

HEALTH WEALTH CAREER

STRENGTH IN NUMBERS

COLLECTIVE DEFINED CONTRIBUTION PENSION SCHEMES

13 DECEMBER 2018

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AGENDA

1

THE CONCEPT OF
COLLECTIVE DC

2

OPPORTUNITIES PRESENTED
BY COLLECTIVE DC

3

RISKS OF COLLECTIVE DC

4

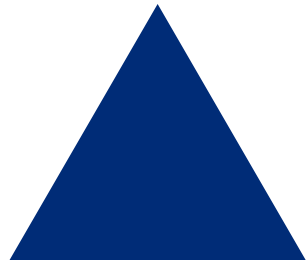
VIEWS, PERSPECTIVES
AND QUESTIONS

STRAW POLL





Workers in the UK generally want an income for life in retirement, rather than a 'pension pot'.



THE CONCEPT OF CDC



TYPES OF PENSION SCHEME

		DEFINED BENEFIT	DEFINED CONTRIBUTION
BENEFITS AT RETIREMENT		Defined	Not defined
COST INPUTS		Not Defined	Defined
INVESTMENTS		Single pot	Pot allocated to each member
FUNDING AND INVESTMENT RISKS		Borne by employer	Each member bears own risk

WHAT IS COLLECTIVE DC?

DEFINED CONTRIBUTION

- *Member and employer costs are fixed*
- *Therefore no benefit guarantees apply*



WHAT IS COLLECTIVE DC?

DEFINED CONTRIBUTION

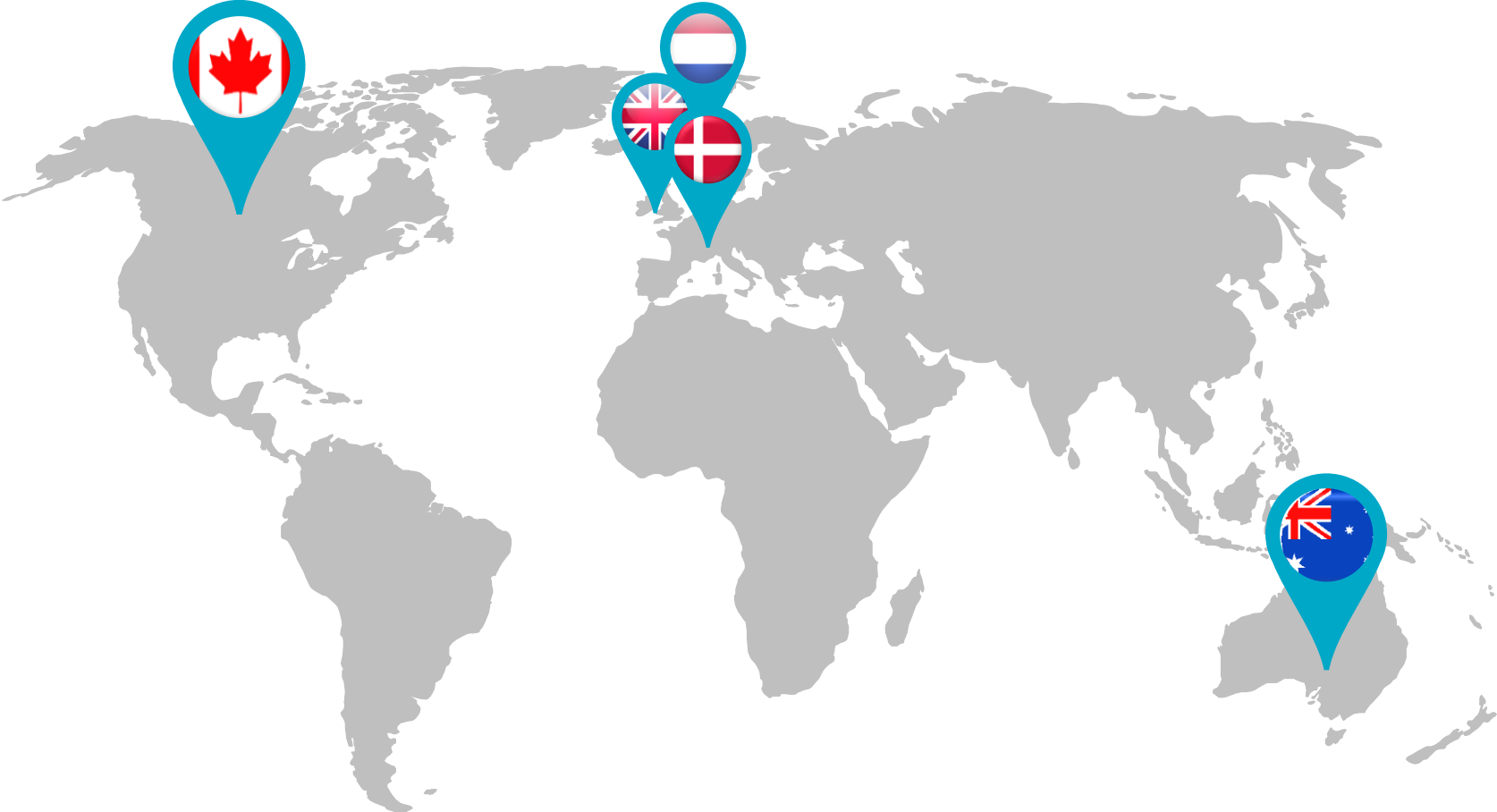
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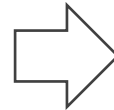
COLLECTIVE:

- *No individual accounts held*
- *Members collectively share the risks (longevity, inflation, investment etc.)*
- *This allows benefits to be targeted*
- *Funding shortfalls addressed by reducing target benefits*

COLLECTIVE DC AROUND THE WORLD



EXAMPLE OF HOW CDC COULD WORK



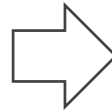
Estimated cost of £4,000 per year Target Pension at age 65 : £19,000

Estimated cost pf target 2% pa increases to age 65: £12,000

Estimated cost of 2% pa increases after age 65: £9,000

Total estimated capital required for target benefit: £40,000

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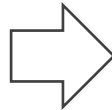
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NOW LET'S ASSUME PLAN HAS A 10% SHORTFALL AND THEREFORE HAS ONLY £36,000 FOR THIS MEMBER

EXAMPLE OF HOW CDC COULD WORK

MEMBER AGED 40
HAS ACCRUED
TARGET PENSION
OF £4,000 PER
YEAR FROM AGE 65

TARGET INFLATION
PROTECTION
@2%PRE AND
POST-RETIREMENT



BENEFIT REDUCTION OPTIONS

Option 1.
Reduce target pension by 10% to £3,600.

Option 2
Reduce Target inflation protection pre and post retirement from 2.0% pa to 1.7% pa.

Option 3
Reduce Target inflation protection post retirement to 1.2% p.a.

POOLING OF RISK

CDC's pooling of risk both within and across different generations gives valuable opportunities to improve the certainty and sustainability of outcomes

The diagram features a large graphic on the left consisting of three concentric circles in shades of blue and teal. A semi-transparent rectangular box is overlaid on the middle circle, containing the text. To the right of this graphic is a large, thick, magenta arrow pointing towards two circles. The top circle is pink and contains the text 'Pooled longevity experience'. The bottom circle is teal and contains the text 'Pooled investment experience'.

**Pooled
longevity
experience**

**Pooled
investment
experience**

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**Pooled
longevity
experience**

**Pooled
investment
experience**

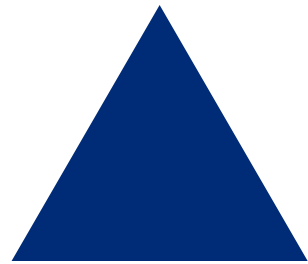
- Reduce the impact of financial 'shocks' on individual members
- Improve scope for benefits to be targeted
- Improve scope for trustees to adopt increased financial risk

STRAW POLL

Employers are concerned that workers in DC schemes won't be able to afford to retire, either because of poor planning and/or poor investment experience



KEY FEATURES OF CDC ENVISAGED BY THE DWP



DWP CONSULTATION

TARGETED BENEFITS	POOLING OF RISKS	GOVERNED SOLUTIONS
<p>“A key principle of CDC schemes is that the benefit level offered can only ever be a target or an estimate...”</p>	<p>“The collective nature of a CDC scheme...should mean that the overall membership will enjoy an element of cushioning from volatility.....”</p>	<p>“Because the fund is administered and managed on a collective basis, there is also no need for members to make choices....”</p>
<p>CDC will be trust-based occupational pension schemes</p>		

DWP PROPOSALS

CONNECTED EMPLOYERS ONLY



- CDC will apply only to connected employers

Master trusts will not provide CDC schemes, at least initially



Existing Trustee knowledge and understanding rules apply

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ANNUAL ACTUARIAL VALUATIONS

Annual actuarial valuations required to test overall sustainability and whether benefit adjustments required



Best estimate funding assumptions



No financial buffer

No reliance on ongoing contributions built into funding strategy



Anticipate gradual maturation of liabilities in funding strategy

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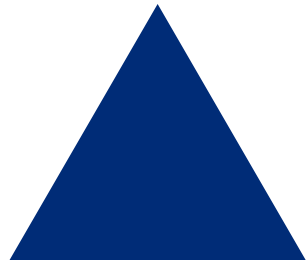
NO DECUMULATION-ONLY CDC

CDC must apply for both accumulation and decumulation



Transfers in by active members only

OPPORTUNITIES PRESENTED BY CDC



MAKING DC OUTCOMES MORE PREDICTABLE

HERE IS A RANGE OF OUTCOMES FROM A CONVENTIONAL DC PLAN ASSUMING A 14% CONTRIBUTION RATE PAYABLE BETWEEN AGE 20 AND AGE 65.



Statistics are based on Mercer's capital market assumptions as at 30 June 2017 and on 4,000 simulations

What this is telling us:

For each default investment strategy, the bottom 25% of default members are expected to attain a fund value of under £300,000 while the top 25% are expected to attain a fund value of over £600,000.

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CDC could target benefits closer to the median outcome – about £500,000. This would compress the range of outcomes and make pension saving more predictable.

BACK-TESTING

Member A

Active: 1968 to 1998 paying 10% p.a.

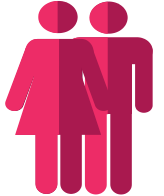
£259,439 fund size at age 65 in 1998



Member B

Active: 1970 to 2000 paying 10% p.a.

£326,286 fund size at age 65 in 2000



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Retires and with draws 6% p.a. of fund value at age 65, increasing at 2.5% per year

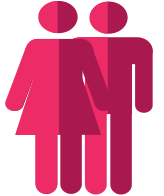


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Initial annual pension in 1998

£482,000

Total amount withdrawn to 31st December 2017

£271,999

Fund size remaining at 31st December 2017



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Member B

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£326,286 fund size at age 65 in 2000

Retires and with draws 6% p.a. of fund value at age 65, increasing at 2.5% per year

£19,577

Initial annual pension in 2000

£512,400

Total amount withdrawn to 31st December 2017

£62,300

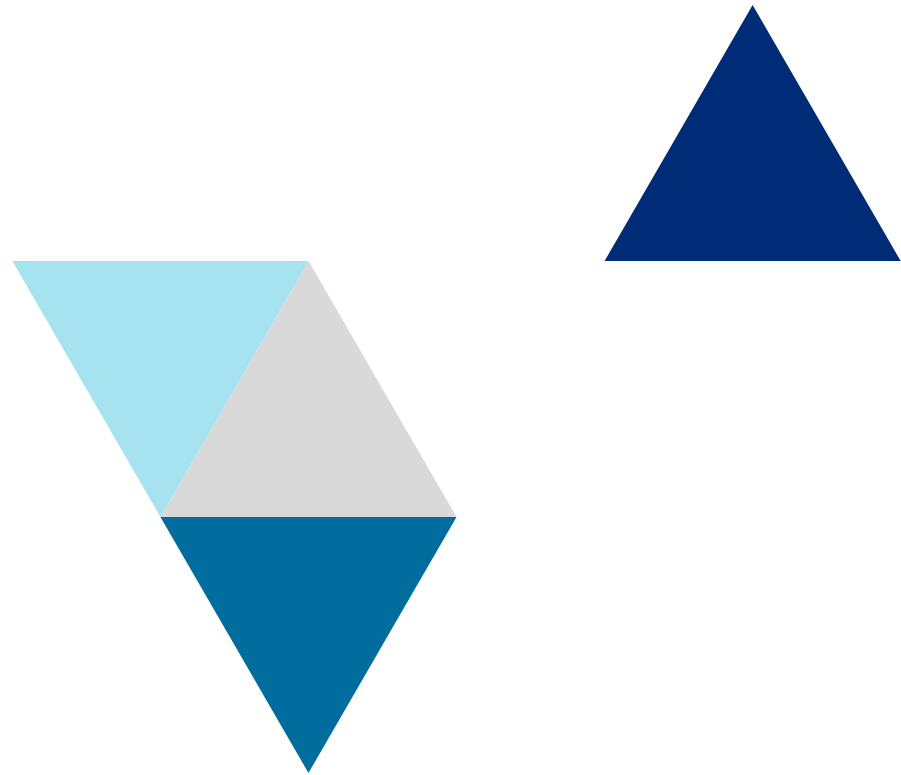
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STRAW POLL

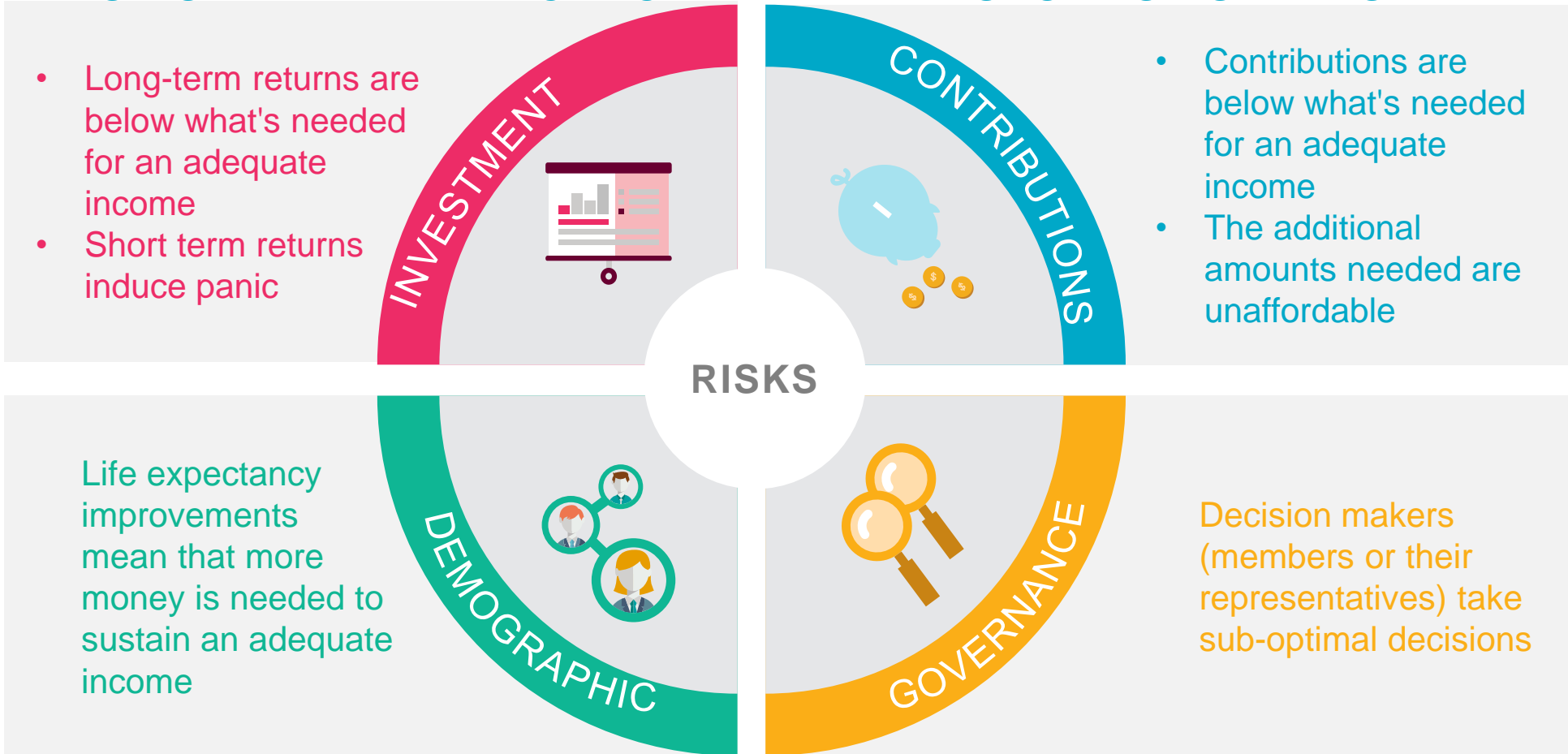
Workers are willing to risk giving up some upside potential in order to have a more predictable retirement experience.



RISKS OF CDC



RISKS THAT IMPACT ON ALL PENSION SYSTEMS



CDC, LIKE ALL FORMS OF FUNDED PENSION PROVISION, IS EXPOSED TO THESE RISKS. THE QUESTION IS WHETHER IT CAN MANAGE THEM MORE EFFECTIVELY?

CDC RISK PERSPECTIVES

POINT

Workers won't trust a system of pension provision that could reduce their expected or actual benefits in payment.

COUNTERPOINT

DC is so exposed to reductions that most members don't have any expectations.

Views on CDC is generally based not only on beliefs about *'What works'* but also on beliefs about *'What's fair'*.

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POINT	COUNTERPOINT
Workers won't trust a system of pension provision that could reduce their expected or actual benefits in payment.	DC is so exposed to reductions that most members don't have any expectations.
Members of CDC won't be able to participate fully in the DC pension freedoms.	CDC savers can transfer out at retirement to a conventional DC arrangement and then enjoy the freedoms.

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Employers are wary that government will impose additional financial obligations on them if CDC becomes distressed.	The DWP proposes making it clear that there will be no recourse to employers for additional contributions.
Workers aren't demanding CDC	Workers in DC schemes are struggling to afford to retire, putting strain on employers.

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STRAW POLL

There is a major loss of faith in the UK in the feasibility of collective pension systems such as DB, with-profits and the State Pension Scheme.

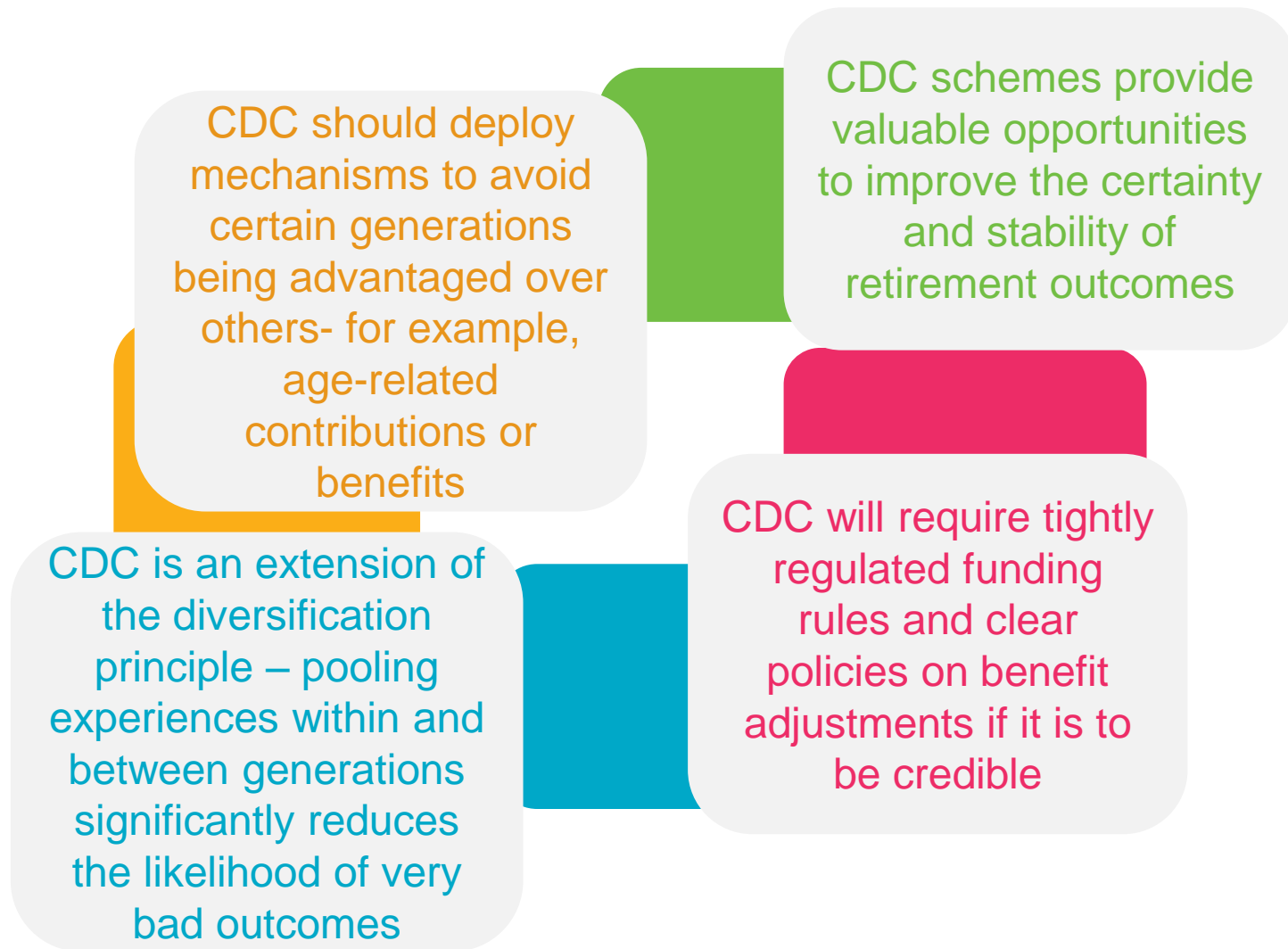


STRAW POLL

Employers that have already switched from DB to DC are unlikely to adopt CDC in the medium term, even if a number of high profile employers did so.



MERCER VIEW OF CDC



STRAW POLL

I have faith in CDC's ability to deliver improved outcomes for members



MAKE



**TOMORROW,
TODAY**

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