British pension industry wary of “collective” DC

By Editorial Staff *Thu, Jun 5, 2014*

The UK's retirement system is a work in progress. With private DB plans expected to vanish in 2016, the government is promoting Danish-style DB/DC hybrids (not US.-style DC) as their replacements. The reaction has been mixed.

The British pension industry offered a mixed response this week to the UK government’s announced intention to create new legislation that will allow the establishment of collective—i.e., centrally managed—defined contribution (CDC) retirement plans similar to Denmark’s.

The UK government’s commitment to CDC was made in the Queen’s Speech, a statement by the head of state describing Parliament’s initiatives in its next session, which begins in the autumn, according to IPE.com.

UK pension law does not currently allow DC/DB hybrids in which plan sponsors and participants share the investment risk. There’s no provision for anything but pure DC, where participants bear the risk for outcomes, and pure DB, where plan sponsors bear the risk.

The new legislation is slated for 2016. That’s when the country launches its new basic “first pillar” old age insurance program. That’s also when workers will no longer be able to substitute participation in an employer-sponsored plan for contributions to the government-sponsored supplemental DC plan, a practice known as “contracting out.”

Many existing DB plans are expected to close when contracting-out ends. When that happens, the government would prefer to see employers adopt CDC plans (also called “Defined Ambition” plans) than to see U.S.-style DC plans become the norm in the UK.

While some sections of the UK industry welcomed CDC, others said plan sponsors aren’t enthusiastic about it, it’s not consistent with the recent abolishment of requirements for annuitization of tax-favored savings, and the timing is bad.

The National Association of Pension Funds (NAPF), for instance, had previously asked the government to slow down its reforms of the DC market, as the industry absorbs other changes, including auto-enrollment and a cap on fees by 2015.

Others said that CDC plans might have difficulty achieving the scale required for success. Duncan Buchanan, president-elect of the Society of Pension Consultants (SPC), said, “It is unlikely employers will feel pressure from employees to establish or contribute to new-style ‘risk-sharing’ schemes. CDC requires critical mass to make risk sharing fair. Without large numbers of members, these collective schemes might not be able to get off the ground.”

Alex Waite, of LCP, a pension consulting firm, said, “This type of pension scheme has some attractions. However, pooling risks between members generates winners and losers, and it is likely that anyone that loses out materially will call foul. Against this background, it is unlikely employers will rush to set up CDC schemes.”

Lee Hollingworth, head of DC at consultancy Hymans Robertson, said CDC would have distinct winners and losers. “Potential losers include younger savers and the less well-off,” he said. “The muted reaction of employers is based in part on the Netherlands’ experience. There, employers have found themselves paying in extra money rather than face the industrial relations impact of benefits being reduced.”

Not everyone is so skeptical. Danny Wilding, partner at consultancy Barnett Waddingham, said that while CDC might not be right for all employers, it would be a welcome new option. “CDC has the potential to offer more generous and stable pension returns to scheme members and act as a viable alternative to both DC and DB schemes,” he said.