TISA Response to:
Delivering collective defined contribution pension schemes

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About TISA

TISA is a rapidly growing, unique, consumer focused membership organisation. Our aim is to improve the financial wellbeing of UK consumers by aligning the interests of people, the financial services industry and the UK economy. We achieve this by delivering innovative, evidence-based proposals to government, policy makers and regulators; the proposals provide practical solutions to major consumer issues.

TISA's growing membership comprises over 200 firms involved in the supply and distribution of savings and investment products and services. These members represent all sectors of the financial services industry, including the UK's major investment managers, retail banks, insurance companies, pension providers, distributors, building societies, wealth managers, third party administrators, FinTech, consultants and advisers, software providers, financial advisers, pension providers, banks and stockbrokers.

TISA's current strategic policy and industry solution developments include:

- **Guidance**: developing a framework to make guidance more widely available to the estimated 42 million UK citizens who will rely on it when making financial decisions
- **Digital ID:** development of a digital identity for consumers of financial services: following successful earlier feasibility work, a project with members has now been established to develop and test a pilot of the Digital ID.
- **Digitalisation**: building on the successful launch of TeX, TISA has initiated a range of member projects developing open standards that support the growth of FinTech and increase consumer access to financial services, while lowering costs for providers.
- **Financial education**: helping to make young people aware of the impact of finance on their life including the KickStart Money project – a £1million three-year programme delivering financial education to 18,000 primary school children.
- **Retirement saving**: strategic policy focused on the needs of millennials and the self-employed and the use of property to supplement retirement income.
- **ISAs**: working with government, the simplification/improvement of this key savings regime.
- **The TISA and KPMG Savings Index:** a biannual measure of typical household savings and debt in Great Britain.
- **Consumer engagement:** alongside our financial education and guidance work, we are also considering how the industry can improve how they identify and interact with vulnerable customers and encourage greater financial capability for UK consumers.

TISA - Providing technical solutions for its members

TISA also provides support on a range of operational and technical issues targeted at improving processes, standards of good practice and open standards, alongside the interpretation and implementation of new rules and regulations, including:

- MiFID II: The publication of good practice guides and open standards, and an industry solution to the collection of target market data and costs & charges.
- CASS/Client Assets: The publication of good practice guides and work on unbreakable term deposits.
- Tackling financial crime, data standards, SM&CR and GDPR.
- Brexit: developing proposals for government that will enable the savings and investments sector to prosper on a global scale to the benefit of UK plc.

TISA - Supporting industry developments

Our work to improve industry infrastructure includes:

- TeX: an industry utility, providing the legal framework and governance necessary for the use of electronic messages facilitating transfers.
- Support for the Transfers & Re-registration Industry Group (TRIG)
- Support for the UK Fund Trading and Settlement initiative (FTS).

Executive Summary

TISA welcomes the opportunity to provide a response to assist the Department for Work and Pensions in considering Collective Defined Contribution (CDC) schemes and are supportive of innovation within the pensions sector, which helps enhance retirement outcomes of consumers.

Whilst this consultation does focus on details surrounding the Royal Mail model, we need to consider the wider picture, as once legislation is enacted to support Royal Mail achieve their CDC aspirations, other employers will be able to establish schemes under the same model. We are therefore aware that there are potential wider industry impacts to consider with the implementation of this CDC model, which are not linked to Royal Mail in isolation.

Given the current public perception of pensions which is highlighted in the Retirement Outcomes Review, it is paramount that the implementation of CDC does not undermine some of the good work which is being undertaken by industry and Government to restore public confidence in pensions. CDC, if not governed properly does have the potential to create negative perceptions as we have seen borne out in the Netherlands for example, with intergenerational issues at the heart of the issue.

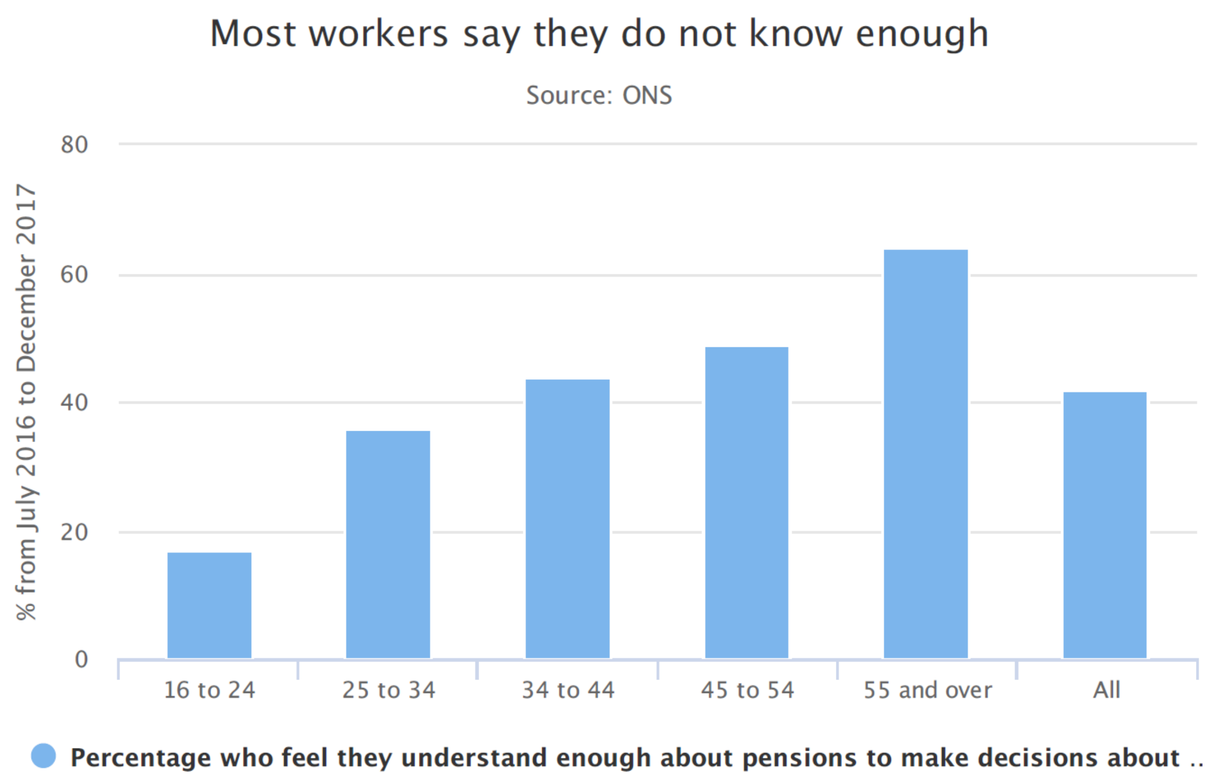
However, if all aspects are positioned correctly, then CDC could become a positive addition to the Defined Contribution landscape, from which appropriate employers and employees could benefit.

Consultation Response

Rather than respond to questions on an individual basis, this response will provide a more general review of the CDC proposals, which is representative of TISA's collective membership.

We do believe that CDC schemes should be classed as Defined Contribution (DC) – this may remove any ambiguity from an employer perspective that there is any form of liability placed on them should retirement benefits not reach or are not maintained at the target level, however this could be dependent on scenario.

However, this does not mean that consumers will understand this important aspect. Most workers do not understand pensions – this was recently evidenced in research undertaken by the Office of National Statistics where 58% of working age Britons did not understand enough to make retirement saving decisions.



The nature of CDC does mean there is an element of uncertainty surrounding accrual and retirement benefits which will not be understood by many. Especially, given that the way in which accrual and benefits are presented lends itself more to a Defined Benefit (DB) scheme communication, which may be perceived incorrectly. This is one of the fundamental challenges that we face with the implementation of CDC.

The proposed Royal Mail model comprises a DB lump sum accruing at a guaranteed 3/80 plus increases and a CDC section accruing on a notional target of 1/80 plus increases. Referring to both sets of benefit accrual as a fraction is misleading and will not help employees understand the important difference between the two in terms of the lack of any guarantee for retirement income and the DB guarantee for the lump sum.

Although other CDC schemes may not refer to accrual in this format, the communication of the potential fluctuation of income accrual and/or income paid is crucial. Whilst an employee may state they understand potential fluctuations, this may not 'cut any ice' should this actually occur. Communications need to be watertight as reductions will almost certainly lead to complaints, with employees stating they were not fully aware of the scheme rules which determine the pension benefit level. This may in turn place additional pressure on the sponsoring employer to fund the shortfall, which in effect creates an unwritten form of liability and would create dangerous precedents for other employers whose schemes fall into similar funding positions.

It is worth recalling the KPMG court ruling in 2004, where their pre-2000 occupational scheme which they stated was DC was ruled as a DB scheme, resulting in a sizeable deficit contribution being paid. The similarities between this and CDC exist, particularly in a scenario where schemes are not governed correctly, there is a widespread reduction in CDC benefits and a corresponding escalation in complaints.

The whole communication challenge is further compounded with the fact these schemes will be used for Automatic Enrolment. Individuals will be automatically enrolled without necessarily understanding or communicating that they understand the potential risks which they have no control over. It is therefore essential that an appropriate communication takes place with the employee prior to their automatic enrolment into a CDC workplace scheme.

In terms of disclosure then we should be looking to achieve a level playing field so that all scheme members of occupational DC, CDC and private DC receive the same mandatory documentation on a prescribed basis. There should also be no reason why CDC is not also subject to the same charge cap that exists for other DC workplace schemes, although it is recognised the calculation would need to be based at scheme level.

It is vital to recognise that many members will have a mix of benefits or at the very least providers/versions of DC. It is important that illustrations of potential future benefits are on the same basis. Currently, several large employer arrangements do not provide illustrations other than as part of their annual pack. The absence of common illustration assumptions will act as a barrier to pensions freedoms and reliable assessment of the level of benefits that the member can expect in retirement. With this in mind, and to save time and costs we would suggest that DC & CDC are subject to the same disclosure and illustration rules as Group Personal Pension plans.

The proposed accrual target of 1/80 of pensionable pay plus increases is the same for all members irrespective of age, however clearly the amount that needs to be invested to achieve this based on future growth assumptions and discount rates reduces as the member is further away from retirement. And with target benefits also relying on a steady stream of new entrants, there needs to be an element of prudence built into transfer and accrual calculations.

The modelling of benefits which have been evidenced within industry to date, largely discounts the effect that transfers out will have on target benefit performance. However, there are a number of reasons why a scheme member would want to transfer out at retirement and take advantage of the pension freedoms. Further work to understand the likelihood of individuals transferring should be undertaken and factored into the modelling.

The concept of inter-generational smoothing is a significant issue to consider and research needs to be undertaken to evidence that the younger generation are comfortable with subsidising the benefits of the older generation. Details of this subsidisation should be communicated in every regular communication.

Comparisons to With Profit funds can be made and we need to be mindful of the complications that have been experienced in managing these in recent years. Many providers apply Market Value Adjustments upon exit in certain market conditions, which can have serious retirement implications for the member.

The reliance of new members and the persistency of existing scheme members does make all benefit calculations complicated and largely incompatible with pension freedoms. Independent Financial Advisers (IFAs) are largely used in the current DC transfer process and the added complications of CDC mean that a comprehensive set of IFA guidelines need to be put in place by the Financial Conduct Authority (FCA) to assist in providing advice on whether to transfer into or out of a CDC scheme. As the RM model is a hybrid scheme with a DB lump sum element, consideration also needs to be given as to whether advice is mandatory above a prescribed transfer value, as per existing requirements for transfers out of safeguarded benefits.

We also need to be mindful that phased retirement is increasingly popular, as individuals work for longer and gradually wind down into full retirement over a period of years. CDC needs to be compatible with modern lifestyles and allow for benefits to be taken on a phased basis and to allow for partial transfers, as many will want to combine the deemed security of CDC decumulation and the flexibility of Drawdown.

And all of this extra complexity which sits on top of individual DC adds a requirement for a new layer of governance, which The Pensions Regulator will need to be geared up to enforce before launch.

In summary, there are several areas where the lower level detail needs to be carefully considered to ensure that the RM CDC model or any future models do not result in any unwelcome surprises for employees, employers, providers, IFAs or regulators.