PPI Submission to the Work and Pensions Select Committee: Governance and best practice in workplace pensions

Summary

I. This submission provides the PPI's written evidence to the Work and Pensions Select Committee inquiry into Governance and best practice in workplace pensions.

II. The predominant form of pension provision in the private sector in the UK in terms of the number of actively contributing members is Defined Contribution pensions. In 2011 there were around 7 million active members contributing to Defined Contribution pensions in the private sector, compared to 1.6 million active members of Defined Benefit pension schemes.

III. The introduction of automatic enrolment is likely to lead to a substantial further increase in the number of individuals saving in Defined Contribution pensions in the future. PPI projections suggest that following automatic enrolment, and if current trends continue, there could be around 15 million active DC savers by 2020, compared to less than 1 million active savers in private sector DB schemes. As a result it is essential that DC pensions provide good outcomes for their members.

IV. There are a range of factors that will need to be considered in order to ensure good outcomes from Defined Contribution pensions for members. These include the need for:

- Higher than the minimum levels of pension contributions required under automatic enrolment legislation from individuals, employers and the Government through tax relief if individuals are to achieve adequate levels of retirement income;
- The importance of investment returns in determining outcomes of DC pensions, and in particular the importance of designing appropriate default funds that balance returns and risk, particularly in the run-up to retirement;
- The importance of transparency in the fees and charges levied by pension providers for both scheme members and employers so that members and employers can make an informed choice about the value for money of their pension scheme and competition among providers is enhanced;
- Given the complexity of the decisions faced by scheme members in converting their pension pot into an income at retirement and that these decisions are for the long-term and in the case of an annuity purchase are irreversible, it is essential

that scheme members have the information and advice that they need to make an informed choice at retirement.
- That the introduction of a single-tier flat rate state pension will reduce, but not entirely eliminate, the interaction of income from workplace pensions with the state means-tested benefit and tax system.

V. There are inherent uncertainties in predicting the likely private pension income that an individual might receive from a Defined Contribution pension. As a result it is essential that providers supply clear communications to members of pension plans that set out the possible retirement income that the pension may deliver under a range of plausible scenarios.

VI. Membership of Defined Benefit schemes in the private sector has been in substantial decline in the UK. Membership of private sector Defined Benefit pensions peaked at around 8 million members in the private sector in the late 1960s, but by 2011 there are only 1.6 million active members in open private sector DB schemes – this is less than 25% of all active members in the private sector. As a result any proposals to reduce the regulatory burden on existing Defined Benefit schemes in the private sector, while potentially welcome, are unlikely to have a major impact in increasing the number of active members of such schemes, although they may help employers who are struggling to deal with the legacy of a closed DB scheme.

VII. The submission considers the evidence on the pros and cons of Collective Defined Contribution schemes. The evidence suggests that Collective DC schemes can provide higher average returns and lower variability of outcomes than standard DC schemes organised on an individual basis. However, Collective DC schemes can also lead to intergenerational unfairness between younger and older members of the scheme if market conditions are unfavourable and any benefit cuts are applied to non-pensioners. Collective DC schemes also need to be organised on a large scale basis with an on-going stream of incoming contributions to ensure their long-term viability and sustainability which would require radical changes to the way that work-based pensions are provided in the UK. However, Collective DC schemes already exist in the Netherlands and Denmark suggesting that pensions can be successfully provided on this basis.

Introduction:

1. The Work and Pensions Select Committee is undertaking an inquiry that is considering governance and best practice in workplace pensions. This submission provides the Pensions Policy Institute's evidence to the inquiry.

2. The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique in the study of pensions, as it is independent (no political bias or vested interest); focused and expert in the field; and takes a long-term perspective across all elements of the pension system. The PPI exists to contribute facts, analysis and commentary to help all commentators and decision-makers to take informed policy decisions on pensions and retirement provision.

3. As the Committee notes, the UK's pensions system is currently undergoing a series of major reforms:-
   - The Government recently announced that it plans to introduce a single-tier flat-rate state pension for future retirees set at a level above the means-tested Pension Credit (estimated to be around £140 a week). A White Paper is expected this year that will set out the operational detail of this new state pension policy with a Pensions Bill to follow.

   - The Government has already legislated to introduce a requirement for all employers to automatically enrol all of their eligible employees into a workplace private pension. Employees will be eligible for auto-enrolment if they are between age 22 and State Pension Age (SPA) and have yearly earnings of at least £7,475 (2011/12 earnings terms).[1] If the employees remain opted-in to pension saving following automatic enrolment, the employee will eventually contribute 4% of a band of their earnings[2], the employer must contribute 3% of band earnings and the Government will contribute at least 1% through tax relief. Once the reforms are fully implemented, an individual who is automatically enrolled into a workplace pension will have a combined contribution of at least 8% of band earnings contributed into a pension on their behalf.

   - In addition, there are significant reforms of the UK's public sector pension schemes following Lord Hutton's recommendations to move the public sector pension schemes from defined benefit final salary schemes to career average schemes and to increase normal pension ages and member contributions in most of the public sector schemes.

4. It would be helpful if any recommendations made by the Committee dovetail with and build on the existing direction of the current pension reforms.

[1] The Government will uprate the automatic enrolment threshold before its introduction in October 2012.
[2] The band of earnings on which contributions are paid is from £5,715 to £38,185, in 2010/11 earnings terms and it will be uprated to 2012/13 earnings terms before the introduction of automatic enrolment.

How many individuals are saving in a workplace pension in the UK?

5. In 2010, around 50% of employees were members of a workplace pension, down from 55% in 1997.[3]

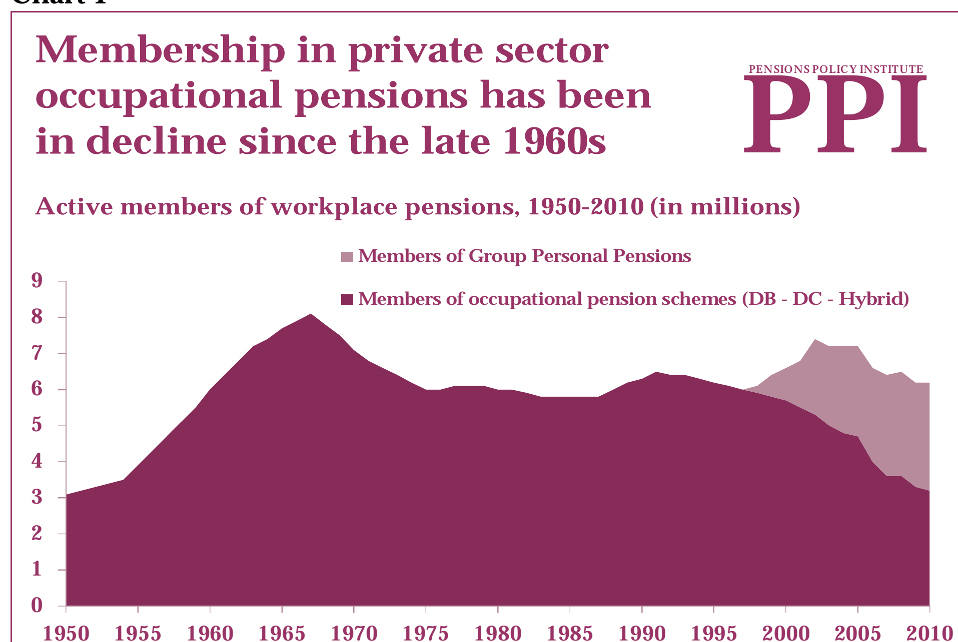
6. Only a minority of working-age adults in the UK are contributing into a pension. Only 36% of people aged 16 to 64 (14 million) were making contributions to any type of private pension.[4] These estimates include members of public sector pension schemes. There were over 5 million active members in public sector pension schemes in 2010. The majority of the public sector schemes are provided on a Defined Benefit basis.

Membership in private sector occupational pensions has declined since the late 1960s

7. Until the 1960s, there was an increase in membership of private sector occupational pension schemes, most of which had, at that time, a DB benefit structure. Membership in occupational pensions in the UK peaked in 1967, when there were more than 8 million active members. Active membership in private sector occupational schemes started to decline from the late 1960s, reaching around 3 million members in 2010, including occupational DB, occupational DC and hybrid schemes.

8. However, membership in personal pensions, including Group Personal Pensions (GPP), Stakeholders Pensions (SHP) and individual plans, has grown since the late 1980s with around 3 million individuals in the private sector workplace contributing to a personal pension in 2010 (Chart 1).

Chart 1[5]

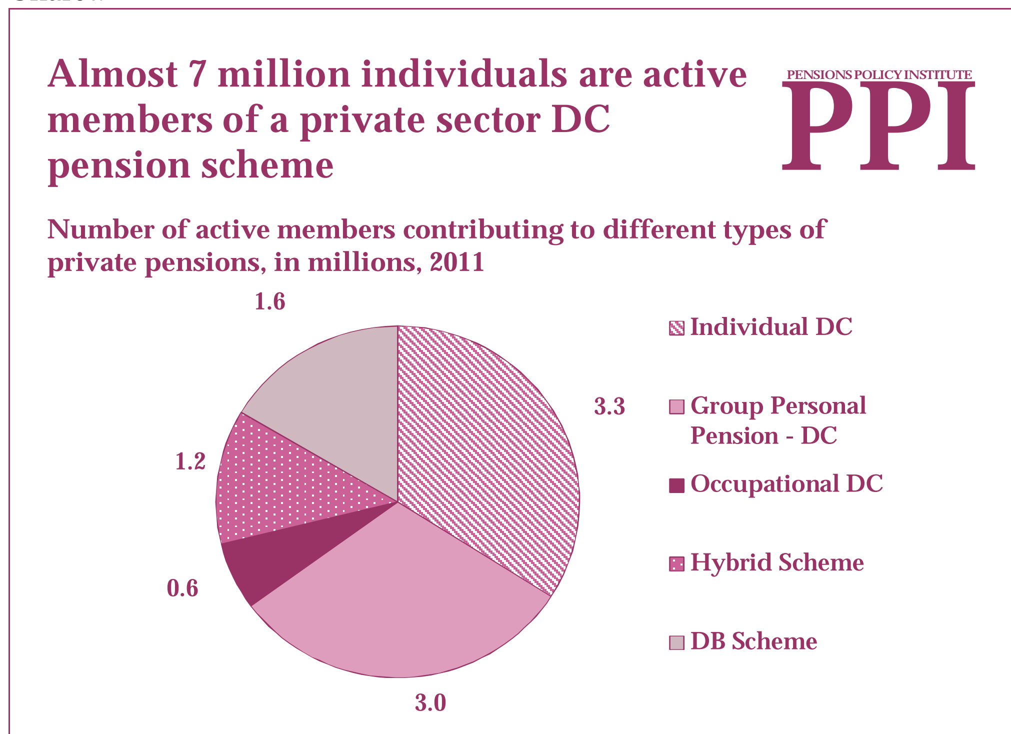


[3] See ONS (2011b) Figure 7.5
[4] See ONS (2011b) Chapter 7, p.3.
[5] PPI estimates based upon: ONS (2011b), Figure 7.1; ONS (2011a), Table 3.6; ONS (2010)

9. The total number of individuals who are contributing to a Defined Contribution pension in the UK is approaching 7 million in 2011. This includes those who are contributing to individual personal pensions, Group Personal Pensions and to occupational DC pensions. A closer look at the latest figures of active membership in private sector[6] pensions shows that out of over 9.7 million active members in 2011: (Chart 2)

- 3.3 million (around 35%) are saving in an individual DC pension ;
- 3.0 million (around 30%) are saving in a Defined Contribution Group Personal Pension;
- 0.6 million (around 5%) are saving in an occupational DC pension scheme;
- 1.2 million (around 10%) are saving in a hybrid pension scheme;
- 1.6 million (around 15%) are saving in a DB pension scheme.

Chart 2[7]



10. In a Defined Contribution pension scheme, the employer commits to contribute a fixed percentage of salary into the pension. However, the employer does not commit to paying a particular level of final pension – the scheme member bears all of the investment, inflation and

[6] In this context private sector pensions excludes public sector pension schemes (including the Local Government Pension scheme), but will include individuals who work in the public sector and contribute to a separate non-public sector DC scheme, such as an individual stakeholder pension.
[7] PPI estimates based on data from TPR, HMRC, ONS and DWP. The chart shows membership of private sector pension schemes, and so excludes membership of public sector pension schemes (including the Local Government Pension Scheme). However, some public sector workers who contribute to non-public sector pension schemes (such as an individual stakeholder pension) will be included in the chart.

longevity risk. Defined Contribution pensions are now the predominant form of pensions offered to employees working in the private sector.

The introduction of automatic enrolment into private pensions is likely to substantially increase the number of people saving in DC pensions in the future

11. The introduction of automatic enrolment into private pensions is likely to lead to a substantial further increase the number of individuals saving in Defined Contribution pensions in the future. This is because most Defined Benefit schemes in the private sector are closed to new members, so it is anticipated that most new pension savers will be automatically enrolled into a Defined Contribution pension.

12. PPI projections suggest that following the introduction of automatic enrolment and if current trends continue there could be around 15 million active DC savers by 2020, compared to less than 1 million active DB savers in the private sector by 2020.

13. As a result it is essential for the success of the Government's automatic enrolment policy that DC pensions deliver good outcomes for scheme members.

How to ensure DC schemes deliver good outcomes for their members?

14. There are a range of factors that will influence the final level of retirement income delivered by a Defined Contribution workplace pension.

    - The level of pension contribution that has been contributed by the individual, their employer, and by the Government by virtue of tax relief on pension contributions. All other things being equal, higher contribution levels are likely to lead to a higher level of final pension.

    - The investment performance of the underlying investments in which the pension fund is invested. This is a major contributor to the final outcome of the level of retirement income generated by a Defined Contribution pension. Over the long-run, a higher proportion of the pension investment portfolio invested in equities may lead to higher average investment returns, but it is also likely to lead to higher variation in investment outcomes than a portfolio invested more heavily in bonds and cash.

    - The structure and level of charges levied by the pension provider. Higher charges will tend to lead to a lower pension income for the scheme member, all other things being equal.

    - The conversion of the pension pot into an income at retirement. For Defined Contribution pensions the member will retire with a

pension pot and will have to decide how to convert that pension pot into a retirement income. The member can take 25% of their pension pot as a tax-free lump sum, but the remainder will need to be converted into a retirement income either through the purchase of an annuity, or through regular scheduled withdrawals through income drawdown.

- The interaction of the workplace pension income with the tax and state benefit system. In the UK the tax system treats pension income as EET – that is Exempt, Exempt and Taxable. Pension contributions are Exempt from tax, investment returns on pension investments are largely Exempt from tax, but the final pension income paid out by the workplace pension is Taxable. In addition, the level of income generated by a workplace pension can affect an individual's entitlement to other means-tested state benefits such as Pension Credit, Council Tax benefit and Housing Benefit.

The importance of communicating potential outcomes to members

15. Given the large number of factors that will determine the final level of income generated by a Defined Contribution pension scheme it is easy to see why pension scheme members may feel overwhelmed and confused by pensions decisions, language and jargon. As a result clear communication about possible retirement income outcomes for members of defined contribution schemes is essential.

16. However, any such communication will need to recognise the inherent uncertainties in a Defined Contribution pension by providing alternative projections based on alternative assumptions about future investment returns in particular. Currently statutory money purchase illustrations stipulate that a nominal investment return of 5%, 7% and 9% should be used to illustrate the potential outcomes from a Defined Contribution pension. However, the investment return that is achievable will be heavily dependent on the underlying investment portfolio that the pension is invested in. It is essential that these assumptions reflect the reality of what is achievable in the current market conditions otherwise they may mislead scheme members.

17. What might best practice in DC schemes look like for each of the factors that affect DC outcomes?

	Best practice in DC pension schemes
Levels of pension contribution	A key risk to the outcomes for members of DC schemes following automatic enrolment is that a combined contribution rate of 8% of band salary is unlikely to be sufficient for most individuals to achieve an adequate retirement income when combined with their state pension income. Even on top of state pensions, combined contributions of closer to 15% of band salary are likely to be needed for a median earner to meet a target replacement rate of a retirement income at State Pension Age of two-thirds of their pre-retirement income. Policymakers will need to consider ways to encourage both individuals and employers to contribute at higher than the minimum required levels required under automatic enrolment legislation if DC scheme members are to achieve good pension outcomes.
Investment Returns	The asset allocation of the pension portfolio between equities, bonds and other assets will be a key driver of the final pension income generated by a DC pension. However, it is also important to recognise the inherent volatility of the returns of some assets, such as equities. It will be particularly important for pension providers to manage the risk of volatile investment outcomes as a member gets closer to retirement, to avoid negative outcomes for scheme members. Under automatic enrolment international experience suggests that the majority of scheme members will simply opt to remain invested in the default investment fund. As a result the design of the default investment fund will be a key determinant of the final pension income achieved by scheme members. Default fund design will need to carefully balance risk and returns and manage investment risk in the run up to retirement.

	Best practice in DC pension schemes
Structure and Level of Charges	Both the charging structure and the level of charges levied by the pension provider will impact on the final pension achieved by the scheme member. Higher charges will tend to lead to a lower pension income, all other things being equal, so from the member's point of view low charges are likely to be desirable. However: • Charges may be higher if some element of information or advice is offered as part of the scheme, which <u>may</u> encourage more people to save, or people to save more. • Some higher charge pension schemes may be invested in a more active way and <u>may</u> outperform lower charge schemes on the investment performance, although this is in no way guaranteed. As a result it is important that the level of fees and charges are transparent and that both the employer and the scheme member understand how much they are being charged by the pension provider and what for. The introduction of a plethora of both charging structures and levels is also likely to make it difficult for both employers and scheme members to compare the charges of different pension schemes. It may be helpful for scheme members for there to be a requirement for all pension providers to re-express their charging structure using a standard comparator metric (eg equivalent to an Annual Management Charge of 0.5%) in a similar way to the use of APRs in banking to enable like-for-like comparisons to be made.
Conversion of Pension Pot at retirement	DC scheme members will need to convert their pension pot into an income in retirement. Members are able to take 25% of their pension pot as a tax free lump sum and then need to decide how to convert the rest of their pension pot into a retirement income. How a member decides to translate their pension pot into a retirement income will be a significant factor in determining their final retirement income. Members who use income drawdown will have greater scope for investment growth but will also be exposed to investment risk if markets fall. Members who purchase an annuity will be exposed to time of purchase risk relating to the annuity rate that is on offer when they buy their annuity. This is a complex area. Some scheme members will want to purchase an annuity – which guarantees a fixed or escalating income for life in return for giving up the capital sum of the pension pot. Other scheme members

	Best practice in DC pension schemes
	may wish to use income drawdown where scheduled withdrawals are made each year from the pension fund. Scheme members who can meet the Government's Minimum Income Requirement of an income of £20,000 per annum have total flexibility over how they use their pension fund. Given that these decisions are for the long-term and in the case of an annuity purchase are often irreversible, it is essential that scheme members have the information and advice that they need to make an informed choice at retirement.
Interaction of tax and state benefit system	The interaction of workplace pension income with the tax and means-tested state benefit system can also affect the outcomes from DC pension saving. The introduction of a single-tier flat rate state pension at around the level of the means-tested Pension Credit level (£140 a week) is likely to reduce some of the negative interactions between workplace pension saving and state means-tested benefits, although it will not necessarily eliminate the issue altogether as eligibility for the full state pension is still contributory and based on National Insurance records and individuals may still be eligible for Housing or Council Tax Benefit. The recent changes to the age related allowances within the tax system will reduce the level of pension income that DC pensions will provide, relative to the tax system that was in place prior to Budget 2012.

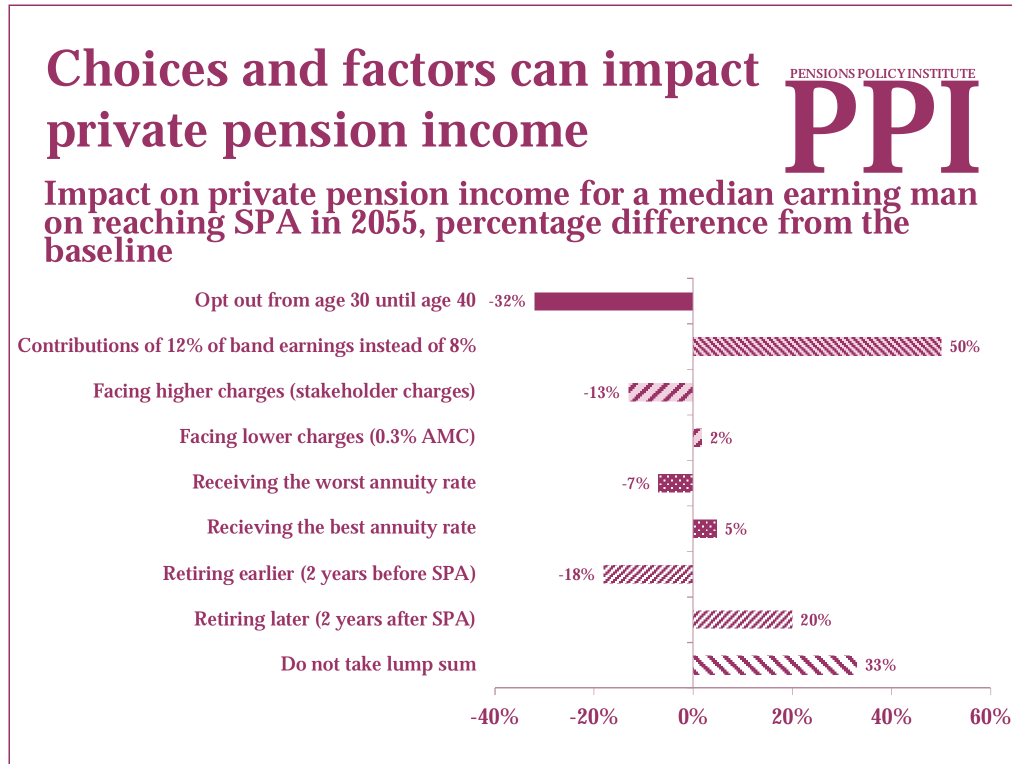
How important is a range of factors and choices in determining the outcomes from DC pensions?

18. In February 2012 the PPI published research commissioned by the National Association of Pension Funds which considered the impact that a range of factors and choices made by individuals or employers could have in determining the final private pension income of a median-earning man saving in a Defined Contribution pension.

Factors and choices which increase private pension income

19. The research clearly illustrated that if the median earning man or his employer were to increase the contributions being paid into the pension scheme from a combined 8% of band earnings, to a combined 12% of band earnings then his private pension income could increase by 50%. (Chart 3) The increased contributions had the single biggest positive impact on the median earning man's final private pension income of all of the factors considered in this research.

Chart 3



20. Other factors and choices also had a positive impact on the median earner's private pension income. If the median earning man were not to take his tax-free lump sum he could increase his private pension income by 33%. However, it should be recognised that by not taking a tax free lump sum he will forego a tax benefit as the tax system actively encourages people to take a lump sum. The vast majority of retirees do take a tax-free lump sum.

21. If he was to retire 2 years after State Pension Age rather than retiring at his SPA this could increase his private pension income by 20% due to the twofold effect of saving more and deferring his annuity purchase.

Factors and choices which reduce private pension income

22. The research also shows the negative impact on private pension income of opting-out of pension saving. If the median earning man opts-out of pension saving for ten years between age 30 and age 40 his private pension income is likely to reduce by 32% compared to what his retirement income would have been if he had remained automatically enrolled and continued to contribute at the minimum levels required under automatic enrolment over that 10 year period.

23. Other factors and choices that can have a negative impact on the level of private pension income provided by a DC pension include being in a higher charging scheme and not shopping around for an annuity.

24. If the median earning man is in a pension that charges the maximum allowable charges on a stakeholder pension scheme (an Annual Management Charge of 1.5% for the first ten years, and 1% thereafter), this could lead to a reduction in his private pension income of 13% compared with if he was saving in NEST with the NEST charging structure of an Annual Management Charge of 0.3% and a 1.8% charge on contributions.

25. If the median earning man takes the lowest annuity rate on the Money Advice Service tables to convert his pension fund into an annuity income at retirement, this could lead to a reduction in the private pension income of around 7% when compared with the median annuity rate on the Money Advice Service tables. [8]

26. One factor which was not considered in this research which does have a substantial impact on the final outcome from a defined contribution pension scheme is the investment returns that are delivered by the underlying investments that the pension fund is invested in. This was not considered in this research because it is not a choice that either an individual or the employer can explicitly make but it is an important determinant of the final outcome of a DC pension.

27. It should be noted that all of the results above are specific to the case of a median earning man and cannot be generalised to individuals with higher or lower earnings levels. The research also considered the impact for a median earning woman.[9]

Governance in Defined Contribution schemes

28. Defined Contribution pensions can have a trust or contract-based governance structure. In a trust based scheme the scheme will have a Board of Trustees who have a fiduciary duty to act in the best interests of the scheme members.

29. Defined Contribution pensions can also be provided on a contract basis where there is a direct contract between the scheme member and the pensions provider (generally an insurance company.) In such cases there is no Board of Trustees. An employer might use a contract-based scheme to set-up a Group Personal Pension and all individual pension plans are provided on a contract basis.

30. Some concern has been expressed that in a contract based Group Personal Pension scheme there is no-one explicitly representing the interests of the scheme member, unless the employer continues to take an active interest in monitoring the on-going performance of the

[8] Annuity rates were accessed on the Money Advice Service website on 6 June 2011. tables.moneyadviceservice.org.uk/Comparison-tables-home/Annuities/Compare-Annuities/

[9] See PPI Closing the gap: the choices and factors that can affect private pension income in retirement for the results for the median earning woman and for a full description of all the assumptions made in the research (2012)

scheme. This may point to the need for tighter regulation of contract-based schemes, than for trust-based DC schemes.

The Future of Defined Benefit schemes

31. Defined Benefit schemes are pension schemes in which an employer commits to provide a guaranteed pension often linked to the employee's final salary, but sometimes to their career average salary. The final pension payable will be determined by the rate of pension accrual within the scheme (the accrual rate), the length of the employee's service and the indexation arrangements within the scheme.

32. As noted above Defined Benefit schemes have been in considerable decline in the private sector in the UK. Membership of occupational pensions in the private sector peaked in the late 1960s at around 8 million members. The vast majority of these 8 million members would have been in Defined Benefit schemes. By 2011, there were only 1.6 million active members still contributing to Defined Benefit schemes in the private sector.

33. The committee asks whether there is scope to reduce the red tape for Defined Benefit schemes to tackle their decline. It is worth noting that the vast majority of private sector Defined Benefit schemes have <u>already</u> closed to new members, and increasingly are closing for their existing members too. As a result, any such measures, while potentially welcome, are likely to only have a limited impact on the 1.6 million active members of private sector DB schemes that remain open. However, such deregulatory measures may help to reduce the cost burden for those employers who are struggling to manage their closed DB scheme.

34. Those DB schemes in the private sector that remain open to new members tend to be a relatively small number of very large DB schemes. In 2011, around 200 private sector DB schemes, or just over 3% of all DB schemes in the private sector had 10,000 members or more; however, they had around 65% of all active members in DB schemes.

Is there scope for greater risk sharing in workplace schemes in the future?

35. A key difference between Defined Benefit and Defined Contribution pension schemes is in who bears the risks inherent in any pension scheme – such as the investment, inflation and longevity risk.

36. In a Defined Benefit scheme it is the employer who bears the risk that investment performance fails to live up to expectations, or that scheme members live for longer than expected, or that inflation turns out to be higher than anticipated.

37. In a Defined Contribution scheme it is the scheme member who bears all of these risks. If investment returns are poor, the member retires with a smaller pension pot and gets a lower pension income, if life expectancy increases faster than anticipated they will receive a worse annuity rate and receive a smaller annual pension.

38. There has been much debate about whether there is scope for greater sharing of the risks inherent in a pension scheme. Private sector pension schemes can also have a combination of DB and DC features. These schemes are often called hybrid or risk-sharing schemes. There is a wide range of such schemes but they can be broadly classified into two groups:
    - A ***mixed benefit*** scheme offers one set of benefits that has elements of both DB and DC, such as a DC scheme with a DB underpin guaranteeing a minimum payment.

    - A ***dual section*** scheme has two sections, one offering DC benefits and the other offering DB benefits. In many cases this may just mean that a DC section has been added to a trust where the DB section is closed to new entrants. In this case the scheme is not sharing risks between the scheme member and the employer.

39. However, it is also possible to have a scheme where active members accrue DC benefits for a certain number of years of service and DB benefits thereafter.[10] Similarly, within this category it is possible to have a scheme with a DB element for members under a specific salary level and a DC section top up for members above. Both of these types of scheme would share the risks more equally between members of the scheme and the employer.

40. It is unclear how much appetite there is to use risk-sharing pension schemes by private sector employers. The evidence surrounding employer attitudes to risk-sharing schemes is somewhat inconclusive. Qualitative research on employers attitudes to risk-sharing schemes conducted on behalf of the DWP in 2008 suggested that only a minority of employers were willing to take on some of the risks inherent in private sector pensions.[11] Very few employers with open DB schemes are planning to move to risk sharing arrangements.[12]

[10] The Pensions Regulator (TPR) (2011) ***DC Trust***
[11] See DWP, Employer attitudes to risk sharing in pension schemes: a qualitative study (2008)
[12] See for example NAPF (2011) NAPF Annual Survey 2010 p20

41. However, this may be a result of only limited risk sharing options being available. More recent surveys by the Association of Consulting Actuaries suggest that employer appetite towards risk-sharing schemes may be more positive.[13] It would be helpful to have a large scale, independent, comprehensive survey conducted on employers' attitudes to risk-sharing to inform the development of policy in this area.

Collective Defined Contribution Schemes

42. There are also other forms of risk-sharing pension schemes. In the Netherlands and in Denmark there is a greater use of Collective Defined Contribution schemes. These schemes pool some of the risks among all of the members of the DC scheme on a collective basis, rather than sharing the risks between the employer and the scheme member.

43. In a conventional Defined Contribution scheme each scheme member has their own allocated pension pot. In a collective DC scheme contributions are paid into a collective, rather than individual fund. This approach allows investment risk to be shared among scheme members and may enable the scheme to be invested in equities for longer than in a conventional DC scheme.

44. In 2009, the DWP published an assessment of the viability of collective DC schemes operating in the UK. The review concluded on the basis of modelling conducted by GAD[14] that there was evidence to suggest that Collective DC schemes produce higher level of pensions than standard DC schemes. This was largely due to the fact that Collective DC schemes can remain invested in equities throughout the entire accumulation period, whereas conventional DC schemes tend to have to move into safer, low return assets as the member approaches retirement. The modelling work also showed that there is lower variability of outcomes in collective DC schemes than in standard DC schemes provided that the scheme does not fail.

45. In a Collective DC scheme if market conditions are less favourable than previously anticipated, then projected pensions for future retirees would be reduced to bring the scheme back into balance. As a result this can lead to intergenerational unfairness, in the sense that older cohorts, may have their benefit expectations met in full, but younger generations may find that their pension benefit levels are cut, if market conditions turn out to be less favourable than anticipated. The modelling work also found that collective DC schemes need a continuing stream of member contributions to ensure their continued viability and stability.

[13] ACA's Pension trends survey: Workplace pensions: challenging times (2011)
[14] See DWP (2009) Collective Defined Contribution Schemes: An assessment of whether and how collective defined contribution schemes might operate in the UK

46. One way to help mitigate the risk of intergenerational unfairness is to use conditional indexation. Under conditional indexation, in less favourable market conditions the scheme can reduce the level of indexation applied for both future pensions (as happens in the Collective DC scheme outlined above) and for pensions already in payment. This helps to spread the risk across generations. However, it may leave both current pensioners and future pensioners with lower than expected retirement incomes.

Could Collective DC or other risk sharing schemes work in the UK?

47. The DWP's modelling work highlights some of the advantages but also some of the issues with collective DC schemes. On the plus side these schemes do potentially offer higher average returns with less volatility for scheme members than conventional DC pensions. However, they also need large and stable schemes with ongoing streams of member contributions and there is a need to consider potential inter-generational transfers between younger and older cohorts of members.

48. The introduction of automatic enrolment in the UK is likely to bring many millions of people into pension saving in the UK. The Government's most recent estimates are that there could be between 5 and 8 million new savers in work-based pension schemes, of which 2 to 5 million are expected to be in NEST as a result of the introduction of automatic enrolment.

49. Many, but not all, of these savers will end up in the large scale DC schemes that are being established such as the National Employment Savings Trust, or will be saving with existing or new providers of pensions in the UK. It is conceivable that these schemes could be run on a collective rather than on an individual basis, if it were felt that this was likely to be beneficial for scheme members although the regulatory framework and the current legislation does not currently envisage this approach.

Niki Cleal,
Director
Pensions Policy Institute
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