



intergenerational foundation

Fairness for Future Generations

Pension Schemes Bill 2014/15 Evidence Submission

Summary

IF opposes the introduction of “collective defined contribution” (CDC) pensions in the UK for the following reasons:

- They are likely to transfer an unacceptable degree of risk on to the shoulders of younger and future generations of savers;
- It is unlikely that proper risk-sharing safeguards will be introduced for legal and political reasons;
- They appear to be incompatible with the new pension freedoms that have recently been announced for savers.

IF thinks it would be more beneficial if instead of trying to create a new category of pension, more effort was put into encouraging young people to save using established forms of pension instead.

1.0 Who we are...

1.1 The Intergenerational Foundation (www.if.org.uk) is a think tank which researches fairness between the generations in the UK, in order to protect the interests of younger and future generations, who are at risk of being ignored by current policy-makers.

2.0 Our submission...

2.1 IF is concerned that the type of “collective defined contribution” (CDC) pensions referred to in Part 3 of the draft bill could lead to unfairness between different generations. Several pensions experts (including the independent pensions consultant John Ralfe, and the Association of Consulting Actuaries (ACA)) have publically issued warnings that the implementation of CDC in the UK context could lead to an unacceptable degree of intergenerational unfairness towards young savers.¹ It is worth noting that the Department for Work and Pensions actually abandoned its previous research into implementing CDC schemes in the UK because they determined that their model of intergenerational risk-sharing would be too unfair.²

¹ Association of Consulting Actuaries (ACA) (2014) *Are collective defined contribution schemes the future for UK workplace pensions?* London: ACA

² Department for Work and Pensions (2009) *Collective Defined Contribution Schemes* London: DWP

2.2 As ACA argued earlier this year, *“the main challenge to the Dutch [CDC] system is that it is potentially unfair across the generations; younger members bear the risk that their benefits will be reduced in future if older members’ benefits are preserved today.”*³ Under a CDC arrangement there is no plan sponsor, and the members do not have individual ownership rights to their pension contributions in the way that they do under a traditional DC scheme. This means that the only guarantors of future benefits are future generations of contributors. As the relationship between the amount an individual pays in and receives in benefits is so weak under a CDC scheme, current beneficiaries are likely to end up being paid a pension which is worth more than their contributions if either longevity assumptions or projected investment returns turn out to have been inaccurate. If younger savers believe that they are making payments into the scheme in order to fund benefits for the current generation of retirees which are more generous than the scheme will be able to provide for them when they retire themselves, it would significantly reduce the incentive for them to save.

2.3 There is a danger that, in effect, CDC pensions could come to resemble so-called “Ponzi” schemes, which depend upon attracting an ever greater number of new contributors in order to fund their current liabilities. Under the worst case scenario, if too many current contributors leave these schemes then they would be likely to collapse, leaving a funding deficit. It is worth emphasizing that the CDC schemes that exist in the Netherlands, which British proponents of the CDC model seek to emulate, do not suffer from this problem because workplace pension saving there is compulsory, so each generation can be confident that the next generation will meet its obligations to pay their pensions. Whether the CDC model is compatible with the highly flexible system of pensions we have in the UK is clearly open to debate.

2.4 In theory, the design of CDC pensions is supposed to balance the interests of younger and older generations by enabling these schemes to reduce benefits in payment and implement less generous forms of indexation if the scheme’s funding projections turn out to have been inaccurate. The pensions expert John Ralfe has argued that for CDC to be implemented in Britain, it would require *“strict and transparent solvency rules, with the ability to cut pensions in payment, and, even claw back pensions already paid, if solvency deteriorated due to poor investment performance or increased longevity forecasts.”*⁴ In practice, it would be far from certain whether such an assault upon pensions that were already in payment would be able to survive legal challenges, given Britain’s tradition of treating pensions in payment as inviolable. It must also be doubtful whether politicians would be willing to allow such reductions in current benefits to take place given that it would harm the interests of an extremely important section of the electorate.

2.5 One other important factor is that it is not at all clear how CDC pensions would be compatible with the new private pension freedoms that have recently been announced. Given the lack of individual ownership rights over pension contributions which are invested in a collective fund, there would have to be some mechanism for enabling scheme members to take all their contributions as flexible drawdown or leave them to their heirs upon death, but

³ Ibid.

⁴ Ralfe, John (2012) “CDC could lead to Ponzi schemes” *Financial Times* 26 April 2012

enabling older people to withdraw money from the collective fund would weaken its solvency position, meaning young people would potentially be asked to contribute more to keep it afloat. IF would urge the Coalition Government to abandon its plans to introduce CDC pensions in the UK, and spend the resources and political capital which would have been used to implement them on getting more young people to save into one of our well-established types of pension scheme instead.

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For more information about the Intergenerational Foundation and its work, please visit www.if.org.uk or contact Liz Emerson, Co-Founder at liz@intergenerational.org.uk.