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Adding shareholder value through pensions

Collective Defined Contribution

Not fit for purpose?

March 2014

Agenda

- Osborne has ruined the debate!
- Certainty for employers
- Planning by employees
- Economies of scale
- Better outcomes from investment strategy
- Overview

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Certainty for Employers

- Key benefit – just like DC from an employer perspective – fixed cash / no residual risk
- CDC has a formula benefit thus employers are at risk from:
  - Capricious Government rule changes (UK pensions)
  - Adverse legal rulings – expectation into promise (KPMG)
  - Union / HR relations pressure (Dutch pensions)
- In Holland the formula benefit is fixed (although can be varied) with the annual contribution changing from time to time as cost of one year of formula benefit changes
  - Not the same fixed profile as DC (can be designed away)

Planning by Employees

- Key benefit – just like DB from an employee perspective – initial pension is known / accurately estimated
- Only initial pension can be estimated and only close to retirement:
  - Increases are discretionary / possibility of deductions
- Uncertainty pre-retirement (DC) replaced by uncertainty post-retirement (CDC)
  - What will your pension be in 15 years time?
    - What will you do at age 80 to mitigate a loss of purchasing power in your pension?
  - PME – since 2007 real value of benefits down by 20% -
    - 5% reduction in 2013 and only one indexation increase
  - KPMG – 50 years of RPI / zero since 1999

Economies of Scale

- Economies of scale can be achieved with any structure (DC, CDC, DB etc)
- Moving on……

Better Outcomes from Investment Strategy

- More equities (e.g. backing pensioner liabilities partially with equities) and no annuities
  - Higher *expected* returns
  - **But** higher risk!
- How does the risk fall across generations?
  - Will we get “clumping” such that rather than (say) having to skip one indexation payment every 10 years we end up having to miss a decade of indexation once every 100 years?
    - KPMG – 50 years of RPI / nothing since 1999
    - PME – 36 years of CPI / 5% cut, one indexation since 2007
  - Is it fair? One particular cohort of members will take the bulk of the pain whilst lots of other cohorts will do exceedingly well

Overview

- CDC is an old idea (KPMG 1949, PME 1971) with known issues
  - In Holland moving towards DC rather than CDC
- CDC proposed benefits do not stack up
- CDC should, of course, be allowed for those employers who want it
  - **But** do any employers want this?
- CDC is unlikely to be popular and rehashing old ideas is unlikely to provide the solution to the UK pension problem
- Osborne has changed the landscape anyway!

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