

DB-DC hybrid idea resurfaces in UK; launches in Germany on January 1

By Editorial Staff Wed, Nov 29, 2017

The British government is looking anew at a hybrid defined contribution plan design that would give participants a non-guaranteed variable income (with or without smoothing) in retirement.



"Defined ambition," a phrase used to describe "collective" defined contribution plans, was championed by Britain's pension chief from 2012 to 2014. The concept is now making a tentative comeback in UK retirement policymaking circles.

A bipartisan group of British politicians has opened a new inquiry into the "merits or otherwise" of defined ambition, which describes pension plans that are a hybrid of defined benefit plans and defined contribution plans (or "schemes" as Britons say).

For participants, these plans would provide less certainty in terms of retirement incomes than DB plans but more certainty than US-style DC plans. They would reduce the risks that employers face.

In essence, plan participants would agree to accept retirement incomes that fluctuate with market performance instead of expecting fixed payouts. Life insurance companies don't play a role in defined ambition or CDC plans. Labor unions would need to play a role in representing participants.

CDC schemes may be "the type of retirement saving plan with the potential to address some of the concerns that policymakers and the public have about the current pension 'offer,'" said the Work and Pensions Committee (WPC) of the House of Commons, in an official statement this week.

The committee has asked for responses to its questions by January 8, 2018. It has posed questions about benefits to savers and the wider economy, converting defined benefit schemes to CDC, and how CDCs would be regulated.

The politicians' questions include:

- Would CDC deliver tangible benefits to savers compared with other models?
- How would a continental-style collective approach work alongside individual freedom and choice?
- Could seriously underfunded DB pension schemes be resolved by changing their pension contract to CDC, along Dutch lines?
- Is there appetite among employers and the UK pension industry to deliver CDC?
- Would CDC funds have a clearer view towards investing for the long term?

"The select committee is aiming... to retain some of the best features of company schemes in a different age when employers are no longer willing or able to sustain the burden of final salary promises to employees, who could instead club together and pool the risk themselves," said Frank Field, Labor Party

member and chair of the WPC. The WPC is also inquiring into pension freedoms.

CDC is a potential source of longer- term investment in growing start-up companies, the lawmakers said. Unlocking such investment was one of the policy goals mentioned by Chancellor of the Exchequer Philip Hammond in his Budget statement this week.

Arguments made against CDC schemes, according to the committee, were that they could further fragment the pension landscape, suffer from lack of demand, or run counter to the trend towards greater individual freedom and choice in pensions.

Though common in the Netherlands and Denmark, CDC pension schemes are not allowed in the UK. But they will become possible in Germany in 2018, under certain conditions. In Germany, according to a recent Aon Hewitt report:

“Social partners [unions and employer associations] are urged to agree on an attractive and well balanced “Defined Contribution” approach. Employers who join such plans are released from any pension liability, which is transferred to the overarching pension fund. The pension fund, which is supervised and managed by the social partners, becomes responsible for the investment of pension assets and payment of pensions. The benefits are based on a “defined ambition approach” which allows for variations in the benefit levels depending on how well investment goals are achieved. Guarantees backed by insurance-type arrangements are not allowed. Further details, such as risk sharing and smoothing mechanisms between the plan participants, need to be agreed on by the social partners.”

In 2014 the UK government intended to alter pension law to make CDC plans legal, as part of a plan by then-pensions minister Sir Steve Webb for greater risk-sharing in pensions. They were even recognized as a distinct pension category in legislation created by the Conservative-Liberal Democrat coalition government. But efforts were shelved after the Tory victory in the 2015 general election.

At that time, the British government did not want to distract from other major reforms such as auto-enrolment and pension freedoms, according to Baroness Ros Altmann, Webb’s Conservative Party successor. Retirement industry representatives also opposed the CDC concept.

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