

Defined benefit and its discontents

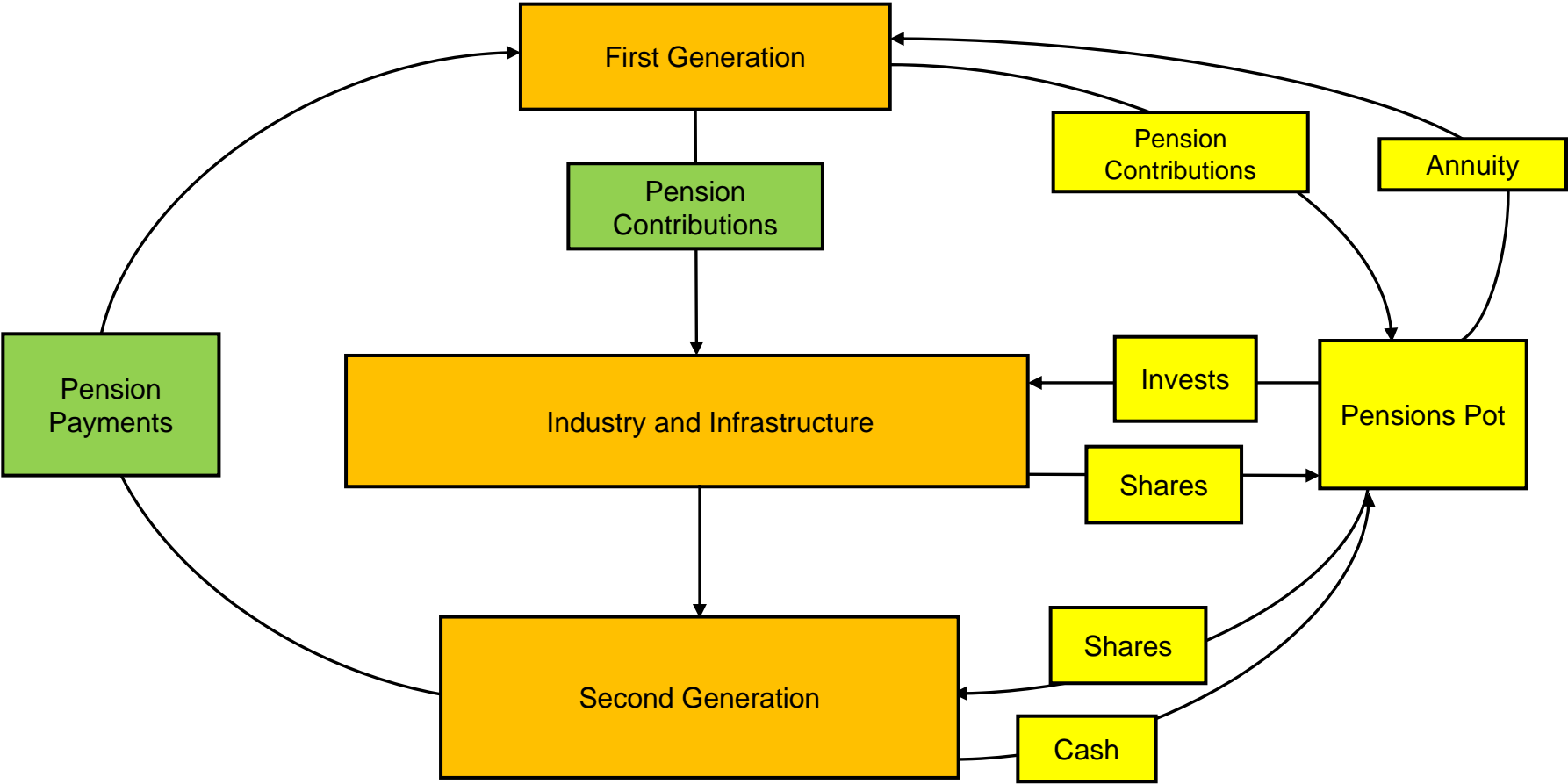
The past, present and future of db in the UK

Hilary Salt



**Unfunded Approach
Public sector**

**Funded Approach
Private Sector**



Current discontents

- Long march in UK from efficient collective db to inefficient individual dc
- Closed db – the worst of all possible worlds?
- How did we get here:
 - Why did employers have pension schemes?
 - Why do employees like db?
 - What are alternatives to traditional db?
 - Why have we lost faith in db?
 - Just how bad is it?
 - What next?

Why do Employers do pensions?

- The four “R”s: recruitment, retention, return, retirement
- Fungibility of assets
- Economically efficient:
 - Pooling risks (including longevity)
 - Lower expenses
 - Unconstrained investment policy

Final salary works for members

- Protection from some risks
- Pensions reflect improvements in living standards
- Some risks remain
- Experience of alternative schemes has been poor:
 - Defined contribution
 - CARE

It's not fair

“Government should replace the existing final salary pension schemes with a new career average scheme.....as I believe this is the fairest way of spreading the effect of change across the generations, and represents the quickest way of ending the in-built bias against those public service employees whose pay stays low over their career, inherent in final salary schemes”

Independent Public Service Pensions Commission: Final Report March 2011

The word “fair” appears 126 times in the report

Alternative benefit designs

- Career Average Revalued Earnings
 - Public service schemes
 - Accrual rate and revaluation
 - Variable revaluation
- Low level db with dc on top
- Cash balance
- Cap and share
- Variable pension age
- Longevity Adjustment Factors

Why have we lost faith in DB?

Attitudes to risk

Loss of benefits

Collective vs individual

Disengagement of employers

FRS17

Full buy out cost

Pressure for higher funding

Intervention in benefit levels

Actual scheme failures

Just how bad is it?

- De-risking:
 - Liability reductions or reshaping
 - Asset de-risking
- Auto-enrolment
- Ending contracting out
- The jilted generation

Where do we go from here?

- Defined ambition
- New public service schemes
- Employees retiring without legacy db
- Preconditions for a new consensus:
 - Growth
 - A shared vision
 - Efficient vehicles
 - Not avoiding risk at all cost