Improving adequacy through Collective Defined Contribution (CDC) schemes

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Cost of Living
The Pension Dimension

Cost of living is one of the biggest political, social and economic issues of the day. It has some important pensions dimensions, including the affordability of pension saving (competing with other financial pressures during working years) and the adequacy of pension benefits (to cover living costs in retirement). Our latest thought-leadership campaign is full of policy ideas to complement the work of the second pensions commission (the Commission) and help tackle the pension savings challenge.

CDC schemes have a key role to play as part of the pensions adequacy solution. The collective risk-sharing in CDC schemes can potentially result in a materially higher income in retirement for members when compared with traditional defined contribution (DC) schemes and does not require active decision-making. Employers have greater certainty in terms of costs and risk when compared with defined benefit (DB) schemes.



Key proposals

Legislation is in force for the establishment and governance of single and multiemployer CDC schemes. Now is the time to make CDC accessible to the self-employed and to ensure that CDC forms an integral part of guided retirement solutions.

Proposal one
Open up whole of life CDC schemes to the self-employed.
Proposal two
Enable retirement-CDC for everyone.
Proposal three
Address the CDC knowledge gap.

Background

The interim report of the second pensions commission highlights that there is a pensions participation gap, which particularly impacts the self-employed. It also highlights the importance of new guided retirement duties, and the need for fair and accessible solutions that protect members from risk.

"Decumulation solutions that rely on engagement and decision-making for the vast majority of savers are not likely to be sufficiently effective. A more protective default mechanism is required to ensure the pension saving journey is smooth, the vast majority of savers are protected from risk, and the system remains fair and accessible up to and beyond retirement."

[Second pensions commission interim report.]

Legal position

Currently, retail customers (including the self-employed) cannot join a CDC scheme because a connected employer is needed for the scheme to meet the criteria to be "occupational". To allow self-employed individuals to join a CDC scheme, legislation would need to be amended by removing the requirement for a member to be in an occupational pension scheme, both for accumulation and decumulation.



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More details

The self-employed are not eligible for automatic enrolment and only 4% of wholly self-employed workers in the UK are currently saving for retirement. We propose opening whole of life CDC schemes to the self-employed either through private providers (master trusts) or potentially a national solution.

CDC schemes remove the need for members to make complex decisions at retirement, which can also be a barrier to saving in the first place. We propose that those with DC savings should be able to purchase a CDC pension in retirement irrespective of the type of scheme they are a member of. However, under current proposals, a CDC option at retirement will only be possible for retail customers if it is part of a scheme-specific guided retirement solution (under new duties expected to be in force from 2029). We propose that it should be mandatory for trustees to consider CDC products as part of their guided retirement solution, and that retirement CDC is made open to all.

Public confidence in pensions and financial services products is low. CDC is a new product, and it will take time for trust and understanding to build. CDC education extends to those involved in the pensions industry as well as members of the public.

In a time of increasing regulatory complexity and focus on improving member outcomes in DC schemes, the knowledge gap around CDC within the industry (trustees, employers and independent financial advisers) could be addressed with further guidance from The Pensions Regulator (TPR) and the Financial Conduct Authority (FCA). Trustee qualifications and Money and Pensions Service knowledge should extend to CDC schemes, and independent financial advisers should not be able to advise on transfers without understanding CDC benefits.

A government-backed education campaign about pension adequacy could raise awareness about CDC. Separately, an exit option (like a cooling off period) for members who choose CDC at retirement will help to build public confidence and avoid "regret risk" while this new option establishes itself firmly on the pensions landscape.

"Self-employed people remain the group least likely to participate in pensions saving. They sit entirely outside automatic enrolment and have extremely low participation rates...As a result, the self-employed represent one of the most significant groups of concern for pension adequacy."

[Second pensions commission interim report.]