

Open consultation:
Extending Opportunities for Collective Defined Contribution Pension Schemes

To: Department for Work & Pensions

By: The Intergenerational Foundation

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The Intergenerational Foundation (www.if.org.uk) is an independent think tank researching fairness between generations. IF's guiding principle is that policy should be fair to all – the old, the young and those to come.

Introduction

The Intergenerational Foundation (IF) is grateful for being given the opportunity to respond to the consultation seeking evidence on policy proposals to broaden the provision of Collective Defined Contribution (CDC) pension schemes. IF strongly believes that all policies must be considered from an intergenerational fairness perspective, thereby protecting the rights of younger and future generations. Since its foundation a decade ago, IF has conducted research on issues facing young people and future generations, including the difficulties young people face to build up savings, how older generations have benefitted from more generous pension schemes than those currently offered to the young, and the precarious future facing young people and future generations if the saving and pensions crisis for young people is not adequately addressed. Although IF is welcoming of policy innovation in relation to pensions, particularly to address the intergenerational injustices of current pension systems, we would like to raise our concerns over the impact that broadening CDC pension schemes may have if they do not satisfactorily address aspects of CDC schemes that are likely to have disproportionately negative effects on young members. Our concerns are summarised below, and mainly pertain to the issues of how older members' benefits might necessitate disproportionately large contributions from younger members, how 'targeting' returns might lead to short-term and risky investments with the risk primarily borne by younger members, and how the marketing of CDC schemes may be overly optimistic by overestimating returns, especially if the marketing of pension benefits is not presented in real terms.

Question 1:

Although IF understands that the main benefits of CDC pension schemes are the pooling of longevity and investment risk and therefore the opportunity to target higher returns, we believe that there are some key principles that should be included in the regulation

broadening CDC pension provision to ensure that the broadening of these schemes does not lead to intergenerational injustices for their members.

1. To ensure that the schemes are sustainable and resilient in the long-term for all members, old and young, a key principle that must be addressed concerns how the risks and rewards are distributed among members. If the scheme is performing well financially and pension payments to members increase as a result, there must also be a fair mechanism in place for ensuring that younger and newer members do not have to bear an unfair contribution burden in cases where the scheme is not performing well. A transparent and fair mechanism that explains how risks and rewards are distributed between newer and older members of the scheme is therefore essential for its long-term resilience, as newer members would otherwise be likely to either leave the scheme or face an unfair contribution burden.
2. IF agrees on the principle that CDC benefits must be assessed on an annual basis to ensure that the problem described in the previous paragraph does not arise. IF also understands that CDC designs should include an aspiration to deliver increases that are at least in line with the CPI, but IF is also concerned that 'targeting' returns, particularly on a short time horizon, might lead to riskier investments. Thus, it is vital that the issues raised in Paragraph 1 are addressed, so that 'targeting' does not result in older members enjoying the rewards while most of the risk/burden is placed on younger members.
3. IF also proposes that a key principle of the legislation must be that employers offering the CDC pension schemes to their employees must also always offer defined contribution (DC) pension schemes to all their employees as an alternative for the employees to choose if they wish to do so. If younger employees feel that the CDC pension scheme favours older members over the young, it would be intergenerationally unfair not to give younger employees the option of a DC pension scheme if they would prefer to choose to participate in a DC scheme.
4. IF is concerned about how the scheme might be marketed to potential members, in particular concerning how the risks involved might affect members. Since modelling suggests that CDC schemes are theoretically able to offer higher investment returns and therefore higher pension payments, it is vital that these aspects are not exaggerated in the marketing. It would be advisable to always present target pension payments in real terms to avoid exaggerating the rewards of the scheme. In addition, it is necessary to accurately explain how the pooling of longevity risk might impact members. Furthermore, the marketing and communications of the schemes must also accurately explain how the risks and rewards are distributed among newer and older members of the scheme. The question of accurate communications and

neutrality in marketing is particularly important from an intergenerational perspective, since newer members are likely to be younger and therefore have less experience and knowledge about how pension schemes function, or the risks associated with different types of schemes. Thus, if the marketing and communications does not accurately explain the risks associated with the scheme, it is likely to lead to an intergenerational injustice where younger members enter and contribute to the scheme to the benefit of the older members without accurately understanding the risk they are taking on.

5. In order to improve the intergenerational fairness of scheme management and simultaneously improve the long-term resilience of CDC schemes, IF proposes that legislation should include that at least two members of the trustees of the scheme are under the age of 35. This would make sure that younger members' views are represented, which is likely to both increase the intergenerational fairness of the scheme and its sustainability in the long-term.

If you would like to learn more about the work of the Intergenerational Foundation or would like to organise a meeting to discuss the points we raise, please contact:

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