The importance of investments in CDC

Chapter 3:
Designing CDC investment strategies around member outcomes

From history to design…

Chapter 2 showed that CDC outcomes depend heavily on economic regimes. CDC changes the investment problem - outcomes are not fixed in advance as in DB, nor determined solely by individual experience as in DC. Investment returns are shared collectively and feed through into pensions over time. So, the next question is more practical:

How should we design investment strategies that deliver good outcomes across those regimes?

How do we assess both “risk” and “success” for CDC?
CDC changes the investment problem. Traditional pension frameworks focus on portfolio volatility and funding levels - but members experience pensions, not portfolios. This article explores why risk in CDC should be measured through member outcomes such as replacement ratios, pension stability and the likelihood of cuts, and why lower volatility does not necessarily lead to better outcomes.

Laun Middleton, Partner

Building portfolios that deliver pensions
Designing CDC portfolios is not simply about targeting higher returns. Different strategies can produce very different pension experiences depending on how they behave through inflation shocks, downturns and recoveries. This article explores the trade-offs between growth and stability, and how CDC portfolios are designed around long-term member outcomes rather than traditional investment metrics.

Ivan Buzulutsky, Partner

If CDC is built to operate across different market regimes, its investment strategy must be designed to perform across them.

What does “risk” really mean in CDC?

CDC forces a rethink of “investment risk”

For decades, pension investment strategy has been built around a familiar framework: maximise return for a given level of volatility. CDC does not fit that framework. CDC does not deliver a pot at a point in time. It delivers a pension that **evolves over time as investment experience is shared** across members. **That changes what risk means and how it should be managed.**

Members experience pensions, not asset price volatility

In practice, strategies that reduce short-term volatility can still expose members to prolonged periods where pensions fall behind inflation or require repeated adjustment. Members do not experience portfolio volatility directly. They experience changes in their pension:

- the level of pension they receive
- how that pension changes over time
- whether it keeps pace with inflation
- the likelihood and extent of reductions

After all, a low-volatility strategy can still deliver poor pension outcomes if it fails to generate sufficient real returns. Equally, a more volatile strategy may deliver better long-term outcomes if it supports stronger pension growth.

In CDC, the relevant risk is not how assets move but how pensions evolve.

From portfolio risk to member outcomes

Because CDC pools risks and adjusts benefits collectively, members experience changes in pension outcomes rather than changes in portfolio values.

This requires a shift from measuring portfolios to measuring outcomes.

Two levels of risk - and why the distinction matters

In CDC, it is useful to separate two different questions:

1. **Strategic risk** – what pension outcomes do members experience?
2. **Portfolio risk** – what portfolio characteristics drive those outcomes?

The CDC transmission mechanism – from investment returns to pensions

How investment outcomes affect pensions

Understanding how CDC schemes translate portfolio performance into member outcomes is central to investment strategy design.

When investment outcomes are stronger or weaker than expected, pensions adjust over time to keep the scheme balanced.

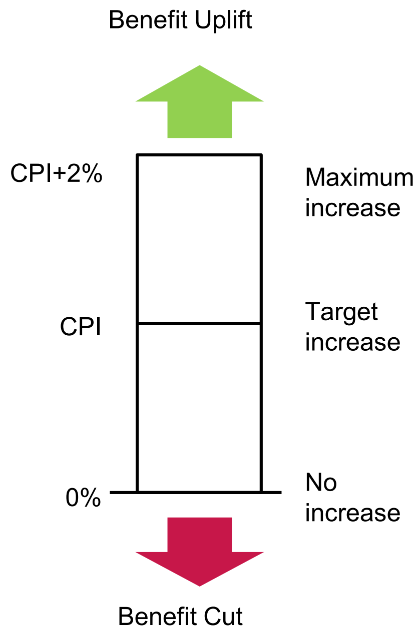
Stage one – adjust future pension increases.

In our simple example, pension increase promised and awarded to members can vary between “No Increases” and “CPI+2%”.

If this is not enough:

Stage two – further pension reduction or uplifts are applied if required.

The result is that investment gains and losses are reflected gradually through member outcomes.



From member outcomes to portfolio construction

Different CDC schemes can tolerate different risks

The level of investment risk a CDC scheme can sustain depends not only on the portfolio, but also on the profile of its membership.

Younger schemes can typically absorb larger short-term investment shocks because they have longer to recover. More mature schemes may place greater emphasis on pension stability and downside protection.

The chart illustrates how risk capacity can vary across different CDC memberships. These differences in risk capacity mean that the investment strategy that delivers the most attractive outcomes can vary between CDC schemes.

Why this distinction matters

Traditional investment frameworks often start with the portfolio and assume member outcomes will follow.

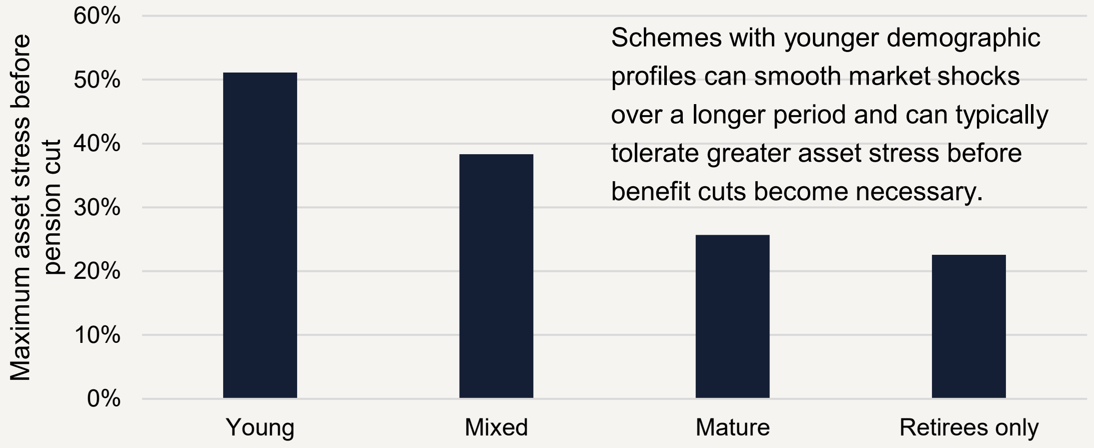
CDC works the other way around. It starts by defining the member outcomes the scheme is trying to support and then asks what portfolio behaviour is required to deliver them.

The required portfolio behaviour – and ultimately portfolio construction – should therefore be driven by:

- downside pension outcomes;
- recovery risk;
- inflation resilience; and
- the sustainability of pensions through time.

Optimising portfolios without reference to member outcomes risks solving the wrong problem.

How membership profile influences risk capacity



Member outcomes
Expected pensions | probability of cuts | Downside outcomes

↓

Required portfolio behaviour
Long-term growth | Recovery after stress | Inflation resilience

↓

Portfolio construction
Asset allocation | Diversification | Implementation

A CDC investment strategy scorecard

A different way to assess CDC investment strategies

Traditional investment metrics alone do not fully capture CDC member experience.

Factor	What it measures	Investment strategies		
		Growth strategy	Balanced strategy	Stability strategy
Expected pension level	Long-term retirement adequacy	🟢	🟡	🔴
Downside pension outcomes	Severity of poor outcomes	🟡	🟢	🟡
Likelihood of cuts	Predictability of pension planning	🔴	🟡	🟡
Intergenerational consistency	The balance of outcomes across the various cohorts in the scheme	🟡	🟢	🟡
Inflation resilience	Ability to support inflation increases over the long term	🟡	🟢	🟡

Illustrative assessment only. Relative rankings will depend on scheme design, demographics and market assumptions. For illustration, we compare three stylised approaches ranging from a growth-oriented strategy focused on maximising expected pensions to a stability-oriented strategy prioritising pension stability.

There is no single best CDC portfolio. The preferred strategy depends on how a scheme prioritises adequacy, stability, inflation resilience and fairness across cohorts and how well the strategy ties in with scheme objectives and benefit design.

Designing portfolios for CDC

Building portfolios that deliver pensions

CDC portfolios cannot be built using traditional pension investment frameworks alone. CDC operates across decades, through multiple economic regimes, while continuing to pay pensions throughout. That creates a different investment challenge:

- portfolios must generate long-term real returns;
- remain resilient through inflation and market shocks; and
- support pension outcomes that members can sustain confidence in over time.

The central trade-off

Every CDC investment strategy involves a trade-off between higher expected pensions and greater stability of outcomes.

More exposure to growth assets increases expected retirement incomes over time. But it also increases:

- variability in outcomes;
- sensitivity to market shocks; and
- the likelihood of pension adjustments.

Lower-risk portfolios may reduce short-term fluctuations but can also reduce real returns and increase the risk that pensions fail to maintain purchasing power over decades.

Designing portfolios for CDC

The charts illustrate two of the key trade-offs in CDC portfolio design. The upper chart illustrates how investment strategy affects both expected and downside pension outcomes for members joining the scheme at different ages.

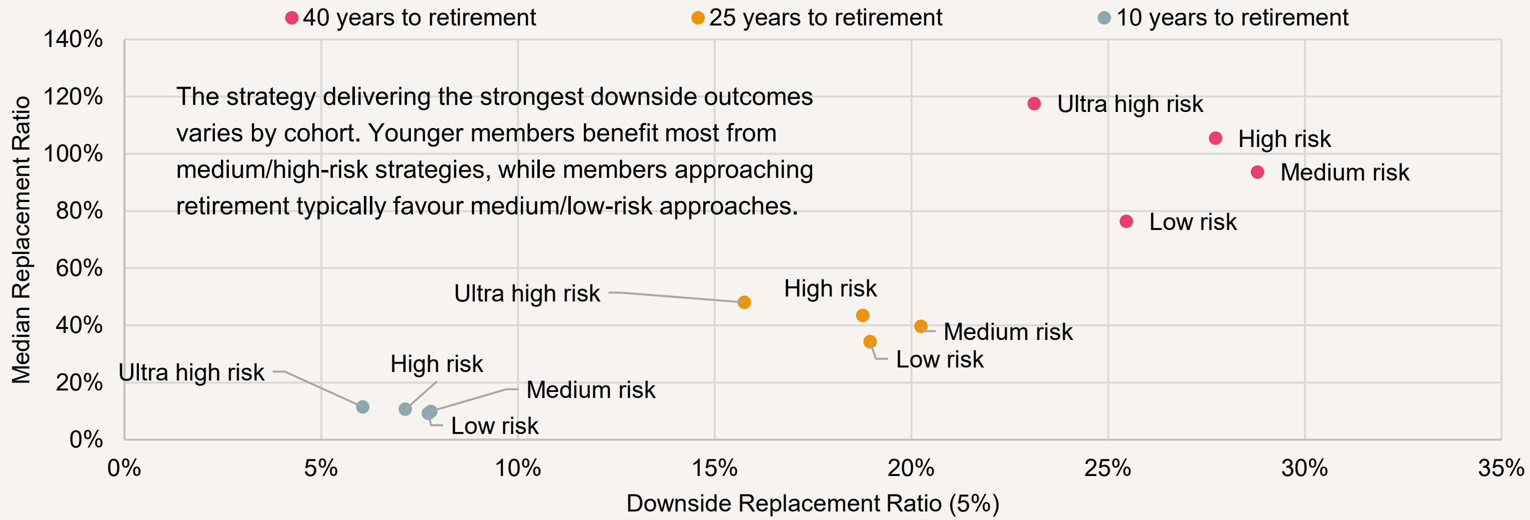
For younger and mid-career members, taking too little investment risk can result in both lower expected pensions and weaker downside outcomes. At the other extreme, higher-risk strategies may improve expected pensions but increase instability and the likelihood of pension reductions.

The preferred balance depends on how outcomes are weighted across cohorts. Younger members benefit more from long-term growth and have longer to recover from market shocks, while members closer to retirement typically place greater value on pension stability.

Our modelling highlights that CDC investment strategy is therefore less about identifying a single "optimal" portfolio and more about balancing pension adequacy and pension stability across the membership as a whole.

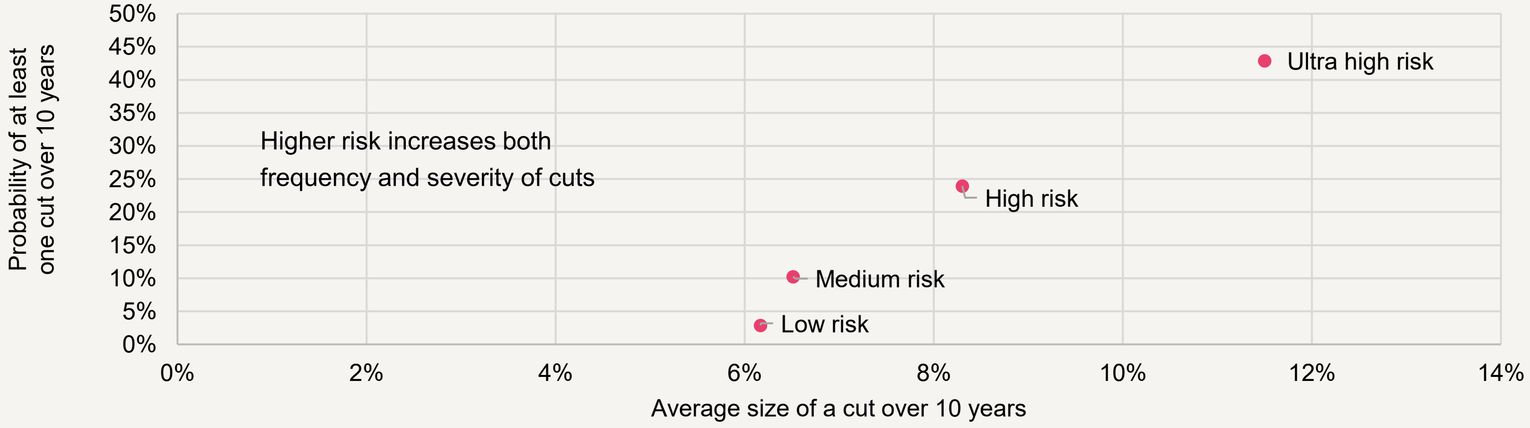
The lower chart shows that increasing investment risk can increase both the frequency and severity of pension cuts. This provides a direct measure of how investment decisions translate into member outcomes.

Expected median member outcomes by Investment Risk Strategy and Years to Retirement



Replacement ratio = pension as a proportion of pre-retirement earnings. Downside replacement ratio (5%) = pension outcome in a severe downside scenario (the least severe in the worst 5% of outcomes).

Probability of at Least One Cut vs Average Cut Size Over 10 Years



Designing portfolios for CDC

Portfolios must be built for regimes, not averages

The previous section considered how schemes balance pension adequacy and pension stability. The next challenge is implementation: how should that risk be delivered through the portfolio?

Chapter 2 showed that the same investment strategy can produce very different outcomes depending on the economic environment. Strong nominal growth, inflation shocks, prolonged drawdowns and slow recoveries all affect CDC differently. This means long-term expected return is only part of the picture.

CDC portfolios must therefore be designed to remain resilient across inflationary regimes, weak real growth environments and prolonged recovery periods. The objective is not simply to maximise expected return, but to deliver sustainable pension outcomes across a wide range of future economic conditions.

In CDC, sequencing risk does not disappear – it becomes a central portfolio construction challenge.

Diversification in CDC is about resilience, not just volatility

Traditional diversification frameworks often focus on reducing short-term volatility. CDC requires something broader: resilience to inflation shocks, market stress and changing economic regimes.

A key observation is that asset relationships can change materially across time horizons. Assets that appear weak inflation hedges over short periods may still support strong real pension outcomes over decades.

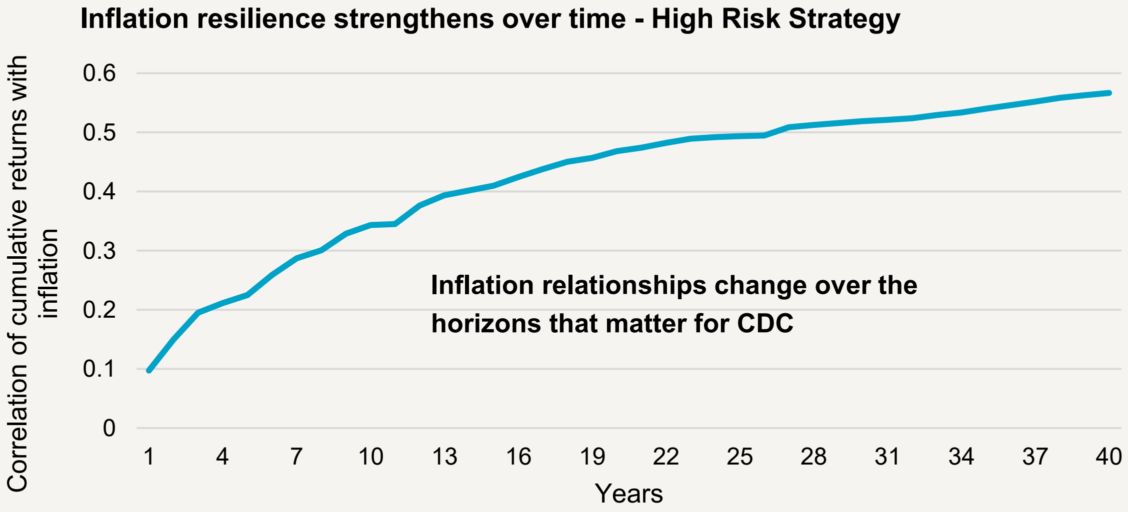
The chart illustrates this principle for one example CDC portfolio.

What this means in practice

Having determined the desired balance between pension adequacy and pension stability, portfolio construction should focus on delivering those outcomes across a wide range of future environments. CDC portfolios are therefore likely to place greater emphasis on:

- long-term growth assets;
- diversification across economic regimes;
- resilience to inflation shocks; and
- recovery dynamics following market stress.

The objective is not simply to maximise return but to generate sustainable real pensions through a wide range of future economic and inflation environments.



Designing portfolios for CDC

The key insight

Higher expected pensions come from maintaining exposure to long-term growth assets for longer. But that requires portfolios that can withstand inflation shocks, market stress and changing economic environments without permanently damaging member outcomes.

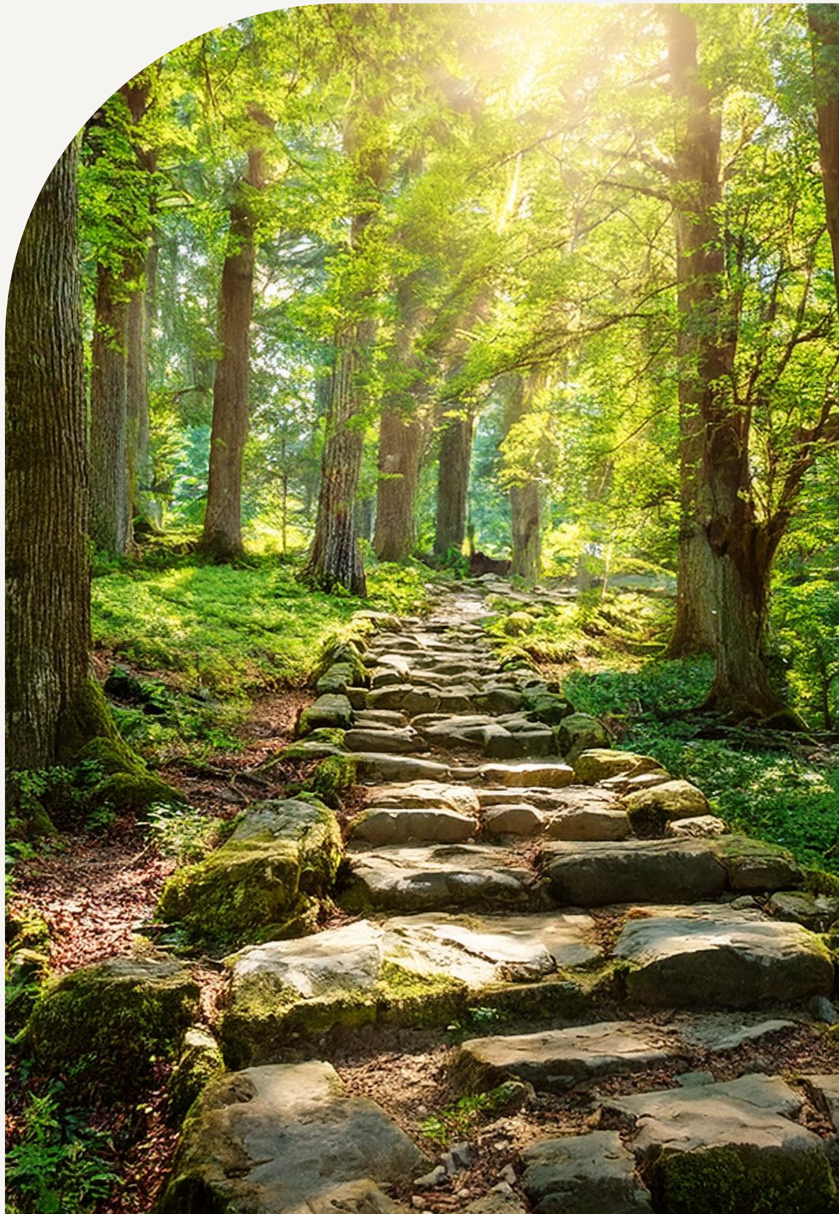
The appropriate balance between pension adequacy and pension stability will vary between schemes depending on their membership profile and objectives. There is no universally optimal CDC investment strategy.

CDC investment strategy is therefore not about avoiding risk. It is about deciding how investment risk is translated into pension outcomes over time.

The objective is not simply to maximise expected return or minimise volatility. It is to deliver sustainable pensions across a wide range of economic environments, while balancing pension adequacy and pension stability for the membership as a whole.

This requires a broader toolkit than traditional pension investing, drawing on the most effective ideas from both DB and DC investment. Long-term growth remains essential, but it must be combined with portfolio designs that remain resilient through inflation shocks, market stress and changing economic regimes.

The challenge for CDC investors is therefore not whether to take risk, but how to build portfolios that can absorb shocks, recover from stress and continue supporting member outcomes through decades of uncertainty.



Contact us

CDC is a fast-evolving area. Get in touch to discuss our latest views on where the market is heading and how we can support you in developing your own approach. Our CDC team brings together specialists across benefit design, actuarial, DB and DC investment, and advanced modelling to advise on every aspect of a CDC scheme.

Andrew Linz
Principal

+44 (0)20 7432 6633
Andrew.Linz@lcp.uk.com

David Wrigley
Partner

+44 (0)1962 873358
David.Wrigley@lcp.uk.com

Helen Draper
Partner

+44 (0)20 3922 1306
Helen.Draper@lcp.uk.com

Ivan Buzulutsky
Partner

+44 (0)20 3824 7257
Ivan.Buzulutsky@lcp.uk.com

Laun Middleton
Partner

+44 (0)20 7432 0605
Laun.Middleton@lcp.uk.com

Mary Spencer
Partner

+44 (0)20 7432 7749
Mary.Spencer@lcp.uk.com

Sam Cobley
Partner

+44 (0)20 7432 0695
Sam.Cobley@lcp.uk.com

Steven Taylor
Partner

+44 (0)20 7550 4599
Steven.Taylor@lcp.uk.com

All rights to this document are reserved to Lane Clark & Peacock LLP ("LCP"). This document may be reproduced in whole or in part, provided prominent acknowledgement of the source is given. We accept no liability to anyone to whom this document has been provided (with or without our consent).
Lane Clark & Peacock LLP is a limited liability partnership registered in England and Wales with registered number OC301436. LCP is a registered trademark in the UK and in the EU. All partners are members of Lane Clark & Peacock LLP. A list of members' names is available for inspection at 95 Wigmore Street, London W1U 1DQ, the firm's principal place of business and registered office. Lane Clark & Peacock LLP is authorised and regulated by the Financial Conduct Authority for some insurance mediation activities only and is licensed by the Institute and Faculty of Actuaries for a range of investment business activities.
© Lane Clark & Peacock LLP 2026 https://www.lcp.com/en/important-information-about-us-and-the-use-of-our-work contains important information about LCP (including our regulatory status and complaints procedure), and about this communication (including limitations as to its use).

Produced as at March 2026