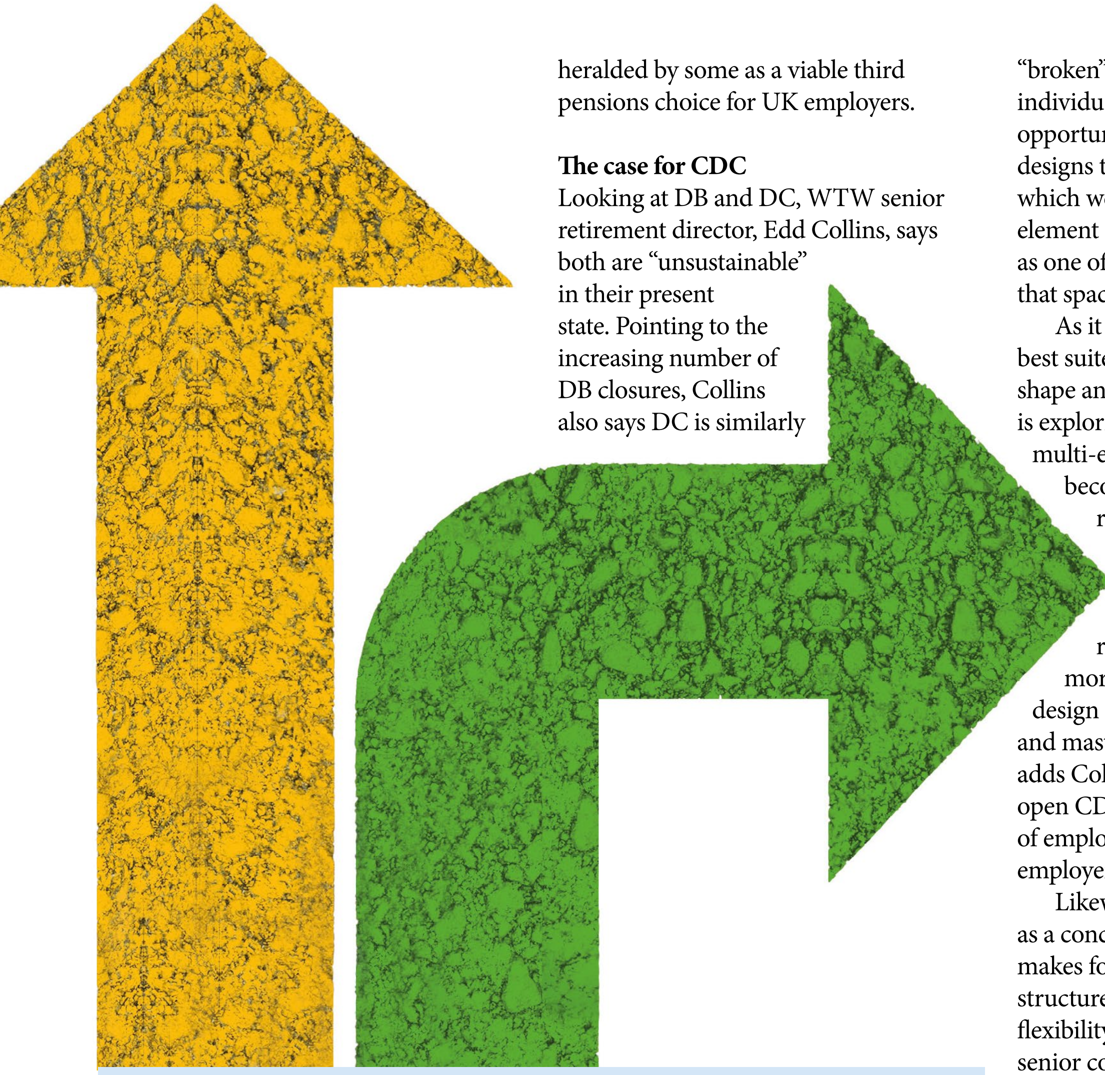
The third choice?

With the UK's first CDC scheme up and running, and the government recently issuing a consultation on enabling multi-employer CDC structures, *Pensions Age* explores whether this is the start of CDC being the 'third choice' between DB and DC pension offerings

Summary
• The government recently consulted on expanding CDC's rules, opening this up to more employers – however the industry is still split on whether the structure is an ideal 'third choice'.
• Advocates argue CDC has the desired flexibility for employers, while helping savers boost retirement provisions. However, critics say demand for CDC is muted and that too much has been promised by its architects.
• The consultation is in its early days, and much still needs to be done to get to the point of a wider rollout.
• Although not included in the consultation, someone would like to see a decumulation version of CDC explored.

The second week in October was a busy one for the collective defined contribution (CDC) structure. First, Royal Mail launched the UK's first CDC scheme which was hailed as the dawn of a 'new pensions era'. Then, the following day, the Department for Work and Pensions (DWP) launched a consultation with a view to extending CDC's legislative framework beyond single or connected schemes. These could be significant developments, given CDC has been



heralded by some as a viable third pensions choice for UK employers.

The case for CDC

Looking at DB and DC, WTW senior retirement director, Edd Collins, says both are "unsustainable" in their present state. Pointing to the increasing number of DB closures, Collins also says DC is similarly "broken" due to the onus this places on individuals: "There is therefore a great opportunity for innovation in pension designs that sit between DB and DC, which we believe need to introduce some element of risk sharing, and we see CDC as one of the key potential solutions in that space."

As it stands, the CDC structure is best suited to large employers similar in shape and size as Royal Mail. The DWP is exploring how whole-life unconnected multi-employer CDC schemes can become authorised and benefit from regulatory oversight.

"We therefore welcome the current DWP consultation on multi-employer CDC regulations, which will allow more flexibility in CDC scheme design and will enable multi-employer and master trust CDC arrangements," adds Collins. "We see this as essential to open CDC up to a much broader range of employers, and particularly smaller employers."

Likewise, there is an argument that, as a concept, the flexibility of CDC makes for a more appropriate pension structure. A key component is the flexibility of CDC, argues First Actuarial senior consultant, Derek Benstead.

"You could almost say that DB is foolish because you're making a commitment that is difficult to adapt to change," says Benstead. "DC is wholly unpredictable for the member, no good for employers seeking to manage contributions into retirement.

"Something that's more flexible, surely that's the thing that lasts and doesn't get into trouble. A scheme that can adapt is a scheme that lasts."

Critics and concerns

Not everyone is convinced though. Independent consultant, John Ralfe, is a vocal critic of the structure and calls it a 'con'.

"CDC is a con," says Ralfe. "Either pensions are guaranteed, or they are not.

Decumulation and CDC?

Some feel that the government could go further in what it is proposing. WTW senior retirement director, Edd Collins, would want to see a decumulation version of CDC explored, as many employers will have already transitioned to a DC and be hesitant to making other changes.

"A decumulation version of CDC could be easily added to these schemes, which would address some of the challenges we see with DC but without the need for employers to go through a process to change their core pension offering for employees," explains Collins. This, he adds, would also be attractive to DC savers to generate a retirement income from the pots they have already built up.

In agreement is Aon partner and head of UK retirement policy, Matthew Arends, who sees a decumulation CDC having appeal with a broader array of savers. However, with only one CDC live in the UK and the current consultation having only just launched, he concedes that decumulation CDC is some time off.

"The next round of CDC regulations will not permit decumulation-only CDC. However, we and others see the potential for it to become an option in due course," says Arends. "But that would require a third round of regulations. It would carry its own separate considerations as you are by definition reducing the pool of people in the CDC arrangement. That will need some thinking."

There is no 'middle way'."

As a result, Ralfe is dubious about the appetite for CDC and how many employers will want to pursue this route even if the ongoing consultation widens accessibility.

"The government has wasted seven years on the CDC folly, just to help Royal Mail solve its industrial relations problems," continues Ralfe. "Where are all the other companies all chomping at the bit for CDC? No one else has said they want to do it. Even on its own terms it needs tens of thousands of members to be viable, so getting a few companies doesn't cut it."

"There is a great opportunity for innovation in pension designs that sit between DB and DC"

Also sceptical about the level of demand for CDC is AJ Bell director of public policy, Tom Selby. Put simply, he says the benefits of a CDC overhaul may not be clear enough to tempt many employers into transitioning to the structure – pointing out that auto-enrolment has already been delivered at great cost to many.

"CDC may be an attractive option for firms with open DB schemes who want to shoulder less longevity risk, but those with an established DC scheme are unlikely to want to go through the hassle of switching to CDC when the benefits are far from clear cut," argues Selby. "While some advocates of CDC promise a land of milk and honey in retirement, there is nothing stopping individual DC savers holding similar investments and enjoying similar returns, as well as benefitting from total flexibility over how they take an income in retirement."

What CDC needs to work

With the consultation due to close on 19 November 2024, a widespread rollout of CDC is some way off. Advocates of the structure are optimistic about what the future holds but concede that work is still required to make these a viable option.

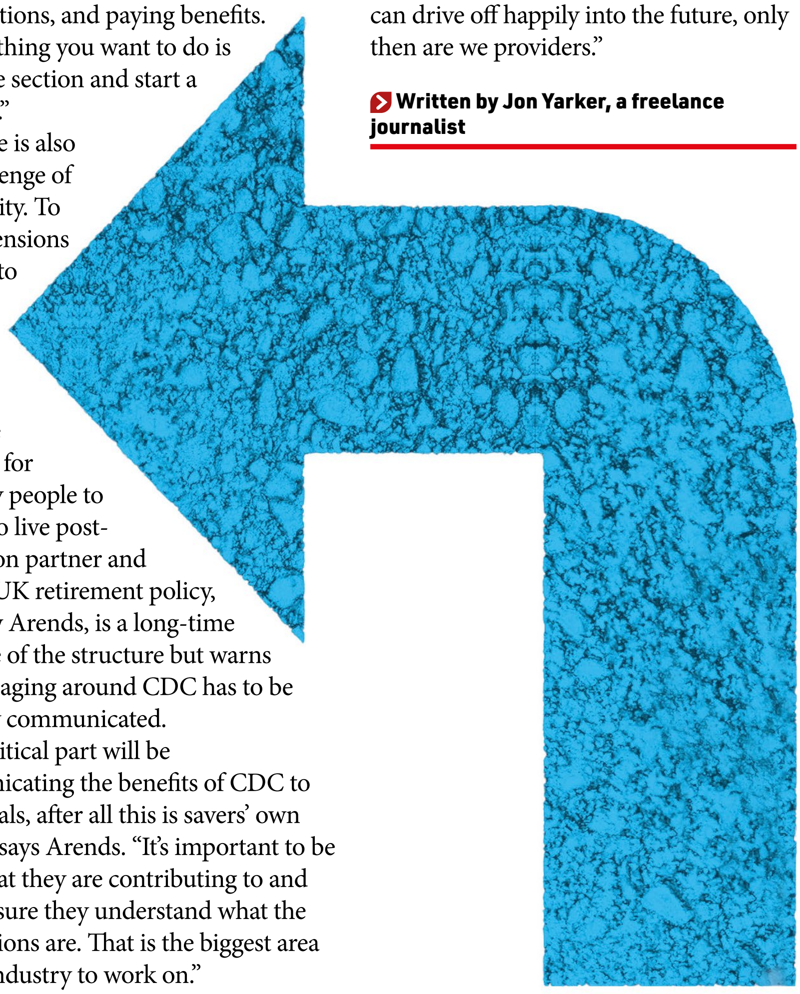
Looking specifically to how the rules are written, Benstead hopes the DWP is not too prescriptive in its regulations and wants a regulatory attitude to match the flexibility of CDC.

"The DWP seems to be trying to anticipate all problems when it is writing regulations," says Benstead, arguing the department is "obsessed" with writing regulations that allow for "sectionalisation".

"As a principle I find that undesirable," he adds. "In the ideal world you want one pool of members that's open to new entrants, collecting contributions, and paying benefits. The last thing you want to do is close one section and start a new one."

There is also the challenge of complexity. To many, pensions difficult to engage with despite the fact these are essential for everyday people to be able to live post-work. Aon partner and head of UK retirement policy, Matthew Arends, is a long-time advocate of the structure but warns the messaging around CDC has to be perfectly communicated.

"A critical part will be communicating the benefits of CDC to individuals, after all this is savers' own money," says Arends. "It's important to be clear what they are contributing to and making sure they understand what the expectations are. That is the biggest area for the industry to work on."



It remains to be seen what the consultation will bring, and if CDC will be subject to future iterations *[see boxout]*, but advocates argue it holds significant potential for the pensions landscape. Using the analogy of the car industry, Benstead argues the pensions industry should be providing people ready-made pensions, and that the CDC is key to this.

"To the extent we take DB schemes, close them down and write them up, we're scrap metal dealers," explains Benstead. "And when we provide people with DC pots and expect them to make their own decisions on what to do, we're giving them people car parts and telling them to make a car. But if we provide them a pension that can be reliably forecasted to reach retirement, and they can drive off happily into the future, only then are we providers."

Written by Jon Yarker, a freelance journalist