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PPI Launch Event Write Up

CDC Decumulation

Overview

On Tuesday 5th December 2023, the PPI hosted a launch event, [The role of Collective Defined Contribution in decumulation](). This report explores the trade-offs in how a decumulation Collective Defined Contribution (CDC) pension scheme may operate under the environment currently envisaged in the UK. The report was kindly sponsored by DWP, TPR, PLSA and Standard Life, with the launch event hosted by PLSA. The launch event was chaired by **Kathryn Fleming, PPI Trustee (Hymans Robertson)** and was attended by 60 people representing a cross section of the industry and government.

Research Findings

John Upton, Policy Analyst, PPI, presented the key findings from the report, including how decumulation-only CDC could work in the UK specifically, other countries' experiences with CDC, and the model of CDC in different economic scenarios. A CDC decumulation scheme will need to consider within its objectives the balance of a higher opening benefit level and the degree of predictability of future benefit levels that can be provided. Higher initial benefit levels can be achieved through growth-orientated investment strategies, though these are associated with greater degrees of investment volatility and, ultimately, greater unpredictability in future benefit levels. Alternatively, using an investment strategy which foregoes greater investment in growth assets, such as a cashflow driven strategy, it is possible to generate a more predictable future benefit level, though starting benefit levels will be lower. Risk sharing between members still operates effectively at a scale below which a scheme may not be economically viable. The benefit level offered by very small schemes will inevitably be less predictable than that offered by larger schemes, all other things being equal. However, the major driver to the scheme's volatility remains investment performance, regardless of scale, as the mortality volatility is lower than investment volatility and consequently has a smaller impact on predictability. Decumulation CDC will face competition from existing decumulation products, new products within the current framework including blended solutions, alongside additional potential competition from multi-employer CDC schemes. Other countries experiences with CDC can help with implementing CDC as a decumulation option.

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Panel Discussion and Q&A

The panel included:

- Julian Barker, DWP
- Vicky Holmes, TPR
- Rauri Grant, PLSA
- Peter Cowell, Standard Life
- Tim Pike, PPI

The following points were raised during the panel discussion and Q&A, held under the Chatham House Rule:

- Could CDC fill a gap in the decumulation market:
  - Ensuring that as many people as possible achieve positive retirement outcomes is at the top of the agenda for both Government and industry. CDC decumulation options have the potential to improve outcomes for some, perhaps many, savers.
  - Automatic enrolment, and the related rise of DC pensions, has brought many more people into pension saving. As private sector DB provision declines, future generations of retirees are increasingly likely to be largely or wholly dependent on DC savings in later life. DC can work well if members engage and make decisions. However, there are challenges around low levels of both saving and engagement, and the introduction of pension freedoms means that DC savers will face very complex decisions at, and during, retirement about how to access and utilise their pension savings.
  - Many savers may prefer to have a secure income in retirement that they don't have to worry about or manage too much. CDC could make it easier for people to achieve security and would not require them to make ongoing decisions about how to manage their money once they have entered the scheme.
- How well will CDC work within the current pensions landscape?
  - Decumulation-only CDC schemes might not work as well for people with multiple pension pots, particularly if there is limited CDC coverage or variation across different schemes.
  - The question was raised as to whether CDC should be the default option for those who do not want to make active choices about decumulation.
- Demand for decumulation-only CDC schemes:
  - Each provider would need to conduct their own assessment of demand for CDC among their members. There are questions as to whether there will be enough demand, both initially and over the longer term, to make it commercially viable for providers to develop this provision.
- Competition between CDC schemes:
  - The average person is likely to opt for whichever CDC scheme will give them a higher level of income at the outset in return for their savings. How can members be helped to understand the caveats around different risk levels and security of income. However, it may be unrealistic to expect most members to fully understand these differences, so

would need to find a way to simplify comparisons, such as a traffic light system of scheme security reflecting the likelihood of delivering targeted benefits vs having to make cuts to benefits. There would need to be strict rules around advertising of CDC schemes to ensure fairness.

- Role of trustees:
  - It is important that trustees are given enough flexibility to put in place pension provision that will most effectively meet the needs of their members.
- Member protections:
  - CDC schemes need to be underpinned by minimum standards and strong communications and guidance for members. It is important that CDC is appropriately communicated and explained to members, both in terms of the potential benefits and the potential risks. Members may need to have the risks explained to them in quite a lot of technical detail in order to ensure that they know what they are entering into.
- Sustainability of CDC schemes:
  - It is vital to ensure that CDC schemes can be stable and sustainable over the long term. There also need to be clear and robust plans in place for wind down of schemes if they can longer provide an income for life.
- Investment strategies:
  - Volatility in member income could become particularly challenging in decumulation-only CDC, compared to whole of life CDC which can share risk across a broader population of members. It was suggested that decumulation-only schemes could end up being very similar in design to annuities and therefore likely to be invested in more defensive assets, compared to whole of life schemes. What role will illiquid asset classes play in CDC investment strategies?
- Are the challenges highlighted exclusive to CDC?
  - The potential for reduced income as a result of lower than expected investment returns or higher than expected inflation is a concern for DC members too, as experienced in recent years.
  - Communication challenges are also present in DC. It was suggested that CDC schemes were to be held to much higher standards in relation to disclosure of risks. There is still work to be done in DC to help members to better understand the benefits and risks of different decumulation options.
- Is it the right time to introduce decumulation-only CDC?
  - Currently low levels of DC savings are unlikely to produce sufficient retirement incomes through CDC, which may mean that CDC as a decumulation option may only start to appeal to significant numbers of retirees when average saving levels grow in future. In spite of this, it might be the right time to begin the conversation as it can take a substantial amount of time to reach the point of being operational – for example, discussions around the Royal Mail scheme began around six years ago (and other discussions around CDC-like schemes such as Defined Ambition even earlier) and is only now approaching the point of becoming operational.

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5th December 2023

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An INDEPENDENT Report by the

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