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What is CDC and how might it work in the UK? Launch Write-up

The Pensions Policy Institute (PPI) held a policy seminar on 29th November 2018 to launch ***What is CDC and how might it work in the UK?***, sponsored by the Defined Contribution Investment Forum (DCIF) and the Royal Mail Group (RMG). What is CDC and how might it work in the UK? sets out the potential benefits and issues for the implementation of CDC in the UK.

Over 80 people representing a broad range of interests within Government, the investment industry, the pensions industry and the third sector attended the seminar.

John Stainsby, **Head of UK Client Group**, **AXA IM**, welcomed attendees on behalf of the hosts.

The Rt Hon. Lord David Willetts, **PPI Governor and Executive Chair of the Resolution Foundation** chaired the event. He described the current pension landscape where there is an imbalance of resources and risk between current DB and DC arrangements and the long-held aim to find an intermediate solution between DB & DC.

Lauren Wilkinson, **PPI Policy Researcher**, presented the findings of the research.

Panel responses to the research

The panel members reflected upon the messages from the research and the implications that these have for their respective perspectives.

- Jon Millidge, RMG, spoke about how intergenerational fairness impacts all pension schemes and that within a CDC scheme it must be addressed within the scheme rules.
- Julian Barker, DWP, spoke about the current progress towards new legislation, and that lawyers had been engaged for drafting. This new legislation could be expected after the next Queen's Speech.
- Louise Farrand, DCIF, spoke about how many of the opportunities, particularly investment opportunities, are not unique to CDC schemes and can also work for individual DC schemes.

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Discussion and Q&A

The following points were raised during the question and discussion session held under the Chatham House rule, chaired by The Rt Hon. Lord David Willetts, with the panellists, (above), Lauren Wilkinson (PPI), and the audience. They do not necessarily reflect the views of the Pensions Policy Institute:

The proposed Royal Mail CDC scheme

- The proposed scheme has been agreed with the Communication Workers Union (CWU).
  - As a union CWU will have a predisposition to collectivisation.
- The ability to deliver target benefit levels has been stress tested by multiple independent parties considering the performance of the investment strategy.
- The scheme benefit structure is familiar to members as the overall design aims to deliver an income in retirement, and a lump sum at retirement.
  - There is a DB lump sum arrangement alongside the CDC benefit.
- If the legislation is in place RMG would like to have the scheme go live as soon as possible afterwards.

Member decisions

- The type of pension scheme an employee can join is not their choice. Potential membership of a CDC scheme is predicated on the employer decision of what type of pension scheme they choose to offer to employees.
- Currently within DC almost all members follow defaults, in membership through automatic enrolment, contribution rates and investment selection. This inertia is expected to play a similar role in member behaviour within CDC schemes.
  - This inertia may help to mitigate adverse selection behaviours which could be exhibited by members which would be damaging to CDC scheme design.
- CDC schemes may present a simpler option at retirement to members than they would face in a DC scheme with the complexity presented by freedom and choice.

Decumulation considerations of schemes:

- Demand for CDC decumulation options will happen in a few years as the number of retirees and the value of their accrued benefit both increase.
  - This will take time to mature unless a scheme allows transfers in.
- To be able to align with Freedom and Choice, members must be able to transfer out of the scheme in the manner of a current DB member.
- The ability to transfer in to a CDC scheme at retirement to use as an alternative method of accessing funds may confuse retirees by presenting another complex option.

Trustees and governance

- What investment guidance will be available for trustees and what should it look like?
- How trustee discretion applied to investment strategy can influence intergenerational fairness by better protecting different cohorts of members.

- Adjustments to benefits will need to be transparent and mechanistic so people understand this is not like With Profits.
- Trustee discretion (either directly or through investment approach) could be used asymmetrically to protect members from a cut in benefits as people will respond more negatively to cuts than positively to increases.
  - This may lead to a bias of behaviour and intergenerational unfairness.
  - Where there is trustee discretion there may be industrial / moral pressure applied.
  - Whether there may need to be restrictions on the trustees' discretion.
- Communication to members will have to be clear to get them to engage with the risks, most particularly when this results in negative changes to benefits.
  - Members will need to understand why benefits are changing.
  - They will need to see changes being applied consistently to all members.
  - There is a considerable risk when benefits may need to be reduced and it is important that members understand and are engaged with the process.

Tax

- This will require greater consideration and may need a bespoke solution from HMRC.
  - The current approach including the Life Time Allowance and the Annual Allowance may not be a suitable fit for CDC schemes.

Intergenerational fairness

- The assessment of intergenerational fairness is a complex matter and there are many criteria which can be used to assess fairness, from outcomes to the degree of risk assumed. These different measures could be used to come to different conclusions over whether a scheme is, or has been, intergenerationally fair.
- There are significant differences between the luck that members may enjoy and inherent bias (or unfairness) that may appear in scheme design which can result in different outcomes for different generations:
  - Some generations may benefit more than others from luck, however this does not necessarily indicate an unfairness or bias in the scheme;
  - Scheme design can be used to eliminate inherent bias;
  - People may mistake luck for bias and vice versa, however they will be more understanding if everyone is ostensibly treated the same regardless of membership status.

Measurement of success

- The implementation of new CDC schemes in place of DC schemes would be considered a success for CDC.
  - Many employers may have recently implemented new DC schemes and may be less likely to change so soon.
  - Employers may be able to communicate that a CDC package is worth more to employees precipitating a movement from DC to CDC.
- The impact of risk sharing potentially producing better results for members for a given contribution rate.