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Collective Defined Contribution (CDC) pensions

Bringing CDC to the UK

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Agenda

- Introduction
- The UK Government’s new CDC framework
- Valuation assumption setting powers
- Scheme design considerations
- Attractive features of CDC for companies
- Commercial opportunities for actuaries
- Comments / questions

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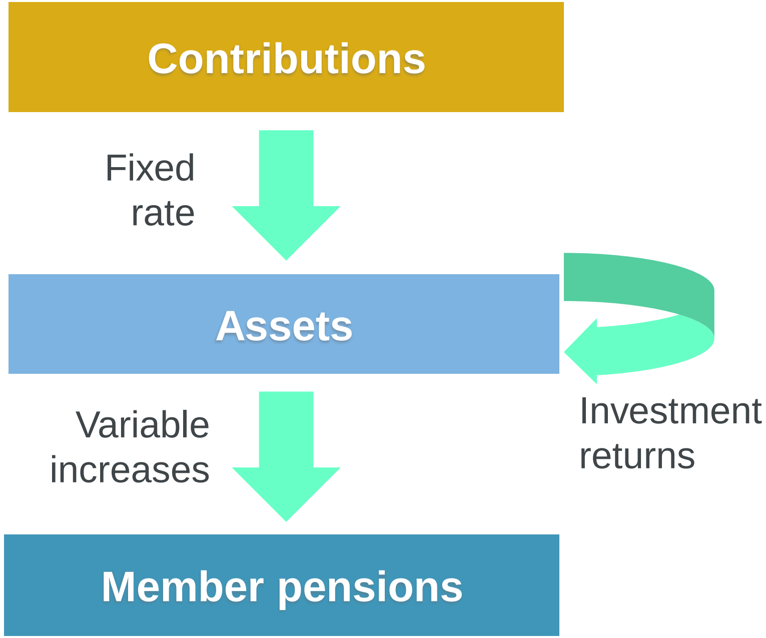
What is Collective Defined Contribution (CDC)?

In Collective Defined Contribution pension schemes savers **pool** their money into a **single fund** to **share the risks** of **investing** and **longevity**.

The fund usually pays benefits in the form of an **annual pension**. **Benefit increases (+ or -) vary** depending on the funding level.

Funding costs are fixed, while the risk sharing supports return seeking holdings so that **higher member pensions** are expected than under traditional DC annuities.

The pooling of longevity means that, unlike individual DC drawdown, **retirement income is evenly spread** over each individual's retired life.



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DWP's initial CDC framework for the UK (1)

Department for Work & Pensions

- **"Money Purchase"** – CDC pensions will be categorised in law as "money purchase" benefits
- **"Own trusts"** – initially, CDC trusts can be established only by single / associated employers
- **Future service only** – employers can provide CDC pensions for future service; past service cannot be converted to CDC, except possibly at the member's choice of a transfer in
- **Authorised by TPR** – employers will require authorisation by the Pensions Regulator before they can open a new CDC scheme
- **Contributions** – these will be paid at a fixed rate of actives' pay; there will be no reliance on employer covenant for past accumulations
- **Investment strategy**
  - set by the Trustees subject to prescription in Rules
  - maturing schemes would increase allocation to bonds / secure income

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DWP's initial CDC framework for the UK (2)

Department for Work & Pensions

- **Annual increase/decrease on benefits**
  - Each year, the same pension increase (or decrease) must be applied across the entire membership (active, deferred and pensioner)
  - To set the increase, CDC schemes will need to undertake annual actuarial valuations to determine the long-term level of increase which the assets fund
  - A 'best estimate' basis is intended for use in the valuations to determine increases, but the Government will not be legislating against the use of prudence buffers
  - The increase mechanism must be inter-generationally fair
- **Communications**
  - Annual member benefit statements must be transparent about expected increases and the risk of cuts
  - Increase levels and backing valuation assumptions will be published for external transparency
- **Transfers:** members can transfer out up until retirement; schemes could permit transfers in
- **Operational expenses** will be subject to a charge cap similar to other money purchase arrangements used for automatic enrolment

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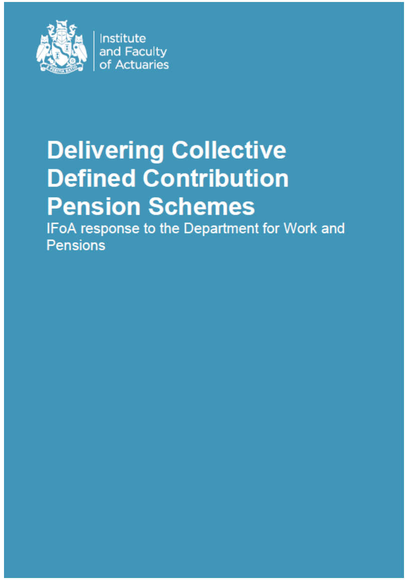
DWP's initial CDC framework for the UK – IFoA response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Delivering Collective
Defined Contribution
Pension Schemes

IFoA response to the Department for Work and Pensions

Summary

- CDC would be a positive development for UK pensions
- Proposals would allow some different designs, and we see this flexibility as a helpful start to the introduction of CDC
- Primary legislation should allow space for further secondary legislation to facilitate other types of CDC schemes, eg master trusts
- The role of actuaries will be critical to ensure CDC is fair and sustainable both in the design of each scheme and then in the increases awarded
- In addition The Pensions Regulator will have an important role in authorising new CDC schemes and providing ongoing supervision
- Good member communications are critical to ensure members understand the nature of the vehicle in which they are investing

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New information from the Oct 2019 Pension Schemes Bill

- Left room for regulations to provide for a wider range of CDC schemes – eg different ways of adjusting benefits, or use of funding corridors, or even different ways of valuing assets
- Included provisions for regulations to allow multi-employer CDC schemes and CDC Master Trusts
- Specifically ruled out use of CDC for the public sector
- 22 of the 40 CDC pages related to the Pension Regulator’s authorisation and supervision of CDC schemes
- Included a provision for the scheme actuary to have regard to guidance from a “person specified… in the regulations”

The 12 December general election is very likely to mean the Bill will ‘fall away’; it will be for the new Government to pick this up again

CDC valuation assumption setting powers

- Trustees of CDC schemes will be required to appoint a scheme actuary, to assist with setting annual increases (through valuations) and member option terms. Three potential governance models:

Assumption-setting approach	Pros	Cons
1. Trustees set assumptions having taken actuarial advice	• Trustees subject to TKU and legal requirements	• If the Trustees do not take the actuary's advice, would that be for the right reasons?
2. Scheme actuary sets the assumptions	• Actuary is subject to professional requirements	• Could still be pressure on the actuary to avoid pension cuts
3. An independent body prescribes the assumptions	• Avoids risk of pressure biasing the assumptions	• Prescription would need enough parameters to be relevant to each scheme

- Under 1 and 2 above:
  - the Pensions Regulator would review the assumptions
  - a "Statement of Valuation Principles" could also be published, for transparency when one of the principles changes, and / or
  - the assumption-setter could have regard to benchmarking against views of others.
- Combinations of the above are also possible, eg independent body sets 'tramlines'

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CDC scheme design – key considerations

Consideration	Option 1	Option 2
Trust vehicle	An employer's trust Accumulation + decumulation	Master trust Decumulation only
Benefit form	Pension (& commutation option?)	Lump sum
Contributions	Fixed rate of pay	Allow to vary over time (within limits) Vary by age / member profile
Benefit accumulations	Fixed rate of pay	Allow to vary over time (within limits) Vary by age / member profile
Benefit increases	Same for all members Same for all accumulation tranches Base on latest funding position Base on 'best estimate' assumptions	Different for actives / pensioners Vary by accumulation tranche More short-term stability Include a prudence buffer
Investment strategy	Target high returns	Ensure the pensions are likely to be stable
Governance	Prescription	Regular judgement

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The IFoA working party's views on design

- Different CDC scheme designs will be suited to different employers / workforces / providers

- All designs should however:
  - Be demonstrably fair in how benefits are determined
  - Aim to outperform insured annuities while having acceptable levels of variability of benefits
  - Be capable of being explained to the membership

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Attractive features of CDC for companies

- Attraction of pooling
  - Income for life from DC savings ➔ more favourable outcomes vs. DC, at fixed cost
  - Employees don’t need to make complex decisions
- Pensions back on HR radar
  - Integration with reward and long-term wellbeing strategies – all helps workforce management
  - Paternalistic employers will want a decent retirement for employees
- Expected choice
  - Single-employer schemes / own Trusts (if scale)
  - Multi-employer schemes e.g. CDC MasterTrusts
    - Menu of contributions & accrual options, with or without sectionalisation
- Favourable with unions

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Commercial opportunities for actuaries

- Legislative requirement for CDC Scheme Actuaries
  - Long-term demand for pensions actuaries

- **Actuaries are essential to the development CDC!**
  - Opportunity to improve pension outcomes for UK workforce
  - Development of CDC through existing MasterTrust regime

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Questions

Comments

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