Pensions Policy Institute
PPI

DWP Consultation Submission: Retirement Collective Defined Contribution pension schemes

Introduction

0.1 This is the Pensions Policy Institute's (PPI) submission to the Department for Work and Pensions consultation on 'Retirement Collective Defined Contribution pension schemes'.

0.2 The PPI is the UK's leading independent authority on pensions and retirement policy. We conduct rigorous, impartial research and analysis from an evidence-based, long-term perspective. Our work is used by government and across Westminster, industry and consumer groups. It informs major decisions that affect millions of people's lives in retirement.

0.3 This submission does not address all of the specific questions in the consultation, neither does it seek to make policy recommendations. Rather, the response summarises relevant conclusions and analysis from research that the PPI has published during the period of this consultation:

- 2025. ***Collective Defined Contribution (CDC) pensions with investment choice***. Available at: https://www.pensionspolicyinstitute.org.uk/research-library/making-cdc-work/

This research primarily concerns whole of life CDC designs.

0.4 The PPI has previously published research which may be relevant to the consultation, however this is already in the public domain and is not summarised in this submission:

- 2023. ***The role of Collective Defined Contribution in decumulation***. Available at: https://www.pensionspolicyinstitute.org.uk/research-library/research-reports/2023/2023-12-05-the-role-of-collective-defined-contribution-in-decumulation/

0.5 Should the department require any further information, please contact:

- Chris Curry, Director, PPI: chris@pensionspolicyinstitute.org.uk
- Sam Eccles, External Relations Officer, PPI: sam@pensionspolicyinstitute.org.uk

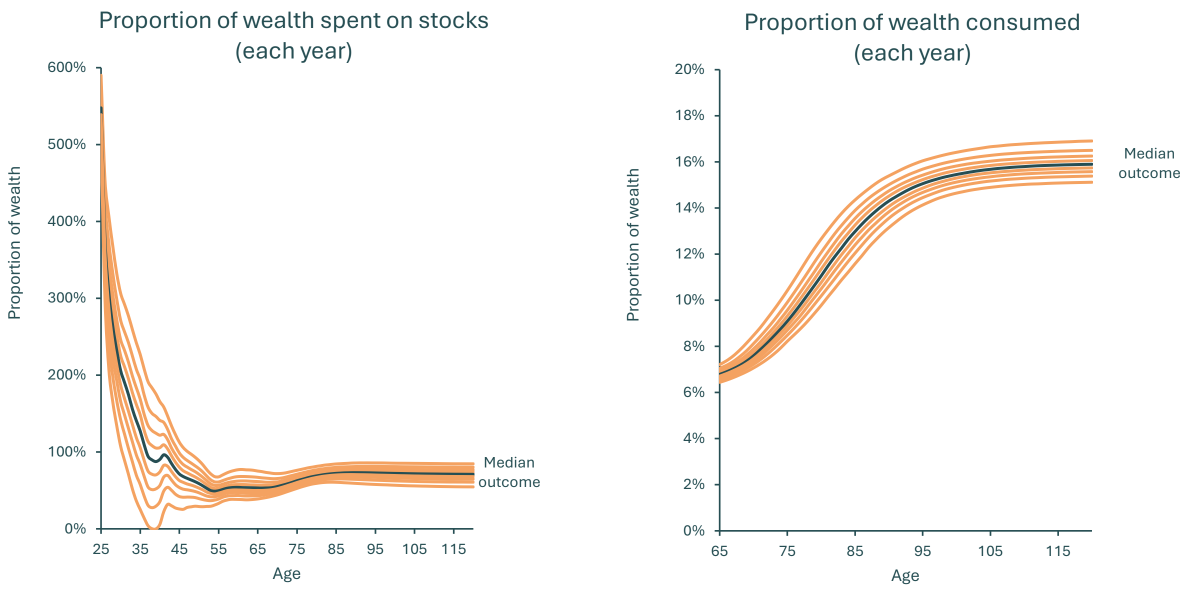
Pensions Policy Institute (PPI)
Thanet House
231-232 Strand
Temple
London WC2R 1DA
t: 07718 647 567
e: info@pensionspolicyinstitute.org.uk
w: www.pensionspolicyinstitute.org.uk

Question 1: How do you anticipate Retirement CDC investment strategies will need to differ from those of whole-life CDC schemes?

1.1 An investor who has an individual DC scheme who wishes to purchase a decumulation only collective-drawdown scheme at retirement should, ideally, follow essentially the same investment strategy as an all-life collective-drawdown scheme before retirement. The key features of this compared to a standard DC investment strategy is the use of leveraged investment when young and some continued investment in risky assets up to retirement.

1.2 The asset portfolio held in a decumulation only CDC scheme should follow essentially the same asset strategy as used to back the liabilities of retired members within a whole of life CDC scheme.

1.3 We determined an optimised strategy for a medium-risk investor [Collective Pensions with Investment Choice: Making CDC work for the UK, Figure 4.4]:



Question 2: What do you estimate the establishment and running costs of an r-CDC scheme to be? Please outline one-off and ongoing costs.

2.1 n/a

Pensions Policy Institute (PPI)
Thanet House
231-232 Strand
Temple
London WC2R 1DA
t: 07718 647 567
e: info@pensionspolicyinstitute.org.uk
w: www.pensionspolicyinstitute.org.uk

Pensions Policy Institute
PPI

Question 3: Should all business plan requirements that would apply to whole-life unconnected multiple employer CDC schemes also apply to Retirement CDC schemes? What, if anything, should change or be added?

3.1 n/a

Question 4: What numbers of member onflows, and at what pot sizes will be needed to achieve stability in Retirement CDC, given there are no ongoing contributions, and what allowances need to be made for members who opt-out of their default pension benefit solution?

4.1 For a CDC scheme running an internal longevity insurance market numerical simulations indicate that when a fund has about 100 members it already achieves about 98% of the maximum potential benefit (when measured in cash terms).

4.2 We have therefore assumed that in any financially viable scheme the fund is sufficiently large to achieve the benefit of pooling.

Question 5: What do you think the effects of the proposed adaptation to promotion and marketing criteria, including a prohibition on member marketing, would be?

5.1 n/a

Question 6: How would an approach to allow access to Retirement CDC via a guided retirement default or formal partnership between trustees, protect members, and impact a developing market? Would there be any unintended consequences?

6.1 n/a

Question 7: What are your views on the risks, benefits and potential protections for members of FCA-regulated pension schemes being transferred to a Retirement CDC to access their pension savings?

7.1 n/a

Question 8: What matters should we consider in developing an actuarial equivalence requirement for transfers into the scheme, and are there other factors to address regarding member entry?

8.1 Since there is a single lump-sum payment, it is essential in a decumulation-only scheme that the benefits a member receives are priced fairly. We have seen that the pricing errors for the oldest

Pensions Policy Institute (PPI)
Thanet House
231-232 Strand
Temple
London WC2R 1DA
t: 07718 647 567
e: info@pensionspolicyinstitute.org.uk
w: www.pensionspolicyinstitute.org.uk

generations in dynamic-accrual schemes are much lower than those for the youngest generation, of the order of 5%.

8.2 This is of the same order as the premium we have assumed one must pay to purchase an annuity to allow for systematic longevity risk, so this level of pricing error seems acceptable.

8.3 It is possible to improve the pricing formula to take into account the fact that indexation will tend to a long-term level. We did this by first computing the price of benefits accurately using rigorous financial mathematics techniques and then finding a simple, but more accurate, approximation formula using statistical techniques.

Question 9: What mechanisms should be introduced to ensure that quotations are accurate and not misleading?

9.1 n/a

Question 10: What are your comments on a 'cohorting' approach to helping well-performing schemes remain affordable for members and are there alternative approaches you would recommend? What should scheme rules on cohorting include? And does the illustrative drafting capture the policy intent and would this drafting work in practice?

10.1 n/a

Question 11: What issues would removal of the upper threshold and allowing the spreading of cuts over the lifetime of the scheme, for schemes using cohorting create, and how might these be mitigated?

11.1 Our simulations of a whole of life CDC scheme showed the effect of market fluctuations is delayed in shared-indexation schemes, members whose remaining life expectancy is short will see relatively small changes in their expected future pension payments, compared to members who are a long way from retirement.

Question 12: Is there any further information that Retirement CDC schemes should be required to provide to new and prospective members?

12.1 We have not performed any consumer testing of communications, as this was outside the scope of the project.

12.2 Research should be conducted to understand to what extent members can understand how different scheme designs operate, how this impacts upon their benefits, and how schemes might be presented to encourage the adoption of designs that most benefit members.

Pensions Policy Institute (PPI)
Thanet House
231-232 Strand
Temple
London WC2R 1DA
t: 07718 647 567
e: info@pensionspolicyinstitute.org.uk
w: www.pensionspolicyinstitute.org.uk

Pensions Policy Institute
PPI

Question 13: Are there practical or operational challenges in delivering Retirement CDC communications through DC scheme trustees, and how might these be addressed?

13.1 We have not performed any consumer testing of communications, as this was outside the scope of the project.

Question 14: What additional costs might a Retirement CDC illustration create, and what considerations should be taken into account to ensure illustrations are realistic, consistent, and not misleading?

14.1 We have not performed any consumer testing of communications, as this was outside the scope of the project.

Question 15: What charging structure/what charge levels is your organisation considering levying on members? If implemented, at what level should a Retirement CDC charge cap be set?

15.1 n/a

Question 16: Do you foresee any areas of potential arbitrage, and how should Government and regulators seek to mitigate this?

16.1 There is the potential for arbitrage where there is unfairness in the pricing mechanism. The sharing of investment risk through equal future indexation and any mispricing creates such an unfairness.

16.2 We have seen that the pricing errors for the oldest generations in dynamic-accrual schemes (using statistically calibrated pricing) are much lower than those for the youngest generation, of the order of 5%. This is of the same order as the premium we have assumed one must pay to purchase an annuity to allow for systematic longevity risk, so this level of pricing error seems acceptable.

Question 17: Are there any other matters you wish to raise in relation to the possible extension of the CDC authorisation and supervisory framework to include Retirement CDC schemes?

17.1 n/a

Question 18: Do you have any comments on the proposed amendment to Regulation 12 of the Preservation of Benefit Regulations 1991?

18.1 n/a

Pensions Policy Institute (PPI)
Thanet House
231-232 Strand
Temple
London WC2R 1DA
t: 07718 647 567
e: info@pensionspolicyinstitute.org.uk
w: www.pensionspolicyinstitute.org.uk