

Consultation: delivering CDC schemes

Alert | 8 November 2018



Introduction

On 6 November 2018, the DWP published its consultation on “[Delivering collective defined contribution pension schemes](#)”.

Key points

- The consultation sets out the Government’s proposals as to how a particular form of collective defined contribution (“CDC”) scheme (the model proposed by Royal Mail) might work in the UK.
- A CDC scheme offers a target (as opposed to a guaranteed) level of benefits.

History of CDC

CDC was first explored by the Labour Government in 2008 and then became part of the Coalition’s “[defined ambition](#)” proposals in 2012.

“Defined ambition” was intended to ensure greater sharing of risk between employers and members. The [Pension Schemes Act 2015](#) (“PSA15”) was designed to introduce a framework for such schemes, but the relevant provisions were never brought into force.

In 2017, the Work and Pensions Select Committee (“WPC”) [launched an inquiry into the merits of CDC schemes](#). The WPC published its [report](#) and recommendations in July 2018, calling on the Government to “move quickly” to enable the creation of the UK’s first CDC pension scheme.

Over the last 18 months, Royal Mail (“RM”) and the Communication Workers Union have been working together to develop plans for a new CDC pension scheme for RM’s workforce. RM then approached the Government to ask it to facilitate the proposed approach in legislation.

The DWP believes that RM’s initiative “could be a model for other employers and other workforces”, and is therefore consulting on a CDC framework that reflects the RM design, as well as exploring the policy and regulatory issues that CDC schemes raise more generally.

What is a CDC scheme?

In a CDC scheme, financial contributions are invested in a collective fund. Broadly, a particular member's pension would be calculated as follows:

- estimating how much money is needed to provide the target level of benefits to each member
- adding up the values for each member to determine the total assets available to provide target benefits to all members
- if the assets available are higher or lower than the estimated money required to meet target benefits, make corresponding adjustments to (i) the current payment of benefits to each pensioner member and (ii) the prospective pensions payable to active and deferred members
- adjusting the future target level of benefits so that the total value of benefits is equal to the total value of assets.

The collective nature of a CDC scheme, and the way it adjusts the level of pensions and prospective pensions, should mean that the overall membership will enjoy an element of cushioning from volatility as investment risk is adjusted for over time and longevity risk is pooled across the membership. Because the fund is administered and managed on a collective basis, there is also no need for members to make choices about the investment of funds or the ways of converting that fund into an income stream in retirement.

New legislative framework

The Government has concluded that the PSA15 does not contain suitable definitions or set out an appropriate framework for the proposed RM scheme or similar such schemes. Fresh legislation is therefore required to achieve this.

Schemes providing CDC benefits will become a new category of pension scheme for which specific requirements and quality features may be prescribed, where necessary.

CDC benefits will be categorised as a type of money purchase benefit, and as such, will be subject to many of the same requirements as money purchase schemes, and will not be eligible for entry to the PPF.

However, the Government recognises that certain obligations, such as the default fund charge cap, may need to be adapted or modified in their application to CDC schemes.

Further key proposals include:

- the introduction of a new CDC scheme specific authorisation process (similar to that for DC master trusts) and ongoing scrutiny by TPR.
- requiring CDC schemes to undertake annual actuarial valuations in order to determine whether benefit adjustments up or down are required
- not permitting CDC schemes to be accrual-only vehicles
- restricting initial CDC provision to schemes sponsored by single or associated private sector employers.

Challenges

The Government recognises that “CDC schemes are not a catch all solution” and states that there are “a number of issues that need careful consideration and handling if this type of scheme is to be properly run, and if members and employers are not to be exposed to unacceptable risk”.

In particular, CDC will pose communication challenges for schemes, employers and the Government, as members will need to understand how benefits work under this new system, and that their monthly pension will fluctuate in value and may decrease.

The consultation therefore asks various questions of the industry to aid its understanding of the issues and solutions and “further develop the technical details” of its approach to CDC.

Next steps

The consultation runs until 16 January 2019. RM will be publishing more information on its proposed CDC scheme during the consultation period, so that those with an interest can consider its approach.

The Government has stated that it is “keen to bring forward legislation to facilitate the setting up of this form of CDC scheme as soon as Parliamentary time allows”.

If you have any questions on any of the above, **please speak to your usual Sackers contact**.