In the U.K., “collective DC” beats “pure DC”: Aon Hewitt

By Kerry Pechter *Wed, Feb 19, 2014*

Collective Defined Contribution (CDC), a hybrid of DB and DC with centrally managed assets and a variable income stream, may be the next big thing in the UK retirement industry.

U.K. employers who find the costs of their defined benefit (DB) plans unmanageable should move toward collective defined contribution (CDC) instead of pure defined contribution plans, according to Aon Hewitt, IPE.com has reported.

A shift to DC plans would only drive up DB sponsor costs because the DC plan sponsors can’t “contract out” of participation in the so-called S2P—the supplemental state pension. They would have to start contributing to S2P, which would raise costs by about 3% a year, according Aon Hewitt.

“We urge them to start considering CDC now,” said Matthew Arends, a partner at Aon Hewitt. “It can be a desirable alternative to implementing a DC arrangement in 2016.” Aon Hewitt also called on the government to provide more certainty on the timetable for legislative changes required before CDC can be implemented.

In any event, the S2P will be gone entirely by 2016, when the U.K. moves to a simpler, single-tier pension like our Social Security program. And CDC—a hybrid of DB and DC with centrally managed assets and a variable income stream—may be the next big thing in the U.K. anyway.

The U.K. pensions minister, Steve Webb, has been a promoter of U.K.-style CDC, which he calls “Defined Ambition.” He was inspired by the Dutch and Danish retirement systems, where collective defined contribution, in which participants and employers share risks, is often the model. In a speech last October, Webb said it was one of the core options he envisaged for the future of U.K. pensions.

CDC has received support from several sections of the U.K. pensions industry and across the political spectrum. Even the opposition Labor Party’s representative for pensions, Gregg McClymont, has backed the exploration of CDC, reversing the sentiments of a 2009 Labor government white paper.

One big question is whether the government will be able to pass legislation supporting Defined Ambition/CDC by 2016, when the single-tier pension will be instituted. If a CDC option isn’t available, DB plan sponsors may choose pure DC instead.

Aon Hewitt said it also expected CDC to be enshrined into legislation by 2015, taking effect as contracting-out comes to an end. Arends called on the government to provide certainty on the timetable for implementing CDC, in a bid to avoid employers having no alternative to pure DC.