PENSIONS POLICY INSTITUTE
PPI

PPI Roundtable
CDC: International Insights

Roundtable write up

The Pensions Policy Institute (PPI) held a Roundtable on Tuesday 14th June 2022. The objective of the Roundtable was to discuss the Briefing Note with an aim to further the discussion around design of Collective Defined Contribution (CDC) schemes in the UK and the potential for future research in this area.

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The focus was on CDC pensions, insights from international CDC schemes, and what models can tell us about how well it could work in the UK. The Briefing Note highlights key areas where further research may be particularly effective.

The roundtable was run as an online seminar with research findings presented by **Lauren Wilkinson** (PPI) and **John Armstrong** (King's College London).

Over twenty people attended this event, representing interests from across industry and government. **Sarah Luheshi** (PPI) chaired the Roundtable.

Presentation prior to discussion

Lauren Wilkinson (Senior Policy Researcher, PPI) presented the key findings from the research.

She explained that the research focused on three countries – the Netherlands, Canada and Denmark – which have implemented CDC schemes in a way that can lend useful insights into how CDC could be implemented in the UK.

Lauren highlighted the challenges of designing valuation and benefit adjustment in CDC schemes, particularly in regards to perceived fairness, and highlighted that UK CDC legislation appears to have learned lessons from other countries which have seen issues of fairness arise from the use of buffers and capital reserves.

She then spoke about the sustainability of schemes in the UK, and particularly how the voluntary nature of UK schemes could pose a potential threat, especially if issues of perceived fairness or economic downturn cause people to opt-out. She highlighted that levels of trust in CDC schemes have been observed to fall internationally following periods of benefit reduction. However, there is an evidence gap in terms of how this might manifest within the UK pension landscape in which membership is voluntary.

Finally, Lauren gave a list of potential areas for future research:

- The impact of voluntary membership on CDC scheme sustainability
- How to determine contribution rates at the right level
- How flexible employee contribution rates could be converted into variable benefit entitlements
- The design of transfer rules and calculation of transfer values
- How to effectively approach member communication to manage expectations and build trust
- The scope for individualisation within CDC schemes.

Dr John Armstrong (Senior Lecturer in Financial Mathematics, Probability and Statistics, KCL) then spoke about a mathematical model that he had developed at KCL. The aim of the model is to further explore the question of individualization in a UK CDC scheme: whether it is possible to achieve both the risk sharing and longevity pooling benefits of CDC, with the equity risk-premium and personalization benefits of DC schemes.

He explained how the model scheme worked, which in broad terms, kept a separate account of each member's wealth, and then when a member died, distributed money to the survivors according to each survivor's life expectancy and the balance of their account. He explained the various possible outcomes that were modelled given different parameters and showed that the model demonstrated that a representative member would be better off in a collective fund with choice, than in several other non-collective or constant income CDC options. John also demonstrated that the model did not require a large number of members, and that any issues with scheme size are down to management costs rather than a need for a large number of similar members. He also mentioned that further benefits might be possible by creating an internal insurance market within such a scheme, where members could choose to exchange mutually beneficial insurance contracts.

Panel Discussion and Q&A

The following points were raised in the discussion. The session was held under Chatham House Rule and the views expressed do not necessarily reflect the views of the Pensions Policy Institute or the panelists (Lauren Wilkinson and John Armstrong).

- **Differences in international CDC schemes compared to a UK equivalent:** Further differences between international examples of CDC and a UK equivalent were highlighted. For example:
    - Many international CDC schemes are converted from existing DB schemes. This meant that issues arose for these international examples of having reserving requirements, and their members expecting the schemes to provide the exact same benefits as the old schemes, and later being disappointed to find out that they did not.
    - In contrast, UK CDC schemes would start from scratch, and have to attract members and build funds.
- **Fairness in CDC schemes:** points were raised both about sources of potential unfairness, and potential definitions of unfairness. For example, it was highlighted that without something like the underwriting process in annuities, low-earners could end up cross subsidizing high earners, and the extent to which this could be replicated in a CDC model

was discussed. The point was also made that multiple definitions of fairness exist, and that different definitions appeal to different stakeholders.

- **Further research avenues:**
  - Decumulation-only models: the three countries in this research (the Netherlands, Canada, and Denmark) did not provide examples of decumulation-only CDC models, although this is being explored in Germany, and may be the basis of future research.
  - Multi-employer CDC: currently, the current UK example of CDC, at the Royal Mail, differs from potential future schemes in that it is a single employer, and therefore has a more predictable cash flow. Multi-employer schemes in the future would have more volatile cash flows and be more vulnerable to individual choice.
  - Transferring out: there is an evidence gap in terms of the effects and nature of people transferring out of future schemes; they are neither comparable to international CDC examples nor DB transfers.
  - Individualisation: there are many ways to allow freedom in CDC schemes, such as in terms of contribution rates and investment strategies. The research could address the potential benefits to savers with different levels of flexibility, as well as the practical considerations of whether it is beneficial to offer full flexibility, and how to ensure good outcomes to savers that do not engage with their pension and follow the default strategy.

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