HOUSE OF COMMONS

Work and Pensions Committee

Oral evidence: Protecting pension savers – five years on from the Pension Freedoms: Accessing pension savings, HC 237

Monday 25 October 2021

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Watch the meeting

Members present: Stephen Timms (Chair); Shaun Bailey; Siobhan Baillie; Selaine Saxby; Chris Stephens; Sir Desmond Swayne.

Questions 140 - 176

Witnesses

I: Baroness Altmann, Pension and investment expert and former Pensions Minister; Angela Gough, Head of Corporate Pensions, Royal Mail; David Pitt-Watson, Leader Tomorrow's Investor Programme, Royal Society of Arts, and Visiting Fellow in Finance, Cambridge University; and Simon Eagle, Senior Director, pensions actuary and GB Head of Collective Defined Contribution pensions, Willis Towers Watson, and Chair of the CDC working party at Institute and Faculty of Actuaries.

Written evidence from witnesses:

The Institute and Faculty of Actuaries (IFoA) CDC Working Group (APS0054)

Royal Society for Arts

Examination of witnesses

Witnesses: Baroness Altmann, Angela Gough, David Pitt-Watson and Simon Eagle.

[*This evidence was taken by video conference*]

Q140 **Chair:** Welcome everybody to this meeting of the Work and Pensions Select Committee where we are taking evidence on the subject of collective defined contribution pensions. We are very grateful to the four witnesses who have joined us, three in the room here and one joining us virtually. What I will do to start is ask each of you to briefly introduce yourselves to the Committee, and to anyone who is watching our proceedings, starting with Baroness Ros Altmann.

Baroness Altmann: Hello. Thank you for inviting me here. I am Ros Altmann. I have spent my entire career looking at all aspects of pensions and pensions policy from an academic research perspective, then managing pension fund money in the City for many years and subsequently advising Governments, industry bodies, pension funds, sitting on boards and also working on the consumer aspects of pensions to help people understand pensions, given the complexity of them.

Chair: Thank you very much and thank you for joining us.

Angela Gough: Hi. I am Angela Gough. I am the head of Corporate Pensions at Royal Mail, which means I am responsible for Royal Mail group pension strategy and I am leading the team that is implementing our new collective CDC pension plan.

Chair: Thank you.

David Pitt-Watson: My background is I am a pensions investor but I am here as co-chair of the CDC working forum from the Royal Society for Arts, which has been interested in CDC and how it can be used to provide better pensions for people in Britain.

Chair: Thank you.

Simon Eagle: Hi, everyone. I am Simon Eagle. I am head of CDC pensions at Willis Towers Watson, a global consulting firm. I have worked for Royal Mail on their CDC pension scheme design and implementation. I have also done wider work with other organisations, including being chair of the Institute of Actuaries CDC working party.

Q141 **Chair:** Thank you very much indeed for the expertise you all bring to this. Can I put the first couple of questions to you? I want to ask each of you if you could tell us what you think the UK should learn from international experience of CDC schemes, and specifically how likely do you think it is that defined contribution savers would choose a CDC decumulation product instead of an annuity or drawdown or one of the products that is available currently?

Baroness Altmann: I think the big learning lesson from other countries is to try to get the communications right, so that members understand what a CDC scheme can do and what it cannot do without building up unrealistic expectations and, also, helping to explain that, although it would be a best efforts exercise to deliver the kind of pension that might be estimated for them, there are no guarantees. If you want a guarantee that costs a lot more, you would go to the annuity market and, with however much was in your fund, you would get less than would be hoped for, promised, expected—whichever phraseology you want to use, they could all be applied—from a CDC scheme.

On the decumulation point, I think that is really interesting because clearly it has been very popular to drop the annuity mandatory requirement. Part of that is because of an unusual circumstance of the central bank's policy of driving down annuity rates significantly, so that the costs of buying a guaranteed pension income have increased. Partly that is because people perhaps have been locking into annuities when they have been far too young.

I think that is something that in any decumulation approach for pensions needs to be borne in mind. If people do not urgently need the income guaranteed for them, many of them may well be crystallising the fund or taking drawdown when they are still relatively young and it is often normally, for most people—whichever way you want to put it—better to wait until later life, in other words your 70s or beyond, not 50s and 60s, before you make an irreversible decision.

CDC will give you an option of having slightly more income and investment growth. There is a benefit from that in a decumulation product but, if you do not need to take the income, actually leaving the fund to grow and then maybe having an opportunity for a better outcome later and, crucially, with a decumulation product, how would it account for someone's health status? That is a significant part of the income value from converting your pension fund into a stream of income. If you have a normal or longer than expected life expectancy, you would have a very different outcome and possibly way of proceeding than if you have a much shorter likely time left.

Q142 **Chair:** Can I pick that point up with you before coming to the other witnesses? You made this point to us in your evidence that if members with lower life expectancy transfer out at full value this will reduce payments to other members and will reduce the advantages in longevity pooling.

Baroness Altmann: Yes.

Chair: Presumably, given the pension freedoms, people with lower life expectancy will be fully entitled to take their money out and you see that potentially as a cause of difficulty?

Baroness Altmann: I think that is a significant risk to the remaining members because, effectively, you are permitting a member to select against the scheme. The member will know things about their own health that the trustees or the other members of the scheme will not necessarily be party to. If all members are entitled to transfer out at full value of their share of the fund, which is the current proposal—we all know how difficult the circumstances were for defined benefit schemes, when everybody thought they were fully funded and all the forecasts suggested they had even a surplus and so on, but ultimately, when the markets collapsed and life expectancy increased by more than anticipated it turned out to be that those assumptions about how much pension could be afforded from the fund were way too optimistic.

Therefore, I think there is a serious risk that pension schemes, which tend to rely on the law of averages, could be selected against. I am not saying this is something that is wrong to do, because if you do have a shortened life expectancy you would want perhaps to transfer out and you don't need a guaranteed lifelong income if your life is not going to be very long, but I think there is an inherent problem in the structure, as currently conceived.

One of the things we tried to get into the Bill was some kind of risk margin or discount for early transfer or transfer out, to build in some buffers against bad markets or perhaps unanticipated life expectancy. The alternative might be to require those transferring to have some kind of health check, as one would do for an impaired life annuity, for example, whereby they would take a lower transfer value. That raises all kinds of other questions that we have not yet dealt within the legislation.

Angela Gough: To answer your first question first about what we should learn from overseas CDC schemes. I completely agree with Baroness Altmann that it is important that comms are strong, that members have a good understanding of what the benefits are and what they are not, and would could happen and the circumstances in which pensions increase and potentially decrease. Therefore, I fully agree that comms are very important.

The other thing that we learned when we were designing our scheme was to ensure that scheme rules mean that the trustees cannot put off making difficult decisions. For example, if the scheme needs to reduce benefits that decision happens straightaway and it cannot be left for later cohorts of members. That is one of the things we considered in designing our own scheme.

I am not sure I would be the best placed to comment on whether or not people are likely to choose CDC for decumulation. We certainly heard from our people that they were really keen for an alternative to annuities and drawdown and that is how the scheme got designed along with our unions, the Communication Workers Union and Unite CMA.

If I was to pick up on the point that Baroness Altmann made about transfer values, potentially Simon Eagle from the IFOA might be able to expand on this a bit more than me but, as I understand it, transfer values will be calculated on a kind of central best estimate basis, but that does not mean you cannot allow for potentially different demographics between the cohort that are choosing to transfer and the cohort that are choosing to stay, so there might be ways to allow for selection risk within the scheme if it is demonstrated that the scheme has a particular type of member who are choosing to transfer out.

Q143 **Chair:** Can I ask, in the Royal Mail case, if members—Royal Mail employees—have some other pension saving somewhere else, will they be able to transfer it into your proposed CDC scheme?

Angela Gough: That decision has not been made yet. That will be something that we are going to discuss with the future trustee board of that scheme.

David Pitt-Watson: I would echo some of the points that have been made by others: the need for good communication, actuarial advice for intergenerational fairness. I think making sure that the rules have been expressed before the event, so that people are on autopilot and it is very clear whether there is any change so that decisions need to be taken, as Angela was saying.

Your question was a bit broader, which was: what might we learn from abroad? The way the RSA came to look at what was happening abroad was because people were saying, "What I need from a pension is an income for life, that is not going to run out". We looked around the world at the countries that gave an income for life and they tended to use CDC. They also tended to be rated as the countries with the best pension systems, in terms of providing protection for people because they had that income for life. I think one of the lessons we could learn is this is a good idea, but it is not straightforward to do.

In terms of the demand, in principle, given that people are wanting an income for life, CDC does look like the answer to that because, if you do not have DBE and if you are saying an annuity is too expensive, there needs to be something like CDC that allows people to share longevity risk. That is what is central to CDC. It shares longevity risk. It means that if people die younger, their funds go to support the people that are going to live to be 106, but everybody ends up having an income that will last them until the day they die.

As I say, when the surveys were done—Simon can perhaps talk a little bit about that, I think you have done some surveys of individuals on this—that income for life is what people want. We have more recently, this summer, actually asked people who are pensions professionals about their interest in CDC and how it might be implemented and said, "Would you rather have a CDC that was whole life CDC, CDC that was decumulation only CDC, or would you be neutral towards the Government allowing any of those?" Actually, 50% of people were neutral but, of the 50% of people who talked about decumulation as opposed to whole life, more were interested in decumulation—I think because it fits rather well onto the DC system that you already have. You end up with a DC pot. It is not a pension. How do you turn it into a pension? CDC could well be an option.

It is subject to all the caveats, including the issues that Ros, Angela and everybody else raised, but it would give you a better deal than an annuity.

Simon Eagle: On the first question about international experience, if I can elaborate on the other panel members' points. I agree that the main learning from the Dutch CDC, the main example of CDC out there, was that you have to communicate clearly with members. The experience after the 2008 global financial crisis was pensions in some Dutch schemes were reduced. Members had been told beforehand that that could happen but they had not understood it, so the big learning from that was you have to go through a feedback loop. You have to ask members, "Now we've communicated this to you, how do you understand the scheme design?" If they have not understood it you have another go at communication.

That is one learning that I believe has been allowed for in the draft regulations for UK CDC. It is going to be a requirement for CDC schemes that they go through that feedback loop. The other main learning I would say from Dutch CDC is about intergenerational fairness. In Dutch CDC there is a kind of risk buffer in the way that you work out pension increases. Dutch pensioners see that as unfair because that is money being held back rather than used to provide them with increases on their pension.

That is another thing that has been learnt from in the UK already. It is a requirement in the draft regulations. When you work out the increase to apply each year, it is not done on a prudent basis with a risk buffer held back. It is done on a best estimate or central estimate basis, which is the very best estimate of the level of pension increase that the assets will find in the scheme, so it won't have that element of intergenerational unfairness that the Dutch have experienced.

Q144 **Chair:** Presumably, though, that would mean that the rate could vary more than would be the case if there was a buffer reducing the variation?

Simon Eagle: Yes, it could very well but at each point in time it is the rate that is estimated to be sustainable over the longer term, so it is the most fair rate that you could apply for the members in the scheme.

On the second question about whether I think there will be take up of CDC at retirement if there is a decumulation option, David mentioned I have some survey data. There was a Willis Towers Watson Global Benefits Attitudes Survey a few years ago, where we asked individuals in the UK what they wanted at retirement in terms of retirement savings. Of those, 60% said they wanted monthly payments guaranteed to last for their life; 21% wanted a pot of money to draw from in retirement; 19% said they had no preference.

The majority wanted regular income in retirement but, if you compare that with the FCA's data on what people with DC pots at retirement are actually doing, only 10% buy insured annuities, so only 10% are getting that guaranteed income for life. There is a big gap between what people are saying they want and what they are actually getting. That indicates to me that the UK retirement options at the moment do not cover enough what people want, so the aim of CDC is to be part of that gap: provide those people with another way to get an income in retirement but in a more cost-effective way than through an insured annuity.

On transfer values that Baroness Altmann mentioned earlier and Angela commented on as well, I have done a bit of work on this with other actuaries. We do not see it as a problem or as a risk that cannot be managed. Members of CDC schemes will have an option to transfer out their benefits but only before retirement. Before retirement, although some have an idea of life expectancy the real differences in life expectancy come in during retirement, so people who are in their 70s or 80s realise that they have a shorter life expectancy than their cohorts, but for people in their 50s and 60s obviously everyone is different, and there is some awareness, but it is not as stark.

There is a chance of selection against the scheme but it is not as stark as if members had an option to transfer out in retirement. In the Act and the draft regulations, there isn't anything to say how the scheme must set transfer values. There isn't anything to say it must be using the same life expectancy as on the main valuation basis used to set increases. If schemes believe there is a risk that they are being selected against by people with shorter life expectancy who are transferring out, the schemes can allow for that in the transfer values.

On the transfer point, the final thing I would say is that under the Royal Mail scheme design, the way transfer values are intended to be worked out—I would expect to see this in other CDC schemes as well—is the share of the collective value of the assets at the point the transfer is taken. It is a bit like the way the annual valuation is done to work out the increases. The way that is done, the cost of paying each member's pension is worked out and added up. The level of pension increase is solved so that that total cost equals the assets of the scheme. Each year what the actuary and the trustees are doing in effect is splitting the assets between all the members and then, if a member takes a transfer value, they are taking that share out of the scheme so it is based on the assets at that point in time. I don't see there is a problem there if asset values fall after that because the transfer value was taken before that fall happened.

I agree that transfers are a challenge, but they are a challenge that can be met by CDC schemes.

Q145 **Chris Stephens:** Probably I should mention my membership of my trade union Unison. I will go through some of these questions. Simon, I will start with you because you mentioned the draft regulations. They are designed to enable the launch of single employer CDC schemes, such as what is happening with Royal Mail. Should the Government broaden the scope of the CDC regulations and, if so, how and when?

Simon Eagle: Yes, I believe the Government should broaden that scope. At Willis Towers Watson we have done some analysis of the kinds of employer who might open their own CDC scheme, and size is an issue. There are costs in implementing the scheme, costs in running the scheme. Based on an analysis of what might be cost effective, we have concluded that ideally employers would have at least 5,000 employees for it to be cost effective to open their own scheme.

Obviously, large employers would fall into that bracket but, for other individuals and employees to have access to CDC, it will need further regulations that allow multi-employer CDC schemes or master trust CDC schemes.

Q146 **Chris Stephens:** Would you see the potential then, Simon, for sector-wide CDC schemes? I am thinking, for example, of the care sector. Do you see the benefit of that as something you would be supportive of to make it a sector-wide issue, not just single employer or even multi-employer?

Simon Eagle: Yes. I see potential for that. I see benefit in that. For it to be sector-wide it needs the sector to be organised, to design an open and multi-employer scheme. Of course, we have that in some current sectors with defined benefit schemes. Some sectors have already organised their own industry-wide scheme. Others have not.

There has been public interest in CDC from the university sector and from the rail sector as well, so there is some interest there. I see some potential in those schemes but I see even greater potential in CDC master trusts. For there to be wide access to CDC pensions I think it will need master trusts in the UK.

David Pitt-Watson: As you know, this Committee looked at CDC three years ago and one of its recommendations was that this should be available for multi-employer. I think that is a good idea. I think it would allow you to have a greater scale, lower costs and better oversight.

I would also say when we did our research of the pensions industry there was a huge desire, "Please, can we see this as multi-employer rather than single employer?", because there are a limited number of employers that have the sort of resource and skill that Royal Mail does. I think Royal Mail has 140,000-something members. It is huge. You can see how this could work so well for people that are moving between one job and another within a sector. It would mirror a lot of the stuff that takes place in Holland, so multi-employer would be a good idea. I think there would be a demand for that.

There could also be demand, as we said, for a decumulation product. Again, a decumulation product could readily be done as a multi-employer product with some caveats.

Baroness Altmann: I certainly think that the economies of scale of having a multi-member scheme would obviously reduce both the costs and the risks. At least in theory that should be the case.

The CDC approach is clearly advantageous for the employer if the alternative scheme is a DB scheme. It is not clear to what extent this is better for the member. It is certainly not better than a DB scheme. Then it depends on individual circumstances as to whether this is better for an individual member than an individual DC scheme, because that will depend on the member's personal situation.

I guess one of the concerns that one needs to bear in mind is obviously the communications, which we have learned from overseas and also, given the UK's history, what kind of inflation protection, if any, could there be in a CDC scheme? Certainly, with the current investment markets, it is rather difficult to see how you can forecast matching inflation with the existing range of assets, such as inflation in gilts.

Q147 **Chris Stephens:** For someone who has been on a picket line to protect his pension scheme, I know that sudden or major changes in pension schemes can make people very nervous and can create great unease among scheme members. How can confidence in these new schemes, like CDC, be built among employees being asked to join them?

Baroness Altmann: I think that is where the big challenge is, I really do. If you were to tell the employees, "In the worst case scenario, you may not get a pension from this scheme. You do not have the benefits at all", that is not remotely any kind of likely scenario but full risk disclosure, unless there is some kind of buffer kept back—and we are not proposing that there will be—worst case scenario, investments go wrong, markets go wrong, the pensioners are normally going to be paid out first or, if not, will have to have their pension severely reduced in order to provide anything for the remaining younger members.

There are significant risks in CDC, which you can choose not to focus on. If you do, I think you undermine some of the value that CDC can bring because, if it is working well, it could indeed be better for members than buying an annuity. On retirement, for example, they should get much better value.

I do still have concerns that when we first talked about CDC, this was in an environment before we had the pension freedoms. If people take advantage of exceptionally strong markets to transfer out, and it is entirely possible that they might, there are intergenerational risks in the opposite direction. Pensioners may not like the fact that they don't get as much as they would have wanted but at least they have got something. Younger members have not yet had anything.

This is a very complex and tricky exercise and I think the way one would need to talk about it, is almost, "Well, this is a better deal than annuities". That is the truth and that is clearly likely to apply to just about everybody. The mortality cross-subsidy is something that you can take advantage of and, if you are lucky enough to live longer, you will do quite well out of this scheme but it is less good at catering for individual circumstances, individual differences or those people who successfully can select against a scheme, which our pension environment is facilitating in a way that was not originally the case when CDC was first proposed. If you have to stay in the scheme, it is very different from being able to transfer out along the way.

Q148 **Chris Stephens:** Simon, David is there anything you want to add, as to how you build confidence among employees who may be asked to move to a CDC who may have great unease?

Simon Eagle: Yes, if I could start answering that. I think the main thing is to explain to the employees what the nature of the scheme is and talk about potential outcomes for the pension.

Some of the work we did for Royal Mail in 2017-18 was along those lines. We tested how their design would have done if it had opened in 1925. How would it have done based on how asset markets actually behaved over the last 90 years? There would have been cuts. There was a simple model where we assumed the scheme was mainly invested in US equities. There would have been cuts in two years in the 1930s because there was the Great Depression in America at that time but there wouldn't have been any cuts at any point since then, so that gave extra comfort that the scheme would have worked very well over the last 90 years.

We also did modelling of the future. Based on different scenarios in the future, we looked at in how many scenarios is there a pension cut? There was a cut in some but it was a relatively low proportion. For the first 30 years of the scheme being open, in the average year it was a 2% chance of a cut. The cuts we are talking about were 3%, 5%, that kind of level. In other scenarios with the scheme, Baroness Altmann talked earlier about possibilities where the scheme just runs out of money. That can only happen if the assets did so badly there was nothing left. That has never happened in history and it is hard to conceive of a scenario where that happened. If that happened in the future it would be because everything has collapsed, so the whole financial system has collapsed. The last thing you would be worrying about would be your pension scheme. It would be, "How do I get hold of food? How do I feed myself and my family?" We are talking disaster situations there.

Yes, I think that is the main thing. The schemes need to explain to members what the estimated pension levels are. Show them that but also show them the variations around that so that people understand the nature of the scheme.

David Pitt-Watson: I would agree with Ros that DB is better but DB is just not available to people in the private sector any longer. If what we are wanting to do is to allow people to have what they say they want, which is an income that lasts until the day they die—and by the way, which most people need; rich people don't need an income because they always have money but most people need one—the only thing we are offering is annuities and, as Ros says, CDC will give you a better deal than will annuities.

I do accept that things can go wrong with CDC but, if they are going that badly wrong with CDC, boy, have they gone badly wrong with drawdown first. If your choice is between drawdown and CDC, you would be better off to have a well-managed CDC. The likelihood of you ending up with nothing is very unlikely because, when things go wrong, it is not just the savers who have to take the brunt of that. The people who are taking money out also need to take the brunt of that, so there is some flexibility there.

This has been modelled back through 80 years and there are reductions, and they are very painful when they happen, but they are single percentage reductions going through the Great Depression or the 1970s and all of those sorts of things.

Baroness Altmann: May I just clarify? I completely agree with David and Simon that the scheme actually running out of money all together is unlikely—it is possible but unlikely, absolutely.

What I was alluding to was the possibility of having a number of small schemes where the assets were not being managed or did not perform as one might have normally wished. It was in the context of having industry-wide large schemes. What we saw with the final salary schemes where the small scheme actuaries had forecast that their pension scheme assets would provide the expected level of pension, after the 2002-03 crash there were not sufficient assets in the scheme to pay all the pensions. Those people who were already pensioners would already have had money from the scheme and had had a better deal in the past. It could not support that kind of pension for the younger members.

Therefore, that is a very tricky communication exercise but the risk—in answer to the original question I was talking about—is much diluted if you have a large scheme with lots of employers and lots of assets in it run professionally than if you have a small scheme or if you have a series of individual employers. Royal Mail, as you say, is a very large employer.

I do not have that concern with Royal Mail. If you want to have this as a model, I would say there is a lot of merit in having this across sectors or industries rather than for individual companies.

DB started as a best efforts basis and then legislation tightened up and forced employers to not be able to get out of it all. I would imagine many individual employers, certainly smaller ones, would be pretty loth to sign up to anything like this, on their own anyway.

Q149 **Chris Stephens:** Thanks, Ros. Angela, thanks for your patience. Obviously, employers and workers would each want to evaluate how successful their CD scheme is or was, so could you outline the role of the trade union in Royal Mail in passing ultimate judgment on the Royal Mail scheme? Is the scheme capable of later amendment if the trade unions have any particular issues around the CDC scheme?

Angela Gough: Obviously, our scheme was designed in conjunction with our trade unions, the Communication Workers Union and Unite CMA. It was designed fully with them. I think, having come into Royal Mail, the thing that I find most impressive about the scheme is just the joint effort and the way that members were put at the heart of it in designing a scheme that worked for them.

There are a number of ways in which the unions will remain involved in the scheme. For example, obviously it will be four member-nominated trustees out of nine on the trustee boards, and those member-nominated trustees will be appointed within a union process. The unions also have their pension actuary input into the scheme funding valuation each year. There are a number of ways in which the union can be alongside us tracking the progress of the scheme and seeing how it is performing.

Obviously, it will be some time before members are retiring with significant benefits from the scheme, but there are things we will be able to do on an ongoing basis to see how it is going. For example, within the first two years the scheme actuary will determine the increase or reduction that can be applied. There will be annual liability statements as well by the scheme actuary. We will be watching it very closely, as will the unions, because we are all keen for the scheme to succeed and for it to do what we want it to do, which is provide our members with a really good pension in retirement.

Q150 **Chris Stephens:** Would you say that the trade union involvement has helped build confidence in the change to the CDC scheme?

Angela Gough: I would say that in designing it together, we were able to bring the perspectives of business, the perspectives of the union, the perspective of members to design a scheme that worked best for everybody that would be sustainable and affordable. I think members have heard that. I think they find it really reassuring when comms is sponsored by all three parties. We are all on the same page putting forward a pension that we think is the best pension for our people.

Q151 **Nigel Mills:** First, when you say CDC gives you a better deal than annuity, is it fair to say some people might decide that the absolute certainty of annuity is the best deal for them and what we are trading off is a bit less certainty for a bit more money in effect?

David Pitt-Watson: Yes and no. You do have a certainty with annuity and that may be of benefit and somebody may want to choose an annuity at that time. There would be a no as well to it, though. If you were saying that annuity was the only thing that was available to you, as opposed to rolling into a CDC, the variation in your pension would be greater because annuity prices go up and down at such a rate. Annuities will not be eliminated as a result of CDC being there. Some people will want them. If you are trying to predict what your pension might be, CDC is a more predictable future to be looking to than an annuity future.

Nigel Mills: Yes, more predictable further out than it is—

David Pitt-Watson: That is right.

Q152 **Nigel Mills:** It makes me slightly nervous that there is a danger that these things get marketed as, "It is much the same as an annuity. It will all be fine. Don't worry", nudge, nudge, "These pesky regulations just make annuities too expensive" and then we all found out the hard way on previous things that actually those pesky regulations were there for some quite good reasons. Things go wrong and you are not quite as certain as you thought.

Angela, could you just remind me what the increased pension for one of your members joining the CDC scheme rather than staying in the ordinary DC scheme is forecast to be? I seem to remember it was 32% from a previous presentation but I might have dreamt that.

Angela Gough: When the scheme was designed we had two firms of actuaries doing various modelling to work out what the benefits expected in our scheme would be. They came out at over 30% higher than a DC scheme with the same contributions. Obviously, that is an expected return and it is not guaranteed, but the modelling did suggest that it would be a substantially higher pension, potentially.

Q153 **Nigel Mills:** Can you help me with where that increased return comes from? How much of that is because you can invest better or it costs a bit less to run than a DC, and how much is just those that sadly die shortly after drawing their pension end up paying for those who happily live a long time after they draw their pension?

Angela Gough: It is a combination of two things. It is being able to invest in return-seeking assets for longer. Under our model, rather than you risking as you come to retirement in order to try to match annuity pricing, the investments in our scheme would be invested in return-seeking assets for all non-pensioners and then there would be a risk over 23 years into retirement. Essentially, you have a higher expected return because you invest in return-seeking assets for longer and you can do that because of the pooling. Then the other part of that higher expected return is not having to pay for an annuity, so not having to pay that premium to an insurance company to buy an annuity.

Q154 **Nigel Mills:** I was trying to just get my head around how much of the increased pension is not because you can make more money on investing but because, if I am lucky and live longer, I get to benefit from those that sadly don't. Is that a large part of the 32% or is that just an incidental part of it?

Angela Gough: I don't have that number to hand. I could either get back to you or possibly suggest that Simon Eagle might be well placed to answer that question. He was involved in the modelling.

Q155 **Nigel Mills:** Simon, you have the hospital pass.

Simon Eagle: That is fine. Thanks, Angela. I can comment more on that. In the figures that we did comparing the CDC to insured annuities—we published the figures last year—the estimated pension was 70% higher than an insured annuity. That is purely down to the different investment strategy. Many, many years of 3% or so higher return does really add up over those years up to retirement and then in retirement as well.

You also asked about the comparison with drawdown because a member could, of course, invest their drawdown pot in a similar way to the CDC scheme. There is very little difference in investment returns there. Of course, the drawdown member has the slight risk of running out of money, so either takes that risk and then finds themselves with no income maybe in their 80s or they draw their money very prudently, very gradually, maybe assuming they are going to live to 100 or even beyond that.

There was a briefing done by the Institute and Faculty of Actuaries on drawdown a few years ago. The conclusion was that a safe drawdown rate is 3.5% of the drawdown pot. To take that as a flat level, an expected CDC pension is 50% above that, plus you expect to see increases to the CPI plus 1% on top of that, so a very big difference in income there. That is mainly down to the risk of—it is the fact that the CDC scheme pools longevity.

This is what I see as the number one issue with drawdown. You have a unique risk to you of living a long life, and that is a very difficult risk to manage and there are great benefits from pooling that risk with other people.

Q156 **Nigel Mills:** What I am trying to work out is how much of the benefit is because it is collective and how much of it is just because you have a better investment strategy than derisking, assuming you want to buy an annuity at 66 or whatever? David, you are looking—

David Pitt-Watson: There is a bit of an overlap because the only other way that you can get the collective benefit that lasts for a lifetime is an annuity. Then an annuity needs to be invested in super safe assets plus all the reserving that you are asking the insurance company to do and the profit taking and all the rest of it. There isn't any other way that you can manage to get that collectively. That is why there is quite a big difference in the decumulation phase between what you would expect from a CDC pot and what you would expect from an annuity pot.

Baroness Altmann: Part of that can be demonstrated by the way defined benefit schemes that end up, or not, in the Pension Protection Fund are operating. If you look at the valuation of DB schemes on an ongoing basis, rather than a discontinuance basis, there is a significant difference. The risk margins and profit margins entailed in buying an annuity will significantly add to the cost, so you have part of the differential being accounted for by risk and profit margins which are, by the way, never disclosed so we do not know what risk and profit margins the insurance companies work on when they price their annuity books.

On top of that, inevitably, if you are investing in guaranteed, low return assets because you do not want risk, you are bound to have much lower investment outcome over any period, if you compare that with the expected return of assets that can take more risk and therefore have higher expected return. You have the two factors. I would say at least 20% to 30% differential between the cost of an ongoing DB scheme versus buying annuities.

Q157 **Nigel Mills:** How would a decumulation-only CDC work? I would presumably tell whoever I was accumulating in, "Don't de-risk me because I am thinking of trying to move my way into a CDC when I hit pension age" or something. Is that how you would have to do this, so I do not weaken my pot before I get there? Do I need to make that decision quite a way before I hit decumulation stage?

Simon Eagle: There would be some investment strategies in accumulation that are better suited if your plan is to buy CDC products at the time and you could not match the CDC product perfectly. You would have some risk in terms of the level of initial CDC pension that you will get when you eventually retire, but there are strategies that manage that risk to some extent.

Q158 **Nigel Mills:** So it is achievable, in effect, I can manage this. What would happen if there were bad market conditions at the time that I thought I would be buying my CDC? I guess I just wait until those market conditions have unravelled a bit, do I, rather than risk doing it at a fixed point that might be wrong?

Simon Eagle: Yes, if you had unlucky timing you would start with a lower CDC pension and you could wait and retire later, in the hope that markets rebound. This is one of the advantages of doing CDC in accumulation plus decumulation the way the Royal Mail scheme works. There are pros and cons for all these arrangements, none of the arrangements are perfect but I can see pros in the accumulation CDC as well for some individuals.

Q159 **Nigel Mills:** Angela, is there a death benefit if somebody does die shortly after they have taken their pension? Do they get anything or is the whole pot lost at that point?

Angela Gough: Within our scheme design there is a 50% pension for a spouse or spousal equivalent and there are also children's pensions, so there are death pensions in our scheme design.

Q160 **Selaine Saxby:** Should master trusts be able to offer collective defined contribution options? I do not mind who goes first.

Simon Eagle: The short answer is yes. As I said earlier, for a large majority of individuals in the UK to have access to CDC it will need master trusts. Master trusts would be a good way of providing CDC in decumulation. Master trusts of course are run by trustees and the trustees will make the decisions around the level of pension increases that the assets fund, so that the pensions are paid out in a fair way.

David Pitt-Watson: I agree with that.

Q161 **Selaine Saxby:** I have a secondary question. Could CDC options be a default product for people currently saving into a defined contribution scheme through autoenrollment?

Simon Eagle: There is sense in that. If you believe that the reason for pension savings is to provide an income in retirement, you would say that a default option should be an income for life in retirement. That is what CDC provides. We have seen that DC savers often go with a default option. What the data shows is that some of them are not making well-informed decisions. Everyone is different but having a default option that would work for the majority of people would make a lot of sense.

Baroness Altmann: With the greatest respect I do see that very differently. The whole thrust of the conversation so far has assumed that everyone should convert their pension fund into a lifelong income at some predefined age. I am not convinced that that is the best way to benefit from pensions, especially in light of pension freedoms. My preferred default option would always be the do nothing option; just keep on accumulating in the pension fund, let it grow and if somebody needs the income and needs to take it out they will make inquiries. There is merit in all of the industry working hard to help people understand better what pensions are all about, rather than relying on other people, supposedly much more clever than them, to tell them how to do it and what is best for them, when it may not be.

If somebody is still working, the fact that their scheme pension age is 60 or 65 does not necessarily mean that they must do something just because they reach that age. They may have lots of ISAs, in which case they are better off leaving the pension money untouched. It seems to me that a pension is not necessarily for everybody best used to guarantee a lifelong income from an age that may well be rather younger than they need that income for. Most people would probably be better waiting until later before they lock in for ever, because then they can never adjust to their changed circumstances.

A point that I also do think could be relevant here, given the overall policy environment, is that if people have not used their pension fund or taken money out or locked into a lifelong pension commitment there could be money left to help them pay for care. If they have not needed the pension income, a lifelong income is not going to be enough in any way to meet care needs in your 80s, but if you have not touched your pension until your 70s or 80s and then you need care, there is an option of having money that could be used for that. I would be very nervous about having any kind of default option that forces people into crystallising their fund, just as I was not comfortable with the mandatory annuitisation, which I think most of us would agree we are pleased we got away from. That is my perspective.

David Pitt-Watson: I think I might come between those two positions. I would not want anything that is forcing people to do things, but if you look at the pensions landscape the degree to which people want someone they can trust to help them make the decision is very high. You will know in most accumulation people just go straight to the default option, rather than choosing the investment they might want. While you do not want to force people to do anything, if you have provided the information and you have proper trustee governance of this—so this is not someone trying to make a profit off you, this is a trustee that owes a duty to you—then the thought that there is a simple way that you could move into a CDC for income, that you were satisfied with, would be quite a sensible thing to arrange for people, but not forcing people. As Ros was saying we have pension freedoms and I do not think we should upset those.

Baroness Altmann: An alternative option would be to build on what Simon was saying, the typical approach is to simply take 3.5% a year. If the academic studies show that that is no longer the appropriate figure, maybe move people into something that is without all the complexities of this. Without all the locking in for ever, if the default product just gives you 3.5% of your fund every year until you decide you want something different, that also would be quite easy to design and justify without having to go down the route of CDC where you are effectively locked in once you are in the retirement or drawdown phase.

Q162 **Steve McCabe:** Good afternoon. I think you have already indicated that the thing about a CDC scheme is that it is predicted income and it can go down as well as up. I think David referred to a report in 2018 when this Committee took a look at that. One of the things that we focused on then was that because of the novelty and the complexity of it we thought good communication about it was absolutely crucial. In that context, what is good communication about a CDC? I am not sure where to start but, Baroness Altmann, I know you have been very keen to see better use of Pension Wise. I do not know if you think that is the vehicle and if we should have automatic referrals through Pension Wise or if there is another way that we should inform people about CDCs.

Baroness Altmann: Thank you for asking that. That is an important question. In direct answer to your suggestion I certainly support and I truly believe that we have not made the most of the Pension Wise service, which is an excellent service that can talk people who do not know anything about pensions through how their pension works, and what their situation is. It cannot make a decision, but it can give them the information. Unless and until we have better informed customers or members, whatever you call them, it is vital that they have an independent, impartial source of help to make what are very complicated potential choices and to lay out the options for them. If they are reliant on their pension provider, then they are at risk of being misled or not being aware of all the potential options. I am in favour of automatic signposting, sending, making an appointment by the provider with Pension Wise. If that means that it costs more to provide the service, I think it is a cost well worth bearing.

Having said that, also what we need is for the industry using workplace autoenrollment to help us get away from this idea that nobody can decide about their pensions, it is all too complicated, leave it to someone else, and do not expect them to engage. I think we have come to the age where you should expect people to be able to engage. It is not as complicated at its basic level as one might be led to believe. You have money, the government adds some money and your employer has added some money, and then it is invested. Start talking about the investments that the money has been put into; start talking about how the money can grow. We can design products that invest in sustainable projects or investments that people can relate to, but nobody tells them about it at the moment. We should be more ambitious to help people understand that pensions are a great product. Their money can do something good not only for themselves but maybe for wider society along the way. That in my view should encourage more people to put more money in, rather than leaving them not to understand it and be stuck in a default option where they stick to the minimum.

Q163 **Steve McCabe:** I do not know if any other members of the panel have anything to add, but I am interested in what is effective communication about this relatively new product.

David Pitt-Watson: I wonder whether Angela from the Royal Mail could answer, because they have had real experience of it.

Steve McCabe: There you go, Angela, I don't know if that was a hospital pass or not.

Angela Gough: I put my hand up for that one as well. Personally, I think communications for CDC are absolutely vital. The scheme needs to be clear and transparent and members need to understand it. I agree that we should not assume that people will not engage in pensions. We should be doing our very best to put pension communications out there that are accessible, understandable and engaging and that people will pick up and read.

In terms of what we have been doing, we have been working closely with both the unions over the last few years and communicating together, which has been helpful. We are still learning. We recently ran a formal consultation with our unions and with our people and we wrote out to around 135,000 people to explain the new scheme to them. We sent them all a booklet. Ahead of that we did focus groups where we understood what people wanted from that, how they wanted us to speak about the scheme, so messaging and tone was directly led by what people said they understood, what people said they wanted, and how they wanted it explained to them. We have put a lot of effort into making sure that our comms are as accessible as they can be, working with external pension comms experts and personally taking responsibility for all of the employer comms that go out.

Moving forward, the employer will keep communicating with our people and the future trustee board will also. We will work together with them. For me, it will be iterative, so it will be a case of learning each time we communicate how that landed, how we can do it better in the future and building that engagement. You cannot expect everybody on day one to wholeheartedly understand the new scheme. Every time you communicate you are building up that understanding, you are building up that engagement.

The scheme is designed so that you do not have to make difficult decisions at retirement, and that is what we heard in 2018 when the CWU and ourselves designed the scheme. It was designed with what people wanted, so they did not have to make difficult decisions, but there are some decisions that we would like people to make. Should they make additional voluntary contributions? When should they retire? What is the right time and age for them? There are things we would like people to decide within the scheme and our comms and engagement strategy must reflect that. It must be first-class to reflect the type of scheme it is and the importance of member understanding within the scheme.

Q164 **Steve McCabe:** I think this is possibly to all of you, but someone mentioned the situation with the Netherlands earlier. What effect would something like the financial crash or coronavirus have on a CDC scheme?

Simon Eagle: Those are both things that we at Willis Towers Watson have modelled. The first one, the 2008 crisis, was based on a simple model where the assets were not well-diversified, but under that model the increases would have been 2% lower in 2009 than if the crash had not happened, but there would still have been an increase and the scheme would have bounced back in 2010 to similar levels to before. Based on a well-diversified asset strategy, such as the one the Royal Mail will have, the effect would have been less than that, so it would not have been as much as 2% in increased levels. With the coronavirus crisis last year we modelled that based on the strategy intended for the Royal Mail, so the good, diversified strategy and the effect then was only 0.25% reduction in the increase in that year. We now know that would have bounced back as well by now, so a very small effect on the pension levels.

Q165 **Steve McCabe:** Is that view shared by all of you?

Baroness Altmann: How much of that might be to do with the central bank response to these particular recent events? In 2008 and for the pandemic the central bank response was basically to prop up asset prices. Whether one has run out of road for that—

Q166 **Steve McCabe:** Yes, so without that what would have been the effect?

Simon Eagle: I do not know. That is hard to quantify. What we can see is that asset markets bounced back and I am sure that was in part because of the central bank response, but there are lots of other factors behind how asset markets behave. We cannot split out that particular factor.

Q167 **Steve McCabe:** You are telling us about the modelling you did based on what happened, I accept that, but it strikes me as a fair point.

David Pitt-Watson: There is a risk that pensions and payment might have to be reduced. There was a study that went back to 1930 up until about 2015 and said, "Okay, put a CDC scheme on autopilot. How often did it need to reduce pensions and payment?" If I remember correctly it is two or three times. The reduction is single percentage, so 3% or 4%. The Dutch experience going through the financial crisis of 2008 was an average reduction of about 2%. The most hit fund reduced by 2% each year for three years, so a 6% reduction in people's income.

If you compare what retirees were getting with what workers were getting in Holland, it was probably not as bad as the reduction that workers were seeing. It did remain quite robust with a 2% reduction, but it did cause a fuss and it caused a fuss because for the previous 40 years that had never happened. It acted almost like DB and then it hit a crisis. This communication stuff that Ros has been talking about is important. People need to know in the good years that bad years can come along and that this is not an absolute guarantee, and that therefore there may be a reduction. It is important that that becomes part of what people understand, if people do understand that there were 40 years beforehand where you got something that was almost as good as a DB.

Angela Gough: I agree. Comms is absolutely key here. There may well be future years when pensions are reduced within our scheme or when increases fall, but the important thing for me is that it is sustainable in the long-term and that members understand that. David is absolutely right, if in the years when things are going well people are reminded of the possibility of reductions and that that can happen when assets do not perform as well, that is the important thing.

Q168 **Steve McCabe:** You have all indicated that this issue about good communication so the person understands what they are doing is very important. Is the risk for someone in a CDC scheme who makes poor choices because of bad information and communication any greater than it is for someone in a DC scheme?

David Pitt-Watson: No, because in a sense your money is being managed by a professional. If you want it in a DC scheme you must try to manage that yourself and go back for advice every five years. The risk within CDC and particularly the risk that you might run out of money when you are 90 and you are no longer capable of it is considerably less in a CDC scheme. Best would be in a DB scheme because you absolutely know what you are getting, but the problem is that the private sector does not have DB any longer.

Angela Gough: I was going to say something similar along the lines of the risk in a CDC scheme is that what happens comes as a surprise and you have not been able to plan for it and you have not understood it and that can cause a certain level of financial stress within the scheme and for members, but compared to a DC scheme you have made fewer decisions about that, so the risk of poor decision-making is lower, at least in our scheme where there is a default. It automatically provides that income over time and the risks associated with decision-making are probably lower.

Baroness Altmann: It depends what you mean by risk. Certainly from an economies of scale perspective a large CDC scheme should give you better investment returns than the same investment in a smaller DC scheme, because the charges are likely to be much higher on an individual scheme basis.

For me, one of the big questions I would be interested to ask is how you cope with different health status of your members. Is there a plan to ask members at a certain age to report on their health? We have the ONS figures that show a 20-year difference between healthy life expectancy in the most deprived and least deprived areas. If you have an individual DC pot and you can buy an impaired life annuity you would probably be better than having assumed a normal or slightly longer than normal life expectancy that might be the case in a CDC scheme and you might be able to buy a 10-year guarantee or a five-year guarantee or something in the annuity market, which I do not think you can do in the DC arena. Individual differences will end up being potentially important, and that is part of the communication challenge. How much will trustees of the CDC scheme be able to point out to members that if they are in poor health they might want to transfer, or they might not get as good value—you cannot give them advice to transfer but they might not get as good value as an impaired life annuity, for example? It is a challenge.

Steve McCabe: That is very helpful. Thank you.

Simon Eagle: To answer your original question or to respond to Ros's points?

Q169 **Steve McCabe:** I was asking about the original point, did you think the risk was any greater but Ros has raised an interesting point about the health factor, which I suppose is going to become more important in the years ahead.

Simon Eagle: Yes, I think the original question has been covered so on the question that Ros raised I would say for a scheme like the Royal Mail scheme, once it is up and running, the main reason it needs to understand life expectancy is to set its increases, so it needs to understand life expectancy on a collective basis. It is across the group as a whole and it would be based on studies of the experience in that group so far and others in the industry and UK-wide studies. The exception to that is when members take a transfer value, and if the scheme wanted to adjust for selection risk of members taking a transfer value when they are in poor health, it would need to point to some evidence there. It would be hard to assess each member's health. There would be expenses to do medical underwriting and that sort of thing, so they would want to point to some other kind of group evidence that says that members who transfer out do have shorter life expectancy and it could allow for that there.

Where individual health is a bigger challenge is if there is a CDC decumulation of the master trust, so if someone is buying a CDC pension at retirement that is a bit like buying an insured annuity and there is more case for assessing health there, so some kind of health questionnaire, maybe medical underwriting as well if it is needed so that the level of CDC pension awarded to that person is appropriate for their life expectancy, so that the purchase terms are fair for them and the remaining members of the scheme.

Baroness Altmann: Why would you not do that in any CDC scheme, though? I do not quite see why there would not be the same need to assess the individual's situation.

Simon Eagle: For a scheme that is accumulation plus decumulation I think the only time there could be a need is if a member is deciding to transfer out, but you would not have members buying into the scheme in the way that you would with a decumulation-only master trust.

Baroness Altmann: But if the member is coming up to retirement and has a very short life expectancy is nobody going to suggest to them that this may not be the best way for them to use their pension savings?

Simon Eagle: I think the member booklet or any transfer quote would need to explain that. As Angela said, it would not be the scheme's role to provide advice to those individuals.

Baroness Altmann: That is what I said, not advice, but how can we make sure they understand what they should be doing and along the way can or should the actuaries build in an assumption of a certain proportion who will transfer out in poor health?

Q170 **Steve McCabe:** It sounds like you are all telling us that there should be some focus on that, that it should be brought to both the trustees' and the members' attention. It sounds to me like that is what everyone is saying.

David Pitt-Watson: I think that feels right and Angela should talk about this as well, but the same sort of thing in DB because, "Okay, I have only three more years to live. May I have my DB?" This is not something that we have come across before. I think in a decumulation multi-employer scheme where this would be particularly the case, the answer would not be to say that this group of workers who do not have a long life expectancy go in the same pot as this group of workers who do have a long life expectancy. That would seem to me to be quite unfair.

The degree to which you would want to do that for individual people who work for the Post Office, for example, I am not quite so sure about that. Part of this is that we are all part of the collective and, "From the age of 25 I have told you you will have an income until the day you die. Now, in the event that you are unfortunate enough to die before you retire your money will still be used to give a better pension for everybody else who is in the pot". That is the nature of CDC, rather than to try to individualise it to the greatest extent possible. If you do that, it becomes costly and you end up back where we are with annuities.

Q171 **Siobhan Baillie:** We have started answering some of my questions, but given the Royal Mail scheme is likely to be the first in the UK following the Act this year, what should we be looking to learn from the collective defined contribution scheme with Royal Mail? How long will it take for us to understand and assess whether the scheme has delivered its intended outcomes?

Simon Eagle: The main learning from the Royal Mail scheme is that it can be done in the UK. You can have CDC where the employees and the union all back it. It is a design that works for all three. When I talk to other organisations about CDC, some are interested in designs like Royal Mail's and others want other kinds of designs that suit their organisation better. The main learning is that it can be done.

On your second question on how we find whether the scheme has achieved its aims over time, there are two ways of looking at that. One is in terms of level of benefits. When the scheme opens there is an estimated long-term level of increases and we all know the increases will be variable, so that initial estimate will not be borne out. There will be some years where it is higher and some where it is lower, and the long-term average will also be different. All we know is that estimate will not be spot on.

What I see as the better test is has the scheme operated in accordance with its intentions? Has it invested the money the way it said it would invest it? Has it worked out pension amounts in the way it said it would? That would be assessed every year and found out every year as the trustees operate the scheme. I guess there is never a point where you say it is done and will work for ever, but at each point you can see that it has worked so far and we are getting increased confidence that it will work in the longer term.

Angela Gough: I echo what Simon said in terms of understanding how it is working. I think it will be a case of continuously monitoring the scheme to work out if it is behaving as expected, if the trustees are implementing the scheme in the way that it was intended and broadly what the viability reports look like, what the increases look like each year.

In terms of lessons learned, I only joined Royal Mail in February of this year and for me what has stood out is that joint working between the union, the members, the company to create what everybody believed was the best pension for our people and for our business, so specifically designed for Royal Mail and Royal Mail's people.

I would also say it has been a great case of Royal Mail and our unions working closely with the Government, with the Department for Work and Pensions, with parliamentarians across the House. We have been grateful for the support we have been given from the Government, from Parliament, to get this to where it is now, and we are optimistic that we are close to having that secondary legislation that we need to be able to launch the scheme next year.

The lessons for me are mainly around everybody working together in a productive way to create this exciting and innovative scheme that will be the first of its kind in the UK.

Baroness Altmann: What should we look out for was part of the question and I would say it will be very important to monitor the outcomes versus the expected outcomes to see how accurate they are over time, to look at the experience of transfers, ideally if possible to measure for those who do transfer how long they live thereafter and whether there is any evidence of selection against the scheme.

In terms of your question of how long it would take to assess this, we are talking pensions. I would say 30 years or more, because what you want to know is that the younger members who are putting their money in today that is paying the pensions of today's and coming up pensioners end up getting what they want. You will not know that for 30 or 40 years. If you look at the experience of defined benefit schemes originally there is some evidence that for those schemes that did not do well, a small minority but it is something that you could look and learn from, there was an element of intergenerational unfairness. Those are things that one can look out for; it is not a reason to not do it and I am very pleased that the Royal Mail has taken the decision to do this and to try to get its members a better outcome than pure DC. That is something that they have worked so hard to do but looking and learning from the experiences when this is introduced in this country to know whether the communications have been successful and if members understand is something that will be important for us to do.

David Pitt-Watson: I echo what others have said. It looks like a better pension if what you want is an income when you retire. I echo what Angela said as well, that this has been done with cross-party, cross-industry agreement in a way that makes you proud of the system working rather than the other way around. Royal Mail is big. It will regulate itself well. We want to see other well-regulated, well-governed and not the sort of problems that Ros was talking about, which would be 20,000 CDC schemes where there are 50 that would be problematic. I think there is a demand for this in decumulation and it goes a long way to addressing the bit that was not answered with pension freedoms. Pension freedoms said, "Look, annuities are so expensive. I cannot force you to buy an annuity because it is just not a good deal" but what it did not do was say, "Well, what else can I buy if what I want is something that is an income until the day I die?" and I think that is what CDC can give.

There are lots of issues that we have raised in this discussion about making that work, but given the upside from CDC this looks like something that ought to be part of the pensions landscape in the UK.

Baroness Altmann: One other suggestion that I think could work very well with what I believe the aims of the pension freedoms were is to have a decumulation-only CDC from let us say age 70 or 75 rather than 55 or 60. That would allow you to benefit from the mortality cross-subsidy in a pool of people who are at the moment reasonably healthy but they do not know what the next few years will bring. They are old enough that they will not be working and that they would need that guaranteed income.

David Pitt-Watson: You can leave some choice in there, but you can also make sure that people who need that security until the day they die are able to set that aside. It may be at 70 they want to do it, maybe later, but if we could do something like that, that would avert what could be a very big problem in 20 years' or 30 years' time, which is people who have saved during their lifetime but they have simply run out of money. It is not clear the degree to which you are seeing this, but you are seeing this sort of thing happen in Australia, where they have a very well-developed DC scheme. If we could do this we could keep the choice but make sure that people who want that insurance that they have an income can have that insurance, that they have an income and that the cost of it is not prohibitively high, which it is right now for annuities.

Q172 **Siobhan Baillie:** Angela, you mentioned working with DWP and I think Chris was talking about working with the unions to do an evaluation, thinking about Baroness Altmann's 30 years. How are you devising your evaluation schemes and studies and have you had help from the

Government Departments for that?

Angela Gough: Yes, we have been working with the DWP and the Pensions Regulator for quite some time now and included in the secondary regulations will be a code of practice for the Pensions Regulator. That will be the basis of how the Pensions Regulator initially authorises the scheme as an appropriate CDC scheme and then there is an annual ongoing supervisory regime as well. We are working with them to understand what it is they would like to see as part of that authorisation and supervisory regime. Of course, we have our own thoughts as well on what we would like to track. We are working closely with them in terms of what they would like us to demonstrate with our scheme and what they would like the trustees of our scheme to demonstrate on an ongoing basis.

Q173 **Chair:** Can I raise a couple of final points? David, your points about what happened in the Netherlands when there was a scheme that reduced by 2% for each of three years, understandably the members of that scheme would have been pretty upset, but were there worse consequences than that?

David Pitt-Watson: That was the very worst scheme, and on average it was 2%, I think.

Q174 **Chair:** Yes. Did the members of that scheme simply complain or was there a worse consequence of the poor performance than simply some members being unhappy?

David Pitt-Watson: That was what happened to the members of that scheme. There were larger reforms that took place in Holland, particularly in public sector pensions, less in private sector pensions. The Dutch system would still be 85% or 90% collective. It might have been 90%, 95% collective before this but some people decided they would rather have a choice and there is now more choice in Holland. For the people who had their incomes reduced it was reduced and they have grown since, so hopefully they are now less unhappy.

Q175 **Chair:** Somebody who is on the Financial Services Consumer Panel told us, "There are lots of potential problems with CDCs and they can in the worst cases begin to look like Ponzi schemes." Ros, this might relate to your point about the worst case scenario. What would that worst case scenario be? What would happen to make one of these look like a Ponzi scheme?

Baroness Altmann: That is just the question of intergenerational fairness. If the younger workers are contributing for 20, 30 or so years and have never had a penny out of it and then at that point in 30 years' time suddenly the markets collapse or the trustees have chosen investments that have done terribly all the people who they had been funding will have had their pensions, most of them will have passed away, and there they are and they would get much less than they had been expecting at that point. Some people had originally argued that DB schemes were a bit of a Ponzi scheme, it was fine while the scheme was young and there was lots of money coming in. It was never going to last when lots of pensioners were there and not many younger workers paying in at the end.

The other way could be that lots of members decide they understand the markets and they transfer the money out when the markets have done quite well and they are right, and then the markets collapse thereafter.

These are not necessarily likely scenarios, but they are risks that normally one would expect an investor, and they are investors, to be warned of in a way that they understand but hopefully does not then frighten them away because they are very unlikely. You do not want people coming back afterwards and saying, "Well, you told me that was a guarantee. You told me that was the pension I was going to get. I have planned around it." That is a bit of an issue, if young people cannot necessarily plan, not that they could in DC either, I am not saying that DC is a better alternative for planning, but we must be careful about overselling CDC as being more like DB than it is.

Angela Gough: For me the key point here is that this is what the regulations are there to stop, so our scheme has been designed with intergenerational fairness in mind and the intention is that it would not work in that way. We are supportive of DWP producing regulations to ensure that the schemes that work that way could not come to be in the UK.

I echo what Baroness Altmann just said around communications. There is something about making sure that people understand the way that their pension is invested and what the potential outcomes of that are. From our scheme's perspective, the increase or decrease that is awarded each year applies across the board and I think that undoes some of that criticism around intergenerational unfairness. You cannot have it so that pensioners come first in terms of awarding pensions and that is not how it would work in our scheme. My main point is that is what the regulations are there for, that is what the regulator is there for and we are working closely with DWP and the regulator to make sure that our scheme works as it is meant to, but also that future pension schemes are appropriate and suitable for the UK pensions' environment.

Q176 **Nigel Mills:** A final question for me, what should we as a Committee recommend regarding decumulation CDC? Should we just wait and hope that some market player fancies a go at this, or does there need to be more Government action to encourage or require one of the big master trusts to work on this and try to offer it? Nest would look like a sensible place to start, I guess, given we own it. Do we need more policy action from the Government or the Regulator to try to make this happen, or do you think it will happen of its own volition?

Simon Eagle: It is a difficult one. It is a bit of chicken and egg, because it needs these schemes to be designed but it needs the law in which they will operate and which of those two comes first is the question. I think from Guy Opperman’s recent statements he has done what he can. He said to the pensions industry he wants to engage extensively on these designs this autumn or winter, so he has given a clear signal for the industry that he will engage. I think it is with the industry now to invest the time in designing these arrangements. I know some master trusts are interested; some are looking at it. What I cannot comment on is Nest. Is there an issue there with Nest leading the market? If they are the first to do this then they are influencing a commercial market. Is there a dynamic there that is difficult?

David Pitt-Watson: Where we are now is we have the legislation for single employers. We have an announcement from the Minister that he is going to start looking at multi-employers, which I think is a very good thing to do. We have a cross-party consensus as well that that is what we want to do when everyone was sitting around when we did this CDC forum at the RSA. There has not been any specific discussion of decumulation yet, but you could see how that fits in to where it is that we might want to go. Here is the thing about this pension stuff, that it all must be part of a system. Everybody is looking over their shoulder, “What is the Regulator going to do? What is the politician going to say? What is the legislation going to allow me to do? Does this make any sense for me to be talking to other people who are part of the same industry about setting something up?”

I wonder whether there might be something that this Committee could say about can we have a vision of where it is that we are taking this, and also can we have a bit of resource behind the delivery of that vision? I would say I think that the work that is being done in the DWP and the professionalism of that work and the commitment of the people that are working towards it is very high indeed, but it is a tiny number of people. This is quite a big policy—there are £2 trillion I think invested in pensions—and we think this could be very considerably more productively invested with choice and all of those things as well. Might there be something that this Committee could do that could congratulate the Government on where they have got to so far, but maybe say, “Here is where we might want to be going over the next two or three years” and put some resource into the consultation and the delivery and resolving all the issues that we know need to be resolved before we can make this happen? I do not know if that is helpful.

Baroness Altmann: I think there is also a role for the Committee to express some encouragement to pension providers to modernise their product offering to reflect a very different environment. We had pension freedoms in 2015. So many of the autoenrollment default products are still life styling, so they are seeing all the equities for the 10 years before someone’s chosen pension age, which may not be anything like the age at which they stop working. So they have come out of the markets, they have not had the benefit of the extra potential returns, they then may go into drawdown and buy back the very same securities at much higher prices that they sold 10 years prior.

There is a degree to which the industry, perhaps for understandable reasons if they think the landscape keeps changing, thinks if we develop a new product, something else is going to come along and make that inapplicable, but we have not seen a different approach to drawdown. We have not seen the 3.5% or 4% withdrawal every year, a simple product, that we could have seen and we have not seen different default options that say, "If you do not want to buy an annuity you do not need to sell all your equities if you are planning to keep invested for longer". Encouraging the industry to be more creative, which would include, potentially, and I do think it is for the later ages, those pension providers who do not offer annuities could be saying, "We can offer higher incomes, with also mortality cross-subsidy but without locking into the extra margins that annuities require" from, let us say, age 75. We have not seen that kind of approach or particular pension approach for those in poorer health, who do not know what their life expectancy is but might feel they are in the wrong pool. A collective for certain professions with lower life expectancy? CDC could be adapted to take account of that and ordinary defined contribution pension products could be, so there is an opportunity that has not yet been taken, I think.

Chair: Thank you. That concludes our meeting. Thank you all for the very thoughtful and interesting evidence that you have given to us. It has been very helpful for our inquiry.