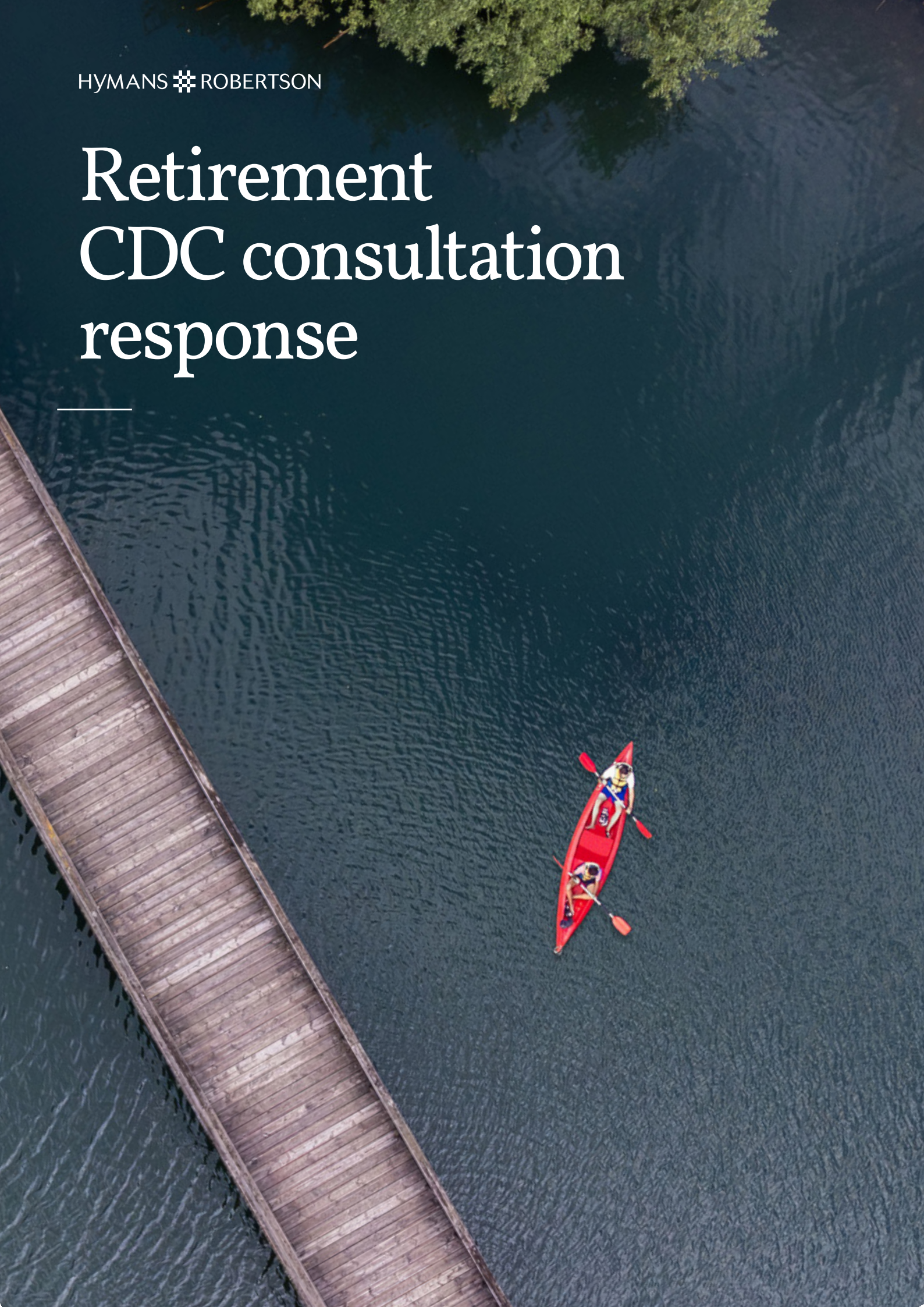


HYMANS # ROBERTSON

Retirement CDC consultation response



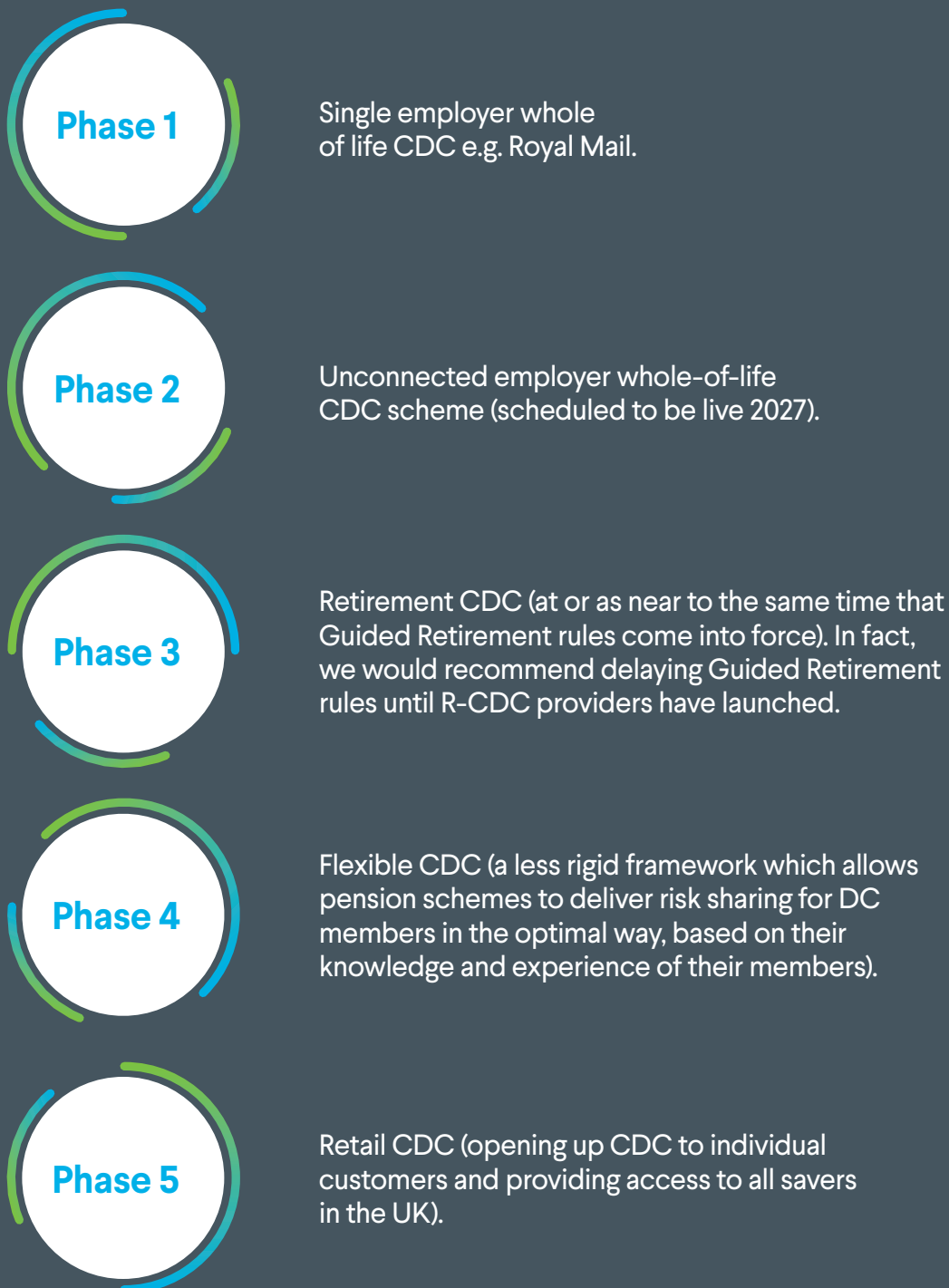
Hymans Robertson LLP is pleased to submit our response to this consultation. Our response is based on our actuarial, investment and longevity experience of pension design and risk pooling. We work with employers, pension schemes and providers and this insight has helped shape our response, but the views put forward are those of ours alone.

We welcome this consultation as part of the advancement of CDC and risk sharing for DC members in retirement. It does not make sense for the over-riding experience of DC members at retirement to be one of 'going it alone', when the industry is well placed to deliver alternative approaches that can deliver better outcomes. Retirement CDC has the potential to deliver between 25% and 50% higher income in retirement than a DC member purchasing an annuity or following a drawdown strategy. It provides a trustee governed solution where members won't run out of money.

It is right that we should establish Retirement CDC (R-CDC) as a solid workplace product first. Then we should move on to open up access to the whole population in retail versions in a safe and controlled way. Trying to offer a retail version from day one risks customer detriment and would considerably delay the launch.

We recognise the importance of keeping focussed on the task at hand but are keen to continue to a future phase of longevity pooling giving providers wider freedoms to create overall retirement income products that meet member needs. This will fit particularly well with the Guided Retirement default approach included in the Pension Schemes Bill, where operating as a default solution will help achieve scale and deliver the best possible outcomes for members.

The evolution of CDC in the UK could then be thought of like this:



In considering the evolution of CDC, we recommend the exploration of a whole of market 'take all' provider, with a commitment to accept any scheme that wishes to join. This would give access to the greatest number of people and allow small employers or others with unattractive commercial profiles to benefit from CDC. It could also serve as a CDC lifeboat for commercial schemes that are unable to continue.

We would be happy to discuss our responses with you if helpful.

Question one

How do you anticipate Retirement CDC investment strategies will need to differ from those of whole-of-life CDC schemes?

In terms of impact on investment strategy the key differences between whole-of-life CDC scheme and retirement-only CDC are time horizon, cash-flow needs and the ability to bear investment shocks.

We would expect a Retirement CDC scheme to have an investment strategy that is more liability and cash flow aware. As a result, we would expect to see a higher allocation to income producing assets, an overall lower level of risk and accordingly a lower level of target return.

For reference we might expect:

- A whole-of-life CDC scheme to target returns in the CPI +3-5% range and Retirement CDC schemes to target returns in the CPI+1-3% range.

- Duration to be roughly half that of whole-of-life CDC schemes. This implies that volatility of indexation rates would be broadly double that in whole-of-life CDC schemes for the same market moves. This drives the need for an investment strategy that has less volatility.

In general, we would also expect to see a higher level of liquidity within the investment strategy. The actual liquidity required (net cashflow position) of the scheme at any point in time would depend on a range of factors (maturity of scheme, number of new entrant retirees each year and their relative pot sizes versus the drawdown payments for existing retirees, acquisition strategy and success of scheme). Liquidity stress test scenarios are likely to be important in testing robustness of investment strategy.

Question two

What do you estimate the establishment and running costs of a Retirement CDC scheme to be? Please outline one-off and ongoing costs?

No substantive data or views to share.

Question three

Should all business plan requirements that would apply to whole-of-life unconnected multiple employer CDC schemes also apply to Retirement CDC schemes? What, if anything, should change or be added?

The overall business plan structure and requirements can remain consistent.

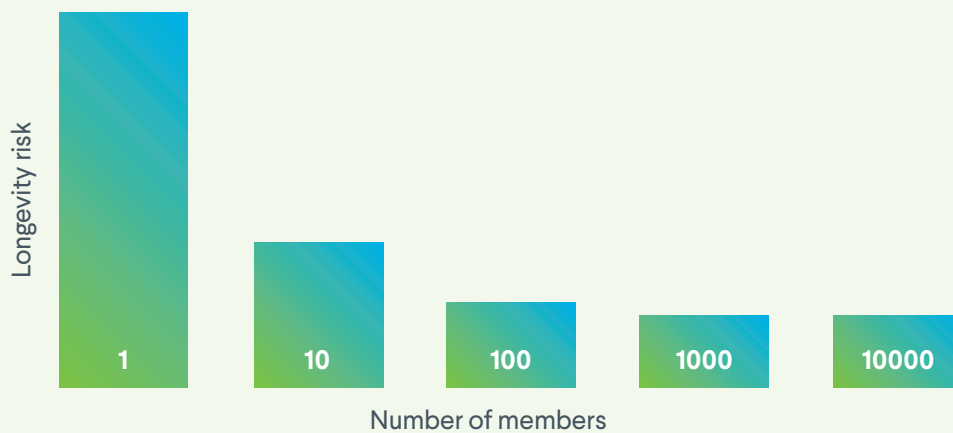
Question four

What number of member onflows, and at what pot size, will be needed to achieve stability in Retirement CDC, given there are no ongoing contributions, and what allowances need to be made for members who opt-out of their default pension benefit solution?

There are several aspects to this:

1. At the point of applying for authorisation, schemes will need enough freedom to market to demonstrate credible demand in line with their business plans. More generally scheme proprietors will be investing according to planned scale in terms of both numbers of members and assets under management. If actual outcomes are very different this could potentially cause strain in terms of long term commercial attractiveness, quality of member services etc. Stability should be seen in this broad context.
2. Scale will be needed to effectively pool longevity risk. Over the long term, most gains from pooling longevity risk have been achieved by the time a scheme has 1,000 members. For smoother year-to-year performance, a Retirement CDC scheme would ideally be growing towards 10,000 members and beyond. The benefits of longevity pooling and risk reduction for members are showing in the graph below. Longevity risk does not go to zero as even with millions of members they are still exposed to 'baseline' longevity risk and 'trend' longevity risk unless the scheme separately hedges those risks with insurance or investment products.
3. Scale will be important for investment costs and range. The fact that it will be DC master trusts and UMES schemes offering Retirement CDC helps in this regard. Provided that the Retirement CDC scheme/section can build on the overall investment scale and sophistication of the provider, it should not be a limiting factor.
4. For cost effective administration, particularly for UMES schemes, they should benefit from the economies of scale of their wider pension provision.
5. We have not considered long term stability in any detail as we expect that will be separately covered by continuity plans. But clearly, Retirement CDC schemes will need a continued flow of new members joining or they will enter run-off with all the decisions and actions that follow.

Pooling reduces risk



Question five

What do you think the effects of the proposed adaptation to promotion and marketing criteria, including a prohibition on prospective member/member marketing, would be?

Good communication will be critical to build trust with members. Trust is central to the success of CDC.

- Employers and trustees should have deep understanding of the benefits and risks of membership of a CDC scheme. This is a high bar but a practical one to achieve given the level of engagement and access to information these groups will have prior to making a decision on whether to offer an R-CDC scheme.
- Members should understand the core aspects of the scheme. The communication obligations on schemes should be for trustees to achieve this without bias to achieve the commercial interests of the proprietor.

Setting out principles that apply to schemes and trustees in communication would be a less restrictive model than the proposed rules on promotion and marketing. These principles should allow for flexibility in dealing with the range of situations that schemes will face in future e.g. people with multiple R-CDC schemes, people with whole-of-life and R-CDC, people assessing their retirement needs across a wider range of income sources etc.

The Pensions Regulator could then be given power of judgement over the application of these principles by TPR, in a similar way to the FCA and the Consumer Duty. The clear, fair and not misleading principles that apply today of clear, fair and not misleading give a strong starting point if applied effectively.

The approach proposed currently could be too restrictive and cause situations where schemes do not provide sufficiently helpful communication to members for fear of breaching the rules (similar to the 'advice gap' issue seen elsewhere in pensions).

In summary, we believe the prohibition on prospective member/member marketing will have a negative impact on the communication experience of members. Given that there are already clear duties on providers to make sure that communications are clear, fair and not misleading we do not think that additional protections are necessary. In addition, with no retail market and therefore a small number of providers regulated by TPR oversight of this area should not be onerous.

Question six

How would an approach to allow access to Retirement CDC via a Guided Retirement default or formal partnership between trustees, protect members, and impact a developing market? Would there be any unintended consequences?

There are two tests we would apply to this in order to deliver good member outcomes across the industry:

- 1) Does it allow members to access the best possible retirement products?
- 2) Will it help or hinder schemes to achieve and maintain scale in the retirement phase?

We believe both of those tests would be satisfactorily met by allowing Retirement CDC to be delivered via a Guided Retirement default.

It feels inevitable that there will be a range of different products and providers initially, and in time some of these will not be successful. That doesn't negate the benefits of including Retirement CDC as an option to fulfil the Guided Retirement requirements. We would expect it to be an attractive option for many schemes.

Question seven

What are your views on the risks, benefits and potential protections for members of FCA-regulated pension benefit schemes being transferred to a Retirement CDC to access their pension savings?

Provided there is a clear governance structure to assess and control the selection of a Retirement CDC for contract based members we believe this is workable and beneficial. As far as possible, product provision and rules between contract based and occupational workplace pension arrangements should be harmonised.

IGCs could have responsibility for assessing whether a Retirement CDC scheme is a suitable vehicle for contract based pension members to transfer to at retirement.

It is less clear that SIPPs should be included from day one. This feels at odds with a model that does not allow Retirement CDC for retail investors. Guidance and support requirements would be higher for retail customers who make more active decisions on the whole. While arguably one could put a similar governance overlay around SIPP customers as contract based workplace members, the case for including these customers at the outset does not feel strong.

Question eight

What matters should we consider in developing an actuarial equivalence requirement for transfers into the scheme, and are there other factors to address regarding member entry?

A number of matters that should be considered:

1. The likely designs that providers may wish to develop and how the requirement and associated guidance supports such elements as, for instance:
 - a. Unisex terms.
 - b. Variable pricing that reflects both commercial realities for the occupational pensions market as well as the differential in scheme expenses that would be incurred (due to average pot sizes, quality of data, administration processes at the point of transfers, the approach to the investment transition).
 - c. Different approaches to underwriting/assessing demographic criteria at either an employer or member level (noting the trade-offs between equivalence with UMES schemes and potential for divergence in regulatory regimes for UMES R-CDC vs DC MT R-CDC).
 - d. Materiality – so that a drive for spurious precision does not increase overall expenses and charges levied on members.

There are many other factors to consider regarding member entry in terms of the quality of the overall member experience. They would include:

- Communications.
- Ability (or not) within the relevant regulations to give good expectations to members of income levels – while avoiding guarantees that do not sit naturally within a CDC scheme. This is also relevant to any 'cooling off' type matters.
- Service levels and smoothness of transition from a member perspective.
- Effectiveness and efficiency of the investment transition, minimising out of market risks and frictional costs, to maximise member benefits.

Question nine

What mechanisms should be introduced to ensure that quotations are accurate and not misleading?

The controls in place for UMES schemes in terms of trustee responsibility and scheme actuary advice on this matter appear to us to provide a high level of protection.

A further layer could be for TPR's code of practice to require a regular (say annual) review of the overall terms of the quotes relative to the benefits awarded. It could require a trustee assessment for any observable bias and whether that is explainable by market moves over the year or whether there are other factors that need to be explored.

The restrictions on marketing to DC members should not mean that it is not practical in a cost effective way for a particular R-CDC scheme to give quotations to those members when that R-CDC scheme is the default Guided Retirement outcome. That would seem to be risk aversion gone too far, leading to member detriment.

Question ten

What are your comments on a 'cohorting' approach to helping well-performing schemes remain affordable for members and are there alternative approaches you would recommend? What should scheme rules on cohorting include? And does the illustrative drafting capture the policy intent and would this drafting work in practice?

We are strongly supportive of the cohorting approach from a policy perspective. It feels important given the tight design requirements imported from the existing CDC legislation.

We agree that schemes should be able to determine their own rules for opening and closing cohorts.

Members with a single pot within a R-CDC scheme they will only experience a single increase rate each year. The cohorting approach should consider transfers in and whether they go into the potentially closed cohort so that members have a single pot (our recommended approach, based on actuarially

equivalent terms at the date of transfer), or transfer in based on terms available to the open cohort at the time of transfer (more confusing for the member, so not our recommendation).

Noting our comments above on actuarial equivalence in practice, and member communication requirements to members, any further requirements obligations beyond an effective regulation requirement to deliver the policy intent onto deliver cohorting should be drawn quite widely. This would give schemes flexibility to respond to market conditions and flows of members.

Question eleven

What issues would removal of the upper threshold and allowing the spreading of cuts over the lifetime of the scheme, for schemes using cohorting, create and how might these be mitigated?

Cohorting will mean that schemes regularly 'revert' new members to their original target benefit, rather than seeing long term indexation switches over time. Importantly, given the shorter duration of R-CDC schemes compared to whole-of-life schemes, cohorting limits the potential scale of drift in indexation.

It seems unlikely to us that the provision of the cap and benefit cuts will be the primary decision making criteria for trustees on behalf of members; or that in advance of retirement, they would be the primary decision making criteria for many members, should they be able to understand the implications.

In all cases, this is about the flow of value of the overall assets between different members. We do not see that these choices cause first order changes in value to members, only the distribution of value. If anything, removal of the 'cliff edge' at zero increases could lead to more investment flexibility which over the long term would add value to members.

Having said that, at a particular point in time the effects of the cap/cuts will have different impacts on different members based on their life expectancy at that point in time. So with hindsight there will be winners and losers. Having a cap/cuts will lead to different winners and losers – it is not obvious to us from a policy perspective that we should prioritise one group over another in the R-CDC context.

Therefore, provided an R-CDC scheme intends to apply cohorting, we would recommend allowing different schemes freedom to design as they most think fit for their prospective members. It does not appear to us that this introduces material risk to future members overall. There is the potential for modest upside in terms of more efficient investment strategies and smoother income outcomes for pensioners.

Question twelve

Is there any further information that Retirement CDC scheme should be required to provide to new and prospective members?

Nothing to add.

Question thirteen

Are there practical or operational challenges in delivering Retirement CDC communications through DC scheme trustees, and how might these be addressed?

This is another area where we do not think it helpful to be too prescriptive. Members are likely to receive some form of communication from their employer (where they are still working at the business with the pension scheme), the scheme Trustee and also the R-CDC provider (if allowed).

A one size fits all approach to who can issue communications risks creating a clunky member experience in some scenarios, when much more natural and effective ones were possible.

To address this the trustees of the R-CDC scheme could be required to own and sign off the communication strategy and deliverables for members. These rules could then allow flexibility over how they are implemented such that different parties are permitted to issue communications.

Question fourteen

What additional costs might a Retirement CDC illustration create, and what considerations should be taken into account to ensure illustrations are realistic, consistent, and not misleading?

Our experience in this area is:

1. SMPI illustrations based on standard assumptions work well enough in delivering a level playing field and consistency, but don't lend themselves to giving the best presentation of expected pension to members.
2. Providing two different forms of projections to a member need not be as confusing and disruptive as one would think (for example DC modelling and member communications that are provided in addition to SMPI statements but on a different basis).

Options would be to:

- use standard returns by asset class – but be wary of unintended consequences e.g. on assumptions that reflect negatively on real UK assets.
- use assumptions that are in line with valuation assumptions set by trustees, with advice from the scheme actuary to balance commercial pressures.

Question fifteen

What charging structure/what charge levels is your organisation considering levying on members? If implemented, at what level should a Retirement CDC charge cap be set?

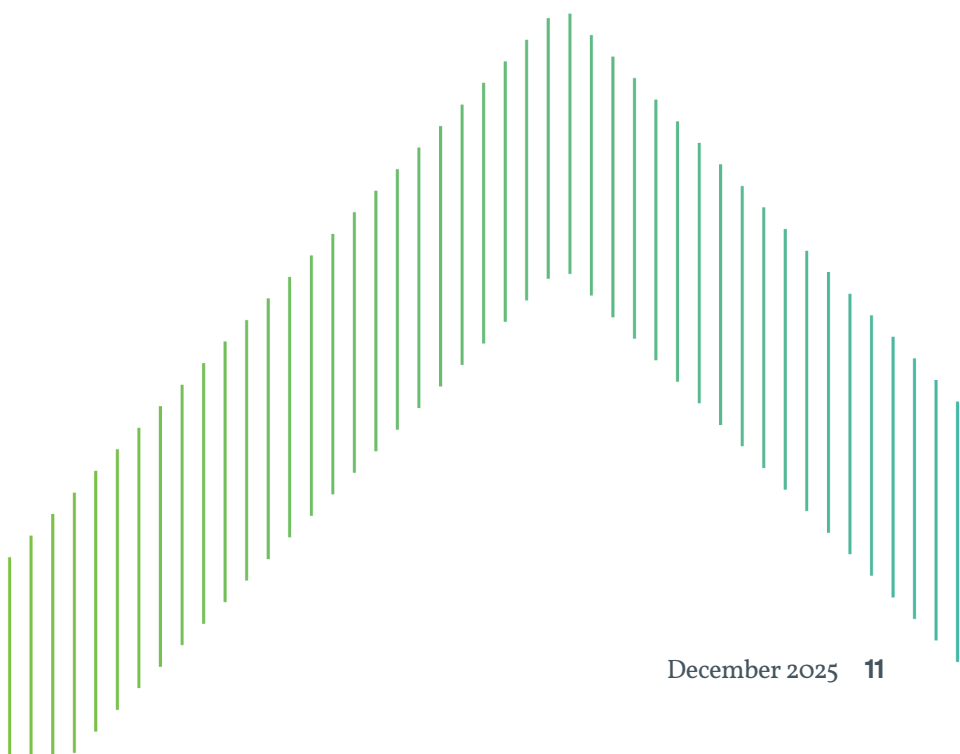
Given the industry focus on delivering the best possible outcomes rather than the lowest possible charges, a prospective value test would better serve the growth of R-CDC than an immediate charge cap from the outset.

Question sixteen

Do you foresee any areas of potential arbitrage, and how should Government and regulators seek to mitigate this?

Government and regulators should continue to provide frameworks for the key retirement provision that the market is seeking to make available for people. This will involve exploring and influencing providers at the cutting edge of changes, for example DB pension superfunds. There will be other cross-over type solutions across the wider retirement space.

However, in our view the Government has done a good job of mitigating issues as they arise and should not let a concern about future issues stifle or slow change. In fact, purposefully moving forward the regulatory agenda so desired products sit within a statutory footing is the best way to mitigate these risks alongside the existing power of TPR, the FCA and the PRA.



Question seventeen

Are there any other matters you wish to raise in relation to the possible extension of the CDC authorisation and supervisory framework to include Retirement CDC schemes?

This is an important phase but we believe that the flexibility to introduce longevity pools without pooling investment risk is an important phase to come – both in the occupational and retail market. And that working out how Retirement CDC fits within retail is important as there is a major need there – a minority of members but large amount of retirement funds that could deliver retirement incomes more efficiently.

There need to be rules and guidance on transferring in and out of R-CDC. Provided the terms are actuarially fair and minimise selection risk amongst remaining members, we think transfers out should be

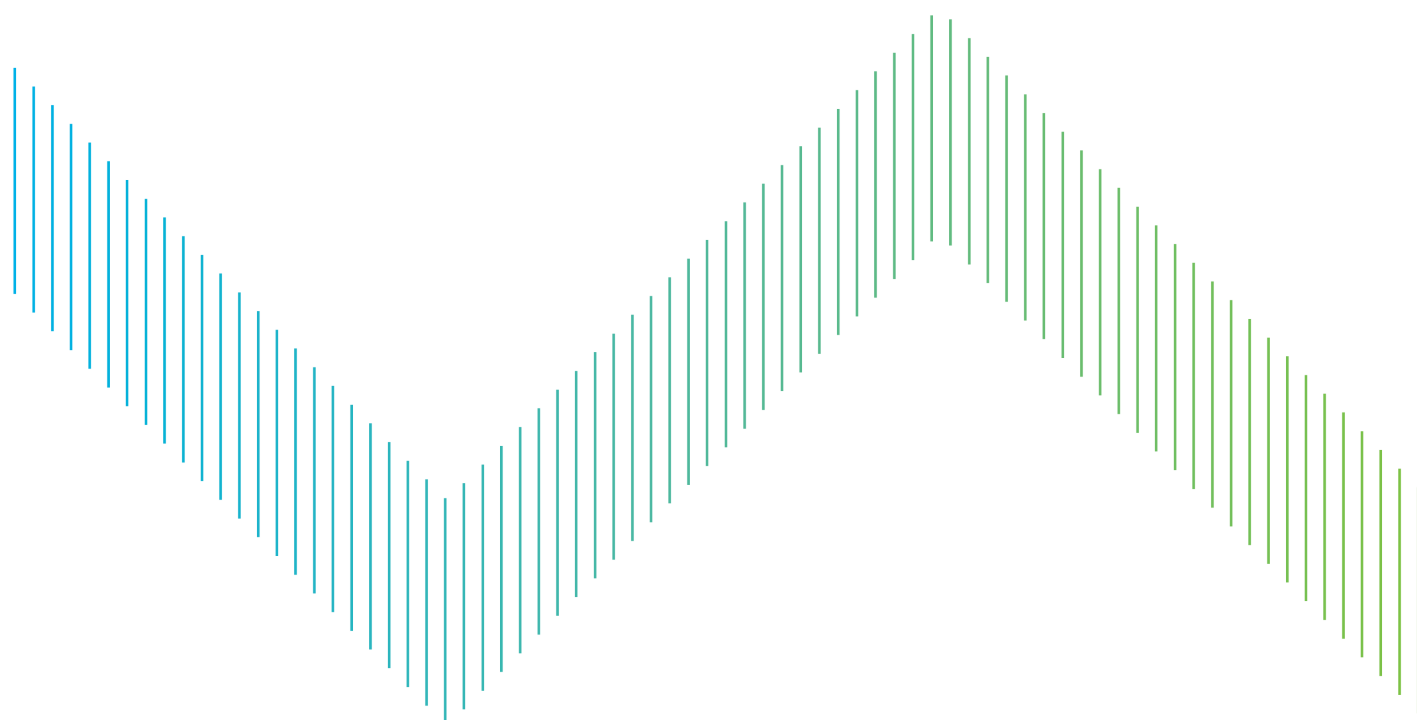
permitted and there will be scenarios where members will validly prefer a transfer than continuing to take a benefit from the scheme.

It's not obvious to us that we shouldn't have R-CDC start ups. Limiting entry only to master trust and UMES schemes is a restrictive practice and risks excluding new entrants who may have significant value to bring. In saying this, achieving scale will be important and we would expect there to be a high bar to becoming authorised as a R-CDC provider to mitigate the risk of a proliferation of poor value small schemes.

Question eighteen

Do you have any comments on the proposed amendment of Regulation 12 of the Preservation of Benefit Regulations 1991?

We support the policy intent and do not have specific comments on the drafting of the regulation.



Hymans Robertson CDC expertise

If you'd like to discuss any of the points raised in this paper please contact us.



Jon Hatchett

Senior Partner

jon.hatchett@hymans.co.uk
0207 082 6167



Paul Waters

Head of DC
Markets

paul.waters@hymans.co.uk
0207 082 6281



London | Birmingham | Glasgow | Edinburgh

T 020 7082 6000 | www.hymans.co.uk

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