PENSIONS POLICY INSTITUTE

PPI

# Cardano and PPI Policy Seminar: The Dutch Experience of CDC pensions and lessons for the UK

Cardano and the Pensions Policy Institute (PPI) held a round-table seminar on the 17th December 2014. Leading Dutch experts presented and participated in a discussion with representatives of the UK pension industry and policy experts. The round-table was held to help facilitate discussion about CDC in the UK and to learn from the practical experience from the Netherlands.

The main points discussed at this round-table were:

1) Risk sharing in funded pension systems.
2) CDCs versus Individual DC schemes.
3) Strengths, weaknesses and trends from the Dutch experience.

**Discussion:**
**Mel Duffield, PPI Deputy Director** presented the details of the PPI modelling. The main points raised were:

- The PPI is developing a new CDC model to test different design features (e.g. funding gates, investment strategies, DC counterfactuals)
- The model is a hybrid of the Dutch system and the New Brunswick experience.
- Further work will be carried out to refine the model.

**Marcel Lever, CPB** presented the details of risk sharing in funded pension schemes. The main points raised were:

- Various reasons were given as to why DB schemes are no longer feasible and where collective DC contracts and individual DC contracts have risen to prominence.
- Theoretically, it is optimal to spread risk over the current and future generations. It was raised by a round-table participant that it may not work in the UK, as collective schemes will be voluntary. Also, it was raised that if younger people know they are risk sharing with the older generations, would this be attractive to them? Another point was that it may encourage people to undertake arbitrage and move between worse performing schemes to higher performing schemes. In response to this, it was mentioned that, as employers make the choices for employees, inertia may prevent this.
- A smoothing window of 10 years (this is where any reduction in the pension amount is spread over a 10 year period) is used in the current Dutch system. It was suggested by a participant why a longer smoothing window, such as 100 years, is not used and the response was that it would be less desirable for younger people. Also, if the economic assumptions were wrong, it will have bigger effect, whereas with a 10 year smoothing period, the effect is reduced.

- In Holland, there has been some distrust with CDCs as it is less transparent for an individual to work out his or her individual property rights.
- A welfare gain of 1% can be achieved with an open scheme (risk sharing scheme) compared to a closed scheme.

**Kees Bouwman, Cardano** presented the details of collective versus individual DC. The main points raised were:
- It is hard to find comparisons of IDC and CDC on a like for like basis.
- A method was presented on how to best compare CDC and IDC in a like for like basis. This was achieved by attempting to match the financial risk exposure of the two as closely as possible.
- The conclusion was that it is possible to replicate a Dutch CDC solution with a 10 year return smoothing using a very specific investment lifecycle in IDC.
- In the Netherlands there is not a clear link between contribution made and pension paid. This makes it difficult to allow transfers out of schemes as it is hard to value their individual pension amount.
- Collectively implemented schemes where the individuals' property rights are transparent and protected would be the preferable approach for CDC.

**Dr Roel Mehlkopf, Tilburg University and Netspar** presented the details of the strengths, weaknesses and trends from the Dutch experience. The main points raised were:
- There has been a reduction in the nominal funding rate in the Netherlands due to demographic changes and withdrawal of sponsors.
- There are high rates of contributions, but this is not sufficient enough to stabilise the funding rate.
- This has led to pension cuts (for some funds) in 2013 and, when the nominal funding rate reached around 100%, the conditional indexation virtually removed. The graph on the cuts to pensions does not show how many pensions didn't have any cuts, and there was some discussion as to what proportion this was.
- A solution was shown that would allow people to have their own IDC and then slowly purchase a collective variable annuity as they grow older. This allows the older population to be in a collective, preventing the conflict between the younger and older groups. This idea was compared to purchasing a deferred annuity.
- The idea of younger people changing jobs more often was brought up by participants during the discussion and this idea was seen as a better option for younger people as they can easily transfer their pension pots, compared to a CDC, if they changed jobs.
- Another idea that was put forward during the discussion is that younger people would not want to purchase an annuity style product at such a young age; this prevents them having to do so.