



## **FAIR, SUFFICIENT AND SUSTAINABLE: COLLECTIVE DEFINED CONTRIBUTION (CDC) PENSIONS**

Dr Con Keating, Chairman, The Bond Commission of the European Federation of Financial Analysts Societies

Webinar

Wed, 25 August 2021, 16:00 BST

# A Word From Today's Chairman



**Professor Michael Mainelli**

Executive Chairman

Z/Yen Group



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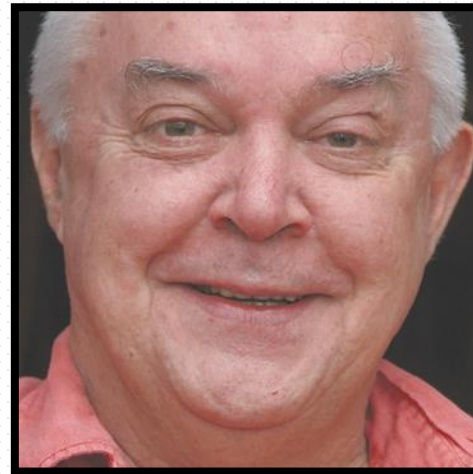
# Today's Agenda



- 16:00 – 16:05 Chairman's Introduction
- 16:05 – 16:25 Keynote Presentation – Dr Con Keating
- 16:25 – 16:45 Question & Answer



# Today's Speaker



**Dr Con Keating**

Chairman

The Bond Commission of the European Federation of Financial Analysts Societies

# Collective Defined Contribution Pensions

Con Keating

August 2021

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# Poll

Are you a fan of Collective Defined Contribution Pensions?

- Yes
- No
- Unsure

## What is a CDC scheme?

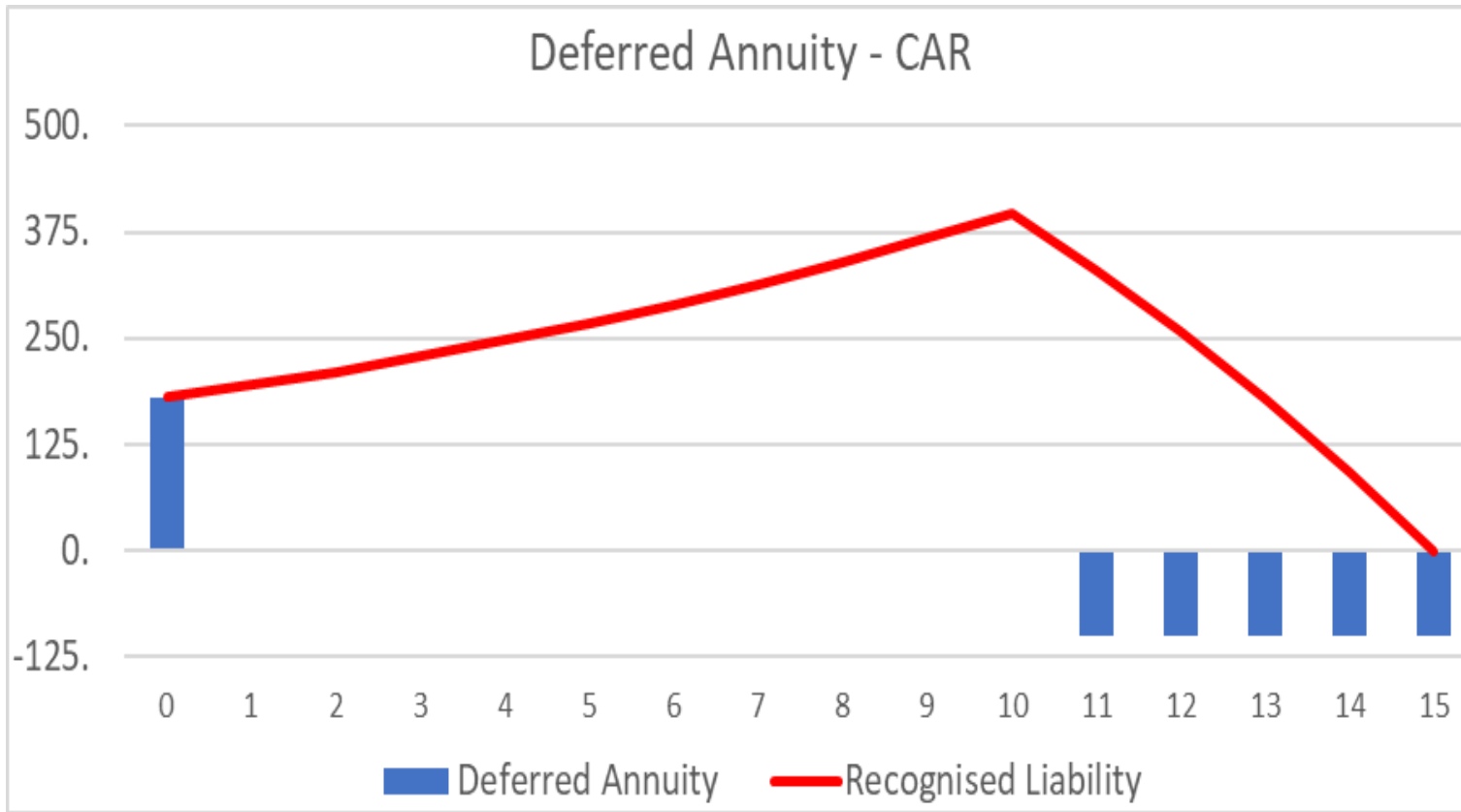
- Pension – an income in retirement
- Individual DC is a tax-advantaged savings scheme
- It lacks decumulation or pension arrangements
- It lacks any/all risk-pooling and risk-sharing arrangements
- Defined benefit – is a pension.
- Has sponsor guarantees -These guarantees are costly
- CDC is collective and offers pensions as aspirations
- Not guaranteed – has only its own resources
- PSA 2021 permits single/connected employer offering
- Multi-employer and much more should follow
- Designs seek to minimise frequency and magnitude of cuts to pensions in payment



## Risk-Pooling and Risk-Sharing

- As a collective, there is pooling of longevity risk
- Well-known from Life Insurance.
- Pooling of investment horizon – overlapping generations
- Scheme life greater than individual lives
- Results in greater risk tolerance and total investment income
- Risk-sharing – mutual insurance in contribution allocation
- Risk-sharing – smoothing to avoid transient market volatility effects

- Fairness – Equity among members
  - Leads to some simple rules
  - Cuts when applied equal for all
  - Cuts to be immediate to the current position or for all future
  - No intermediate term – though Regulations admit this
  - No use of new contributions to subsidise prior deficits
  - Or distribute surpluses
  - Distinguish transient from trend (signal from noise)
- 
- Contractual Accrual Rate – Discount Rates

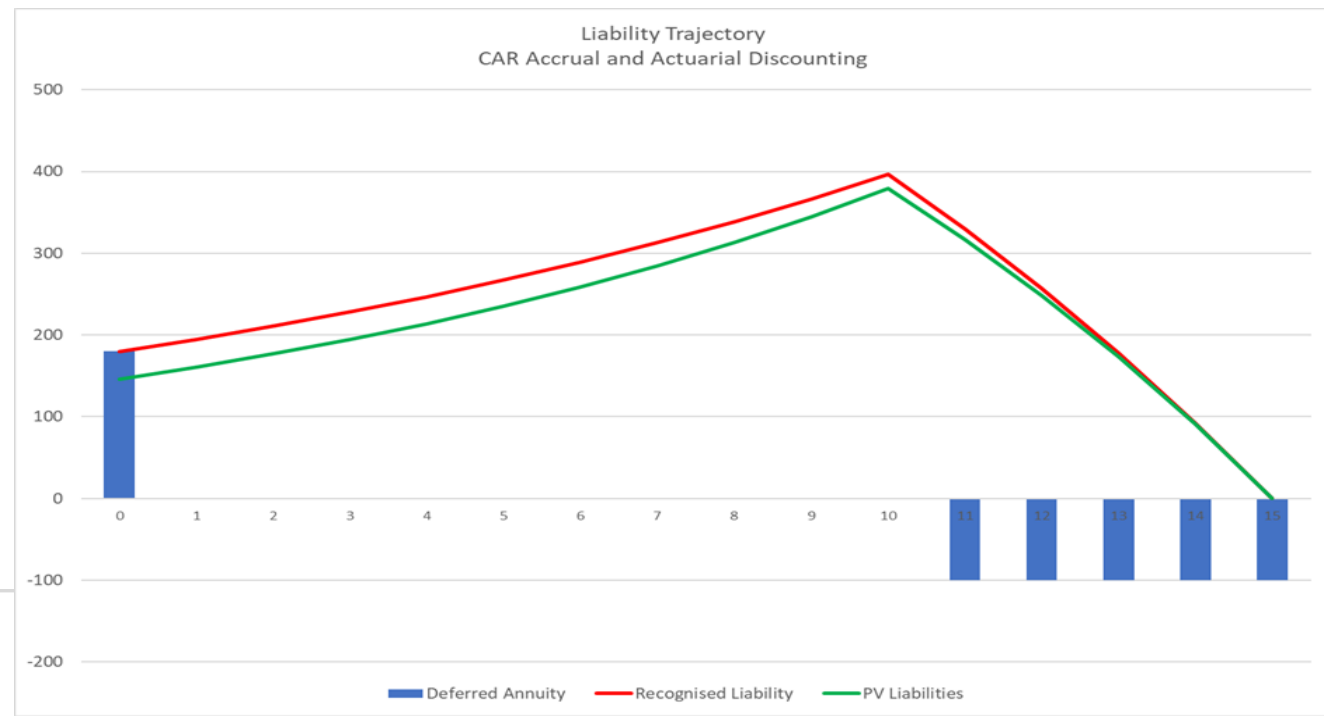


CAR – Contractual Accrual Rate

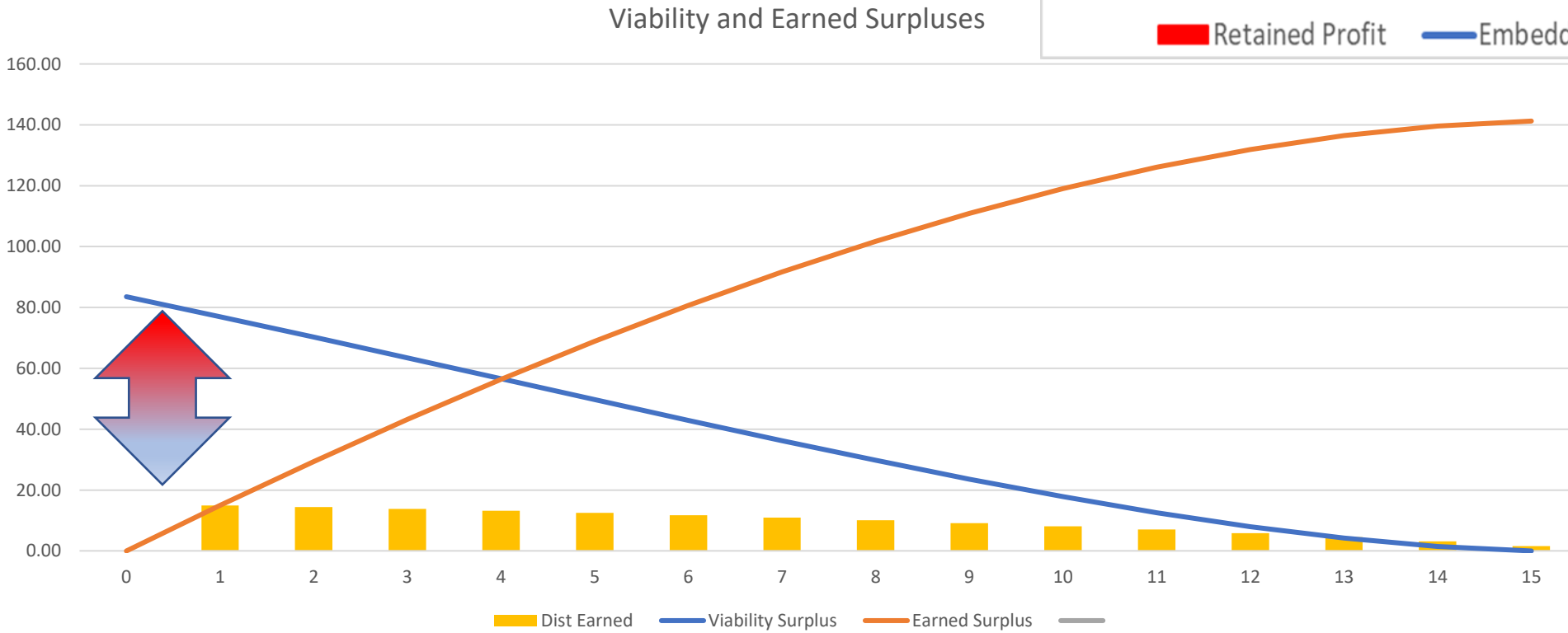
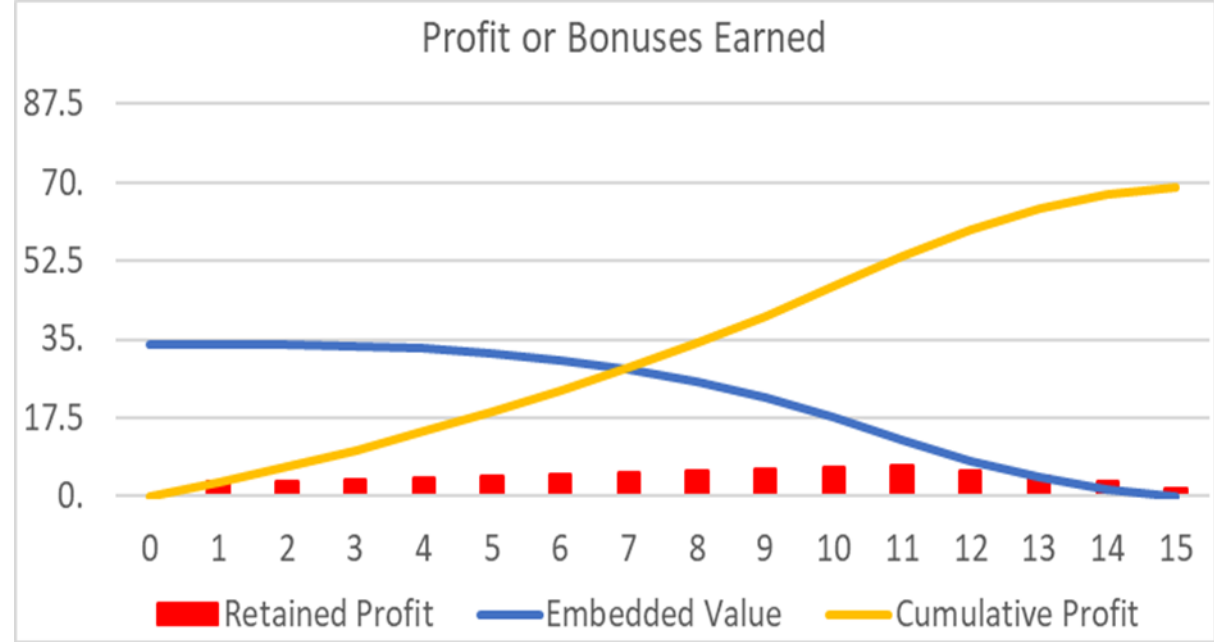
- A ten-year deferred five-year fixed annuity of £100 pa - Premium £180
- CAR is 8.23% pa
- Results in the liability trajectory shown

## CAR Cont.

- Introduce an asset offering 10% pa
- Discounting at this rate – pv £146
- But profit not earned
- This is an embedded value

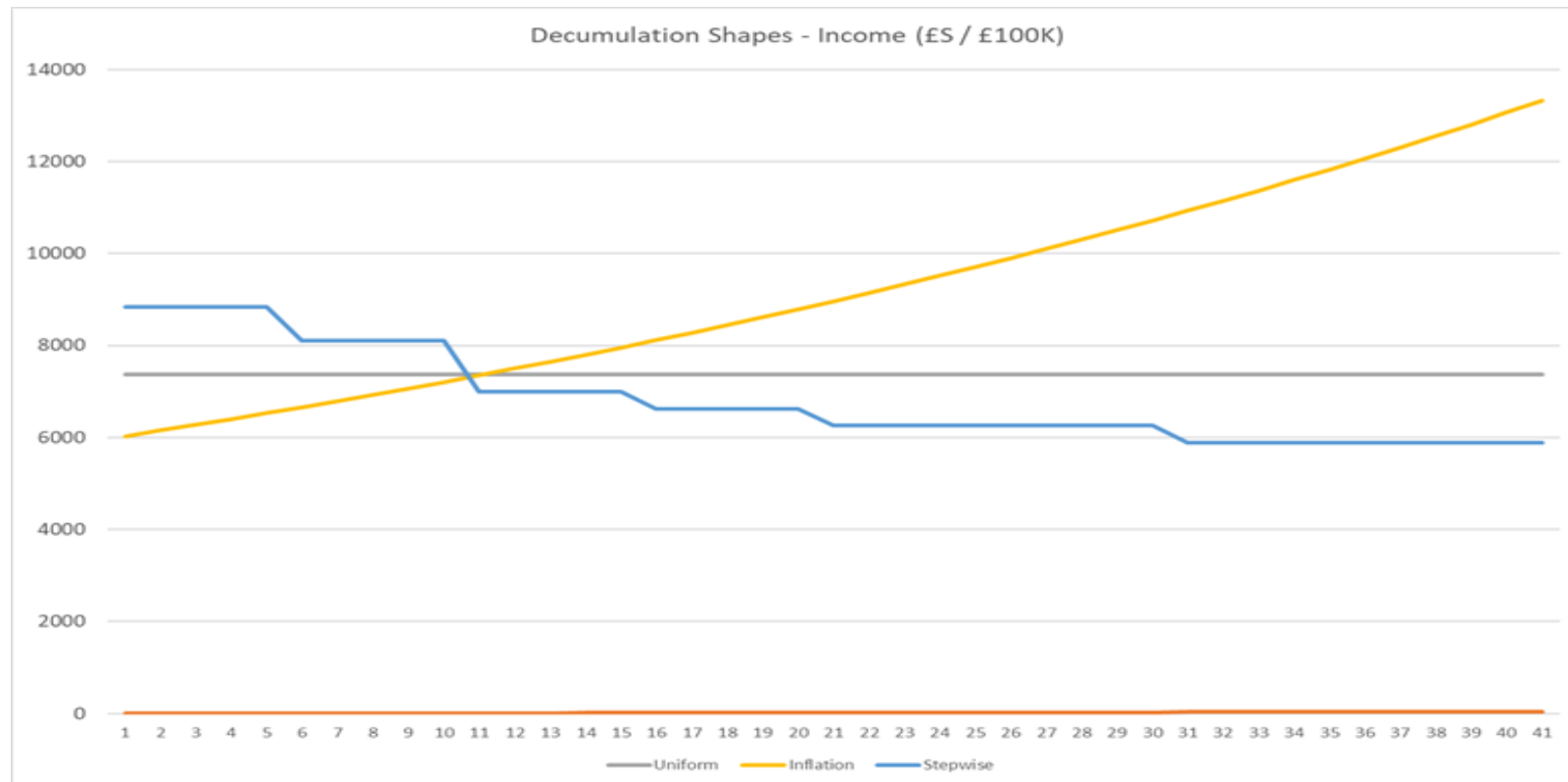


- Diagram shows evolution of embedded value
- Realised profit
- And cumulative profit



# Decumulation

- Membership is heterogenous
- So, flexibility in retirement income patterns is desirable





## Contributions

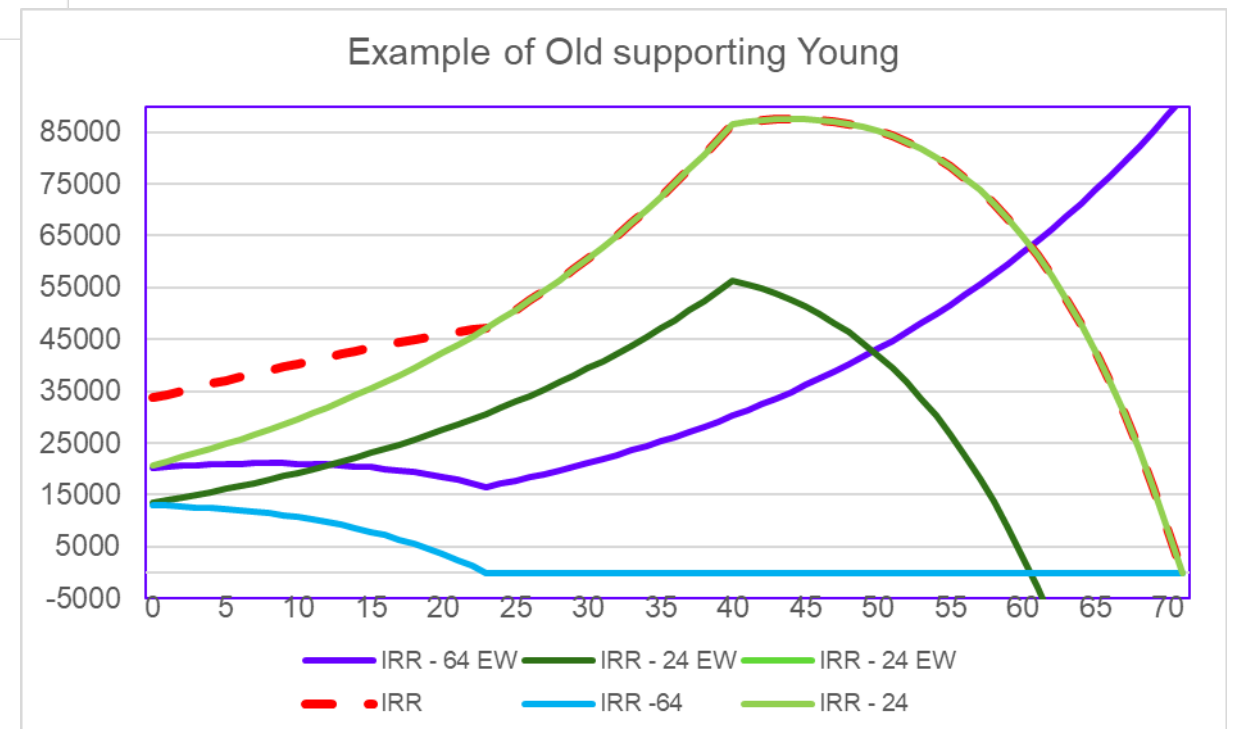
Contribution of 15% salary allocated DB style – at high required CARs young support old

At low required CARs old support young  
Mutual insurance

What happens if we allocate IDC style?

Older get rich

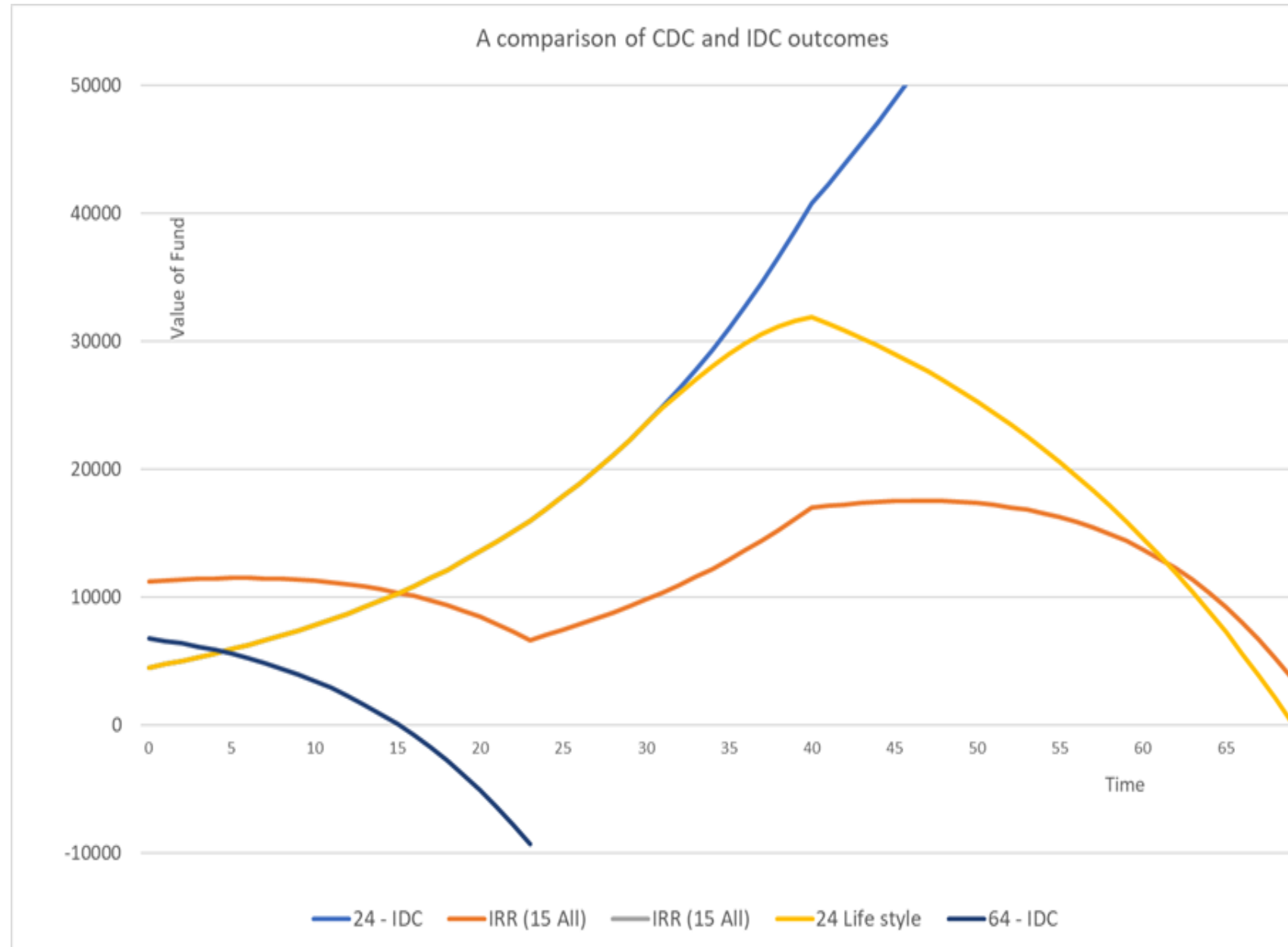
Younger fail to get full pension





## outcomes

- IDC versus CDC
- All earn scheme return
- Old lose some
- Young get rich
- But if the young life-style
- Young do not receive their full pension.



## Risk-sharing Rules

- These are a form of fair smoothing
- Can help to reduce transient volatility and sequencing risk
- It is the actives and deferreds who support pensioners when scheme is in deficit
- Two rules: If scheme is in deficit (on car basis) – set time for recovery –  $1/\text{deficit}$  in years
- Set maximum amount (10% of active/deferred beneficial interest)
- When a pension is paid in full in deficit, the beneficial interest of actives/deferreds are increased
- Rebalances beneficial interests and maintains fairness.

## Valuation

- Regulations require an annual viability valuation
- This is forward looking and relies on the expected return on assets as its discount rate for projected benefits
- If in deficit cuts to benefits must be made
- This needs to be complemented by consideration of the status quo
- Has the scheme progressed to date in accordance with the promises made?
- This valuation compares assets held with the accrued value of projected benefits
- Calculated using the CAR
- This is where risk-sharing rules would apply
- In simulation, cuts occur less than 0.5% of the time
- And are small, limited to less than 5% of current pension.

## Poll 2

Do you believe that CDC pensions will become an important part of private pension provision?

- Yes
- No
- Unsure

# Thank You

Collective Defined Contribution Pensions: An Overview - <https://bit.ly/2WiNYJ3>

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# Thank You For Listening



## Forthcoming Events

- Thu, 26 Aug (09:00-09:45) Sandboxes? Where's The Software?
- Tue, 07 Sep (10:00-10:45) Assessing Extraordinary Claims: Actuarial Science And The Search For Truth
- Wed, 08 Sep (15:00-15:45) The Code Of Capital: How The Law Creates Wealth And Inequality
- Wed, 15 Sep (15:00-15:45) Deforestation-Linked Sovereign Bonds – A Nature-Based Solution?

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