Institute and Faculty of Actuaries

March 2023

IFoA response:

DWP consultation on extending opportunities for Collective Defined Contribution (CDC) pension schemes

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

Within the actuarial profession we have experts in technical detail, executives in small and large financial institutions, and practitioners working within the financial system itself. Our outlook is rooted in our Royal Charter (dating back to 1884) and in our long history of working with policymakers to effect change. We focus forwards on how we can help individuals and organisations solve financial and risk-related problems in the 21st Century. Please contact Caolan Ward, Policy Manager, (caolan.ward@actuaries.org.uk) if you have any questions about this response or need further information.

Executive summary and overall comments

The Institute and Faculty of Actuaries (IFoA) welcomes the DWP's consultation on Extending CDC schemes. 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 11 actuaries, who cover 5 separate consulting firms, an asset manager, 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.

Our key points in relation to the consultation are as follows:

- CDC has a lot of merit, in allowing access to cost effective income for retired life, which is managed for individuals without them having to make difficult decisions.
- Therefore extending CDC would be a positive development for UK pensions which would be in the public interest, so long as doing so comes with sufficient protections to ensure only schemes with robust designs can be opened, and those deciding whether to join the scheme (whether employers, employees or other individuals) are given sufficient and unbiased information about the scheme so that they can make an informed decision.
- Whole life / decumulation only: We believe there is a high level of demand in particular for decumulation CDC as a new option for DC retirees. We can see that extending whole life CDC to multi-employers and master trusts is less of a step from the current single-employer whole life regime than allowing decumulation only, which features a purchase process at retirement. However we note that if a whole life scheme accepts transfers in near retirement, this poses similar design considerations and challenges to decumulation only.

- As we note in Q1, we consider that multi-employer / master trust CDC schemes will need to be able to tranche members (while continuing to pool risks among them) in order to remain commercially viable. This would also make feasible the DWP's objective for increases to be at least CPI, at least for new entrants.
- As we note in Q20-24, we believe it will be possible for decumulation schemes to achieve scale; we agree with the DWP that good communications will be important to support member decision making and we make some suggestions for requirements here.

We would be happy to meet with the DWP to discuss the above or our following answers to the consultation questions.

Chapter 3: Key principles for new types of CDC schemes

Question 1: Do you agree with the key principles we have identified as necessary for the new types of CDC schemes and in particular whole-life multi-employer CDC models? If not, please set out why.

We agree with these other than adjustments being made without variation across the membership. As multi-employer or master trust schemes will be open to new entrants (whether employers choosing to put their workforce in the scheme or individuals choosing decumulation only), and especially where those new entrants might choose between different vehicles, if the initial increase expectations are driven by past experience (from other joiners) this would be a distorting factor. For example if a scheme is doing well and giving CPI +2% pa increases, that would be likely to put off new joiners who can get CPI elsewhere (with higher initial benefits as a result, to preserve actuarial value). Therefore for these schemes to be commercially feasible they need to be able to tranche members. There can still be risk sharing across members, but with allowance for differences between tranches, driven by the experience from the commencement date of each tranche.
We understand the aspiration for increases to be at least CPI. This applies under the existing single-employer regime when the scheme is first opened. Multi-employer / master trust schemes will be taking on new entrants over time therefore arguably the CPI minimum should apply to each new entrant rather than just at authorisation, so that new entrants aren't joining a scheme with an expectation of real reductions and/or a high probability of nominal cuts? This continual CPI minimum for new entrants could work under a tranching approach (see first paragraph above) but there may be occasions where increases (based on latest estimates from existing accruals) are below CPI.

Chapter 4: Defining qualifying benefits and qualifying schemes
Question 2: Do you agree with our thoughts on what requirements might need amending to accommodate these new CDC designs? What new triggers for sectionalisation other than a change to the actuarial plan do you envisage might be appropriate in these new schemes?

We think that CDC regulation 4.1 can be removed in its entirety. We think that there should be as little sectionalisation as possible so that the risk-sharing pool is as big as possible. Different benefits do not have to be accrued in different sections as long as each type of benefit is priced and valued on a fair, consistent basis.

For example, benefit designs where accrual rates vary should be allowable within a single section as long as actuarial consistency is maintained. In particular, accrual rates could be set to be of actuarial value to the contributions paid for each individual member (ie actuarial cost-neutrality). This should accommodate accrual rates which vary by factors including:

- **Age**
- **Contributions paid**
- **Financial conditions**
- **Benefit features chosen, such as a contingent spouse's benefit or a five-year guarantee**

This should apply to single employer schemes as well as multi-employer CDC pension schemes.
It would be helpful if the DWP could confirm that the existing age discrimination exemptions already provide for such designs (or if this is not considered to be the case, make any changes necessary to accommodate CDC contribution rates or accrual rates that vary by age).
We also agree that single employers should be able to access these new design flexibilities, e.g. where accrual rates can vary by age and over time (although, for the avoidance of doubt, not all of the new requirements discussed in this response have to be applied to single employer CDC schemes).

It is not clear to us what the "actuarial plan" in the question refers to. We can think of more than one possibility. Further clarification would be helpful.

Chapter 5: Authorisation
Question 3: Should the definition of "operates" at section 7(5) of the 2021 Act be amended for whole-life multi-employer CDC schemes? If you agree, please set out how.

We agree that some amendments are likely to be needed.

As well as members and employers or prospective employers, monies could come from other sources, and a person should be considered to be "operating" the CDC scheme if they receive money from any sources in respect of contributions, fees, charges and other purposes.
For sectorial whole-life multi-employer schemes, there could be different sources of seed capital. For example, from a single lead employer (the equivalent of a "principal employer") establishing the scheme, or from a group of founding employers who initially agree to fund and set up the CDC scheme, a central source such as historic institutional assets, individual member contributions sponsored by unions, or, should legislation permit, direct contributions from employers' current arrangements if, for example, the scheme is to be set up as a new section to an existing arrangement.

Legislation should enable the person operating the CDC scheme to accept money from these sources towards setting up and authorising the scheme, without breaching the prohibition. Restricting the possibility of sharing the initial costs of schemes could limit the growth of CDC. The expectation would be that the relevant parties would come to reasonable agreements as to the share of contributions to the scheme, and any conditions attached to them (e.g. should the authorisation not proceed).

For a commercial whole-life scheme, we would not expect further monies to be paid by the commercial provider once the seed money has been paid for initial set up and authorisation. However, given the need for a backer throughout the life of the scheme (Question 8), we suggest a person handling such monies after the initial costs should also be considered to be "operating" the scheme.

We note that in all cases no payments could be received from (or benefit paid to) individual employees prior to authorisation.

Question 4: How might legislation capture persons performing the functions listed at paragraph 39 in commercial and sectorial schemes so that they are within scope of the fit and proper persons test? Are there other persons that should be brought within scope of the fit and proper persons test for these new schemes?
In general we think those persons to be tested for Master Trusts could be read across to CDC schemes.

Those establishing the scheme: for sectorial schemes we expect this will be undertaken by a clear body, most likely a pensions board that currently runs DB and DC schemes in that sector. The Regulator's current CDC code says *"where the roles are fulfilled by a corporate entity, we will assess the appropriate senior individuals, but we will not normally assess the corporate entity"* and we expect this will be sufficient.

Those marketing and promoting CDC schemes to prospective employers and members: should be required to be fit and proper, whether for a sectorial scheme or commercial. We see a limited distinction here, as in some cases the sectorial provider may also wish to grow their scheme (for example, driven by the aims of an in-house provider).

Scheme funder and scheme strategist: It is likely that the functions of scheme funder and scheme strategist could be performed by separate individuals in some circumstances and so separate definitions could be required. As the CDC regime is in its infancy, it seems unlikely that many potential strategists would pass the competency test at the required level for Master Trusts (especially that they have the appropriate experience to carry out their role).

Question 5: Do you agree that those marketing and promoting CDC schemes should be within scope of the fit and proper persons test where certain conditions apply, and if those conditions should be similar to those in Master Trust schemes?

The conditions for Master Trusts appear appropriate for commercial CDC schemes. We note that the Master Trust regulations permit (but do not require) the Pensions Regulator to assess the fitness and propriety of a marketer or promotor, and the details are then filled in in the Code of Practice. We think this would provide the flexibility needed to ensure sectorial and commercial CDC schemes can be treated appropriately as required.

Question 6: Are any changes or additions needed to Schedule 1 of the 2022 Regulations in respect of matters to be taken into account by TPR, as part of the fit and proper test to reflect the new roles envisaged to exist in sectorial and commercial schemes?

We suggest

- the scheme strategist should be included (Q4; Schedule 1 para 3 of the Master Trust Regulations)
- there should be flexibility in the regulations to include other persons who the Regulator decides should be assessed (Schedule 1 para 2 of the Master Trust Regulations)

Otherwise, we believe the fit and proper persons requirements for single-employer CDC schemes are also appropriate for sectorial multi-employer CDC schemes. Where further skills, knowledge and understanding might be required for persons involved with multi-employer schemes, these requirements should be sufficiently covered by Schedule 1 Para 3 of the 2022 Regulations. We note that there are limited opportunities for those involved to have gained sufficient experience on CDC schemes, before being assessed by the Regulator as a fit and proper person.

Question 7: Are the current scheme design requirements including the tests still appropriate for assessing soundness in the new whole-life multi-employer schemes? Are there any additional soundness considerations or tests needed in light of the new designs?

In general, we agree that the scheme design and viability requirements should read across to multi-employer CDC schemes.

Scheme design requirements

Some adjustments may be required to permitted scheme designs to ensure that flexibilities including different contribution rates and age-related scales are permissible.

Viability requirements

Communication - we agree that the same considerations around communications to members should apply to whole-life multi-employer schemes as for single and connected employer schemes.
It appears reasonable to consider the clarity, completeness, and accuracy of communications to employers and prospective employers.

We would expect the information disclosed to prospective employers needs to be sufficient to allow them to understand the potential risks and costs, identify potential cross subsidies between employers and compare alternative commercial providers in terms of both risk and cost. The information should, at a minimum, include details on running costs and expenses, including any potential liability on a triggering event; how benefits are adjusted and recent adjustments applied, what that means for the risk exposure of different categories of members (including from any multi-year adjustments outstanding), and target investment performance and returns.

Gateway tests and live running tests - we believe that these tests remain appropriate (and appear likely to be easier to demonstrate for an age-related benefit structure - in fact most of the tests would fall away if the benefits accruing are of equivalent value to the contributions being paid on behalf of that member, but could still be relevant if some level of deviation from equivalent value is allowed).
As noted in Question 1, we suggest that consideration is given to extending the requirement that increases of at least CPI should be expected on initial application to that being the case for all new entrants to the scheme (with the terms set accordingly). This would then form part of the live running tests.

Question 8: If a scheme funder equivalent is introduced for the new whole-life multi-employer CDC schemes including Master Trusts, should similar scheme funder requirements to those in the DC Master Trusts regime apply? Are there any changes needed to ensure there is a clear focal point for TPR's scrutiny and liability for meeting the relevant costs?

For sectorial multi-employer CDC schemes, it is not clear that the concept of a single "funder" is practicable. In practice, the liability for paying additional administration charges would likely be shared between all the participating employers rather than falling on a single employer. In addition, a current employer is unlikely to meet the requirement to only carry out activities that relate directly to the CDC scheme as set out in paragraph 59; whilst there could be processes in place to apply to the Regulator for exemption (such as those for Master Trusts), this seems unnecessary for current employers.

We suggest that the trustees or strategist should be responsible for identifying the source of funding, and this forms part of the initial approval process and annual review. This might include review of covenant, legally binding agreements, cash in bank accounts, escrows etc.
For commercial CDC schemes, we would expect similar funding structures to DC Master Trusts, and agree that the concept of a scheme funder could be appropriate with similar requirements to those applying to the Master Trust regime. Having the same requirements would also simplify the process for current Master Trusts to create new CDC sections.

Question 9: Should business plan requirements, similar to those for Master Trusts, be introduced for commercial and sectorial CDC whole-life multi-employer schemes? What, if anything, should change? Who should be responsible for preparing the business plan?

We agree that a business plan should be required for both commercial and sectorial CDC multi-employer schemes. We think the framework for the business plan, as set out in the 2018 Master Trust Regulations,

would mostly be suitable for both sectorial and commercial CDC schemes, but the contents of the business plan would be expected to differ between commercial and sectorial providers as set out in the Regulator's code (and again for decumulation only vehicles if introduced).
We would suggest that the business plan includes setting out how the funder expects to recoup initial expenses over the long term as the scheme scales up. It must also be made clear how cross-subsidies in meeting expenses between generations will be limited, whether by fixing annual management charges or otherwise. If scheme trustees or the scheme strategist are responsible for identifying and confirming the source of funding, a report of this should be included in the business plan.

Question 10: Do you agree that the existing requirements should apply to new whole-life multi-employer schemes and are additional requirements needed to help ensure that communications used in promoting and marketing the scheme are not misleading? How might Schedule 4 of the 2022 Regulations be amended to achieve this?

For members already in the CDC scheme, we agree the current communication requirements are suitable and would also be suitable for sectorial multi-employer schemes.

We believe that, to mitigate the "over-promising" risk, it is appropriate for the communication used for promotional and marketing purposes to be included in the requirements in a proportionate way. This will be particularly important for commercial CDC schemes.

Question 11: Are any changes or additions needed to the requirements in Schedule 5 of the 2022 Regulations to reflect the new designs and relationships anticipated in the new whole-life multi-employer schemes?

We expect CDC schemes will become more commonplace over time, and there will be individuals and employers wishing to transfer their pension pots to different CDC schemes and/or different sections of the same scheme. The "member records" requirements need to be able to cater for this.
If the "funder" concept is decided not to be appropriate for sectorial schemes (see our thoughts on Q8), we suggest Para 6 should be expanded to include those who contribute to funding and the trustees' or strategist's determination on the suitability of funding.

Question 12: Do you agree that it is reasonable for the existing requirements in regulations 15 and 16 of the 2022 Regulations to apply to the new whole-life multi-employer CDC schemes, and that the continuity strategy should include an aspiration to operate the scheme as a closed scheme?

We agree that the existing requirements are suitable for whole-life multi-employer CDC schemes.
We do not support the additional requirement for an aspiration to operate as a closed scheme following a triggering event, although this should clearly be the option to do so where it would be in the member's best interests. Indeed, we anticipate that schemes would need to mature before operating as a closed scheme became a realistic and cost-effective alternative, and that being forced to indefinitely run a loss making CDC scheme would be a significant deterrent to commercial providers to set up a CDC scheme in the first place.

Instead, the best option for such schemes would be to transfer to another, similar CDC scheme. For example, if NEST were to set up a CDC scheme that was able to receive transfers from other CDC schemes, this could be a good option.
It is reasonable for commercially set up CDC schemes to aspire to operate as closed schemes following triggering events.

Chapter 7: Valuations and adjustments

Question 13: Do you agree that most of the existing requirements can read across to the new whole-life multi-employer schemes? What changes including the one proposed above do you think should be made to the existing requirements and why?

Yes, we agree that the provisions can broadly read across to multi-employer schemes.
We agree with the proposal that schemes should be allowed to provide 'one-off' increases to benefits where projected future affordable increases are above a certain threshold. We suggest though that instead of incorporating a specific threshold in the legislation, this is a benefit design choice (which TPR will be able to review as part of the initial authorisation process). We would like this additional flexibility to apply to the existing single employer regime as well.

As noted in Q1, we disagree with paras 80 / 81 if tranches of members are to be accommodated, in which case the benefit adjustments would not be the same across all members without variation.

Chapter 8: The ongoing supervision of CDC schemes
Question 14: Do you think that the list of events in regulation 23 of the 2022 Regulations needs amending for the new whole-life multi-employer CDC schemes? If so, why? Are there new events that should be added or current events that should be removed?

We do not see the need for additional events to be listed. We note that TPR would already be notified each year following a valuation of the amount of benefit adjustment and assumptions underlying that, and so that would include informing it of the application of a cut or cap, or of a change used to the assumptions for the accrual rates.

Question 15: Do you agree that the list of triggering events that apply to single or connected employer CDC schemes needs some revision to accommodate whole-life multi-employer CDC schemes? Are there new events that should be added or current events that should be removed?

Triggering events 4 and 5 could be reconsidered for multi-employer schemes. If one employer among many in a multi-employer scheme becomes insolvent or unlikely to continue as a going concern, it may be of no consequence for the future of the CDC scheme. Either this should not be a triggering event in a multi-employer context or, if it remains a triggering event, it needs to be possible that the triggering event can be resolved very quickly, perhaps after no more than a letter from the trustees to TPR confirming that the exit of the employer is of no material consequence.
References to the scheme employer could change to the scheme funder.

Chapter 9: Continuity options

Question 16: Is a similar approach to the wind up commencement time (and the cessation of contributions/accruals) appropriate in respect of the new whole-life multi-employer schemes? If not, why not? Given AE obligations, how might participating employers be provided with sufficient opportunity to make alternative arrangements, before contributions are prohibited in the whole-life multi-employer CDC scheme being wound up, whilst managing risks to members?

If there has been no warning of an impending wind up, it may be better if additional accrual is allowed for a short time frame. This could give participating employers time to find alternative arrangements for their employees if there was no warning that the wind was going to be triggered. The additional accrual could be:

- Continue to accrue CDC pension - this could be allowed if the default wind up option is to transfer to another CDC pension scheme.

- Start to accrue a DC pot - if the scheme is set up to provide for this.

Question 17: Are the current default and alternative discharge options sufficient for the new whole-life multi-employer CDC schemes?

In our opinion, the current discharge options should be expanded for all types of CDC pension scheme, including single-employer schemes.
We think that the best solution (for members) on wind up of a CDC pension scheme could be a bulk transfer to another CDC pension scheme.

For this to be possible, there needs to be at least one CDC pension scheme which is able to accept CDC assets and benefits where there is no associated employer. The question then arises as to whether the receiving scheme has to be a master trust CDC provider or (if there were to be one) a "default" CDC provider similar to the role NEST plays for DC pensions.

On a similar note, we believe that CDC pension schemes should not be restricted to only offering CDC pensions to employees associated with particular employers. CDC pension schemes should be able to offer CDC pensions to diverse populations, including the self-employed.

Question 18: Do you agree that the existing framework for the wind up of a CDC scheme can read across to the new whole-life multi-employer schemes? What changes, other than the ones mentioned above, do you consider should be made for these new schemes?

The existing framework for the wind up of CDC schemes seems onerous. A simplified approach could be allowed for both the new schemes and single/associated employer schemes.
Simplifying the wind-up process will reduce the required wind-up reserves, thus making CDC pension schemes more attractive to funders, and possibly potential participants.

The first option for all CDC pension schemes on wind up, should be to transfer to another, similar, CDC pension scheme. This is particularly important for CDC pensions in payment, where vulnerable members may struggle to cope with all of the options available with a DC pension pot. A CDC pension will match their previous expectations more closely without the need for difficult decisions. The trustees could still decide to give members the option of transferring out on wind up.

If a transfer to another, similar, CDC pension scheme is not available, we suggest members' benefits should be 'de-collectivised' (ie with not further longevity pooling, akin to having individual pots) at the point that wind-up commences.

Chapter 10: Other policy considerations

Question 19: Do you agree that the existing requirements, outlined in Chapter 10, which apply to single or connected employer schemes can be read across to the new whole-life multi-employer CDC schemes, other than where a modification has been highlighted?

There is a separate policy consideration that we believe could differ from the consideration for single-employer schemes - Auto-Enrolment thresholds. Our understanding of the existing requirements is that they are on the Cost of Accruals basis used for DB schemes, to reflect that actuarial values of CDC accruals in those whole life schemes will vary over time and by member. Whereas, in the CDC Whole Life schemes designed based on the principle that the value of accrual should equal the contributions being paid for each member, as we raise in Question 2, there is a strong case for the auto-enrolment thresholds to instead be no more than those for individual DC. This is because each individual is accruing a benefit of the initial value of

their contributions, but with higher expected annual retirement income than if it were being paid into an individual DC scheme.

Chapter 11: Decumulation-only arrangements
Question 20: Who would be responsible for meeting the costs of establishing the arrangement and the short-medium term operating costs?

Inevitably the provider would need to cover the upfront set-up costs and may need to further subsidise cost in the initial short-term growth phase of a new CDC proposition until it reaches scale. However, we would expect member charges to cover these operating costs in the medium term, if the offering is to be commercially viable.

A further consideration would be any future wind-up costs. It is important that a provision is made for that. One potential solution is that money is put aside in an escrow account.
To ensure that this remains an attractive market for commercial providers, there needs to be a balance with any proposed charge cap and limitation to seed sponsor's upfront commitment so that providers can generate a reasonable return within an acceptable timeframe.

Question 21: How could such arrangements establish scale and what evidence is there to support this? In addition, until such schemes achieve and maintain scale do commercial providers envisage providing the funding needed to smooth volatility and deliver the aspired to pension benefits? How would the potential issue of small pots be addressed?

It is recognised that scale will be important to make CDC a success, and from a regulatory perspective there is a strong preference for a small number of well-run large CDC schemes, as opposed to a proliferation of smaller ones. It is expected that some of the initial new entrants are likely to be existing players in the UK pension market, such as DC master trusts who would bring an existing captive customer base. It is also recognised that there is a general theme of consolidation happening in the UK pension market and any new entrant would be required to produce a business case with evidence of projected future flows**.**

We also note that many other countries have successfully implemented CDC schemes. The Netherlands is the country often quoted as having the most developed Collective DC system as employers moved away from DB pension plans. However, there is also evidence in other countries like Canada (such as the UBC Faculty Pension Plan, which offers a Variable Payment Life Annuity option to its members at retirement and has assets of c.£1.8 billion) and, more recently, in Australia with QSuper. QSuper has seen assets of c.£100m within a year and a half. Both the Canadian and the Australian examples pool longevity risk but do not share investment risk among members.

It would be expected that a commercial provider would provide the upfront economies of scale savings expected from a successful CDC scheme. However, we would not expect the scheme funder to smooth volatility of, say, the underlying investment experience. In fact, to do so would go against the principle of CDC and the pooling of longevity and investment risk.

It is recognised that decumulation-only CDC would have embedded administration costs per member and therefore, similar to annuities, it is unlikely to be attractive for small pots, and it is expected (and in our view would be appropriate) that commercial providers would set a minimum amount that they would accept into the scheme. This does not stop members combining their underlying small pots, which would be supported by the forthcoming pensions dashboard. It is also acknowledged that there may be a place in the market for a government-backed CDC offering that captures smaller pots and/or is the CDC “of last resort”.

Question 22: What mechanism should be used to determine the price at which people might buy into a decumulation only CDC arrangement and what can be done to ensure individuals are treated fairly? In addition, should mortality underwriting be a feature of these arrangements, and how would this best be done?

What is crucial is that the buy in CDC price is actuarially cost-neutral. This will rely on a consistent approach/methodology to assumptions such as future mortality and expenses. The assumptions about future asset returns net of targeted pension increase will be of most importance, given the need to treat members fairly across generations. In order for the statement of targeted / estimated increases to be reasonable, it will be important to ensure that such assumptions are not deliberately overstated for commercial reasons.

We would note that adjustments to benefit payments would require an approach akin to an annual actuarial valuation. Underlying CDC pricing would also need to be updated regularly and a cooling off period would be required.

The feature of mortality underwriting would involve a cost benefit analysis. In Australia and Canada similar schemes do not include mortality underwriting. Using medical underwriting would be more complex and expensive than not doing so. We note though that other UK pension products will often allow for some level of medical underwriting including postcode analysis and other lifestyle factors/habits such as smoking. We suggest therefore that mortality underwriting be permitted by the legislation should a scheme choose to do this as part of its benefit design, but that it is not a requirement for approval.

Question 23: What steps can be taken to ensure communications to members help them understand how these new arrangements will work and how can consistent standards be achieved in the way commercial arrangements market their products to prevent over-promising?

Communications will be critical to the success of a decumulation only CDC arrangement and it is important that members understand the risks and benefits of the scheme.

Since members will need to choose between CDC decumulation and other options at retirement we propose that communications should explain the following risks and benefits versus other options (annuity, income drawdown, cash out):

- CDC provides an income for life as does an annuity. With income drawdown and cash out there is a risk of running out of money if the member lives longer than expected.
- The level of income from CDC is uncertain and can rise or fall depending on both the performance of underlying investments and the longevity experience of the members of the CDC plan. With an annuity the level of income is guaranteed (at a fixed level or increasing depending on the type of annuity purchased).
- CDC may target inflation-linked increases over time but these are not guaranteed and depend on performance of underlying assets and the longevity experience of the members of the CDC plan. The only way to guarantee an inflation-linked income is with an inflation-linked annuity.
- CDC removes the need for post-retirement decisions, as does an annuity. With income drawdown and cash out the member needs to make decisions about how much income to draw (based on how long the member expects to live/wishes to draw an income for) and how the money is invested.
- With CDC pension benefits and life annuity contracts, the pension dies with the member (subject to any guarantees). Other options give members the possibility of leaving part or all of their pension as an inheritance.

Regarding the specifics of a provider's CDC decumulation product we propose that communications should cover:

- Target pension increases (eg CPI inflation), if there are targeted pension increases, while stressing the increases are not guaranteed and cuts are also possible.
- Explanation of mechanism for determining pension increases or reductions.
- Asset allocation of underlying investments and some measure/indication of investment risk.
- A standardised and understandable approach to illustrating the level of risk inherent in the scheme. This will be essential to avoid members simply choosing the scheme that promises the highest target pension increases (by adopting the most risky investment strategy, or being overoptimistic in their investment return assumptions)).
- Total fees charged to members as % of assets per year.
- Conditions of exit (eg during cooling off period)
- Explanation of what happens if provider closes down product

To help prevent over-promising by commercial providers, the trustees of a CDC scheme should state their actuarial and investment policy, have it approved by TPR and publish it. The same actuarial policy must be used both for pricing and for the annual valuation determining the variation of benefits, followed by the communication of the valuation outcome. That policy is transparent because it is published, and anyone can look at the published documents and consider for themselves whether the policy is biased. While this will lower the scope for misleading communication, it is unlikely that individual members will understand it much, so it is essential that the separate communication of risk to members is sufficiently complete and understandable for them to make informed choices between products**.**

Question 24: What other changes in addition to those set out in this document, do you think need to be made to ensure the effective and fair operation of decumulation only CDC arrangements?

The single-employer CDC regime has a very specific mechanism for applying pension cuts over a period of up to 3 years. While this mechanism might suit some CDC designs, other designs might work better with alternative ways for determining cuts, especially when there are tranches of pensions with different adjustments each year (see Question 1).

The Institute and Faculty of Actuaries have also carried out some research on other (non-CDC) arrangements which involve longevity risk-sharing among the members. Longevity risk-sharing removes the need for members to guess how long they will live, as it removes idiosyncratic longevity risk from members. Longevity risk-sharing results in members having a higher income compared to income drawdown, all else being equal. This is because the shorter-lived members subsidise the longer-lived members, similar to the operation of defined benefit pensions and life annuities. This approach features in the QSuper in Australia and the UBC Faculty Pension Plan's Variable Payment Life Annuity. Such an arrangement could offer a menu of possible benefits to its members, such as level income or inflation-linked income, and similarly for single life and joint life benefits. More generally, there should be some flexibility in the regulations to allow CDC arrangements to tailor their benefit offerings to meet the needs of their members.