

# CDC: Beyond the headlines

A focus on intergenerational  
risk transfer



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Collective Defined Contribution (CDC) is in the spotlight following the government's publication of the multi-employer CDC regulations, with the first multi-employer CDC schemes potentially operating from early next year. Most of the commentary has focused on the headline benefits. But CDC schemes also come with challenges, in particular, intergenerational value transfer. In this article, we explore how thoughtful design could help to address this issue.

## Key takeaways



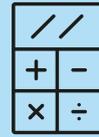
CDC schemes offer meaningful benefits, but these advantages come with trade-offs that must be recognised and managed.



Ignoring the 'time value of money' process when awarding pensions can create substantial intergenerational unfairness, in our view.



Benefit adjustments are unavoidable in CDC but how benefits are adjusted matters. Indexation-based adjustments transfer investment risk from older to younger members. This may compound intergenerational unfairness unless schemes explicitly compensate for it.



There are also other aspects of CDC that put younger members on the back foot. In principle fairness can be improved, by adjusting accrual rates, but appropriate adjustments are easier to make for some aspects than others.

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There are various advantages to CDC schemes. Through pooling of longevity risk, and adopting a higher return-seeking investment strategy, CDC seeks to offer a higher expected income for life than alternative approaches.

CDC may also simplify decision-making for members, removing the need for investment decisions in the accumulation phase, or drawdown decisions in the decumulation phase.

However, none of these benefits come for free. Longevity pooling compromises death benefits, higher expected returns come with greater uncertainty and simplified decisions inevitably impact individual flexibility.

In our view, another key concern with CDC schemes is that they may create intergenerational unfairness.

In this article we identify the key sources of intergenerational unfairness and explain how accrual rates—which in a multi-employer CDC scheme can be different between members—may be adjusted to deliver a fairer balance between younger and older members.

**How CDC schemes work**

CDC schemes share similarities with Defined Benefit (DB) schemes, but don't receive deficit contributions from sponsors. Unlike Dutch CDC schemes, UK CDC schemes do not operate with buffers; instead, target benefits are adjusted so that the present value of liabilities is recalibrated to equal the market value of assets at each valuation.

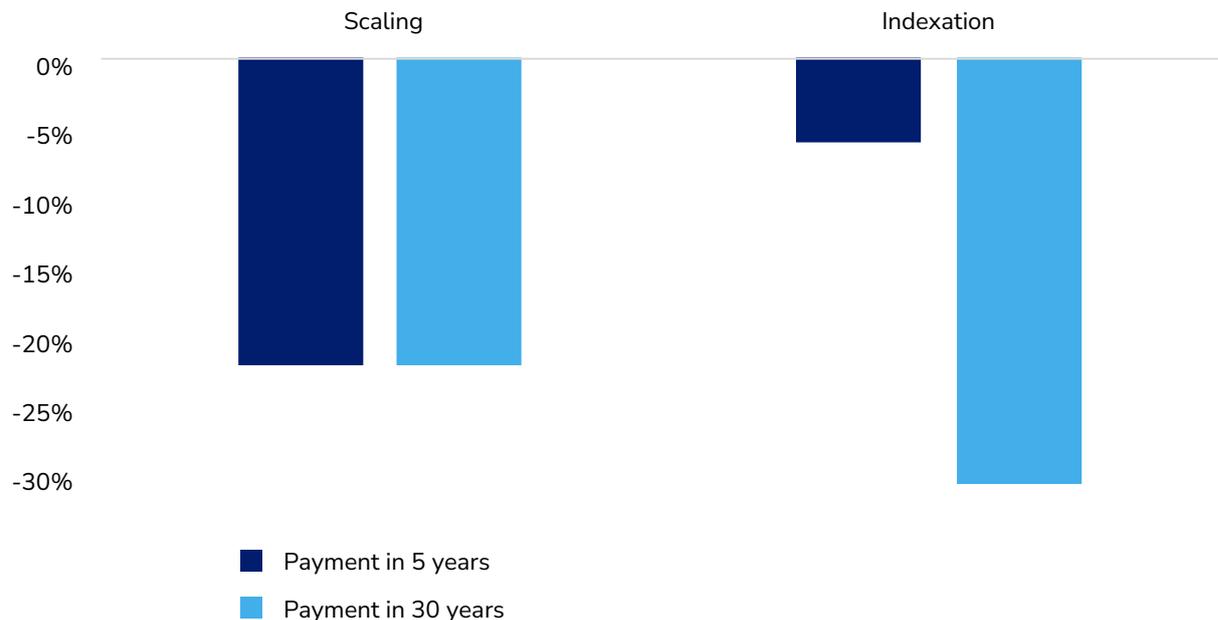
How benefits are adjusted matters. For example, if scheme assets fall by 18% relative to liabilities<sup>1</sup>, overall benefits must be reduced by the same proportion, but there are different ways this can be achieved. There are two main approaches.

**Scaling approach:** All expected benefits payments are cut by 18%, with no change to the indexation rate of the scheme (the rate pensions are increased each year).

**Indexation approach:** The rate of benefit increases (indexation) is reduced. For a scheme with a 20-year duration, reducing indexation from 3% to 2% per year results in an overall liability reduction of 18%. The impacts are much greater for longer-dated cashflows as you can see below.

1. Any fall in assets relative to best-estimate liabilities is permanent in expectation until benefits are adjusted. This is by construction. Benefit adjustments are also permanent in expectation.

**Impact on projected benefits**



Source: L&G calculations, as at January 2026.

**Assumptions, opinions, and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass**

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The indexation approach stabilises short-term payment levels, typically benefitting those near or at retirement, but increases the variability of long-term payments. In effect, this allows a scheme to de-risk older members (since their payments are relatively near-term) without using low-returning bonds or annuities. If the main risk constraint is that benefits are relatively stable once they become payable, this allows the scheme to invest more aggressively to increase expected outcomes without leverage. This is what underpins the oft-quoted expected uplifts of CDC versus DC.

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The chart illustrates the greater downside risk for younger members. They also have more upside risk, but it isn’t the case that ‘more downside is OK because there is more upside.’ If members are exposed to more investment risk, they ideally should be rewarded with a commensurately higher investment risk premium, in our view.

In practice we believe CDC schemes are likely to use a hybrid approach of scaling and indexation, because a very high or low indexation rate could be problematic<sup>1</sup>.

### Tackling potential unfairness

For the purposes of this article, we define fairness as follows: **Contributions equal the present value of expected benefits<sup>2</sup>, calculated using an appropriate risk-adjusted discount rate, at the time of contribution<sup>3</sup>.**

Other objectives, such as simplicity, can be balanced against fairness but shouldn’t be confused with it. Below we outline four potential sources of intergenerational unfairness and how they might be fixed by setting appropriate accrual rates that dictate how much expected pension is awarded for a given contribution. The first source is likely to matter the most in practice, but the other sources are material too. A key idea here is that there is no unfairness that — at least in principle — can’t be compensated for through changing accrual terms.



## 1. Time is money

Ignoring age when awarding expected pensions is 'unfair' mainly because it ignores the time value of money. Providing an expected pension from retirement is much cheaper for younger members, who must wait longer to receive it. As an example, if expected real returns are 5% pa then a 25-year-old should be awarded approximately seven times<sup>4</sup> as much expected pension for a given contribution than a 65-year-old, purely due to the time value of money.

The chart below, shows how flat accrual rates are generous to older members and miserly for younger members.

The solution is to allow for market-sensitive time value of money when awarding pension accrual. In other words, to achieve fairness accrual should depend on both age and market conditions. As we shall see next, however, this isn't quite the whole story.

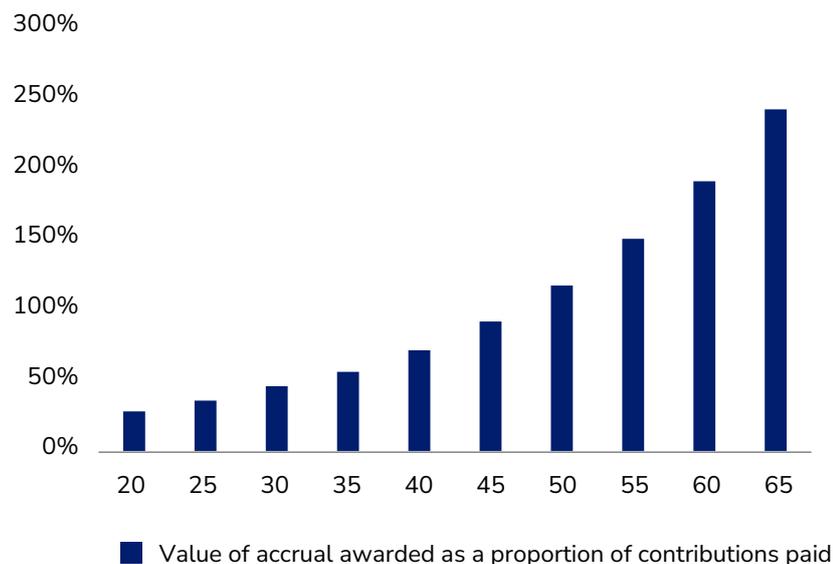
## 2. Investment risk transfer

CDC scheme regulations prescribe a best-estimate basis for the valuation of total scheme liabilities. That works for the whole scheme<sup>5</sup> but, for schemes that feature some indexation, is not ideal for individuals. This is because we ought to allow for both the expected level of target benefits and their risk.

To illustrate the importance of risk, suppose you disinvest £100 of your savings from bonds and put it into equity instead. The expected size of your investment in the future goes up. But to determine its present value, that expectation should be discounted at a higher rate to reflect the higher risk involved. After all, right now you still only have £100!

A higher discount rate should be used for younger members because their promises fall further into the future where – as explained earlier – investment risk has been transferred. The discount rate should therefore include a higher risk premium. In contrast, benefits due to be paid soon are stable so should be discounted at close to risk-free rates. This isn't just saying younger people's accrual should be cheaper (our first point) – it's saying it ought to be even cheaper than that.

### Flat accrual rates lead to less valuable accrual than contributions for young members



Source: L&G calculations, as at January 2026. Expected real return is 5% pa.

Assumes benefit adjustments are 100% scaling. Assumptions, opinions, and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

In practice the calculation of fair value is easiest using 'risk-neutral valuation' techniques<sup>6</sup> – the same techniques used to value derivatives and options with complicated payoff structures.

How much difference does this make? The answer depends on how much indexation is in the benefit-adjustment mechanism. No adjustment is needed for a pure scaling approach. For a pure indexation approach, our calculations indicate that a 25-year-old could justifiably receive around double the accrual versus an age-related best-estimate approach<sup>7</sup>. For a sensible hybrid approach suitable adjustments are smaller and could merit around a 10-20% uplift.

### 3. Perpetual motion

The way CDC schemes work is that the de-risking of members as they get older relies on there being younger members of the scheme to pass investment risk down to. However, this only works if younger members continue to join the scheme. If they don't, then a generation that had risk passed down to them doesn't get to do the same.

### 4. Assumption uncertainty

If longevity expectations or expected returns turn out to be underestimated, the impact falls disproportionately on younger members. Younger members are essentially selling a form of insurance against assumption uncertainty to older members. But in practice this is extremely hard to quantify and explain.

## Building trust for the future

We believe that CDC schemes have some attractive features, but their long-term success depends on thoughtful design that addresses intergenerational fairness. By clearly defining fairness and adjusting accrual rates to reflect differences in time value, risk and life expectancy, CDC schemes may

be able to maintain their benefits while minimising potential inequities between generations.

Although perfect fairness is unattainable, we believe balancing simplicity and equity is essential for building trust and sustainability.



1. A negative indexation rate would result in a falling pension. A very high indexation rate e.g. 10% pa would result in very 'back-end loaded' pension payments.
2. Note this is calculated ex-ante (before the outcome is known), not ex-post (after the fact). Fairness means that members receive benefits of equal value to their contributions, not necessarily that every transaction is neutral in hindsight. Pooling longevity risk, for example, results in those who live shorter subsidising those who live longer, but who these people are is only known after the fact.
3. A similar principle can apply to transfers in or out.
4.  $1.05^{(65-25)} = 7.04$
5. Assuming the scheme is perpetual.
6. Determining the real-world discount curve is tricky to do in practice. An alternative approach is neater computationally (albeit less intuitive) and involves first moving from a real-world probability measure to a risk-neutral one by stripping out the risk premium from stochastically simulated asset returns. Simulated payments across years are computed using these returns, given the benefit-adjustment approach. Finally, payments are discounted at risk-free rates, and the mean average is taken.
7. For a CDC scheme with duration of 20 years.

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### Key risk

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