Institute and Faculty of Actuaries

September 2023

IFOA response: DWP consultation on 'Helping savers understand their pension choices' – July 2023

Overview:

The IFoA Collective DC (CDC) working party welcome the opportunity to respond to a subset of questions from the consultation. The IFoA is the UK's professional body for actuaries, who are uniquely placed to assist in the design of and assessment of retirement solutions. This response has been drafted by our CDC Working Party of 12 actuaries, who cover 5 separate consulting firms, two asset managers, an academic researcher and an in-house investment expert with overseas CDC experience. Between them they have carried out extensive work on CDC design and modelling.

IFoA remain of the view that CDC has merit and it would be in the public interest to extend it to in-decumulation CDC as long as it comes with sufficient protections for members. We also consider that NEST (or another provider of last resort) could have an important role to play in this.

Question 1 – Should it be up to trustees to determine the other suitable suites of products?

We agree with DWP that DC savers should have access to an appropriate range of decumulation products, and that DC Trustees should have responsibility to determine this range to offer to their members.

If decumulation CDC emerges as a viable option for UK pensions, Trustees should be expected to consider this new type of product and whether any offering should form part of their product suite. If CDC is not included within the suite, the Trustees should be able to explain why it is not appropriate to introduce it (or a pathway to it) for their scheme.

Any Trustee requirements should be considerate of governance challenges faced by small schemes. Although we acknowledge the drive for consolidation and generally see scale as a good thing, some schemes have complex structures that can result in difficulties consolidating past service benefits e.g. DC with underpins, which are unattractive to providers. In some cases it will be appropriate for the scheme to conclude it is not cost effective for them to provide certain products, or a pathway to those products. Trustees could also consider as part of this whether it would be in members' interests for future DC accumulation to be provided elsewhere (such as NEST, see Q18, or another provider) and whether members might be better served by transferring legacy savings with them, so that at retirement they will have access to a range of DC decumulation options.

Question 2 – What can government do to help a CDC-in-decumulation market emerge?

Legislation

Clear commitment from Government and signposting of timescales for legislation is very important to ensure potential providers are given confidence that any work on CDC decumulation solutions is likely to be a worthwhile investment.

Currently there is no widely accepted blueprint for the optimal CDC decumulation solution. Therefore, to encourage innovation, legislation should not be overly prescriptive on the specific design. For example, flexibility to offer longevity pooling solutions (without investment risk sharing) could be made available through CDC decumulation legislation.

The authorisation process and supervisory regimes by tPR should provide the necessary protections, ensuring any new CDC solution is fit-for-purpose. However, it will be important to ensure the authorisation hurdle is not so burdensome and expensive as to discourage providers from entering the market.

Protection for members

One key challenge facing CDC solutions is providing confidence to the first generation of members (and their advisors). Adequate protections need to be put in place for CDC members in scenarios where CDC does not achieve required scale and becomes unviable.

The government should consider their role in providing protection for these members. One option could be to have a fallback CDC provider e.g. NEST (see Q18), that would accept transfers in from a CDC scheme that is winding up. An alternative solution could involve converting to drawdown pots (especially for younger pensioners) or annuity purchase (especially for older pensioners), albeit accepting a lower level of income or increases - for example converting to a flat annuity. However we think that a bulk transfer from one CDC scheme to another CDC scheme is the preferable way to wind up a CDC scheme.

Accumulation and decumulation CDC

One way to help achieve adequate scale for CDC is to allow solutions that can provide both whole-life and decumulation-only options. For example, with the right governance framework, a whole-life multi-employer CDC schemes could also offer decumulation CDC (through transfers in at retirement). Having this flexibility would increase the attractiveness for providers considering establishing commercial whole-life multi-employer CDC schemes, and would facilitate a form of decumulation CDC for the scheme's whole life members.

Default solutions

A key factor in the growth rate and success of CDC will be whether CDC is included as part of the default solution for members. We believe CDC should be chosen by the member "opt in basis" rather than automatically (i.e. opt out). However, for members with non-trivial pot sizes, CDC could form part of an illustrative / example solution sent to members as part of the retirement communications. For example, 25% cash lump sum, 25% income drawdown and 50% CDC. Although this would not be an opt-out default solution, it would provide clear signalling for members to consider CDC as part of their retirement solution and potentially opt into it. Clear communication will be required to ensure any illustrations are not interpreted as advice.

Prospective providers may be discouraged from entering the market if CDC is not expected to feature prominently as part of the retirement solution shown to DC members, to help it build scale.

Pathway to CDC

DWP has also raised the possibility of requiring DC trustees to provide a pathway to CDC in-decumulation, for those DC schemes which cannot provide it themselves. Such a requirement would increase member access to CDC and also give potential providers additional confidence of building scale. It would be too soon to put in place a requirement for when CDC in-decumulation is first available. However, a potential requirement could be considered again once CDC in-decumulation has been established.

Question 18 – Do you have views and evidence on how this can be delivered in ways that achieve our policy aims of stimulating CDC in decumulation, enabling Nest to provide the services outlined in this consultation, while ensuring a healthy competitive marketplace?

We support the provision by NEST of a range of appropriate DC decumulation products, to improve retirement prospects for its members, including income drawdown solutions and a pathway to annuity purchase options. We consider that CDC should also form part of this, as an option for members who wish to receive a cost effective income for life.

Further we suggest NEST (or another Government-supported provider) should be committed to accepting transfers from other CDC solutions that are winding up and wish to offer NEST CDC to members. This would help in a number of ways including:

- Providing comfort to members considering CDC solutions (and their advisors)
- Provide comfort to other DC scheme Trustees who are including CDC within their suite of products offered to members
- Help make CDC more attractive for potential providers

NEST exists as a ‘provider of last resort’, and any CDC solution provided by NEST needs to balance the objective of establishing a CDC market with the risk of discouraging other participants. In particular, NEST’s CDC offering should not be subsidised by Government to such an extent as to make a CDC decumulation offering commercially unviable for potential providers.

With regards to timing of NEST launching a CDC solution, in order to avoid risking stifling private sector provision before it can launch (and creating a monopoly), we suggest NESTs is launched at least two years after the private sector have an opportunity to launch a CDC offering. NEST’s launch could then fill any gaps in the market, such as CDC provision for smaller arrangements where it is not sufficiently cost effective to provide a pathway to private sector CDC, NEST’s launch might also stimulate further private sector innovation from that point.

Flexibility on scheme design within legislation will be important to ensure private sector offerings can differentiate.

Consideration could also be given to provision by NEST of accumulation CDC (whole-life).

Question 20 - Are you able to provide a breakeven point in pot size for providing certain decumulation products or services? Would this be different for decumulation only CDC’s?

The breakeven point will depend on the scheme specifics and is a commercial consideration. Therefore, it is for the providers to answer. We believe it will be appropriate for providers to set a minimum pot size to ensure the scheme is commercially viable. Depending on the minimum size set by the providers and the government’s desire to allow members with smaller pots to access CDC, the government could provide a small pot CDC solution through NEST (see Q18).