CSFI
Centre for the Study of Financial Innovation

PENSION INSURANCE CORPORATION

CDC pensions: Are the proposed new collective pension schemes a boon or a con? A round-table in the CSFI/PIC series with John Ralfe (John Ralfe Consulting), Kevin Wesbroom (Aon Hewitt), Louise Inward (Pension Insurance Corporation) and Mark Rowlinson (First Actuarial).

Held on Tuesday, 15 July, 2014, from 12.30-2.15pm.
At the London Capital Club, 15 Abchurch Lane, London, EC4N 7BW.

Collective defined contribution (CDC) pension schemes, or “target pensions”, share risks between savers. In the UK Government’s Pension Schemes Bill, they fill the “defined ambition” gap between “defined benefit” – a firm promise on retirement income – and “defined contribution”, where it all depends on the size of your individual pot and the markets on the day you retire.

John Ralfe, writing in the FT, has warned that CDC schemes can resemble a “Ponzi” arrangement because they depend on new members’ contributions to keep the scheme flush enough to pay out the “target” pensions. If the oldies take too much out, it will be just another way to rip off Generation Y.

But CDC, emulating the much-admired Dutch system, has many advocates, including Kevin Wesbroom, who has argued that these schemes deliver better outcomes for members.

They do address most people’s first question about a pension scheme – what will my income be in retirement? But without the pesky guarantee of a DB scheme (that’s a big but).

Our round-table, in the Pension Insurance Corporation Fellowship series, brought not only these protagonists together, but others on the panel and in the audience with equally strongly held views.

The pros for CDC schemes included:

1. Auto-enrollment brings individual savings together in a big efficient fund, with a default investment strategy. CDC would mirror this in the “decumulation” phase, paying them a pension for life. People would not have to make a decision (one that would scare them). Benefits would be “target” amounts with no guarantees, letting employers off the hook.
2. A few big CDC funds would provide economies of scale, enable more investment risk to be taken than an individual could bear, and would share longevity risk.
3. Outcomes based on volatile investment performance would be smoothed, rather like a with-profits fund.

4. It could appeal to employers to put their contributions into a CDC, while the employee might put the money into an individual DC pot that they would own.
5. These schemes will be transparent, with actuaries and trustees publishing valuations, results of stress tests etc.
6. Intergenerational risk is exaggerated. Every pension saving arrangement carries the risk that one generation will do better than another.

The cons:

1. CDC schemes will not be attractive to employers, who have already decided they prefer plain DC, where their responsibility ends at making contributions into employees' funds.
2. There are set-up costs, and yet no initial reserve to help with subsequent bad years.
3. Regulatory risk: the history is that target benefits are turned into hard promises.
4. For employees, this does not fit the bill of providing something simple that can be trusted. The working of these funds is complex.
5. Post-Budget, the focus is on individual pots from which cash lump sums or income can be drawn down. 'It's mine.' But the CDC proposals offer no clear property rights.
6. In contrast to the Netherlands, where such schemes are heavily regulated (including allowing pensions in payment to be cut), the proposed CDCs will be drawn up by trustees and actuaries – trust issue again, and a very difficult job for those two parties.
7. Smoothing is seductive, but it might mean that an individual would draw out more or less than the sum they thought they had built up; and on transferring out, there would be unpopular haircuts.

Questions included whether employees would interpret "targets" as guarantees, which would run reputational risk for employers if the outcome disappointed.

There was scepticism that these schemes would encourage more saving and/or more trust in the pensions/insurance industry. That trust was very thin on both employer and employee sides.

Transparency would not help because the projections would vary and there would be a gap between the notional pot and the amount people could transfer out.

Sincerely yours,

Jane Fuller
Co-director
CSFI