UK ponders ‘Defined Ambition,’ a path from DB to DC

By Editor Test *Fri, Jul 26, 2013*

A centrally-managed pool of defined benefit funds would aim for a target participant benefit of 1/80th of salary per year of service, based on a combined employer/employee contribution of 20% of salary. But participants would share some of the investment risk.

Britain’s Department for Work & Pensions continues to entertain ideas for a nationwide collective defined contribution investment fund in the UK that would employers to pool their defined benefit pension budgets into a “centralized vehicle” that deliver pensions based on performance.

This fund would aim for a target participant benefit of 1/80th of salary per year of service, based on a combined employer/employee contribution of 20% of salary. The fund is part of a new employer-sponsored retirement savings initiative in the UK known as “defined ambition,” unveiled last November, as a potential alternative to defined benefit plans.

Last month, DWP minister Steve Webb expressed an interested in a collective pool of savings. Participants would have notional, not personal, accounts in such a pool, and would have rights rather than ownership to an accrued benefit at retirement.

This week, a partner at the consulting firm of Barnett Waddingham, Danny Wilding, said that introduction of a “basic” collective defined contribution (CDC) system in the UK would not cause a “massive” legislative burden to the government. The collective model is “the horse [the DWP] should be backing initially,” he said.

“You then calculate the target benefit of 1/80th of salary for each year of service,” Wilding said. “You value that on some pre-agreed actuarial basis, and then you look at the aggregate value of all of those target benefits and compare them with your collective fund.” Such an improved DC model would be preferable to “DB-lite,” as certain reforms to the defined benefit system have been called.

Defined Ambition is based on the idea of shifting some of the investment risk that a DB plan sponsor currently shoulders onto the plan participants, while preserving the concept of a lifetime income.

If the collective fund were only able to meet 90% of the target, Wilding said, then members would only see 90% of the proposed benefits. But if the fund were able to deliver higher benefits, the additional income could also be distributed among members. The type of CDC currently used in the Netherlands imposes benefits cuts if funds are falling short of promised payments, allowing the scheme to recover, without the promise of a bonus during bull markets.

According to Wilding, single large employer could operate a standalone fund, but that smaller employers should probably seek out industry-wide or other collective arrangements. “As long as the employers agreed on the criteria up front – agreed the target benefits, and these targets benefits are valued for the purpose of pooling – then there is no reason why employers shouldn’t work together on this,” he said. Any future change would require agreement across all employers.