There have been many changes across Europe in recent years when it concerns the pensions landscape, but one subject has been particularly rearing its head to bellow its importance.

"It is," says Denton partner, Carolyn Saunders, "the emphasis on the importance of decumulation and recognising that it is as important as accumulation. It's knowing that people cannot be left unsupported when they're making complex decisions."

Talking about and working with the decumulation phases has been a subject taken up by both Amundi and PensionsEurope in reports released in December and October last year. PensionsEurope, in particular, looked at the issue in its *Good Decumulation of Defined Contribution Pension Plans Throughout Europe*, saying that increasing longevity and the cutting back of first-pillar pension provision on the continent was putting increasing weight on DC schemes when it came to the decumulation phase. It is up to these schemes, wrote PensionsEurope, to "provide appropriate solutions".

DECUMULATION

Drawing the future

A look at developments in the decumulation markets across Europe and potential future strategies for decumulation that countries could adopt

WRITTEN BY **PETE CARVILL,** A FREELANCE JOURNALIST

"In DC pension schemes," wrote Amundi in *Optimal Decumulation Strategies for Retirement Solutions*, following up on the subject, "there is no guarantee of pension payments after retirement, so it is important to develop appropriate decumulation strategies to efficiently convert wealth into income."

All of this comes within the general trend across Europe as country after country has moved from DB to DC provision.

"Europe is moving more in the direction," says PensionEurope secretary general, Matti Leppälä, "of DC and individual risk-taking. This means that the decumulation phase is becoming more challenging. We published a paper on this where we recognised the problem and said that the next biggest study will be around the decumulation phase and the challenges it represents."

He adds: "The emphasis has been on the accumulation period; we generally haven't thought about the decumulation process and what the options are."

A heterogenous Europe

The picture is also staggeringly different across Europe, with decumulation being various and varying mixes of people taking out lump sums or opting for annuities. Countries like Germany, Italy, and Spain have strong DB markets, with pensions largely being the remit of governments. Consequently, the DC sector in these nations is relatively underdeveloped. And weaker DC sectors mean that few people can be persuaded into buying an annuity as their pots of saved money are relatively low. Just one or two per cent of people in Italy opt for annuities, with the rest taking a sum from their pots.

Perhaps the biggest transition currently being undertaken is in the Netherlands, which is phasing its DB landscape into a DC one. Whatever happens in this relatively small nation will have huge ripples across the rest of the continent, as the country currently holds pensions assets worth 213 per cent of its GDP (the second-highest in Europe after Denmark at 233 per cent).

The new Dutch pension system is complicated, but aside from the switch to DC, a number of other measures are being put in place. These include the introduction of three new types of DC scheme (a solidarity contribution scheme, a flexible contribution scheme, and a contribution-capital scheme that is only for pension insurers), flat-rate contributions, the lowering of a minimum age to enter the pension scheme from 21 to 18, the removal of the tax limitation on pension accruals (although it remains on the contributions), the treatment of net pensions almost equal to pensionable salary, and the requirement for transition plans.

That is a lot, but not all: The new act, introduced last year, also allows for partner pensions to be brought into line with current market practice.

"In the Netherlands," McKinsey senior partner, Cristina Catania, says "they have sizeable tax advantages: Contributions are deductible from current taxable income and both returns and capital are tax free. Moreover, from 2000, the government made mandatory for workers in many sectors the participation in a collective pension fund with the introduction of the Act on Obligatory Participation in an Occupational Pension Fund."

She went on: "At country-level, we observe an uneven level of maturity of the decumulation pension market. For example, the Dutch and Danish markets seem to be more mature (and less attractive for pension scheme providers) than the Italian or Irish markets. In fact, while in the first two countries the pillar II and III assets represent over 150 per cent of GDP (151 per cent and 192 per cent respectively) in Italy and Ireland the same ratio does not reach 30 per cent (11 per cent in Italy and 27 in Ireland)."

CDC schemes

One development in recent years has been that of collective defined contribution (CDC) schemes. In 2022, WTW outlined three main benefits of a CDC scheme. The first was that contributions are fixed, resulting in a more-sustainable system. The second was the expectation of higher levels of pension for a given contribution. Lastly, the firm said that the schemes are set up to do what a pension is typically expected to do – provide an income for life in retirement.

"The typical setup with DC schemes," says the company's senior director, Valentina Rocchi, "is to go for an annuity from the scheme or the insurer, along with some kind of lump sum. What's been coming out in the market – and what we haven't seen much of in the UK – are CDC plans, where there's a common, shared pool of assets from where the drawdown is paid out."

A CDC scheme is when both employers and employees pay into a collective fund. This will then pay an income in retirement but without the same guarantees of a DB scheme.

"Basically," says Saunders, "it is a DC scheme but the difference between the two is that a CDC will target a particular level of benefit, and contributions are calculated with that target in mind. If the scheme does well, the benefits can be increased above that target. And if they are doing less well, then they can be cut back. Nothing is guaranteed, but you hope that with the power in a large pool, you can beat the target with economies of scale."

Pensions Policy Institute policy analyst, John Upton, is more sceptical about CDCs: "There's a lot of hope that these will be a silver bullet," he says.

"WE GENERALLY HAVEN'T THOGHT ABOUT THE DECUMULATION PROCESS AND WHAT THE OPTIONS ARE"

"And there is a hope that they will replace the DB schemes that we can no longer afford, and it will stop pensions from being just a big pot of money where you have to make your own decisions about longevity versus a regular income for the rest of your life."

He goes on: "I think a lot of people pin a lot of expectations on CDC to replace DB with something that looks like it. It'll also remove a lot of these decisions from retirement. CDCs can also invest in riskier assets and possibly get more bang for the pension holder's buck."

The next few years are going to be interesting as Europe tries to contend with the fact that its populations are ageing. Shifts in the pension system will be one result of that.

"I think there's going to be a compromise," said Rocchi, "between annuities, duty-of-care protections, and total freedom. It'll be somewhere in the middle where there is some protection, but also freedom. That's where I see the market heading."

One question that remained unanswered is whether there is the political will to make tough decisions impacting on pensions. Certain aspects of pension provision, such as the UK's triple lock, are popular with voters and will be hard to abandon. For most parties in a fractured political landscape, it is likely that there will not be political capital or a determination to make such adjustments.