Business, Innovation and Skills estimated the cost to business of an audit to be £7,700.48[38]. This has been uprated to 2020/21 using data from the Office of National Statistics[39], the cost in

[38] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/348795/bis-14-1059-revised-impact-assessmenton-reform-of-audit-exemptions-26-march-2014.pdf
[39] https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/l522/mm23

2020/21 prices is therefore £8,600. The business would also have a professional spend approximately two hours preparing the accounts, at an hourly rate of £100.87.

Auditing accounts

$$£8{,}600 \text{ cost of audited accounts} + (2 \text{ hours preparing the accounts x } £100.78 \text{ hourly wage}) = £8{,}800$$

The impact of providing such information will depend heavily on how much of this information the has available, and what will need to be created separately. We estimate that the total cost of meeting the 'financial sustainability' authorisation criteria will be £10,400 in the 2nd year of the appraisal period. Regardless of whether a business has an existing DB or DC scheme, if they transition to a CDC, they will incur this additional cost. We believe they will only incur this cost if the benefits outweigh it.

Communication requirement

This authorisation criterion aims to ensure effective scheme communications are delivered to relevant persons in relation to the scheme. The Regulator is expected to take the following into account when deciding whether a scheme meets the communication requirement:

- the necessary functionality (capability and capacity) and maintenance of IT systems for delivering scheme communications
- the systems and processes for ensuring there are sufficient human resources, with relevant skills, qualifications, and capacity for delivering scheme communications
- quality assurance systems and processes – whether there are systems and processes for assessing and improving the effectiveness of scheme communications, ensuring they are accurate and not misleading and reviewed by appropriate persons within the scheme
- member engagement – systems and processes for gathering member feedback, taking it into consideration in designing scheme communications and for reporting to trustees and members as to how feedback has been taken into account in the design of scheme communications.

There will be an initial cost to businesses as they explain the new pension structure to members and clearly state the differences between CDCs and other forms of pension provision. This cost is likely to be higher for early adopters, as over time we would expect a bank of communication materials to be built up by existing scheme consultants.

A CDC scheme will have a host of disclosure requirements to follow; the majority of which will be similar to DC requirements but with some tweaks. However, CDCs will also have additional publication requirements which will need the development of some documents such as the scheme design statement, benefit statement, and valuation and benefit adjustment statement.

The simpler annual benefit statement impact assessment[40] outlined the cost and timings of re-designing benefit statements. Whilst this does not provide an exact proxy, industry engagement provided some insight on how long it could take to draft member communications and who might be involved. There was a range of responses suggesting transition could take between one to two years, but we have assumed it would take around one year to design new member communications; including any testing and time for sign off. The main

[40] https://www.legislation.gov.uk/ukia/2021/77

cost would be for marketing colleagues to draft new communications materials and then getting these signed off by the relevant trustee:

Drafting new communications (low estimate)

$$1 \text{ marketing colleague x } (35.7 \text{ hours a week x } 26 \text{ weeks}) \text{ x £}22.26 \text{ hourly wage} = \text{£}20{,}700$$
$$1 \text{ trustee x } 2 \text{ hours to clear new communications x £}100.78 \text{ hourly wage} = \text{£}200$$

Drafting new communications (best estimate)

$$1 \text{ marketing colleague x } (35.7 \text{ hours a week x } 52 \text{ weeks}) \text{ x £}22.26 \text{ hourly wage} = \text{£}41{,}300$$
$$1 \text{ trustee x } 2 \text{ hours to clear new communications x £}100.78 \text{ hourly wage} = \text{£}200$$

Drafting new communications (high estimate)

$$1 \text{ marketing colleague x } (35.7 \text{ hours a week x } 104 \text{ weeks}) \text{ x £}22.26 \text{ hourly wage} = \text{£}82{,}700$$
$$1 \text{ trustee x } 2 \text{ hours to clear new communications x £}100.78 \text{ hourly wage} = \text{£}200$$

Therefore, we expect the cost of drafting new communications to be £41,500 in the second year of the appraisal period.

We asked respondents to our consultation[41] about the distribution of member communications and a few felt it made financial and logistical sense to send all communications provided by a new CDC scheme electronically by default. Given that CDC schemes will be established by single connected employers with existing communication systems, we assume communications will likely be done by email and therefore incur negligible costs. If businesses choose to send out communications via alternative methods, such as by post, this would incur an additional cost. However, this is at the discretion of the business, and we have not accounted for this in our estimates.

Alongside the new communications, CDC schemes will be expected to evidence to the Regulator they have the relevant systems in place for communication clearly and effectively with their members. Responses to our consultation[42] expressed that the communication requirement and materials would not be significantly different from DB or DC schemes. Many existing pension schemes and businesses will already have communication systems and processes in place which can be adapted for the requirements of CDC schemes. As such, we expect ongoing communication costs to be comparable to those experienced by any large pension scheme after the creation and drafting of new communications to members.

Responses to our consultation[43] suggested that new schemes were unlikely to publish additional communications beyond the statutory requirements outlined in the regulations, for fear of overloading members with information. If businesses, choose to send additional communications outside those outlined in the regulations or use alternative methods of contact with members this would incur an additional cost. This is at the discretion of each business, and we have not accounted for this in our estimates.

At this stage we are unsure how this might be evidenced to the Regulator. Therefore, we have assumed it would take two trustees around eight hours to collect the evidence and information required to satisfy the Regulator:

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[41] https://www.gov.uk/government/consultations/the-occupational-pension-schemes-collective-money-purchase-schemes-regulations-2021/the-occupational-pension-schemes-collective-money-purchase-schemes-regulations-2021#chapter-3-criteria-for-authorisation
[42] https://www.gov.uk/government/consultations/the-occupational-pension-schemes-collective-money-purchase-schemes-regulations-2021/the-occupational-pension-schemes-collective-money-purchase-schemes-regulations-2021#chapter-3-criteria-for-authorisation
[43] https://www.gov.uk/government/consultations/the-occupational-pension-schemes-collective-money-purchase-schemes-regulations-2021/the-occupational-pension-schemes-collective-money-purchase-schemes-regulations-2021#chapter-3-criteria-for-authorisation

Collecting information for communications requirement

$$2 \text{ trustees} \times 8 \text{ hours taken to gather financial information} \times £100.78 \text{ wage rate} =$$

$$\mathbf{£1,600}$$

We therefore estimate that the cost of meeting the communications criterion will be £43,100 in the 2nd year of the appraisal period. Regardless of whether a business has an existing DB or DC scheme, if they transition to a CDC, they will incur additional costs to draft new communications and satisfy the Regulator's requirements. We believe they will only incur this cost if the benefits outweigh it.

Systems and processes requirement

This authorisation criterion aims to identify whether the systems and processes used in running a CDC scheme are sufficient to ensure that it is run effectively. Schemes will be expected to have the appropriate systems and processes to enable them to maintain a good standard of administration and governance so that there is adequate security for members' savings and their data.

Matters which the Regulator may take into account include whether:

- the IT systems have the capacity and capability to process financial transactions securely, accurately and by automated means
- there are specified systems and processes to support the annual valuation and benefit adjustment process
- there are systems and processes for investing contributions in accordance with the scheme's investment policy, and for recording investment decisions and for recording, managing, and reviewing the risks associated with investment decisions
- systems and processes ensure that adequate member records will be kept and regularly reviewed and cleansed if required, particularly those relating to each member's pensionable service and their accrued rights within the scheme
- there are systems and processes for ensuring that there are sufficient human resources with the skills, qualifications, and capacity necessary to run a CMP scheme in accordance with Part 1 of the 2021 Act
- the systems and processes ensure that, for each financial year, in respect of each scheme member in decumulation, records are maintained including the amount of pension or other benefits received
- there are systems and processes for:
- engaging with and managing service providers
- effectively managing governance of the scheme
- identifying, managing, and monitoring risks – operational, financial, regulatory and compliance
- facilitating member engagement, bringing member's views of the scheme to the attention of trustees, and directing any member complaints to the correct channel for resolution

These regulations do not mandate the use of certain IT systems and are about minimum standards rather than gold-plating. The expectation is that schemes will have the right systems and processes in place to deliver what is set out in their business plan.

One response to our consultation[44] estimated the cost of creating a distributed ledger technology, smart contract-based system capable of single or multi-employer application at between £0.75 million and £1.25 million. In instances where the creation of new systems is necessary, the mid-point (£1 million) would be our best estimate at this stage.

Cost of creating new systems (high estimate)

((£1,000,000 cost of creating new systems and processes) + (27 hours taken to demonstrate that the CDC meets the requirements x £100.78 wage rate)) = £1,002,700

However, given the similarities in the administration and running of DB and CDC schemes, we expect new administration software would not need to be produced. Instead, multiple respondents noted that initial adjustments to existing software will be required to incorporate the relevant CDC components.

Responses to our consultation showed that costs are difficult to estimate at this stage but that amendments to existing systems and infrastructure could be done at 'relatively modest cost.' We assume this to be 10% of the quoted cost of creating the systems from scratch, in line with the adjustment costs for Master Trusts system and processes. Ongoing costs are thought to be similar, if not less, than comparable DB schemes.

In addition to this we estimate that one person in each scheme will have to spend 27 hours collecting this evidence and showing that the scheme meets the requirements. This is largely in line with the estimates used for the Master Trust authorisation impact assessment. The overall cost to business is therefore calculated as:

Cost of minor adaptations to existing systems (best estimate)

(((£100,000 cost of adjusting existing systems and processes) + (27 hours taken to demonstrate that the CDC meets the requirements x £100.78 wage rate) = £102,700

We therefore estimate that the cost of meeting the system and processes criterion will be £102,700 in the 2nd year of the appraisal period. Regardless of whether a business has an existing DB or DC scheme, if they transition to a CDC, they will incur an additional cost of meeting the Regulator. We believe they will only incur this cost if the benefits outweigh it.

Continuity Strategy

This authorisation criterion requires trustees of a CDC scheme to prepare a continuity strategy document which sets out how the interests of the scheme members will be protected if the scheme experiences a triggering event. Triggering events can pose a serious risk to the future of the scheme and the interests of members.

The strategy is envisaged to be a high-level but wide ranging and flexible document which provides a framework for identifying key actions, decisions, and owners of actions required to deal with a triggering event period. The continuity strategy must also set out the timescales within which the scheme will resolve the triggering event and how the costs of continuing to operate the scheme and resolve the event will be funded.

The aim of the continuity strategy requirement is to demonstrate that trustees have considered and anticipated risks that may arise in future. The strategy should explain what plans trustees have put in place so

[44] https://www.gov.uk/government/consultations/the-occupational-pension-schemes-collective-money-purchase-schemes-regulations-2021/the-occupational-pension-schemes-collective-money-purchase-schemes-regulations-2021#chapter-3-criteria-for-authorisation

that the consequences of these events can be managed in an orderly fashion, and that scheme members will be adequately protected during this process.

The approach we have taken is similar to that taken in the Master Trust authorisation regime.

The Master Trust authorisation estimated that it would take two people around 18 hours each to prepare the continuity strategy. However, we have assumed that schemes applying for CDC authorisation will take longer to prepare their continuity strategy given that, compared to Master Trusts, CDC schemes have an extra continuity option which they will need to account for.

Draft Continuity Strategy (low estimate)

(2 trustees x 18 hours taken) x £ 100.78 =

£3,600

Draft Continuity Strategy (best estimate)

(2 trustees x 36 hours taken) x £ 100.78 =

£7,300

We therefore estimate that the cost of meeting the continuity strategy criterion will be £7,300 in the 2nd year of the appraisal period. Regardless of whether a business has an existing DB or DC scheme, if they transition to a CDC, they will incur an additional cost of meeting the Regulator's requirements.

Valuation and Benefit Adjustment

Each year after authorisation, CDC schemes are required to run an actuarial valuation and benefit adjustment process. Benefits can be adjusted every year in order to keep the value of assets held and the projected costs of benefits in balance, so the schemes are financially sound. The regulations outline strict rules for CDC schemes to follow around benefit adjustment, which ensure that all members are subject to the same adjustments.

CDC schemes must operate in ways that avoid bias in favour of any group or cohort of members by requiring:

- valuations to be undertaken using a central estimate methodology that does not seek to be overly optimistic or to build in prudence
- any adjustment of benefits to apply to all members without variation
- any increases in benefits resulting from the valuation to be sustainable

There was a concern expressed about how members, especially pensioner members, would adapt to sudden decreases in benefits. We believe that for a well-designed CDC scheme, cutting the rate of benefit in payment should be a rare event. But we are conscious that in some extreme scenarios cuts in benefit of several percentage points might be needed. This will be mitigated by the multi-annual reduction mechanism, which is designed to help smooth the impact of reductions, included in the regulations.

Engagement with industry suggested this was a potential cost that was very difficult to predict given the Regulator's Code and expectations are currently unknown. Although our engagement identified that the valuation and benefit adjustment process is likely to involve significant actuarial and administrative input. In

the absence of other evidence, we have used the triennial valuation of DB schemes as a proxy. The Regulator collected data on the cost of triennial valuation, of DB schemes[45], shown below in Table 5:

Table 5: Cost of triennial valuation, by scheme size[46]

	Small scheme (12-99 members)	Medium scheme (100-999 members)	Large scheme (1000 - 4999 members)	Very large scheme (5000+ members)
Scheme cost (median)	£15,000	£32,440	£62,248	£286,986
Scheme cost (mean)	£16,694	£39,556	£102,860	£240,858

If we assume only larger employers will open a CDC scheme, then the very large scheme estimate may be the most suitable. This information was collected in 2012 so this has been uprated to 2021 using data from the Office of National Statistics[47], the cost in 2021 prices is therefore £334,200.

Therefore, the cost of the annual valuation and benefit adjustment is £334,200, each year after authorisation. If a business has an existing DC scheme and they transition to a CDC they will incur an additional cost in the yearly valuation of the scheme. Existing DB schemes currently run triennial valuations and we would expect the cost of these to be higher than the annual valuation required for CDCs, however, we do not know by how much at this stage so cannot estimate the potential savings.

Ongoing Supervision

Once a CDC scheme receives authorisation, it will still be required to be able to demonstrate to the Regulator that it continues to meet the authorisation criteria on an ongoing basis.

Responses to our consultation[48] indicate that the potential ongoing financial costs associated with ensuring the scheme continues to meet the ongoing supervision requirements will be broadly similar to the costs under an existing closed DB or hybrid pension scheme of similar size, although the spread of costs may be different.

The biggest annual cost is likely to be the annual actuarial process (discussed above), though this will likely be offset by cheaper costs of administration and communications.

Our engagement with industry has suggested the actuarial, communications and IT costs required for a CDC scheme would not differ significantly from a DB scheme although there will be additional costs associated with ongoing requirements to report to the Regulator.

At this time, the Regulator's exact ongoing supervisory requirements on CDC schemes are unknown but we assume that it will broadly include the supervisory return plus engaging in pro-active regular meetings and quarterly discussions with the Regulator.

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[45] https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/db-scheme-costs-research-2014.ashx
[46] https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/db-scheme-costs-research-2014.ashx
[47] https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/d7bt/mm23
[48] https://www.gov.uk/government/consultations/the-occupational-pension-schemes-collective-money-purchase-schemes-regulations-2021/the-occupational-pension-schemes-collective-money-purchase-schemes-regulations-2021#chapter-4--valuation-and-benefit-adjustment

Supervisory return

The supervisory return will be used by the Regulator to inform its ongoing risk assessment of schemes and enables the Regulator to place a minimum reporting requirement on schemes to maintain at least annual contact with the Regulator. This will complement the close collaborative engagement that the Regulator envisages developing with CDC schemes on an ongoing basis.

The supervisory return is an important tool for supervising CDC schemes and ensuring they continue to maintain the high levels of compliance expected from them. Its contents will, alongside the viability report and continuity strategy, inform the Regulator's ongoing assessment of the scheme against the six authorisation criteria.

The Regulator will determine the exact form of the supervisory return including the precise details of what it should cover. However, the expectation is that the supervisory return will only ask for information that the provider should already be collecting and therefore should not incur additional cost or effort beyond collating in the return. We have assumed it would take two trustees around eight hours to collect the evidence and information required to satisfy the Regulator:

Collecting information for supervisory return

$$2 \text{ trustees x } 8 \text{ hours taken to gather information x } £100.78 \text{ wage rate} =$$

$$\mathbf{£1{,}600}$$

Significant event

Significant events are events that may affect the ability of an authorised CDC scheme to continue to meet the authorisation criteria. For example, if a scheme has a change of trustee this is a significant event because the fitness and propriety of a trustee is linked to the authorisation criteria. The Regulator must be notified in writing, as soon as reasonably practicable, if a significant event has occurred to an authorised CDC scheme.

These requirements are designed to protect members by ensuring that the Regulator is made aware of such events and can engage with the scheme as necessary to obtain additional information or require action to be taken. We do not expect significant events to be a common occurrence as CDC schemes should be authorised and subject to ongoing supervision.

The Master Trust authorisation impact assessment[49] assumed one member of staff would spend 30 minutes drafting and sending the relevant information to the Regulator. Intelligence supplied by the Regulator suggests that CDCs are likely to have to report changes to at least 1 or 2 'fit and proper' people each year, plus reporting more infrequent significant events such as change or failure of systems and processes around once every five years. From the 3rd year of the appraisal period, we have assumed that there will be two significant events per year that they are required to notify the Regulator of.

Cost of notifying the Regulator about a significant event

$$2 \text{ significant events per year x } 1 \text{ trustee x } 0.5 \text{ hours to notify the Regulator x } £100.78 \text{ hourly wage rate} = £100$$

Risk Notices

[49] https://www.legislation.gov.uk/ukdsi/2018/9780111169261/pdfs/ukdsiod_9780111169261_en.pdf

Risk notices are a supervisory tool that allows the Regulator to issue a notice to the trustees of a CDC scheme if it considers there is an issue of concern in relation to the scheme and that the scheme will breach the authorisation criteria, or is likely to breach them, if the issue is not resolved.

This mechanism enables the Regulator to require action from the trustees on a structured basis in order to resolve its concerns before the situation deteriorates any further. It will help mitigate the risk of the Regulator having to decide to withdraw a scheme's authorisation, which may not be in the best interests of members.

The risk notice requires trustees to set out how the issue will be resolved by submitting a resolution plan to the Regulator. Penalties apply for non-compliance, which reflects the seriousness of the issues and that further regulatory action is likely if they are not resolved. The trustees are also required to provide progress reports to the Regulator so that it can monitor progress and ensure that the appropriate action is being taken.

Resolution plans and progress reports must be provided in a manner and form specific by the Regulator. This may depend on a case-by-case basis and require more or less work depending on the issue of concern. Therefore, we have assumed one trustee may take around 5 hours to submit the initial resolution plan, but subsequent progress reports should take less time. Depending on the success of the resolution plan, trustees may have to submit one or more progress reports.

Cost of submitting a resolution plan to the Regulator

$$1 \text{ trustee x } 5 \text{ hours to notify the Regulator x } £100.78 \text{ hourly wage rate} = £500$$

Cost of submitting a progress report to the Regulator

$$1 \text{ trustee x } 2.5 \text{ hours to notify the Regulator x } £100.78 \text{ hourly wage rate} = £300$$

Triggering event

The 2021 Act places certain requirements on CDC schemes including the need for the Regulator to be notified if the scheme experiences a triggering event, which can pose a significant threat to the future of the scheme and the interests of members. Following discussions with the Regulator, we think it is very unlikely that there will be any triggering events during the appraisal period, we therefore feel it would be disproportionate to assess all the likely costs given their scale.

Over the life of a CDC scheme, events may occur which impact the security and strength of the financing arrangements which supported the Regulator's initial authorisation of the scheme. We expect that trustees will in any event keep the Regulator up to date about any planned or emerging significant events because of the collaborative supervisory relationship we envisage developing between CDC schemes and the Regulator.

There would be a cost to notifying the Regulator as in the case of a significant event above.

Cost of notifying the Regulator about a triggering event

$$1 \text{ trustee x } 0.5 \text{ hours to notify the Regulator x } £100.78 \text{ hourly wage rate} = £300$$

Implementation strategy

An implementation strategy is a document setting out how the interests of members are to be protected following the occurrence of the triggering event. The document must detail the decisions and actions that will need to be taken in order to resolve the triggering event, identifying the person responsible for taking them and the timescales for taking them.

It must also contain a communications plan setting out what information will be provided to employers and members including which continuity option is being pursued. This approach is consistent with that taken with the master trust authorisation regime.

The implementation strategy will need to be prepared by schemes that have a triggering event and will be specific to the continuity option that they have chosen or are required to take due to Regulator action.

Consistent with the assumptions used in the Master Trust Impact Assessment, we believe that a scheme would have three trustees spend at least 27 hours writing the implementation strategy, should a triggering event occur.

Implementation strategy

3 trustees involved in creating the implementation strategy x 27 hours taken to create the implementation strategy x £100.78 wage rate = £2,100

Continuity option 1

This option will arise where the trustees of the CDC scheme are required by the Regulator or choose to wind up the scheme following a triggering event. Triggering events are not common within pension schemes, and have much greater consequences than significant events, which can happen as a part of regular business.

We think it particularly unlikely that a scheme will be required to go through this winding-up process and leave the market during the appraisal period, given the amount of investment that has gone into developing the regime.

There would be a cost to the scheme in carrying out the responsibilities required during a triggering event period. These include:

a. notifying the Regulator that there has been a triggering event;

b. creating an implementation strategy, and having it approved by the Regulator;

c. notifying all employers that the scheme has experienced a triggering event, and how they plan to transfer members out and wind up the scheme;

d. notifying all members of the choices available to them;

e. periodically reporting to the Regulator about the scheme's progress in addressing the triggering event.

A scheme following option 1 will have to notify the Regulator of the occurrence of a triggering event and spend time writing and clearing documents to send to members, employers, and the Regulator.

The implementation strategy would have to set out how members' interests will be protected while the scheme winds up and must also set out the levels of administration charges faced by members, in order to ensure compliance with the prohibition measure.

The implementation strategy would also have to include details of the scheme to which they propose to transfer existing members of the scheme to (when known), and detail when they expect to transfer existing members from the scheme.

There will be more information in the Regulator's Code of Practice, but it is seen as disproportionate to update these costs given the unlikelihood and scale of costs.

Continuity option 2

Continuity option 2 provides for the resolution of a triggering event. The aim of continuity option 2 is to allow some flexibility for trustees where the triggering event does not warrant the winding up or closure of the scheme.

We assume that, if a CDC scheme experiences a triggering event within the appraisal period they will choose, wherever possible, continuity option 2 and resolve the triggering event rather than winding up the scheme and exiting the market.

Where the trustees decide to pursue continuity option 2, they must notify the Regulator when they consider that the triggering event has been resolved.

We do not expect any triggering events over the ten years, due to only one expected scheme and the authorisation and supervisory regime mitigating some of the causes of triggering events.

In the case where a triggering event occurs, schemes would not have to communicate with members as in the continuity option 1 scenario above, so would not incur the cost of communication with members. The cost would therefore broadly be similar as for a scheme following continuity option 1 but without the additional cost of member communications.

There will be more information in the Regulator's Code of Practice, but it is seen as disproportionate to update these costs given the unlikelihood and scale of costs.

Continuity option 3

Following a triggering event, continuity option 3 provides for a decision to be taken to convert the scheme to a closed scheme. In relation to a CMP scheme, this means closed to new contributions or new members (or both).

This is intended to address a scenario where, for example, an employer with power under the scheme to close the scheme chooses to do so in order to deliver an income stream to members in retirement through the scheme but for the scheme not to have any active members going forward. A scheme may only operate on a closed basis if this is provided for in the scheme rules and the trustees have received a notification from the Regulator that it is satisfied that the preparations for conversion to a closed scheme are complete and will resolve the triggering event.

It is difficult to accurately assess the counterfactual in this situation, as we do not expect a CMP will experience an event that would cause it to close. The loss of revenue compared to the baseline would depend on the number of members that expected to join who now could not.

These are expected to be used only in exceptional circumstances. The financial sustainability requirement should ensure that the scheme has the capital in order to resolve the issue at hand or wind-up the scheme appropriately.

Automatic enrolment quality requirement

For schemes used by employers to fulfil their automatic enrolment (AE) duties, there must be a quality test to ensure the scheme is compliant with the relevant AE tests. Existing regulations did not make provisions for CDC schemes to ensure they are AE compliant. This change will require trustees of CDC schemes to certify that their CDC scheme provides at least as good an outcome as the AE DC minimum for all (or nearly all) scheme members.

Given that employers and trustees would have been required to fulfil this test for the workplace pension scheme they offer, regardless of whether the counterfactual if a DC or DB scheme, we assume this is a net zero cost to business.

Benefits

Running costs

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

Evidence shows that although the DB sector as a whole remains sustainable, the associated costs are high and higher than what was expected at the time the DB schemes were introduced, with longevity growing faster than expected and investment returns staying low for a sustained period of time[50].

According to the latest data from the ONS[51], over the calendar year 2018, sponsoring businesses of DB schemes paid normal contributions worth around £17.6 billion, and special contributions worth around £8.7 billion, in total. Over the same time period, DC scheme sponsoring businesses paid about £11.7 billion of normal contributions, and about £0.31 billion of special contributions.

DB sponsoring businesses may also incur indirect costs associated with the natural uncertainties arising from their commitment to sponsor a DB scheme. For example, any changes in life expectancy and/or investment return forecasts would alter their estimated DB pension liabilities and thus their balance sheets, making them more uncertain and volatile, and in turn potentially making their business less attractive to potential investors or creditors. Replacing DB with CDC would result in a saving in this sense as well. There is a strong financial incentive for DB sponsoring businesses to switch to CDC, but it is not possible to know how many of these would have switched to DC in the counterfactual scenario with no CDC option.

Given the vast uncertainty around how a business may set up their CDC scheme and that CDCs are a permissive measure, we are unable to quantify the potential benefits to business.

Costs and benefits to other affected parties

Costs to members

On an individual basis some members may incur costs associated with the introduction of CDCs. Given the uncertainty around scheme design and future adoption of CDCs we have discussed these qualitatively but are unable to quantify the potential costs to members.

Where the counterfactual is DB, all members are expected to face greater uncertainty in their pension income under CDC given that all the risks and associated costs under CDC are with them rather than their employer. Where the counterfactual is DC, members may be worse off for the following reasons:

Not all members will gain from CDCs

Any collective scheme will smooth, to a certain extent, outcomes between members and outcomes over time. So, whilst overall members might benefit, some may experience a worse outcome than under an individual DC. One reason for this is that a member could be due to retire in ‘strong’ economic conditions and potentially may have received a higher income from annuitizing than under the smoothed CDC benefits. However, the risk of the member retiring in ‘strong’ economic conditions is placed solely on the member.

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[50]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/693655/protecting-defined-benefit-pension-schemes.pdf

[51]https://www.ons.gov.uk/economy/investmentspensionsandtrusts/datasets/mq5investmentbyinsurancecompaniespensionfundsandtrusts

A further reason is that the member may die at a young age. This is an inevitable consequence of pooling risk and happens in both DB schemes and annuities where those that die young subsidise the pensions of those that live longer.

Foregone opportunity

An individual's preference between an individual and collective pension depends on objective expected outcomes, such as income level and risk / volatility, and their subjective preferences around risk aversion and, more generally, their lifetime utility function.

For example, some members may choose for their pension to be invested in higher risk investment strategies or prefer Environmental, Social and Governance (ESG) funds. However, if an employer who currently offers a DC scheme chooses to offer a CDC scheme, there may be individuals that prefer a DC scheme and the flexible investment choice. Under a CDC they would no longer have the option to choose where their fund is invested.

In this case members would either have the option to potentially move jobs to an employer that offers a DC scheme, transfer out of the CDC scheme itself or negotiate with their employer to contribute to a separate scheme, as is currently the case for members of occupational schemes that are not happy with their current pension arrangements. An example where this could occur is in a situation where, from the individual's point of view, there are undesirable transfers and subsidies, for example, from young to old or from poor to rich.

Although 96% of memberships in non-micro DC schemes are invested in the scheme's default investment strategy[52], members rarely exercise their ability to choose investments in DC schemes. Moreover, members in DB schemes are unable to choose where their pension fund might be invested so the cost of foregone opportunity is likely to be low.

Benefits to members

Our assessment (in line with consultation responses) is that a CDC that is sufficiently well designed, run, and regulated can provide a more stable outcome for members at a lower cost than individual DC. There are several reasons for this:

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

This is an inherent feature of CDC. The expectation is also supported by existing modelling-based evidence. For example, a study from the Netherlands 'Benefits of Collective Risk Sharing in Defined Contribution Pension Systems'[53], suggested up to 15 per cent higher pension payments in 'bad' economic scenarios than the individual contract'.

This is also supported by modelling from Willis Towers Watson[54] which looked at the effect of the pandemic on CDC pensions under the design published by Royal Mail. They found that, for a CDC member about to retire, the Q1 market shock would have little effect on their initial retirement income, but potentially a modest reduction in long-term future pension increases depending on how markets develop. As intended, Q1 market falls would have been smoothed out and the member could retire as planned without the need to face a difficult retirement decision. By contrast, a member about to retire with a DC pension would be facing an 8% reduction in their pension due to unlucky timing.

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[52] https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2020-2021
[53] By Marcel Lever and Thomas Michielsen, Sept 2014. Available at: <https://www.netspar.nl/assets/uploads/P20161100_occ009_Lever_Michielsen.pdf>
[54] How would recent market falls have affected members approaching retirement in a CDC scheme? - Willis Towers Watson

However, the ability to smooth out shocks in 'bad' economic scenarios also means smoothing out in 'strong' economic scenarios too.

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

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

Potentially higher pensions overall (but not for all)

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

AoN Hewitt have modelled the historic behaviour of an illustrative CDC plan compared with DC schemes over the period from 1930 to 2012. The outcomes of their modelling suggest that over the period CDC reaches a better outcome than DC.[55]

Based on a different set of assumptions and approach, Cass Business School's modelling[56] suggested that a CDC scheme can generate a pension that is 30% higher, and volatility per unit of return in the CDC scheme is just 16% of that in the individual DC scheme. An additional study from the Royal Society of Arts' study in 2012[57] showed an improvement of 37% in pension outcomes from a move to collective pension provisions.

Moreover, a DWP commissioned study[58] by the Pensions Policy Institute (PPI), which compared a CDC scheme like that modelled by AoN with various individual DC alternatives, found that CDCs outperformed individual DCs in terms of the average income replacement rate in almost all the modelled scenarios.

The modelling outcomes depend on several assumptions, among them those associated with the design of the CDC plan. Also, investment behaviours are driven by a complex set of factors and given that CDCs do not exist in the UK, the underlying modelling assumptions are theoretical and / or based on international evidence. It is not possible to accurately predict outcomes for future UK CDC schemes, but the available modelling evidence suggests that CDC, if well-designed, has the potential to deliver a higher level of overall pensions than individual DC.

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

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[55] http://www.aon.com/unitedkingdom/attachments/aon_hewitt/dc/Aon_Hewitt_The_Case_for_Collective_DC_Nov13.pdf (page 31)
[56] Independent Review of Retirement Income: Report, David Blake, March 2016. http://www.pensions-institute.org/IRRIReport.pdf
[57] https://www.thersa.org/discover/publications-and-articles/reports/collective-pensions-in-the-uk#
[58] Modelling Collective Defined Contribution Schemes, PPI, 2015. http://www.pensionspolicyinstitute.org.uk/publications/reports/modelling-collective-defined-contribution-schemes

Annuities are insurance policies which pay an annual income for life in exchange for a lump sum. DC members can use their pension pot (or part of it) to buy an annuity and have a guaranteed stream of income for their whole lifetime. But buying an annuity may be costly as the price has to cover not only the insurer's costs of providing it but also the insurer's premium and other fees. For example, Longevitas[59] say that 'an insurer in the UK will typically charge around 5% more than it expects the annuity to cost'. In CDC, a lifetime stream of 'target' level pensions could be provided without the need for the member to buy an annuity, so CDC represents a potential efficiency saving.

"Hands off" access to a professionally managed investment strategy

DC members have more discretion and responsibility for managing their pension strategies. Depending on individual preferences, some may consider this to be in their best interest, but some may prefer "hands off" access to a professionally managed investment strategy, which CDC type schemes can offer. For example, the UK section of the 2013 AoN Hewitt Global Pension Risk survey received 241 responses, of which 46% mentioned 'members don't need to be involved in investment' when asked 'What do you see as the biggest positives of Defined Ambition plans?'[60]. This was among the key arguments presented to DWP by the CWU for why their members support CDC.

Costs to the Regulator

The Regulator may experience reduced costs as a result of pro-active on-going supervision of CDCs. This could mean that the Regulator has to direct less resource towards CDC supervision in the event of an unexpected failure. As this is difficult to calculate it has not been monetised at this stage.

The total cost to the Regulator will count as a direct cost to business, as the majority of this will be paid for by CDC's application fees which have already been counted as a direct cost to business, however, we have calculated the cost in this section as the difference between the cost to the Regulator and the amount recovered through application fees.

In each subsequent year, the amount to be paid to the Regulator will be recovered through the general levy, minus any application fees already costed as a direct cost to business in that year.

Wider economic and societal impacts

CDCs could bring investment benefits to the wider economy. As mentioned above, CDC schemes are expected to be able to invest (over their lifetimes) a greater proportion in a cyclical, long-term returning assets than DC. These might include, for example, investing in illiquid assets such as infrastructure projects. However, investment choices and their impacts on wider economy are always complex and hard to assess / predict.

Additionally, the introduction of CDCs could allow for improved industrial relations between employers and their workforce and labour unions, particularly in the case of negotiations regarding pension provision, across the relevant workforces. In the case of Royal Mail specifically, this extends to improving industrial relations with up to 140,000 employees. As such, there is the potential for improved economic output to the wider economy – this is especially the case given the nature of postal services provided by Royal Mail. However, estimating the extent to this is beyond the scope of this Impact Assessment given its complexity.

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[59] https://www.longevitas.co.uk/site/informationmatrix/areannuitiesexpensiveenough.html
[60]http://www.aon.com/unitedkingdom/attachments/aon_hewitt/dc/Aon_Hewitt_The_Case_for_Collective_DC_Nov13.pdf (page 11)

Intergenerational fairness

In principle, CDC plan design involves risk sharing, which is likely to occur both between the members of the same cohort and between different cohorts. Critics of CDCs often claim that they are inherently unfair towards younger generations as older people may have first call on the pooled fund to pay their pensions, and workers may have to make up any shortfall with increased contributions. The main lesson to be learned from abroad is the Dutch experience. The Dutch regulatory system for CDCs requires a very high level of certainty that target benefits and inflation increases can be paid by prescribing large funding buffers. Slow growth in asset values means that when the buffers were expended in the financial crisis, they could only be restored through increased contributions from younger workers[61].

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

Some other views from the pensions industry also seem to suggest the risk of intergenerational fairness is solvable. AoN Hewitt, for example, mention that dealing with these issues of smoothing requires very careful communication to members and good actuarial processes[62].

CDC schemes will be required to have processes in place to ensure their members can understand that benefit levels might be regularly adjusted accordingly. We anticipate that CDC schemes will make use of modern methods of communication, including social media and video to help ensure members can access the information they need to do this in the most appropriate way for them.

Small and Micro Business Assessment (SaMBA)

There is no evidence of any disproportionate cost on small and micro businesses for this legislative change. This proposal creates the option for employers to enrol their employees into a CDC pension scheme. Therefore, businesses will only undertake the associated costs of enrolling their employees into a CDC scheme if they believe it to be beneficial for them to do so relative to the next best alternative.

Moreover, although all businesses will have the option to do this, we expect large employers to be more likely to undertake this option due to the advantages of economies of scale, the pooling of risk among a larger group of members and the greater the ability to undertake more long-term investment strategies. This opinion is supported by industry in the consultation responses.

Monitoring and Evaluation

The legislative framework aims to provide transparency about the operation and effectiveness of CDC schemes and requires the publication of certain scheme information. In addition, the Regulator plan to collect and monitor data on CDC schemes in the same way as they currently do for occupational DB and DC schemes, looking at schemes, members, and assets. DWP will monitor how the first CDC schemes operate and their performance and effectiveness at providing pension incomes, using this information.

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[61] https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/580/580.pdf

[62]http://www.aon.com/unitedkingdom/attachments/aon_hewitt/dc/Aon_Hewitt_The_Case_for_Collective_DC_Nov13.pdf

The authorisation and supervision process will require schemes to set out and report on their on-going viability informed by their annual valuations and taking account of any guidance produced by the Institute and Faculty of Actuaries. This will allow an assessment of these schemes to provide the level of income they aspire to, to be made on an on-going basis.

In addition, we will engage proactively with employers, workforce representatives and schemes to identify any issues they are having around the new regime as it beds in and seek views from schemes and the Regulator to provide assurance on the effectiveness of the authorisation framework. Investment and providing pension income is a long-term proposition and as such monitoring will be on-going.

Key assumptions/sensitivities/risks

Scope of Impact Assessment

This impact assessment only seeks to cost the additional marginal cost of these regulations. There are costs associated with establishing a CDC scheme which are outside of the scope of this impact assessment, such as scoping of scheme design before application. These costs are optional, and we assume that they will only be incurred if the benefits are judged to outweigh them.

Unknown counterfactual

The costs and benefits are highly dependent on the counterfactual (whether a firm's employees would in future be enrolled in a DB scheme, a DC scheme, or a hybrid DB/DC scheme) which is not possible to predict. Particularly for DB employers, there are uncertainties as to whether they would switch to DC in the absence of CDC legislation. **In any counterfactual all employers with eligible employees will be required to set up a workplace pension and automatically enrol eligible employees.** Therefore, there are some costs that businesses would still incur regardless of whether they adopted a CDC scheme. For these costs we estimate there to be a net zero cost because businesses would have had to undertake them under any counterfactual.

We have good data on how many employers currently offer DB, DC, and hybrid schemes, but we do not know what employers will choose to do in the future in relation to their scheme choice for occupational pensions.

Demand for CDC schemes

Previous consultations[63][64] demonstrated strong support for legislative changes that would enable CDC schemes to be created. However, at this stage we are only aware of one employer, Royal Mail Group, who has a clear plan to deliver a CDC scheme. For this employer, they have undertaken extensive additional scoping and implementation work which other schemes would be unlikely to incur. The Royal Mail Group CDC scheme is highly specific and to extrapolate costs or benefits for this employer to wide businesses would be highly commercially sensitive and speculative. Give no other businesses are currently developing plans to adopt a CDC we are unable to present aggregate costs or benefits. The Institute and Faculty of Actuaries CDC Pension Scheme Regulatory Working Party suggested has been informed that it is unlikely another CDC scheme will open within a year of the Royal Mail Group, and that there are unlikely to be more than ten CDC schemes by 2025[65].

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[63]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/756275/delivering-collective-defined-contribution-pension-schemes.pdf
[64]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/786395/response-delivering-collective-defined-contribution-pension-schemes.pdf
[65]
https://www.actuaries.org.uk/system/files/field/document/RB%20May%202021%20CDC%20Working%20Party%20Paper.pdf

Moreover, at this stage we only expect larger businesses to be able to offer CDC schemes. The legislation only allows for single or connected employers and therefore, an employer must be large enough to sustain the contributions required for a CDC scheme over the long term. It is highly unlikely smaller or medium sized employers would be able to afford the costs of setting up a new scheme and maintain the long-term employee contributions required for a successful CDC scheme.

Engagement with industry has suggested once CDC regulations are laid and more schemes are set up, the process and costs associated with setting up should be lower. This is because businesses will have clear regulations and guidance to follow, and they can learn from the schemes set up earlier.

Bespoke scheme design

The regulations for CDC schemes are designed to give businesses the ability to design the scheme around their needs and business. There is significant scope for bespoke scheme design. Whilst the Royal Mail Group are designing a CDC scheme that suits their business needs, this design may be unsuitable for another larger employer. Therefore, the current regulations outline the minimum standards for CDC schemes, but businesses may choose to do additional work, which may incur higher costs, depending on how they decide to set up and run their scheme.

We are not certain how other models, outside the Royal Mail Group, might look like. Scheme design is heavily choice driven. For example, some businesses may opt for higher benefit rates or contribution rates. There may be circumstances where businesses create a scheme with more regular communications with members than the statutory requirements. Therefore, we are not able to estimate the exact costs of all potential CDC scheme designs. There may be circumstances where businesses incur higher or lower costs depending on their bespoke scheme design.

Uncertainty of costs

CDC schemes are an entirely new additional to the pension system and there are no schemes operating or authorised. This impact assessment with be published before any schemes are able to apply for authorisation and the Regulator's Code and guidance are published.

Assumptions

Average hourly wages

For average hourly wages we have used the ONS' Annual Survey of Hours and Earning (ASHE). This provides annual estimates of paid hours worked, weekly, hourly, and annual earnings for UK employees by four-digit Standard Occupation Classification 2010.

We have used the median hourly gross pay for each profession where relevant. This is then uplifted by 27% for overheads from the previous version of the Green Book (no updated estimate is available)

Table 6: Annual and hourly gross pay in the UK for the main occupations involved in the set-up and running of a CDC scheme, 2020

Description	**Annual pay - Gross (£) - UK 2020**		**Hourly pay - Gross (£) - UK 2020**	
	Median	**Mean**	**Median**	**Mean**
Corporate managers and directors	44,500	59,693	22.73	28.56
Information technology and telecommunications professionals	43,592	47,128	22.44	24.11

Legal professionals	47,342	61,375	26.35	32.14
Management consultants and business analysts	40,268	45,123	21.47	23.77
Business and financial project management professionals	49,142	55,276	24.63	27.35
Actuaries, economists, and statisticians	45,057	68,853	22.93	27.87
Finance and investment analysts and advisers	35,555	43,998	18.69	21.59
Sales, marketing, and related associate professionals	38,390	45,271	17.53	21.14

Source: ASHE Table 15[66]

Trustees

Previously we have used the Regulator's data on 'Number of Trustees – by scheme size' which estimates three Trustees per Scheme[67]. However, ongoing feedback from the pensions industry to other impact assessments has indicated 8 trustees per scheme[68]. Other feedback also included increasing the average trustee wage from £22.73 (not including overheads) to £100.87 (including overheads) to allow for a more representative size, structure, and wage profile of a board of trustees[69].

[66]https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/regionbyoccupation4digitsoc2010ashetable15
[67]https://webarchive.nationalarchives.gov.uk/20170712122409/http:/www.thepensionsregulator.gov.uk/docs/trustee-landscape-quantitative-research-2015.pdf
[68] https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes-response-and-consultation-on-regulations/impact-assessment-on-climate-change-risk-governance-and-disclosure-tcfd-proposals#fn:100
[69] https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes-response-and-consultation-on-regulations/impact-assessment-on-climate-change-risk-governance-and-disclosure-tcfd-proposals#fn:33