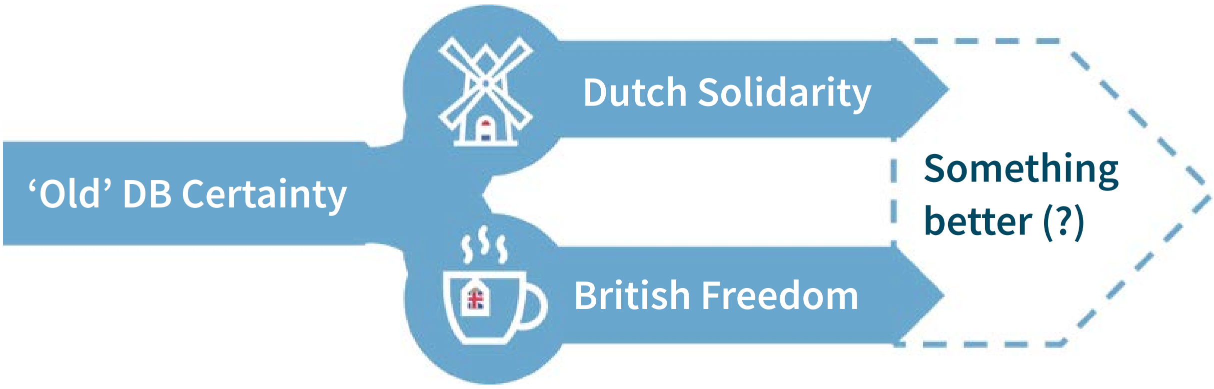
RETIREMENT ON A DC PENSION

SIMILARITIES, DIFFERENCES, AND IMPROVEMENTS IN NL AND UK

BY **GIJS CREMERS** AND **HANNAH ENGLISH**



Both in The Netherlands and the UK, workplace pensions have been transitioning from Defined Benefit (DB) schemes, towards Defined Contribution (DC) schemes. As a result, members of a scheme will directly bear the risk regarding their income after retirement. The way the transition from DB to DC is handled in both countries varies. The Dutch pension system attempts to mitigate some of the risk to members, using a collective 'solidarity' system, whereas the British pension system allows members to make more flexible individual choices.

We have investigated the Dutch and British DC workplace pension system looking for similarities, differences and improvements. This article provides a summary of a research paper on the decumulation phase of DC pensions. Another research paper regarding the accumulation phase will be published soon.

DUTCH AND UK SYSTEMS AT A GLANCE

Both in the UK and in The Netherlands, pensions are moving from DB to DC systems. Currently, most pension schemes in The Netherlands are either a DB scheme or a collective defined benefit (Dutch CDC) scheme. In both schemes, the accrued pension rights form the basis for premium/contribution and investment policies. New legislation in the Netherlands means many existing DB rights will instantly be transformed into DC capital sums. In the UK a trend in moving from DB scheme contributions to DC scheme contributions has been increasing significantly over the past 10 – 15 years.

In the UK there are many options for participants at retirement, including purchasing a fixed annuity, drawdown, taking a lumpsum (25% tax free) or keep saving. In the accumulation phase this means lifecycles are more tailored towards individuals. For example, interest rate hedging varies for individuals targeting buying an annuity versus taking a lumpsum.

The Dutch system uses individual DC capitals that are collectively managed. Choice at retirement is limited to either a fixed or flexible annuity combined with the option of a small (10%) taxable lumpsum. Default lifecycles in The Netherlands are therefore much more focused on one single retirement choice (for example a fixed annuity) with lower cash allocation and a designated interest rate risk hedge. In the accumulation phase lifecycles need to be 'tailored to the >

UK System	Dutch System
+ Individual freedom to use a part of the pension capital to reduce one's mortgage, cover health expenses, etc. + Capital after death still belongs to participant (falls to estate) - Micro longevity risk: if you live longer than expected, members may run out of money - Investment risk is not shared over multiple years or generations, resulting in (theoretical) lower allocation to risky assets	+ Sharing longevity risk and spreading investment risk means less fluctuations in pension payments - Buffer capital may be required to facilitate risk sharing - After death, remaining capital does not belong to individuals' estate - Limited individual choice with respect to investment mix and retirement options

collective' meaning that studies amongst participants with respect to risk attitude are required.

Both the Dutch system and the UK system have their benefits and drawbacks.

THE WISDOM OF COMPROMISE?

Whereas the UK system may suffer from a lack of risk sharing, the Dutch system strongly limits individual choice. A possible improvement in the UK is to introduce an element of pooling of risk amongst individuals. Currently, pooled solutions are being investigated in the UK. Making a pooling product available to members in retirement will provide members in the UK with an option to invest some (or all) of their pension savings in a product that provides protection against longevity and investment risks. An important consideration will be how assets are transitioned from an individual pot to a pooled 'collective' and when or how frequently this should occur. Introducing this as an option to sit alongside un-pooled solutions would allow members to continue to access some the flexibilities that are currently present in the UK system.

Similarly, introducing an option to split the pension pot may benefit the Dutch system. An extra degree of choice (for instance increasing the lumpsum possibility to more than 10%) or a partial drawdown will give members more options to tailor their pension to their personal situation. A key issue is that members would need to make an advised choice as to what option (or combination of options) is best for their situation. In The Netherlands, by law there is a certain degree of obligation to inform members about the choices they have. The more choices they have, the more difficult it will be to enable members to make the right choices. Education is needed to support members to make the right choices.

A combination of Dutch Solidarity and British Freedom, where members can split the pension capital into a collective part (with risk sharing) and individual part (flexible individual choices) could present an optimal range of options to members in retirement. <

GIJS CREMERS is partner at Sprenkels, Amsterdam.

HANNAH ENGLISH is Senior Consultant at Hymans Robertson in London.