

**Summary**

- The government has launched its consultation on whether CDC schemes should become commonplace in the UK pensions landscape.
- The Royal Mail Group is expected to be the first organisation to adopt a CDC scheme.
- Experts are divided on the merits of CDC pensions.

# Love it or hate it

## Jack Gray looks at the potential of CDC schemes in the UK and why they seem to evoke a love/hate industry response

The flavour of the month – collective defined contribution (CDC) pension schemes – seem to be provoking a Marmite-type reaction from those in the industry. Love them or hate them, CDC schemes are being touted as a middle ground between defined contribution and defined benefit scheme structures.

The government has expressed its support for CDC pension schemes, although it acknowledges the need for formal legislation before CDC can become a reality. A consultation was launched on 6 November to assess the logistics and next steps of implementing CDC schemes. Royal Mail working with its trade union, the Communication Workers Union (CWU), will likely be the first to offer a CDC pension plan to employees once its DB scheme closes, and legislation allows.

In a letter from the Minister for Pensions and Financial Inclusion, Guy Opperman to the Work and Pensions Committee on 4 September, Opperman outlined the government's plans: "Our current focus is on the constructive approach adopted by both Royal Mail and CWU. We are therefore concentrating on a framework that is appropriate to their needs.

"If, following consultation, it seems beneficial to lay foundations for a

CDC framework more widely, we will endeavour to ensure that any initial legislation can be adapted without unnecessary delay to address this at a future date, if the appetite is there."

So it seems as if the government likes Marmite. However, as with the famous spread, there are those who are not so keen. Hargreaves Lansdown senior analyst, Nathan Long explains: "In theory there's plenty to like about CDC pensions, however in practice their design makes them far better suited to working trends 30 years ago than today's modern, flexible working patterns."

### What is CDC?

CDC schemes are being promoted as a compromise between DB and DC, as they spread the risk between the employer and employee. Instead of workers paying into individual pots, everyone's money is pooled together, which can hedge the longevity risk. However, it still offers no retirement guarantees to those savers. Royal Society of Arts (RSA) fellow, David Pitt-Watson says: "CDC is a middle ground, offering a retirement income like DB, albeit without the guarantees that DB would offer. So private-sector employers can afford CDC."

CDC schemes can command lower admin fees through economies of

scale. They can also spread funds in their large pot across a broader spectrum of investments compared to individual DC schemes. Once the member reaches retirement, the scheme provider will calculate how much the scheme will pay out every month for that individual.

Royal Mail Group legal director, pensions and employee benefits, Richard Poole comments: "Such schemes can take a less conservative investment strategy in members' later years than individual DC schemes, allowing higher potential returns. They do not require members to purchase an annuity if they want to receive an income for life in retirement, and they can benefit from an overall reduction in costs."

According to research from RSA and Aon, comparing DC and CDC schemes, a collective pension would on average have outperformed an individual DC pension by 33 per cent in 37 of the past 57 years.

Aon senior partner, Kevin Wesbroom details why he believes CDC will be a great addition to the landscape: "CDC incomes will be a huge improvement for many members by offering a strategy that means they will not outlive their retirement savings – and conversely will not live too cautiously because of this fear – and who do not want to deal with the challenges of balancing investment returns with security and flexibility."

However, there are some obstacles in the way of CDC schemes becoming widespread. There have been concerns that there may be a lack of appetite amongst employers. As many have already made the switch from DB to DC schemes, why would they want to go back to



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shouldering more risk?

Furthermore, some argue that it will not solve the problem of people generally not saving enough into their pension pots and that CDC does not work with pension freedoms. Long argues: “CDC pensions do not dovetail well with pension freedoms and flexible working patterns, which is problematic as the pension freedoms have proved extremely popular.

“In the years ahead people will need control to dip into their pension, starting and stopping income to coincide with changes to working patterns. These are features that CDC pensions don’t seem easily able to incorporate.”

### Government consultation

The Department for Work and Pensions (DWP) has confirmed that further legislation will be needed to introduce CDC schemes into the UK pensions landscape. It has published a consultation paper that specified that all CDC schemes should be subject to a charge cap of 0.75 per cent and all CDC schemes will be required to engage in annual independent valuations. However, the DWP is unsure on the appropriate methodology for calculating cash-equivalent transfer values for CDC members before retirement, how best to communicate to members the risks and benefits of a CDC scheme, and how member benefits and the scheme funding position should be calculated and reported.

Poole says: “This is an important step forward in allowing us to offer a CDC scheme for our 141,000 employees as soon as possible. Meanwhile, we are

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continuing our work on the detailed CDC scheme design.”

### Abroad

CDC schemes are commonplace in a small number of other nations, including the Netherlands. In the RSA and Aon report, *Collective Pensions in the UK II*, they found that a typical young Dutch person is likely to get a pension fund that is at least 50 per cent higher than their equivalent British counterpart, which they argue is at least partially down to the use of CDC schemes.

The Netherlands also ranks top of the Melbourne Mercer Global Pension Index for 2018, while other nations that use CDC schemes, Denmark, Australia and Canada, rank in second, fourth and tenth respectively. The UK finished in fifteenth place, which suggests that we may have something to learn from the countries that have adopted CDC.

However, things may not be that simple, as Wesbroom explains: “The key lesson is to recognise the differences between these jurisdictions. In the

Netherlands and Canada, CDC schemes were used to replace existing DB pension rights. That will not be the case in the UK, where any existing rights would remain unchanged, and CDC will operate for future service benefits only.”

### Adoption

The RSA created a cross-industry forum on CDC before the government’s consultation, and suggested three areas that should be considered before CDC schemes could be introduced to the UK. It said that any government legislation needs to be ‘future-proofed’ so CDC sponsors can be confident that it will be consistently applied, that schemes will be governed by trustees acting for the benefit of members and that existing master-trust schemes should be adapted for CDC pensions.

Being the first organisation to express its commitment to a CDC scheme, Royal Mail has had the task of setting the tone for future schemes. Poole explains its plan: “We have committed in principle to introducing a CDC scheme, with a

separate DB lump sum section sitting alongside it. Royal Mail will contribute 13.6 per cent, with the employee contributing 6 per cent.

“We are very keen – as are the CWU – to see CDC become a reality in the UK. We believe CDC is right for our workforce and our business. We also see CDC schemes as an important third option in the UK pensions landscape, complementing those currently available,” he adds.

Love them or hate them, CDC schemes, like the nations divisive yeast spread, seem like they could become a mainstay in the UK pensions industry. With government support and such a large company potentially adopting this structure, it appears as if there will at least be some experimentation with the CDC concept.

Experts seem to be unable to agree on whether CDC is a good idea. However, people don’t agree on Marmite either, and that is considered a British staple.

➤ **Written by Jack Gray**