Additional written evidence from The Institute and Faculty of Actuaries (IFoA) CDC Working Group (APS0070)

Thank you for the recent opportunity extended to Simon Eagle to represent the Institute and Faculty of Actuaries (IFoA) by giving oral evidence to the Select Committee on 25 October. The IFoA continues to be of the view that the introduction of collective defined contribution (CDC) schemes is in the public interest, to potentially allow (defined contribution) DC savers a new option under which they might take advantage of risk sharing and receive an efficient income in retirement

There were two items that were touched on in the oral evidence session, where we would like to expand on our comments as follows.

CDC as a default product

There was a question from Selaine Saxby MP about whether CDC options could be a default product for people currently saving into a defined contribution scheme through auto-enrolment.

We would support that as a default option when a member chooses to retire, because:

- surveys of individuals repeatedly show that the majority of people would like a regular income in retirement;
- CDC is a way to provide that income, which is expected to be much better value for money than insured annuities; and
- There are indications that many non-advised DC members are not making decisions that will lead to an efficient regular income, with many drawing down at high rates and / or leaving investments in cash. Further, early indications following the introduction of investment pathways in February 2021 are that take up is low: this all points towards permitting CDC as a default.

To be clear, we are not advocating that there is a default age at which DC pots are automatically converted into CDC pensions, as was discussed by others at the oral evidence session. DC schemes allow members to select a retirement age (or have a default retirement age for those who don't choose one), and members would be provided with a CDC income quote before reaching that age; unless they opt out, the CDC pension would then be put into payment.

CDC schemes are not Ponzi schemes

The Chair quoted someone from the Financial Services Consumer Panel who had said CDC schemes "in the worst cases begin to look like Ponzi schemes".

We see this comparison as fundamentally invalid and using emotive language to unjustly worry consumers. Ponzi schemes are fraudulent financial schemes, intentionally designed to lure money from investors that will be misappropriated. CDC schemes are highly-regulated collective pension arrangements run by trustees to pay pensions to their members for financial security in old age. The regulatory regime will ensure that CDC scheme funding levels never fall to the point where there is no money left to pay members' pensions, absent a calamitous collapse of financial markets and the world economy, at which point society as a whole will have more pressing concerns.

Even putting this fundamental difference aside, and there is the question of how CDC schemes will determine pensions in a fair way across generations of members. The draft regulations include design requirements which ensure pensions are paid in an inter-generationally fair way, without bias between generations. In the unlikely scenario where asset levels drastically fall, pensions are reduced for all members going forwards to reflect the lower assets available. This would affect pre-retirees more, as they have a greater number of years of pensions to be paid, however that simply reflects that they are the generation that are being paid pensions after the asset fall event. If markets recover, the asset levels in CDC schemes would again lead to increases in the levels of pensions paid to members.

To be clear, and referring to oral evidence from other panel members, CDC schemes will not behave like pre-2005 (defined benefit) DB schemes in which pensioners were prioritised above non-pensioners resulting in some younger members getting very low or no pensions. Instead, CDC schemes reduce pensions for all members according to the scheme's inter-generationally fair rules.

Next steps

We were pleased that the Committee's questions in the session began to explore the provision of CDC pensions through master trusts. We feel that the greatest potential for members would be for CDC to be provided through master trusts, and would be happy to provide the Committee with further evidence on this point.

Future work and the 'Great Risk Transfer' report

As the Committee progresses with its inquiry, we would like to draw attention to the IFoA's 'Great Risk Transfer' (GRT) report. The IFoA has identified that over recent decades there has been a trend of the transfer of risks from institutions – such as employers, the state and financial services providers – to individuals.

The GRT report has unearthed a number of considerations/recommendations relevant to the Work and Pensions Committee and the current call for evidence on accessing pension savings. Prominent examples of the GRT trend include the steady shift from DBDC pensions and from annuities to drawdown.

The report has been created after extensive engagement within the financial services sector including multiple stakeholder meetings and roundtables and engagement with the department and Minister. Recommendations within include more detail on CDC schemes, the operation of Pension Wise, decumulation pathways and general considerations surrounding pension savers and risk.

Indeed many Committee members may be already aware of this work and the IFoA would be happy to provide more detail as the inquiry progresses.

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