What will a pension scheme look like in 20 years time?
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Agenda

• A brief history!
• Drivers and factors
• The immediate future
• The longer term
• What we need to do to encourage change!
There is a clear trend for a move away from final salary

A history of DB plans in the UK

- Prior to 1990 (roughly)
  - Indexation largely provided on discretionary basis
  - Viewed as guaranteed by “the fund” by employees
  - Not debt from an employer perspective
  - Strong market performance never exposed the financing risks
  - Low compliance cost
- Since the 90’s
  - Discretionary increases became guaranteed
  - Longevity risk became apparent
  - Investment performance “unmasked” the risks within DB plans
  - Pension commitments are now enforceable corporate debt
  - Compliance cost is high (including PPF)
The development of the DB cost profile

So is the future defined contribution?

- For many DC is the design of choice
- Some organisations however believe that there are advantages to offering something different
  - Competitive advantage in the employment market
  - Retention and reward of key staff
- But is this wishful thinking?

DC will preferred choice by some (many) but other may seek to do different
The role of legislation – market views

Beliefs on the Role Legislation Should Play in Occupational Pension Provision:

- Substantial overhaul of UK pension legislation is needed to allow new pension designs to emerge: 22% strongly disagree, 23% disagree, 14% agree, 16% strongly agree.
- There will be significant interest from employers in new pension designs: 46% agree, 27% strongly agree, 23% disagree, 16% strongly disagree.
- Legislation should permit employers to specify which groups of members they share risk with: 54% agree, 48% strongly agree, 63% disagree, 64% strongly disagree.
- Legislation should remove political interference and be placed in the hands of an independent public body: 58% agree, 52% strongly agree, 25% disagree, 22% strongly disagree.
- The introduction of NEST will lead to a significant increase in the number of employees belonging to some form of pension arrangement: 38% agree, 35% strongly agree, 20% disagree, 23% strongly disagree.

What would a new framework look like?

• **Freedom over benefit structure:**
  - Member only or spouse’s benefit
  - Increasing or not in deferment or payment

• **Align risk management with those taking risks**
  - Sponsor’s take financial risk so give them power to manage the risk
  - Controls are required to ensure risk taking is sensible (today and tomorrow)
What would a new framework look like?

- **Permit risk sharing frameworks:**
  - But require that they have a plain English set of principles
  - Need to be clearly communicated, understood and *trusted*

- **Employees or members:**
  - Why share risk with someone who is not connected to the business?
  - Allow an enforced fair transfer to DC on leaving service voluntarily (protection on redundancy required)

Possible designs: Collective DC

- Has been used in the Netherlands
- Current difficulties exist because of underfunding: there may be a cut in all members benefits
- Contains significant cross generational funding which only works where the culture supports this
- 14 funds are due to cut benefits by 1 January 2011!
Possible designs: Conditional indexation

- CARE with discretionary indexation?
- Who controls indexation?
- Is the discretionary indexation process clear and can it be trusted?
- Will it be robust when plans mature
  - consider a plan with 1/3 active members, sponsor preference to keep discretion down and adjust pay?

Possible designs: limited duration plans

- Pensions units with limited guarantee period (say 10 years)?
- Guarantees fall away on leaving service
- Units can be reinvested on expiry of the guarantee period
- Short term aligns more closely with shorter term corporate focus
Influencing change

• Incremental change is not enough! This is a big problem and demands a big solution
• As a profession and industry we need to influence:
  – Political parties
  – DWP
  – EU parliament

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.
The views expressed in this presentation are those of the presenter.