

A guide to Collective Pensions*

***also commonly referred to as Collective Defined Contribution (CDC)**

Produced by the Collective Pensions Policy Team at the Department for Work and Pensions

What is a Collective Pension (CP) scheme?

- Introduced by the **Pension Schemes Act 2021**. CPs are a third type of scheme in addition to Defined Benefit (e.g. NHS Pension Scheme) and Defined Contribution (e.g. Nest).
- CP - both the employer and employee contribute to a collective fund which provides an income in retirement. Unlike in a defined benefit scheme the employer does not need to guarantee the benefits paid by the scheme.
- CP schemes provide a target pension, the pension it pays can be decreased or increased depending on the performance of the pooled fund.

	DB	DC	CP
Longevity Risk	With the employer	With members, individually	With members, shared collectively
Investment Risk	With the employer	With members, individually	With members, shared collectively
Pension level	Guaranteed level of income for life	Function of individual savings pot and how member chooses to access it in retirement	Targeted level of income for life

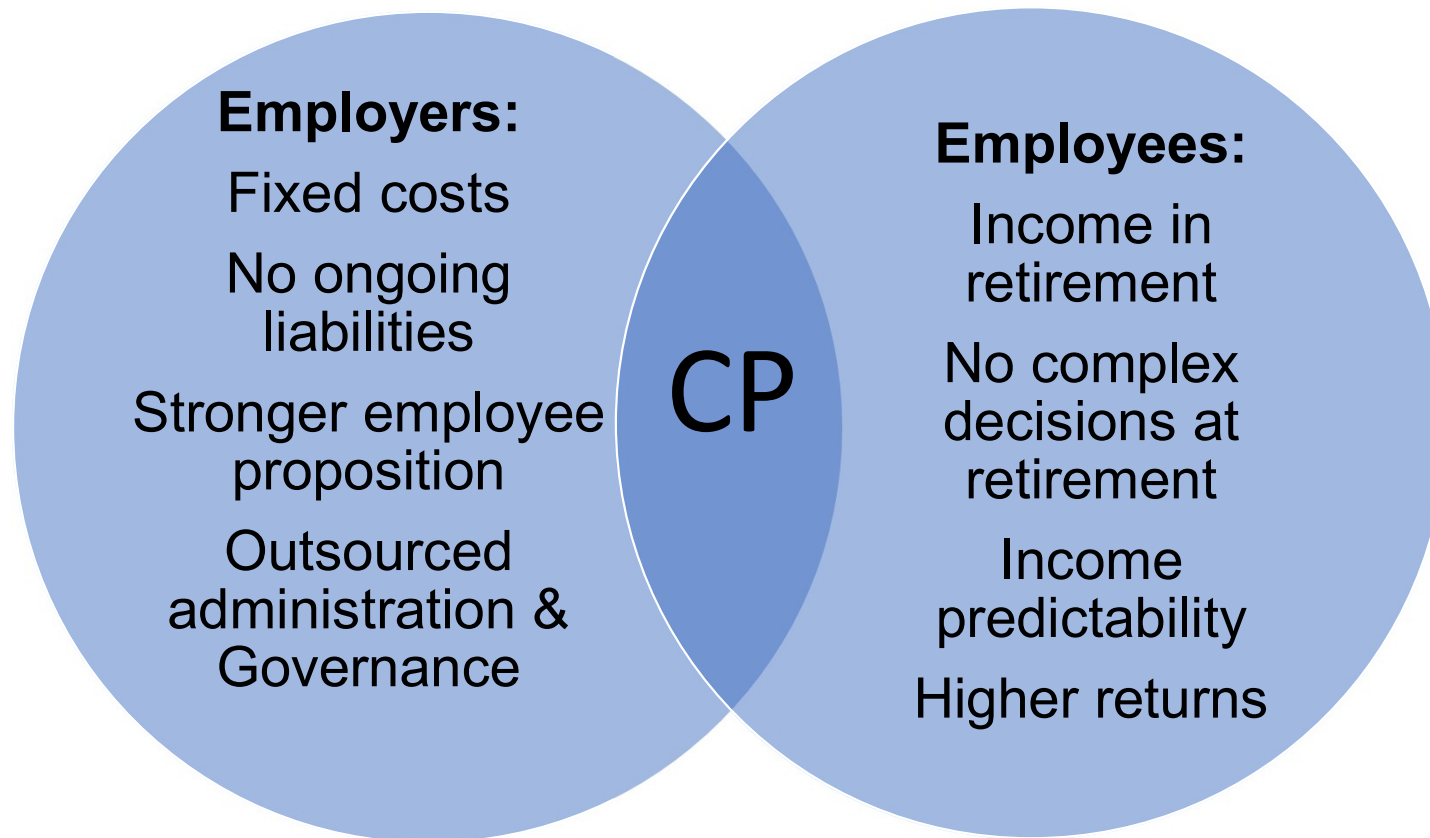
What are the key features of CP?

- **Collective Fund:** both the employee and the employer pay into a collective pension fund from which pensions can be drawn.
- **Smoothed Investment Volatility:** returns are smoothed out over time, and risk is shared across the scheme protecting savers from sudden market crashes right before or during retirement
- **Target Pension:** Members' pensions are based on a target amount rather than a guaranteed amount.
- **Valuations and Adjustments:** benefits are adjusted every year to keep the value of assets held and the projected costs of benefits in balance. Any adjustment of benefits must apply to all members without variation.
- **Member Outcomes:** CPs can remain invested in more growth-related assets for longer. Industry modelling suggests higher returns for the generality of members than DC schemes as a result. CPs are designed to deliver inflation beating increases.
- **Member Experience:** CDCs offer members a seamless transition from saving into receiving a retirement income for life.
- **Employers:** Employers have fixed liabilities, and the potential of higher expected benefits and pension for life in retirement could bolster the employee proposition and aid recruitment and retention.

What do savers want?

- Almost three-quarters of DC members want an income from their pension despite 50% of pots currently being taken out entirely as a lump sum
- CPs help avoid the complex planning required in retirement – majority (77%) of DC pension holders who are yet to access their pension did not have a clear plan

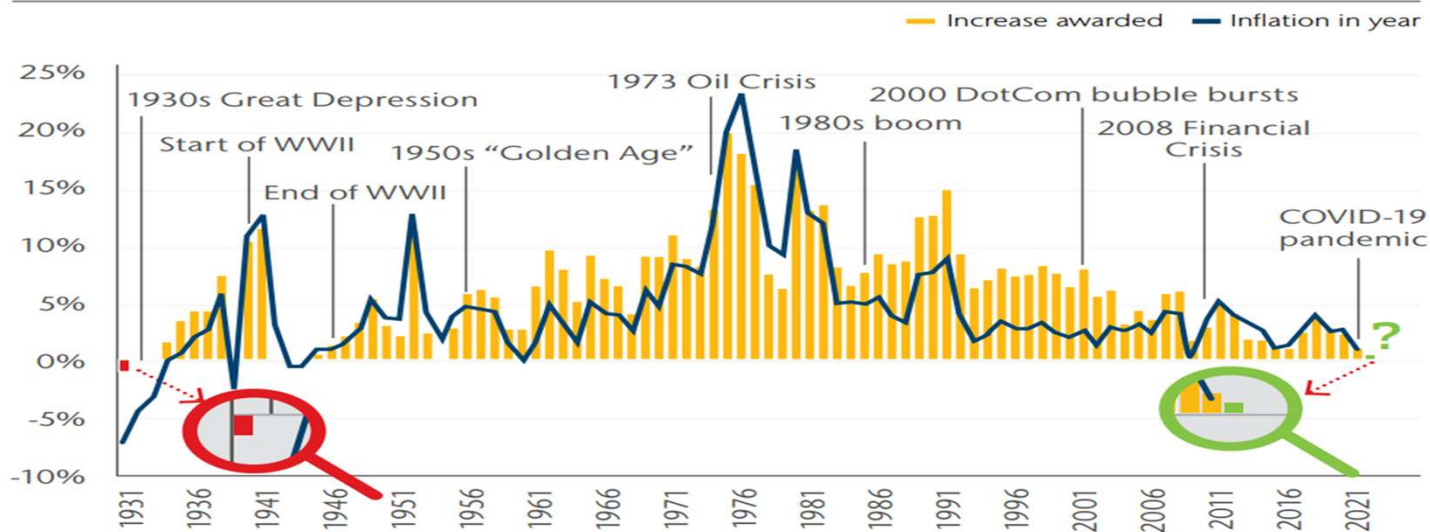
The value of CP for Employers and Employees



Analysis - CPs protect members from market volatility

- CP v DC between 1930 and 2012 found CPs would offer more stable pensions and a higher median income
- A well-designed CP scheme targeting inflationary increases (as illustrated in the model below) would not have needed to cut members' benefits in the wake of 2020's adverse markets (which fell approx. 30%)

Back-testing CDC benefit adjustment outcomes



Taken from Aon's 'Collective DC in adverse markets' paper.

Benefits of a sector wide CP

Scale (Institutional Investing Power): Through larger scale, sector-wide schemes can reduce member borne investment management and administrative charges. They can also access higher-yield, longer-term infrastructure and private market assets – can boost member returns as a result.

SME's (Levelling the Playing Field): SMEs who lack financial capacity or scale to build a bespoke single-employer plan can pool their resources to offer a better pension offering with the governance costs met by the scheme provider.

Portability: Employees moving between different companies within the same sector can seamlessly keep contributing to the *exact same* collective fund. Avoids the accumulation of lots of inefficient small pots, keeps retirement considerations unified/simpler for members and reduces cost inefficiencies of new enrolments for employers.

Recruitment and Retention: A sector-wide CP even the smallest employer to offer an income-for-life pension package. A flagship scheme strengthens the overall employment value proposition of a sector.

What CPs can also offer

Cash Lump Sums at Retirement: Members can typically take up to 25% of their pension value as a tax-free cash lump sum at retirement and subject to standard UK allowances cap. All prospective providers intend to build this into their scheme design.

Spouse's & Dependant's Pensions: income paid out by a pension scheme to a surviving partner, civil partner, or qualifying dependant after the pension member dies for a guaranteed period.

Serious Ill-Health Lump Sum (Terminal Illness): allow you to take your money early if you become terminally ill, subject to UK tax law and the specific rules of the scheme's trust.

Transfers in: Members can transfer in their existing DC pots into the CP scheme.

Transfers out: Before retirement members retain their statutory right to transfer out all or some of the cash equivalent of their accrued pension rights to another eligible option.

Continuing the conversation....

If you would like to discuss any of the points raised in this slide pack in more detail or have any other questions regarding collective pensions, then the policy team at DWP would be happy to have a chat.

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