COLLECTIVE DEFINED CONTRIBUTION (CDC)

The Dawn of a New (Pensions) Era

MAY 2021

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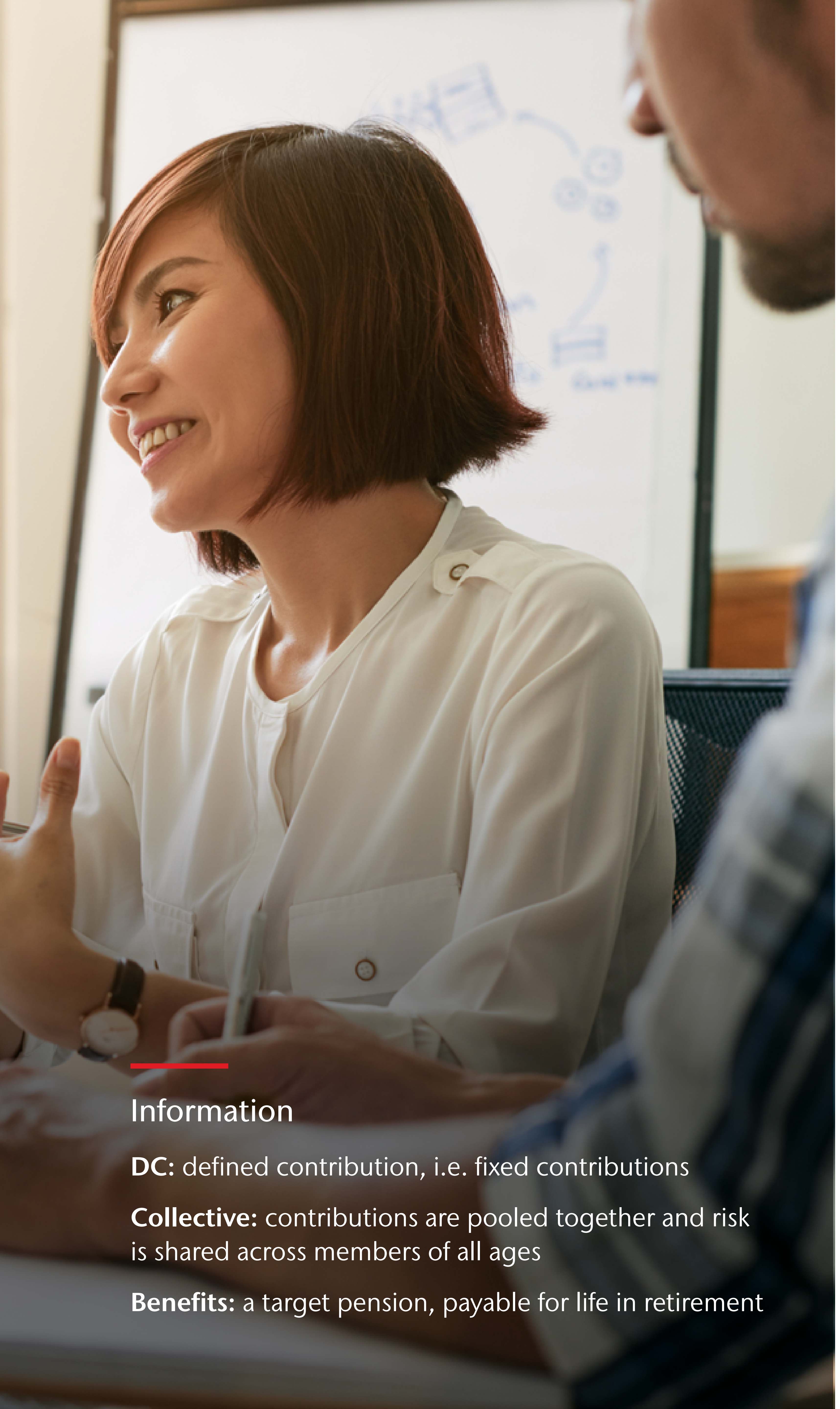


Information

DC: defined contribution, i.e. fixed contributions

Collective: contributions are pooled together and risk is shared across members of all ages

Benefits: a target pension, payable for life in retirement

What is a CDC pension scheme?

CDC can provide what the majority of pension savers want in retirement: a target, inflation-linked income payable for life from fixed-cost DC savings, without having to make complex financial and investment decisions along the way.

How is this achieved?

Pooling of assets

By pooling assets, the time horizon of a typical CDC scheme will be longer than the lifespan of an individual DC member, allowing a less conservative investment strategy. Given their scale, CDC schemes can seek greater investment returns through investing in different types of assets, and can hold these assets over a longer time horizon than savers would otherwise be able to do individually. This leads to better average outcomes for DC savers compared with individual DC where an annuity is used to secure income in retirement, or where savings are drawn down over time and either run out early, or are left unused.

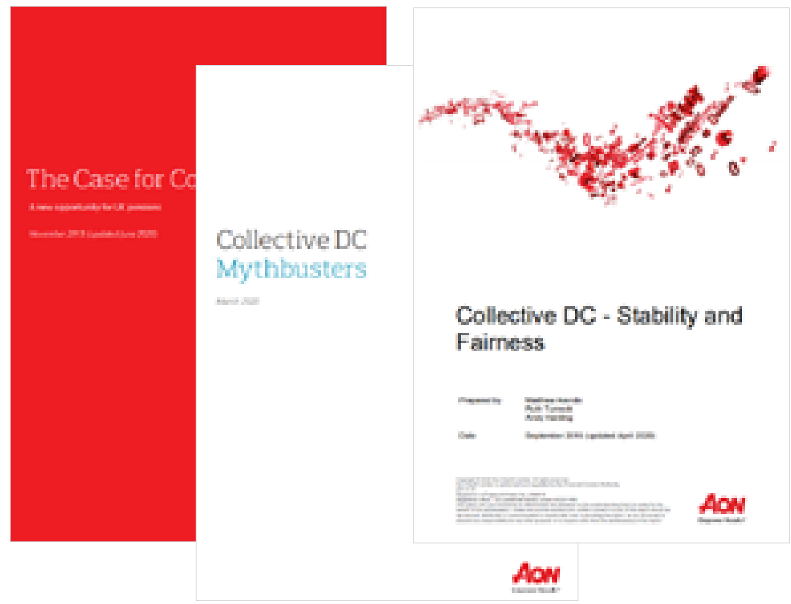
Target pensions

Benefits in CDC are not guaranteed: CDC schemes will aim to increase benefits each year, e.g. target inflation. Member outcomes will ultimately depend on things like how markets perform, and the latest views on life expectancy.

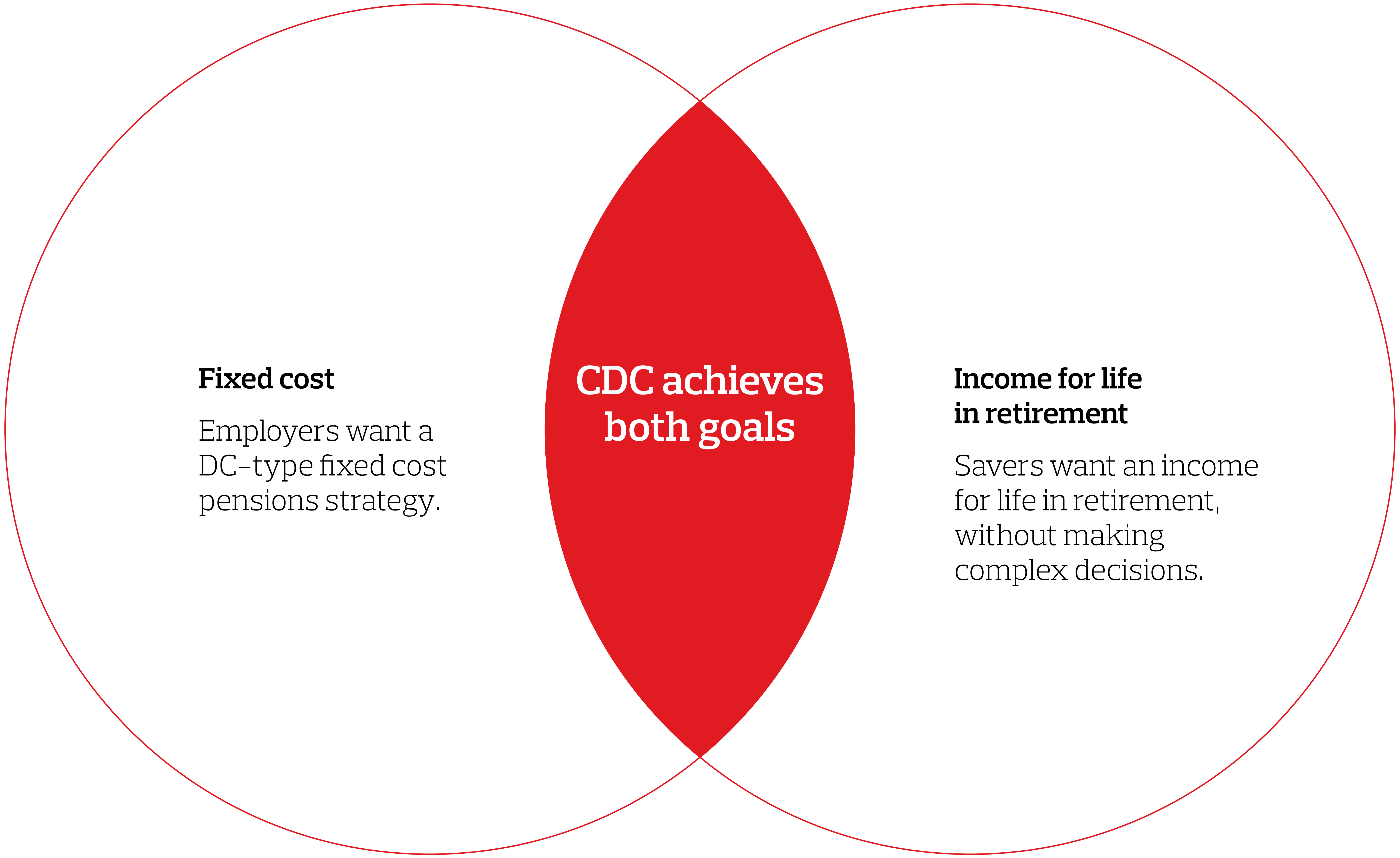
Each year, all members' target pensions will be adjusted to ensure the scheme remains fully funded so the value of assets exactly equals the value of liabilities.

For example, if markets perform better than expected, pension increases will be higher than target. Conversely, increases may slow down if markets underperform, and benefits may be cut if market performance is very poor.

Further reading and Aon thought leadership on CDC can be found here.

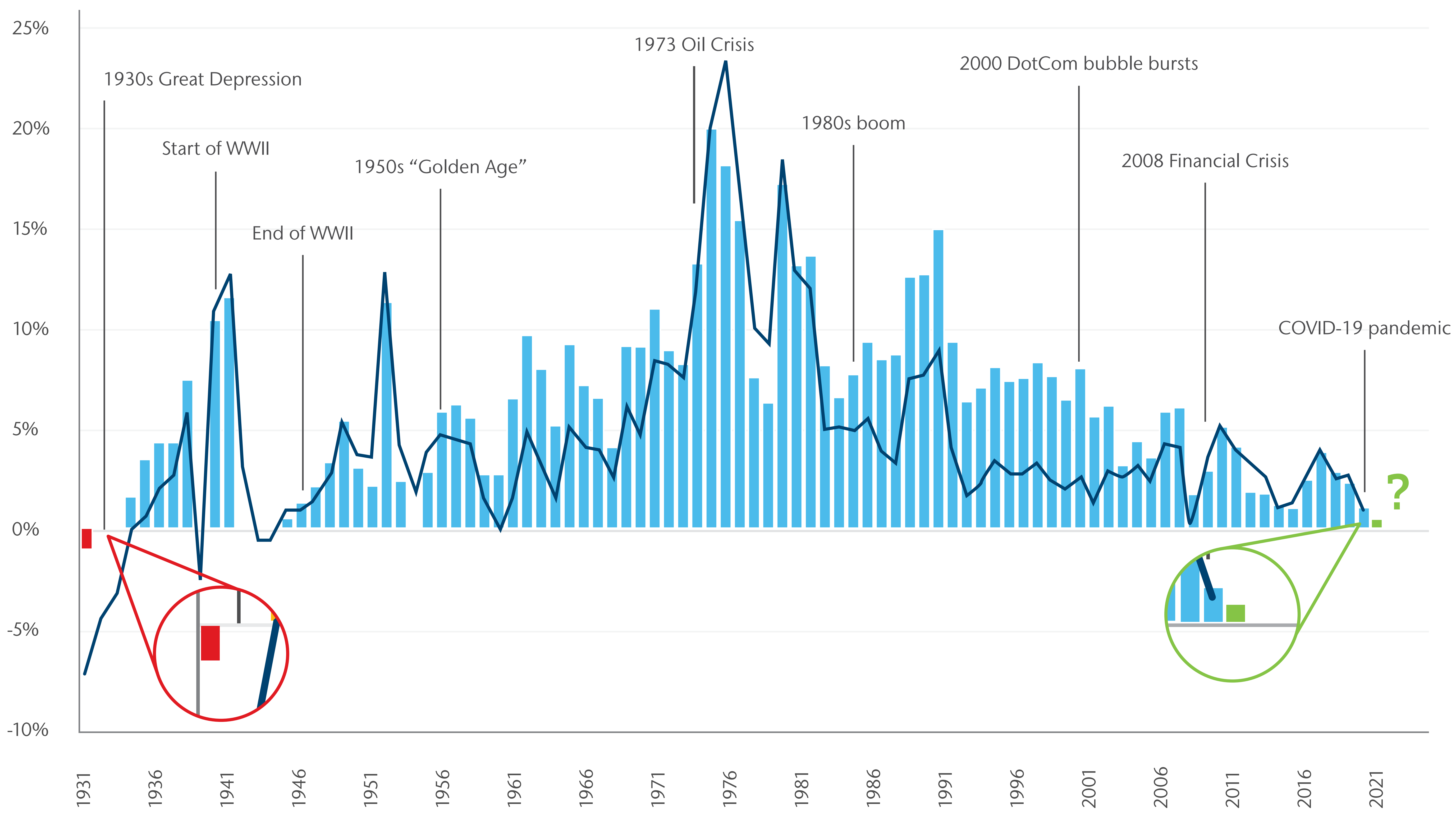


Value of CDC for employers and pension savers



The value of CDC: Resilience in adverse markets

Back-testing CDC benefit adjustment outcomes



CDC in adverse markets

A well-designed CDC scheme targeting inflationary increases would not have needed to cut members' benefits in the wake of 2020's adverse markets.

Back-testing the impact of market performance over the past 90 years revealed only one benefit cut — following the Great Depression — would have been made.

[Aon's 'Collective DC in adverse markets' briefing paper can be downloaded here.]

Flavours of CDC

Own trust

Suitable for paternalistic single employers / groups with 5,000+ employees, who may be unionised.

Multi employer / industry wide

Suitable for a group of employers, including those operating in the same industry.

Master trusts

Available for all employers (regardless of size) to help employees build up CDC pension.

Available for DC savers at retirement – sitting alongside existing drawdown and annuity purchase options in the DC decumulation space.

Innovation to provide CDC pensions for the self-employed?

Expected Timeline for CDC

Royal Mail's Collective Pension Plan — ready to open

Summer 2021

'Own trust' CDC

DWP consultation on regulations covering CDC trusts established by single employer groups.

End 2021

'Own trust' CDC

Regulations and TPR guidance (including authorisation and ongoing supervision regime) in force.

2022

Wider CDC

Consultation on regulations covering multi-employer, industry-wide and commercial CDC schemes, including CDC within master trusts.

2023?

Wider CDC

Regulations and TPR guidance (including authorisation and ongoing supervision regime) in force.

Timing

The timing of secondary legislation will be demand led – engage with DWP and let us know if interested.

Could a CDC scheme be right for me?

Workforce scale

Yes if 5,000+ employees as part of single employer group.

Employers with fewer than 5,000 employees may be better suited to multi-employer or industry-wide CDC, or CDC master trusts – talk to us if interested in these flavours of CDC.

Paternalistic and / or unionised

Yes if you want to provide employees with better pension outcomes, delivered through an income for life in retirement, for a DC-type fixed cost and risk profile.

Yes if workforce is partly or wholly unionised.

Review pensions strategy

Yes if reviewing current DB and / or DC pensions strategy.

Yes if there is a desire to harmonise pensions strategy across workforce, and reintegrate pensions with wider HR, reward, wellbeing and business strategies.

Royal Mail's proposed 'own trust' CDC design

Contributions

Employer & member contributions fixed as a percentage of pensionable pay.

Target CDC pension

1/80ths of pensionable pay (accrued in blocks and subject to adjustment each year).

Retirement age

Normal Retirement Age of 67.

Contingent pensions

50% of member's CDC pension (and subject to adjustment each year on same basis as for other members).

Target adjustment

Targeting inflationary increases – actual adjustment (increase or decrease) for all members is calculated each year.

Valuations

CDC schemes will have annual valuations to determine scope for future pension increases: the valuation rebalances the value of the liabilities to equal the value of the assets so there is no funding surplus or deficit.

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