BRIEFING
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Collective DC Schemes: Where are we now?

The Pension Schemes Act 2015 providing the legislative framework for Collective DC Schemes received Royal Assent on 3rd March, 2015.

Since then:

- we have had a General Election in which the then Pensions Minister (Steve Webb) lost his seat, and
- we have a new Pensions Minister (Dr. Ros Altmann, or, more correctly, Baroness Altmann) who was appointed as Minister for the State of Pensions on 11th May, 2015.

The Pension Schemes Act 2015 sets out the legislative framework for collective DC schemes (using the language of the Act, schemes that provide "collective benefits"). However, the detail is to be set out in Regulations (which are awaited).

Attached is a note which pulls together various of Dr. Altmann's published statements (before becoming Pensions Minister) on collective DC schemes. In summary, her views are supportive of those schemes. That said, it remains to be seen whether being Pensions Minister will result in changes in those views.

Philip Bennett and Sandy Maudgil, partners in our Pensions Group, have been active in looking at a number of the legal issues in respect of CDC schemes over the last year and half.

Most recently, Philip spoke at an International Pension and Employee Benefits Lawyers Association Conference Workshop on Defined Ambition/Shared Risk/Collective DC Plans and Other Innovative Designs on 18th May, 2015, with Angela Mazerolle (Superintendent of Pensions, New Brunswick) and Louis Kuypers (Supervisor of Financial Institutions, Dutch Central Bank).

Some of the potential advantages of Collective DC Schemes identified in Philip's paper are set out in the Appendix on the next page.

A copy of Philip's paper can be accessed at the following link www.slaughterandmay.com.

Further information about Slaughter and May's involvement in developing the legal thinking in the UK on collective DC schemes (and links to some other useful materials) can be accessed here www.slaughterandmay.com.

Appendix

ADVANTAGES OF COLLECTIVE BENEFIT (OR CDC) SCHEMES[1]

1. The case for collective benefit or CDC schemes is that they should, on average, provide members of such schemes with a greater level of retirement income (something in the region of 20-25%[2] (possibly more) with a lower level of volatility in terms of range of out-turns for any particular member).

2. This improvement in the level of retirement income is said to be achieved:

   2.1 in part, through the ability to invest with longer time horizons in growth assets than any individual member (particularly in the de-accumulation period post-retirement) could sensibly choose,

   2.2 in part, through the savings achieved by not buying an annuity (regulatory capital cost and profit margin), and

   2.3 in part, through the overall reduction in costs achieved through the economies of scale.

3. However, the risk sharing needs to be managed with care to avoid older generations ending up with greater benefits than, with hindsight, they should have ended up with (but with the benefit having been paid out no ability to clawback the benefit).

4. A point to draw out is that if a contribution rate to a money purchase scheme is at the same percentage of pensionable pay for, for example, a 25 year old employee and a 64 year old employee, the amount of retirement income generated by that contribution (assuming both employees are on the same level of pensionable pay) will, after allowing for inflation, be very substantially higher for the 25 year old.

5. In contrast, in a defined benefit scheme, 1 year's accrual of defined benefit pension for a 25 years old costs substantially less than 1 year's accrual for a 64 year old.

6. Depending on the design of the target benefit to be provided under a collective benefit scheme, the same cost differential can arise as in a defined benefit scheme.

7. It is also possible that, in the UK context, a collective benefit scheme may also become attractive as a "de-accumulation option" for those with money purchase benefits who are moving into retirement.

8. Such a collective benefit scheme could offer:

   8.1 a higher level of predictability of retirement income and protection against outliving the individual's retirement savings than income drawdown by the member from his or her retirement savings[3], but

   8.2 at a lower cost than purchasing the certainty of a guaranteed level of retirement income for life from an insurance company by way of an annuity (but with the associated certainty of that retirement income being at a substantially lower level than that provided under the collective benefit scheme).

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[1] The full text of Philip's paper dated 11th May, 2015 is available here www.slaughterandmay.com

[2] Paper (July, 2012) by David Pitt-Watson and Hari Mann for the Royal Society of Arts entitled "*Collective Pensions in the UK*", and the Government Actuary's Department paper "*Modelling Collective Defined Contribution Schemes*" (published December, 2009) and the Aon Hewitt White Paper "*The Case for Collective DC*" prepared by Kevin Wesbroom, David Hardern, Matthew Arends and Andy Harding (published November, 2013).

[3] Because, with effect from 6th April, 2015, there is no longer a requirement to purchase an annuity and the individual is not constrained as to the rate at which he or she may drawdown those retirement savings.