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CENTER FOR RETIREMENT INITIATIVES

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Securing a Reliable Income in Retirement: An Examination of the Benefits and Challenges of Pooled Funding and Risk-Sharing in Collective Defined Contribution (CDC) Plans

New CRI Policy Report

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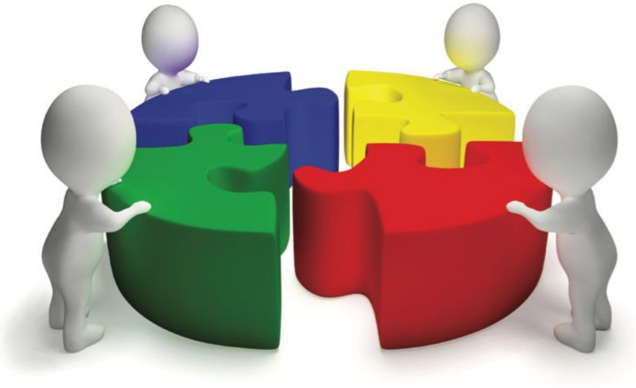
Securing a Reliable Income in Retirement

An Examination of the Benefits and Challenges of Pooled Funding and Risk-Sharing in Collective Defined Contribution (CDC) Plans

Charles E.F. Millard • David Pitt-Watson
Angela M. Antonelli



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CENTER FOR RETIREMENT INITIATIVES

Our Panel:

- **Bradford Campbell,** Partner, Faegre Drinker Biddle & Reath LLP, and former Assistant Secretary, Employee Benefits Security Administration, U.S. Department of Labor
- **Alwin Oerlemans,** Head of Product Management, APG Asset Management, the Netherlands
- **David Pitt-Watson,** Visiting Fellow, Cambridge University's Judge Business School, United Kingdom
- **Terry Pullinger,** Deputy Secretary General (Postal), Communication Workers Union, United Kingdom

Moderator:

- **Charles E.F. Millard**, former Director, Pension Benefit Guaranty Corporation and Senior Advisor, Amundi Asset Management

Introduction:

- **Angela M. Antonelli**, Research Professor and Executive Director, Georgetown University's Center for Retirement Initiatives

David Pitt-Watson

Royal Society for Arts

and

Visiting Fellow

Cambridge University’s Judge Business School

United Kingdom

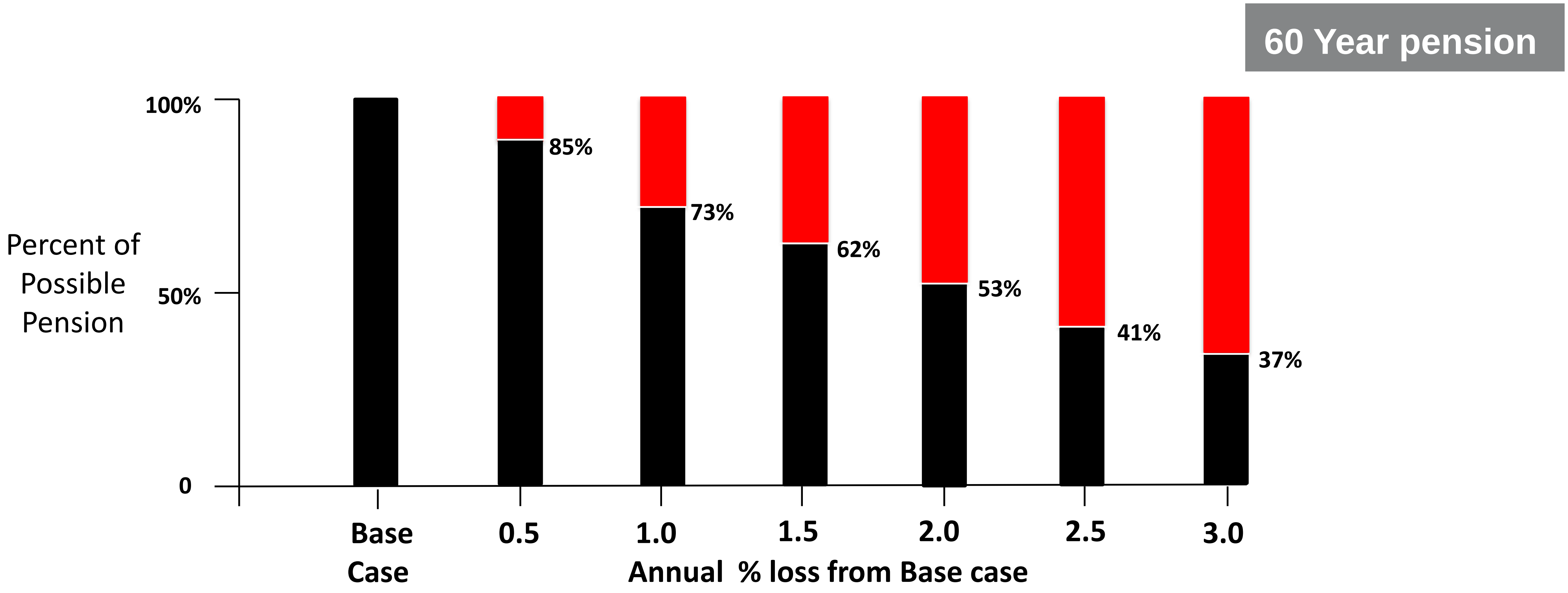
The Benefits of Pooled Pensions

The Logic, the Evidence and the Opportunity

The World's Best Pension Systems Are Characterised by Effective Systems of Pooling

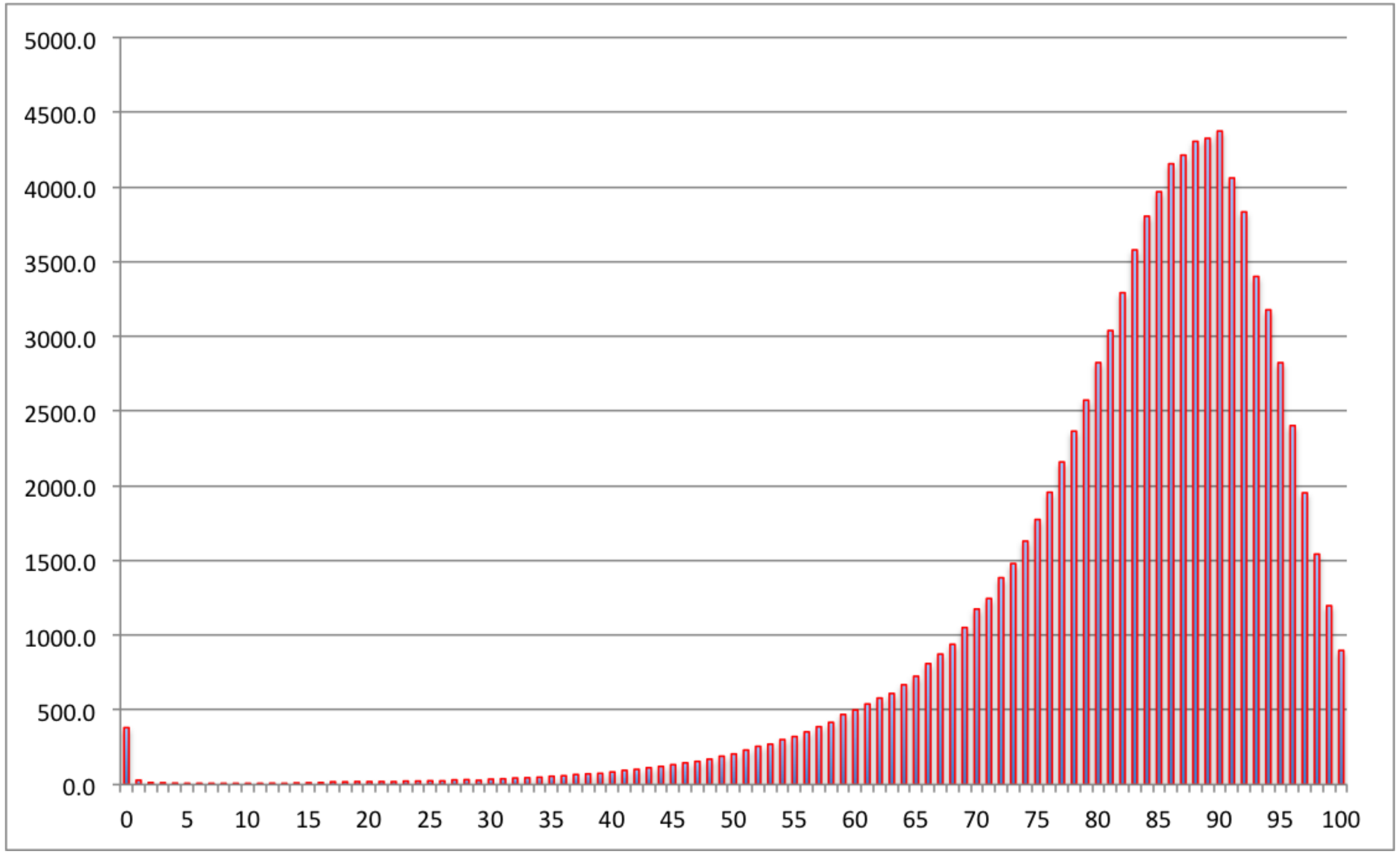
- "I want an income which will last from the time I retire until the time I die' (RSA Citizen Juries)
- That is the aim of the world's best pension systems
- They all use pooling because:-
  1. It allow a sharing of longevity risk
  2. It facilitates professional management—low cost risk adjusted returns
  3. It creates long term pools of capital
  4. It mitigates timing risk
- These advantages make a big difference to outcomes
  - Failure to use pooling results in a huge drop in productivity

Small Annual Differences Have a Big Impact
Loss to pension-in-payment of higher charge or loss of return



'I know not the day of my death' Genesis 27.2

Expected age of death per 100,000 females (UK 2010-12)



Studies of Pooled Pensions

Study	Comparison made/methodology	Key Variables	Upside
Almeida and Fornia	DB vs DC for same expected lifetime income	Longevity risk Investment portfolio	**85%**
UK Government Actuary	DC+Annuity vs CDC Various scenarios, Monte Carlo Simulation	Investment portfolio	**39%**
Royal Society of Arts (RSA)	DC+Annuity vs CDC Simple cost modelling	Costs	**37%**
AON Hewitt (+RSA)	DC+Annuity vs CDC Modelling on historic returns 1930-Present	Historic returns	**33%**
Pension Policy Institute	DC+Annuity vs CDC Modelling expected returns	Investment returns	**Over 40%**
Willis Towers Watson	DB vs CDC Typical asset allocations and returns c2020	Investment returns	**40%**
	DC+Annuity vs CDC returns c2020	Investment returns	**70%**

What are the Problems of (non-DB) Pooling?

- Participants bear all the risk. So as in all DC, benefits can vary. (Though variance is manageable)
- So communication critical
- All design features and judgements need to be fair between generations
- Skilled, accountable, <u>trustee</u> governance is vital

Options for Introducing CDC

- Single employer ‘whole life’
- Multi employer ‘whole life’
- For ‘decumulation’ of DC (401K) savings (Queensland)
- Using two ‘pots’ (TIAA CREF)
- With or without some externally guaranteed elements
- **Each has its own pluses and minuses, and needs appropriate oversight**

Implications

- For very obvious reasons the world's best pension systems use pooling to create a lifetime retirement income
- But the traditional pooled DB system is being abandoned. Annuities are expensive
- Need to think through how we introduce a more effective and productive system which offers
  - A good return
  - A low cost way to share longevity risk
- The benefits of doing so are vast, now and for future generations
  - More than 30% uplift

Alwin Oerlemans

Head of Product Management

APG Asset Management

the Netherlands

Overview of Dutch Pension System

Fourth Pillar: Home & personal accounts	≈ 60% Home ownership	
Third Pillar: Individual (10%)	Voluntary pension products	Particularly relevant for self-employed
Second Pillar: Occupational Pensions (40%)	**Mandatory via employer (collective labour agreement)** **Funded: €1,691 billion (216% GDP); ≈ 200 funds** **Earnings-related pension schemes** **Pension funds governed by social partners**	New pension contract New contribution methodology Include self-employed in future UFR discount rate (≈ 0.5%)
First Pillar: State Pensions (AOW) (50%)	Mandatory (not means-tested) Pay-as-you-go financing Retirement age 66y 4m (2021), 67y (2024) Flat rate: €1,293 (single) or €1,767 (couple) / month	Increasingly financed by taxes Retirement age increases with longevity

Towards better pension outcomes

	1950s	1990s	2000s	2010s	2020s
Governance	Basic design 1st and 2nd pillar pension system in the Netherlands	Industry wide pension funds open up to the world	Consolidation pension fund sector (1000 > 500) New solvency rules and more regulation Switch from final pay DB to career average DB with conditional indexation **Start of Collective Defined Contribution (CDC)**	Consolidation continues (500 > 200) Strong focus on governance pension funds New IORP e.g. Premium Pension Institution (DC) and General Pension Funds (APF) **CDC 2nd wave (after credit crises)**	3rd stage consolidation PensionTech **Implementation new pension contract**
Investments	Fixed income portfolios (some real estate)	Investment restrictions lifted allowing global diversification	Diversification to alternative investments Responsible Investing In some cases de-risking in CDC funds Use of derivatives for hedging	Real assets Responsible Investing to the next level Lifecycle investing in DC Focus on investment costs	**Personalization of pensions** 

Terry Pullinger

Deputy General Secretary, Postal Communication Workers Union

My Motivation

- Responsible for c120,000 Postal Workers
- To protect one of the greatest inventions in our social history and still relevant – the postal service
- To protect the employment, standard of living and retirement security of postal workers

History of Pension Revision

- Defined Benefit (DB) Final Salary Scheme Closed to New Entrants in 2008
- 2008 Defined Contribution (DC) Scheme Opens for New Entrants
- 2018 DB Scheme Closes to Future Accrual
- Defined Benefit Cash Lump Sum Scheme Put in Place Until the New CDC/DB Opens

“If necessity is the mother of invention, then adversity must surely be the father of reinvention”

Reasons for Change

- Royal Mail were paying 17.1% of pensionable salaries contribution to the DB Scheme and it would have had to rise to over 50% from 2018

- The cost to Royal Mail of the 17.1% contribution was £400m which would have risen to over £1bn

Solution Scope

- 40,000 in DC Scheme/80,000 in DB Scheme

CWU Priorities

- Wage in Retirement/Equality of Provision

Royal Mail and the CWU Agreed Principles

- Royal Mail and CWU are committed to providing the best possible pension arrangements for our staff
- The objective is to provide a “wage in retirement”, while avoiding the costs and volatility of insured annuity purchase
- To provide one pension scheme for all employees
- A plan which was simple for staff
- These objectives pointed to a CDC design. As this was not possible within the current legislative options, we agreed to jointly lobby Government to enable it

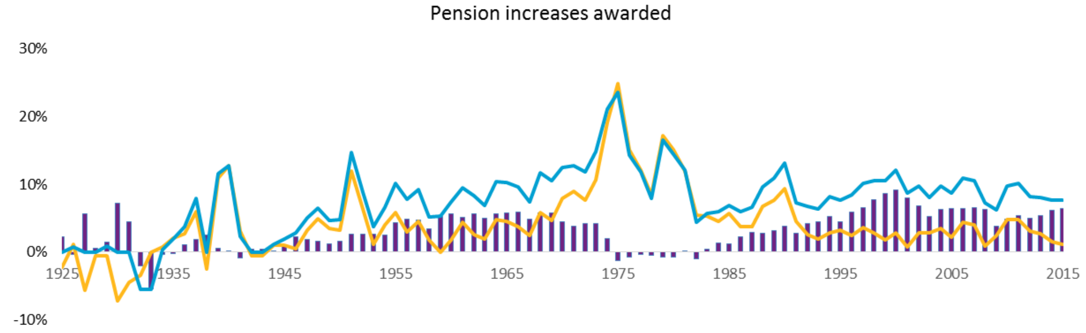
Overview of Our Intended Design
The New Collective Pension Arrangement

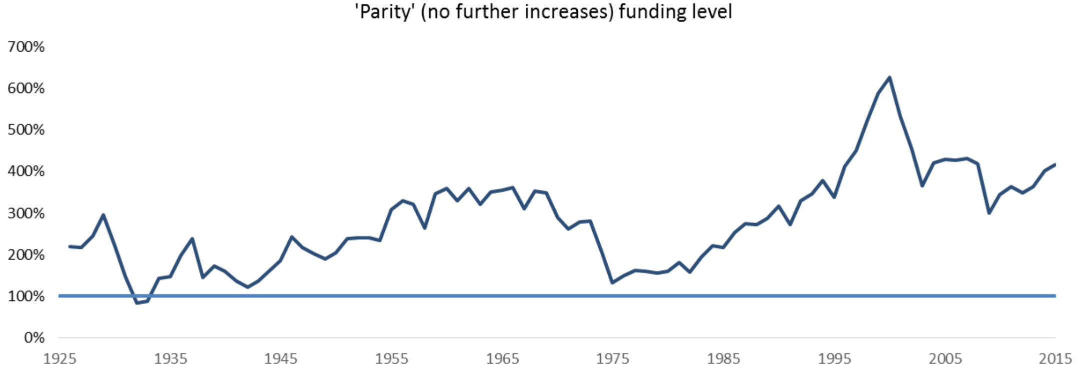
As we set out in the agreement we reached in February, our intended scheme design is as follows:

Royal Mail Collective Pension Plan	
Eligibility	12 months' service
Pensionable pay	Basic pay (actual) plus pensionable allowances and bonuses
Contributions - members	6% of pensionable pay
Contributions - employer	13.6% of pensionable pay
Pension Section - CDC	1/80th of pensionable pay, plus increases (minus any cuts)
Lump Sum Section – DB	3/80ths of pensionable pay, plus increases
Expected average increases	CPI + 1% pa (broadly equivalent to RPI)
Normal Retirement Age	67 (new State Pension Age)
Lump sum on death in service	4 x pensionable pay
Dependants pension	50% of member's CDC pension, plus increases (minus any cuts)
Ill-health benefit (outside registered plan)	50% of pensionable pay, less State benefits, payable for up to 3 years, plus a lump sum at the end of the 3 years.

CWU The communications union Royal Mail Group

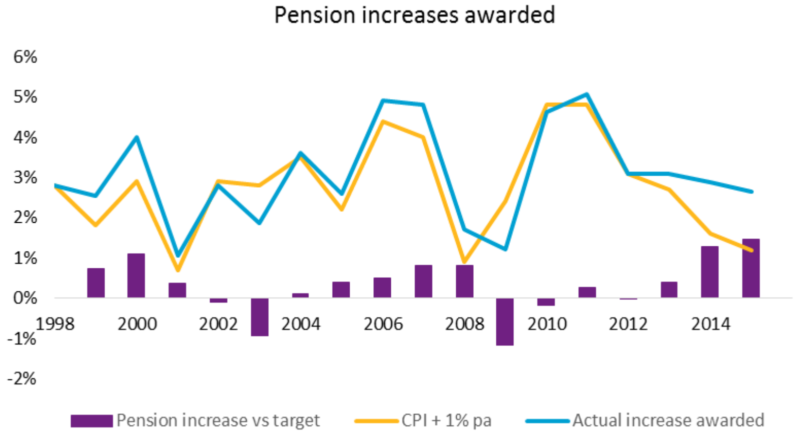
Back Testing of Increases





Plan starts 1925 – **key results:**

- Average investment return since 1925: 10.8% pa (= CPI +7.6% pa)
- Pension cuts: two during Great Depression; 5.5% in 1932 and 1933
- Average pension increase: 7.5% pa (=CPI +4.2% pa)



Plan starts 1998 – key results:

- Average investment return since 1998: 8.3% pa (= CPI +6.5% pa)
- Pension cuts: none
- Average pension increase: 3.1% pa (=CPI +1.3% pa)

Analysis Provided by Willis Towers Watson

UK Government & Legislation Process

- 2012 Department of Work & Pensions Paper – Reinvigorating Workplace Pensions
- 2015 Pension Bill – cleared the path for ‘collective benefits’ beyond DB
- 2021 January Pensions Bill (enabling the introduction of CDC) cleared through Parliament
- 2021 February it became law via Royal Assent
- Regulations come into force later part of this year or early next year

Bradford Campbell

Partner

Faegre Drinker Biddle & Reath LLP

and

Former Assistant Secretary

Employee Benefits Security Administration

U.S. Department of Labor

QUESTIONS?

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