TISAtalk 12th June 2014

AMBITION

Two new pieces of legislation announced as part of this year's Queen's speech will introduce ‘radical reforms’ to UK pensions, including the ability of pension savers to pool their resources into ‘innovative’ collective defined contribution (CDC) schemes. The legislation that will be introduced before the 2015 election is a Pensions Tax Bill, which will give savers more freedom to access their pension savings in whatever way they wish, and a Private Pensions Bill, which will allow for the introduction of defined ambition (DA) pension schemes as a separate category from existing defined benefit (DB) and DC schemes. These DA or CDC schemes allow pension contributions to be pooled to form a single 'mega-fund' for investment purposes.

Employers will decide whether to adopt a collective DC scheme and in the early years the take-up will probably be modest. However the pensions industry should embrace the opportunity to provide an alternative form of pension. CDC offers an opportunity for employers to provide potentially better pensions to members whilst retaining full control of pension costs and savers should welcome a form of pension that is likely to provide a higher income in retirement than a standard DC scheme.

In a collective pension, employers and employees pay a fixed contribution but the pension risk is shared between members of the scheme. They have been particularly successful in the Netherlands, where such schemes pay benefits to members directly from the collective fund in proportion to that person's contributions rather than requiring the member to convert his or her individual contributions into an annuity.

In a traditional DC scheme the final value of the pension fund the member receives depends on the performance of that member's individual contributions, meaning that it is that employee who bears the full risk of the pension losing value. Until now, DC savers have generally purchased an annuity from an insurance company that will convert the pension fund, or part of the pension fund, into a regular pension income. However, the chancellor’s radical announcements in the budget allow members to access their pots from age 55 and take all as cash if they really wish to. These proposals will be taken forward as part of the newly-announced Pensions Tax Bill.

The new Private Pensions Bill would allow for the creation of new forms of workplace pension with greater risk sharing between employers and employees. It would create three mutually exclusive definitions for pension scheme type based on the degree of certainty in the benefits offered to members. New 'defined ambition' governance, disclosure and funding requirements could be extended to schemes that offer salary-related benefits without going as far as to offer a guaranteed retirement income or DC-style benefits backed by a guaranteed minimum level of income or guaranteed investment returns. CDC schemes would come under the new DA regulatory requirements.

It is true that as with all things, there are some possible disadvantages with this proposed concept. Pensions in payment could fall and pensions are at the mercy of market forecasts and actuarial accuracy. If pensions are too generous because of forecast errors, they would have to be cut. Younger members may end up with lower pensions than older members and low earners may subsidise higher earners. The success of these schemes relies on trust between generations and requires an ongoing pool of new members.

The Private Pensions Bill will also include a new 'guidance guarantee', under which all members of DC pension schemes would be offered "free and impartial guidance" on the range of options available to them at retirement.

TISA has now launched the industry wide Retirement New Guidance project to help the Treasury, DWP and FCA delivery the distribution mechanism required for April 2015, which presents a considerable challenge in view of the very short timescale.

Peter Smith, Head of Distribution Engagement