

Summary: Intervention & Options

Department /Agency: Department for Work and Pensions	Title: Impact Assessment of the Government consultation on risk sharing pension schemes	
Stage: Consultation	Version: Consultation Stage	Date: 5 June 2008
Related Publications:		

Available to view or download at: <http://www.dwp.gov.uk/pensionsreform>

Contact for enquiries: Mary Ball

Telephone: 020 7712 2756

What is the problem under consideration? Why is government intervention necessary?

Recent years have seen a decline in the provision of Defined Benefit pensions in the UK which is believed to have been accompanied by a fall in employer contributions. This decline has been driven by a number of factors which have increased the costs and risks faced by employers who run DB schemes. Whether and at what speed the decline of DB provision and its replacement with DC provision continue into the future are crucial for the counterfactual to potential policy options (i.e. what would happen if those options were not adopted).

This consultation explores whether there are sufficient flexibilities within the current regulatory framework, whether there are barriers which should be removed, or whether legislating to allow for new forms of risk sharing scheme is necessary or appropriate.

What are the policy objectives and the intended effects?

The policy objective is to encourage employers to continue to provide high quality pensions of a form that is appropriate to them. The two main forms of pension provision in the UK today, final salary Defined Benefit and pure Defined Contribution, allocate risks mainly to the employer and mainly to the individual member respectively. Risk sharing is possible under the current regulatory framework but has not been widely taken up. Providing employers with greater flexibility over the form of pension scheme they offer could encourage the continued provision of good occupational pensions in the UK.

The policy options considered would provide ways in which different types of pension schemes could be established, but this would be at the discretion of scheme sponsors. **These options would not impose any mandatory costs on pension schemes or their sponsor employers.**

What policy options have been considered? Please justify any preferred option.

- Making risk sharing easier within the current regulatory framework
- Introducing conditionally indexed career average scheme
- Introducing Collective Defined Contribution schemes
- Extending conditional indexation of benefits to existing UK DB schemes

There is no preferred approach – this document merely seeks to set out and analyse the proposals and solicit views on them.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? Following the consultation, the Government will consider the case for change and would, if necessary, bring forward proposals and any required legislation as soon as practicable.

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

Mike O'BrienDate: 5 June 2008

Summary: Analysis & Evidence

Policy Option: 1 New conditional indexation schemes

Description: A new type of conditionally indexed career average salary pension scheme

COSTS	ANNUAL COSTS		<p>Description and scale of key monetised costs by 'main affected groups'</p> <p>Compared to a counterfactual of continuing DB provision, conditional indexation (CI) would transfer cash flow risks to scheme members. This will have a net cost if members find it more costly to bear risks than scheme sponsors do. Over the long term CI does not reduce the expected value of member benefits, but the move from final salary to career average could do so. Compared to a counterfactual of moving to DC provision, the effects would be the reverse. The net impact would depend on the behaviour of scheme sponsors and the counterfactual considered.</p> <p>There could be some costs arising from setting up and administering new schemes, but these would only arise if the scheme sponsor chooses to take up the option. No additional costs would therefore be imposed by this option.</p>
	One-off (Transition)	Yrs	
	£		
	Average Annual Cost (excluding one-off)		
	£		Total Cost (PV)
<p>Other key non-monetised costs by 'main affected groups'</p> <p>Members receive less certainty about the level of benefits they receive.</p> <p>Members and sponsors will have a more complicated and less transparent scheme which may require additional regulation.</p>			

BENEFITS	ANNUAL BENEFITS		<p>Description and scale of key monetised benefits by 'main affected groups'</p> <p>The benefits to sponsors are the mirror image of the costs to scheme members outlined above.</p>
	One-off	Yrs	
	£		
	Average Annual Benefit (excluding one-off)		
	£		Total Benefit (PV)
<p>Other key non-monetised benefits by 'main affected groups' Employer -increased certainty because of more controllable pension scheme costs which could result in improved company viability. Scheme members - may increase likelihood of continuing high quality pension provision by the employer.</p>			

Key Assumptions/Sensitivities/Risks In the long run scheme funding levels would be set so as to provide a reasonable expectation that members can be fully compensated for any lost indexation.

Price Base Year	Time Period Years	Net Benefit Range (NPV)	NET BENEFIT (NPV Best estimate)
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What is the geographic coverage of the policy/option?		Great Britain	
On what date will the policy be implemented?		Unknown	
Which organisation(s) will enforce the policy?		The Pensions Regulator	
What is the total annual cost of enforcement for these organisations?		£ Unknown	
Does enforcement comply with Hampton principles?		N/A	
Will implementation go beyond minimum EU requirements?		N/A	
What is the value of the proposed offsetting measure per year?		£ N/A	
What is the value of changes in greenhouse gas emissions?		£ N/A	
Will the proposal have a significant impact on competition?		No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium Large
Are any of these organisations exempt?	N/A	N/A	N/A N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)	
Increase of	£ N/A	Decrease of	£ N/A
Net Impact		£ N/A	

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Summary: Analysis & Evidence

Policy Option: 2
Conditional indexation
for existing DB schemes

Description: Allow existing Defined Benefit schemes to apply conditional indexation to pensions in payment for future accruals only

COSTS	ANNUAL COSTS		<p>Description and scale of key monetised costs by 'main affected groups'</p> <p>Compared to a counterfactual of continuing DB provision, conditional indexation (CI) would transfer cash flow risks to scheme members. This will have a net cost if members find it more costly to bear risks than scheme sponsors do. Over the long term CI does not reduce the expected value of member benefits. Compared to a counterfactual of moving to DC provision, the effects would be the reverse. The net impact would depend on the behaviour of scheme sponsors and the counterfactual considered.</p> <p>There could be some costs arising from setting up and administering new schemes, but these would only arise if the scheme sponsor chooses to take up the option. No additional costs would therefore be imposed by this option.</p>
	One-off (Transition)	Yrs	
	£		
	Average Annual Cost (excluding one-off)		
	£		Total Cost (PV)
<p>Other key non-monetised costs by 'main affected groups' Reduced certainty for scheme members over their benefit levels and additional scheme complexity. There is also an issue of equity since only pensioner members bear the costs of lost indexation.</p>			

BENEFITS	ANNUAL BENEFITS		<p>Description and scale of key monetised benefits by 'main affected groups'</p> <p>The benefits to sponsors are the mirror image of the costs to scheme members outlined above.</p>
	One-off	Yrs	
	£		
	Average Annual Benefit (excluding one-off)		
	£		Total Benefit (PV) £
<p>Other key non-monetised benefits by 'main affected groups' Employer sponsoring schemes - increased certainty over pension scheme costs could result in improved company viability. Scheme members - may increase likelihood of continuing defined benefit pension provision by employer.</p>			

Key Assumptions/Sensitivities/Risks In the long run scheme funding levels would be set so as to provide a reasonable expectation that members can be fully compensated for any lost indexation.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?		Great Britain	
On what date will the policy be implemented?		Unknown	
Which organisation(s) will enforce the policy?		The Pensions Regulator	
What is the total annual cost of enforcement for these organisations?		£ Unknown	
Does enforcement comply with Hampton principles?		N/A	
Will implementation go beyond minimum EU requirements?		N/A	
What is the value of the proposed offsetting measure per year?		£ N/A	
What is the value of changes in greenhouse gas emissions?		£ N/A	
Will the proposal have a significant impact on competition?		No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium Large
Are any of these organisations exempt?	N/A	N/A	N/A N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)	
Increase of £ N/A	Decrease of £ N/A	Net Impact	£ N/A

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Summary: Analysis & Evidence

Policy Option: 3
Collective DC
schemes

Description: Collective Defined Contribution pension scheme

COSTS	ANNUAL COSTS		<p>Description and scale of key monetised costs by 'main affected groups'</p> <p>Compared to a counterfactual of continuing DB provision, collective defined contribution (CDC) would transfer cash flow risks to scheme members. This will have a net cost if members find it more costly to bear risks than scheme sponsors do. Compared to a counterfactual of moving to DC provision, the effects would be the reverse. The net impact would depend on the behaviour of scheme sponsors and the counterfactual considered.</p> <p>There could be some costs arising from setting up and administering new schemes, but these would only arise if the scheme sponsor chooses to take up the option. No additional costs would therefore be imposed by this option.</p>	
	One-off (Transition)	Yrs		
	£			
	Average Annual Cost (excluding one-off)			
	£		Total Cost (PV)	
<p>Other key non-monetised costs by 'main affected groups' Members will still have some uncertainty over the eventual benefit they receive, although less so than in a normal defined contribution scheme. The scheme is not as simple for them to understand as a normal defined contribution pension where the individual has their own account.</p>				

BENEFITS	ANNUAL BENEFITS		<p>Description and scale of key monetised benefits by 'main affected groups'</p> <p>The benefits to sponsors are the mirror image of the costs to scheme members outlined above.</p>	
	One-off	Yrs		
	£			
	Average Annual Benefit (excluding one-off)			
	£		Total Benefit (PV)	
<p>Other key non-monetised benefits by 'main affected groups' Employer -greater certainty over pension scheme costs could result in improved company viability. Scheme members - pooling arrangement allows smoothing of investment risk; greater likelihood of continuing high quality pension provision by employer.</p>				

Key Assumptions/Sensitivities/Risks In the long run scheme funding levels would be set so as to provide a reasonable expectation that members can be fully compensated for any lost indexation.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?				Great Britain	
On what date will the policy be implemented?				Unknown	
Which organisation(s) will enforce the policy?				The Pensions Regulator	
What is the total annual cost of enforcement for these organisations?				£ Unknown	
Does enforcement comply with Hampton principles?				N/A	
Will implementation go beyond minimum EU requirements?				N/A	
What is the value of the proposed offsetting measure per year?				£ N/A	
What is the value of changes in greenhouse gas emissions?				£ N/A	
Will the proposal have a significant impact on competition?				No	
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		N/A	N/A	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)				(Increase - Decrease)	
Increase of	£ N/A	Decrease of	£ N/A	Net Impact	£ N/A

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Conditional indexation – career average schemes

B.1 This section provides an initial analysis of what the proposals for conditionally indexed career average schemes might mean for schemes and sponsors as well as for individual members. A full assessment of the impact of conditional indexation would require modelling of scheme funding outcomes that reflects potential future variations in relevant economic variables, and link those outcomes to individual pension accruals. DWP has not commissioned a model of this kind at this stage but the initial analysis set out in this section illustrates the potential impact of these proposals.

Scheme level analysis

B.2 We have used a stochastic model developed by PGGM¹, a Dutch pension fund, to look at how these proposals might impact on pension schemes and their members. Further details of the modelling can be found in Annex C.

B.3 The PGGM model is based on the characteristics of the PGGM pension fund and uses assumptions appropriate to the Dutch pensions and economic environment. It cannot be taken as being representative of UK schemes but does illustrate the likely scale of impacts of a switch from unconditional to conditional indexation in the context of one specific career average scheme.

B.4 In the base case of the model, we assume the scheme is initially fully funded, to meet both existing and expected future indexation costs. We then compare, over a 15 year period, the range of outcomes if the scheme provides unconditional indexation (subject to a cap of 2.5 per cent per annum) with outcomes under a conditional indexation arrangement. The conditional indexation rules used are set out in Annex C.

Table B.1: Average indexation quality delivered by the scheme (as a percentage of cumulative inflation over 15 year period)

Without conditional indexation	82%
With conditional indexation	73%

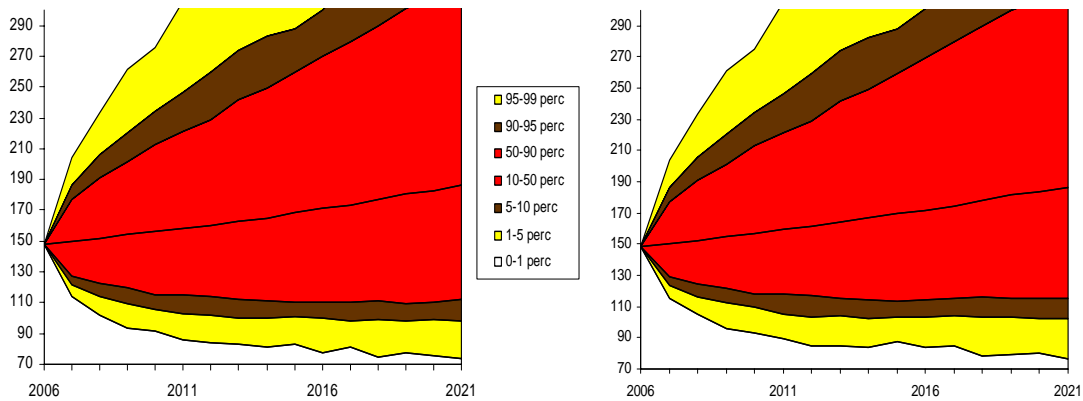
Source: DWP modelling

B.5 The average indexation quality refers to the average proportion of cumulative indexation received over the 15 year time horizon of the model. Table B.1 shows that, with unconditional indexation subject to a cap, indexation would on average be 82 per cent of total price inflation. This is less than 100 per cent because the existence of the cap means that less than full indexation is paid in years when inflation rises above the cap. So, for example, pension rights worth £100 in the base year would be worth £82 in real terms by the end of the period with unconditional indexation and £73 with conditional indexation.

B.6 The chart in Figure B.1 shows the projected distribution of outcomes for the scheme funding ratio. The funding ratio is calculated on a nominal basis, which means that it excludes the cost of future indexation. A funding ratio of around 150 means that the scheme is fully funded to the extent that it can pay total liabilities, including full indexation.

¹ PGGM administers collective pension schemes for the healthcare and social work sector in the Netherlands.

Figure B.1: Distribution of the funding ratio, unconditional indexation (left panel) and conditional indexation (right panel)

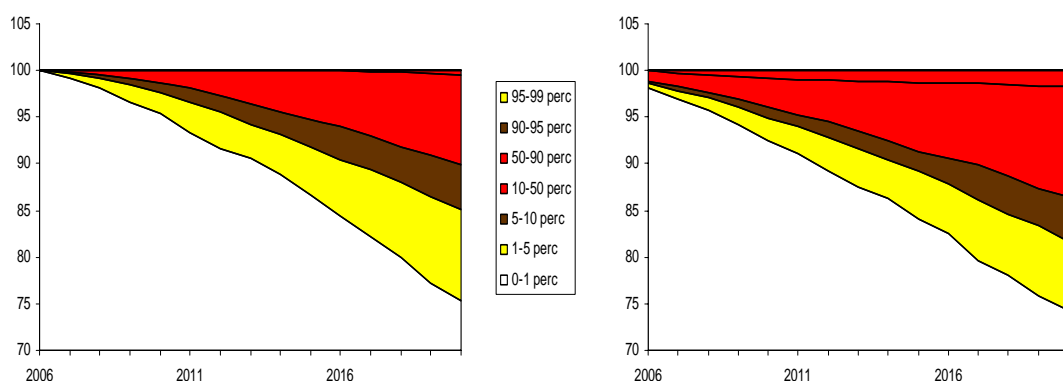


Source: DWP modelling

B.7 The distributional charts for the funding ratio show that the probability of worse scenarios of underfunding decreases somewhat in the case of conditional indexation compared to the case of unconditional indexation, although the impacts are not particularly marked. Although conditional indexation helps to maintain the funding position of the scheme, the range of potential adverse funding outcomes remains quite wide.

B.8 Figure B.2 shows the projected distribution of the real value of members' pensions. The relative pension represents the value of the pension as a proportion of the pension that would be paid if benefits were fully linked to inflation (without any cap). Since even in the best economic scenarios the maximum pension received can never exceed 100 per cent of the targeted pension, the chart only shows the outcomes in the bottom half of the distribution. In effect the best 50 per cent of outcomes in the distribution collapse to a straight line at the 100 per cent relative pension outcome line.

Figure B.2: Distribution of the relative pension value, unconditional indexation (left panel) and conditional indexation (right panel)



Source: DWP modelling

B.9 The distributional charts for the relative pension outcome show that the entire distribution of outcomes shifts down under a conditionally indexed scheme compared with the unconditional scheme. Again, however, the distribution is not markedly different, indicating that conditional indexation in this case has a limited impact on the value of members' pensions.

B.10 We have also tested the sensitivity of these results to altering some of the main assumptions. Annex C sets out more detail on the alternative scenarios and the modelling results.

Pension outcomes for members

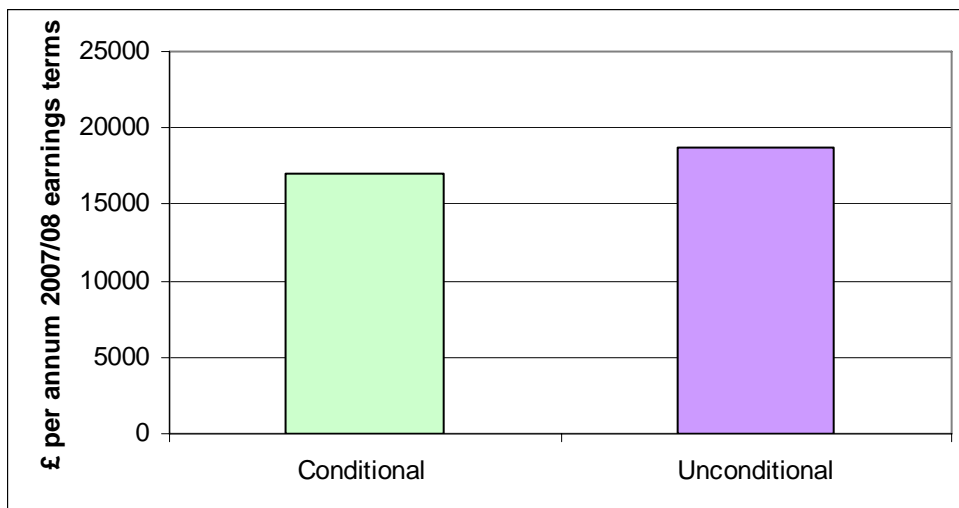
B.11 The relative pension distribution charts in Figure B.2 above provide some idea of the effects of conditional indexation on the individual member's pension outcome. However, it is instructive to also look at the impact in terms of monetary amounts.

B.12 The analysis focuses on comparing the pension outcomes on retirement from a conditionally indexed career average scheme with those from a career average scheme with unconditional indexation. For the purposes of this comparison the following assumptions have been made:

- Members have a starting salary of £30,000 on joining the scheme, which rises over time, and spend 30 years in the scheme;
- The asset allocation is 60 per cent equities, 40 per cent bonds; and
- Contribution rates are equal in both schemes and at the level of average DB contribution rates in the UK.

B.13 We have assumed that in one in five years indexation is removed². Figure B.3 shows pension outcomes on retirement under both scenarios in 2007/08 earnings terms.

Figure B.3: Pension outcomes on retirement for a career average scheme, under conditional and unconditional indexation, 2007/08 earnings terms



Source: DWP modelling

B.14 The chart shows that as expected, pension outcomes are lower across the distribution of outcomes under conditional indexation. Under conditional indexation pension incomes are estimated to be around 10% lower.

² This is necessarily a simplistic assumption as actual levels of indexation would depend on scheme funding positions, the precise specification of conditional indexation rules, and the time period considered. Different assumptions would clearly change the ratio between the outcomes.

Qualitative assessment of financial impacts for sponsors

B.15 These proposals would involve setting up a brand new scheme. The initial set-up costs will form a significant part of the costs to the sponsor in implementing this proposal over and above maintaining existing forms of provision. If these proposals were implemented they would be optional and the costs in this section would therefore only arise if the scheme sponsor chooses to take up the option.

B.16 There will also be the costs involved in running the scheme, but it is not clear that these would be any greater under these proposals than would be the case for an existing DB scheme. Examples of on-going costs will include:

- Cost of professional advice;
- Cost of compliance with regulations (which may also feed through to the cost of professional advice); and
- Administration costs – the costs of communicating to members information about their benefits, which may be higher under these proposals due to the complexity of the scheme, the requirement for annual valuations.

B.17 A potential saving to the sponsor arising from these proposals would be realised by moving from a final salary to a career average DB scheme. It has already been noted in Chapter 5 that moving from a final salary DB scheme to a career average scheme can reduce costs.

B.18 The issue of whether savings would also arise from conditional indexation is less clear cut. If the scheme were always sufficiently well-funded, indexation would always be paid and there would be no savings. In the event of indexation being removed, the sponsor must make good the lost indexation when the scheme's funding position improves sufficiently. As long as the lost indexation is fully compensated later on there would be no net saving to the sponsor – all that changes is the timing of the payment. The sponsor would only make a net saving in the long-run if the catch-up indexation did not compensate the full value of the lost indexation.

B.19 So the real benefit of this type of conditional indexation scheme to the sponsor would not be the ability to make savings, but the cashflow impact – the ability to shift expenditure from times of low scheme funding to times of higher scheme funding. Deferring the payment of indexation to times when the scheme's funding position is better frees up money to improve the financial health of the scheme when it is needed most. This should make for a more sustainable pension arrangement.

Conditional Indexation for all schemes

Scheme level analysis

B.20 The proposals in this section are very similar to the proposals for conditional indexation career average schemes and the impacts are therefore similar. The scheme-level analysis in the previous section also provides some insight into the Lewin proposals. The reader is therefore referred to the relevant section of the previous section.

Pension outcomes for members

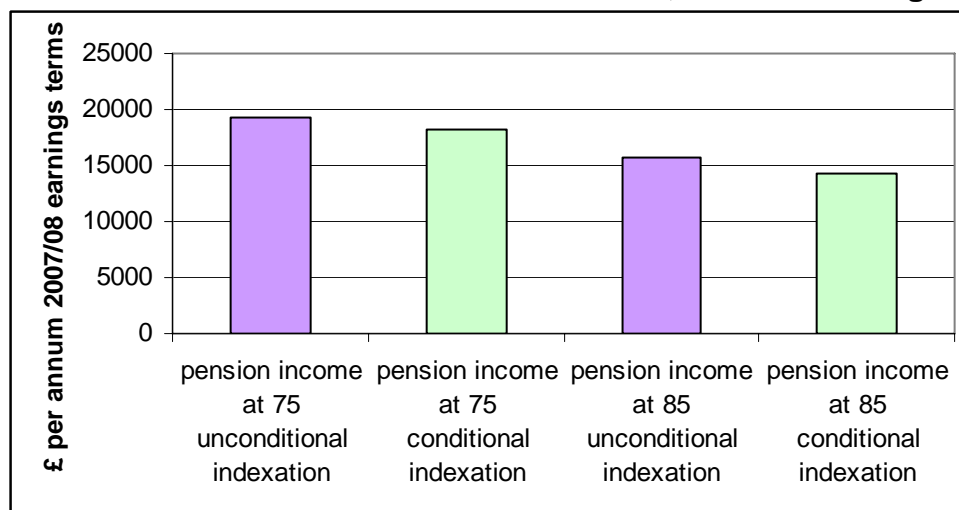
B.21 In order to consider the impact of these proposals on individual members' pension outcomes, we have undertaken some modelling of outcomes under the current indexation regime and the proposed conditional variant. Since the Lewin proposal would apply to all existing DB schemes, it is best conceived of as applying to final salary schemes, since these form the majority of DB schemes in the UK.

B.22 The analysis therefore focuses on comparing the pension outcomes on retirement from a conditionally indexed final salary scheme with those from a final salary scheme with unconditional indexation. For the purposes of this comparison the following assumptions have been made:

- Members have a starting salary of £30,000 on joining the scheme, which rises over time, and spend 30 years in the scheme;
- The asset allocation is 60 per cent equities, 40 per cent bonds; and
- Contribution rates are at the level of average DB contribution rates in the UK.

B.23 We have assumed that indexation is removed one in every five years³. The chart below shows pension outcomes 10 and 20 years after retirement (since the proposal affects pensioners only) under both scenarios in 2007/08 earnings terms.

Figure B.4: Pension outcomes 10 and 20 years after retirement for a final salary scheme, under conditional and unconditional indexation, 2007/08 earnings terms



Source: DWP modelling

B.24 The chart shows that as expected, pension outcomes are lower under conditional indexation. Under conditional indexation pension incomes are estimated to be around five per cent lower 10 years after retirement and around 10 per cent lower 20 years after retirement.

³ This is necessarily a simplistic assumption as actual levels of indexation would depend on scheme funding positions, the precise specification of conditional indexation rules, and the time period considered. Different assumptions would clearly change the ratio between the outcomes.

Qualitative assessment of financial impacts for sponsors

B.25 This proposal would be the simplest and cheapest to implement from the viewpoint of the employer since it would not require the setting up of a new scheme (unless the employer chose to do so). Instead the desired effect could be achieved by opening a new section of an existing scheme. However, this would result in the cost of tracking a new set of pension accruals subject to a different indexation policy regime.

B.26 If these proposals were implemented they would be optional and the costs in this section would therefore only arise if the scheme sponsor chooses to take up the option.

B.27 Beyond that there would also be the usual costs involved in running the scheme; again it is not clear that these would be any greater under these proposals than would be the case for an existing DB scheme. Examples of on-going costs would include:

- Cost of professional advice;
- Cost of compliance with regulations (which may also feed through to the cost of professional advice);
- Administration costs – in particular the costs of communicating to members information about their benefits, which may be higher under these proposals due to the complexity of the scheme.

B.28 The conditional indexation feature is not devised to produce savings, rather to allow the deferment of indexation payments to a point where the scheme's funding position is healthier. The sponsor would only realise savings if lost indexation is not fully re-paid. There is a greater chance of this happening under these proposals compared to the ACA variant purely because the former applies conditional indexation only to pensioners. Since, all else being equal, pensioner members will have a greater risk of dying sooner than active or deferred members, there is a greater chance that pensioners (especially older ones) might not live to see any lost indexation fully repaid. In such circumstances the sponsor would make a financial gain.

Collective defined contribution schemes

Pension outcomes for members

B.29 The analysis in this section focuses on the pension outcomes for members in collective DC schemes compared to individual DC schemes. For the purposes of comparison both arrangements are assumed to have the following features:

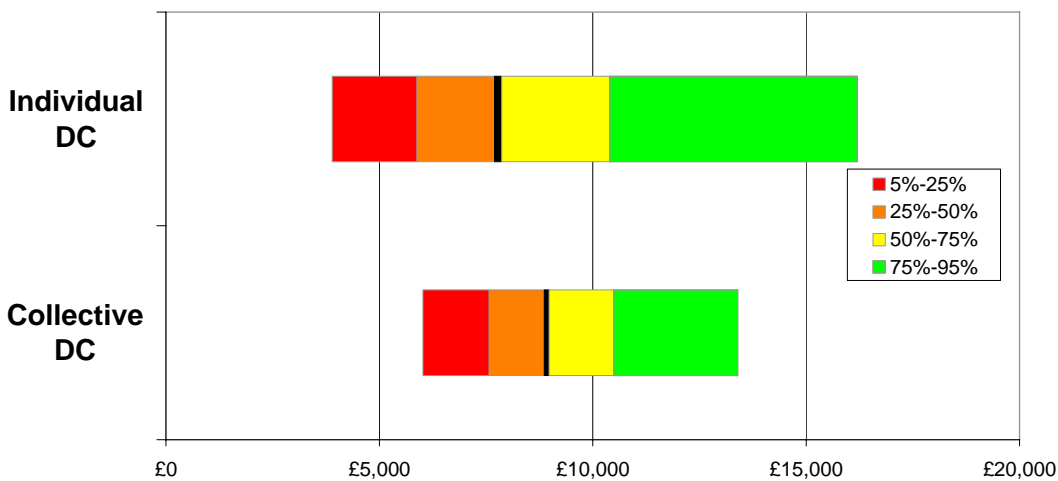
- Members have a starting salary of £30,000 on joining the scheme and spend 30 years in the scheme;
- The fund is invested in equities and property for most of the pre-retirement phase. Under individual DC a gradual switch into bonds is assumed in the 5 years prior to retirement. For collective DC the scheme is invested in equities and property throughout the accumulation phase;
- Members buy a level annuity at retirement with an external provider and leave the scheme.

B.30 Under the collective DC arrangement there is a target amount of pension each year. This target is calculated allowing for revaluations prior to retirement that are expected to broadly match rises in inflation. However, these revaluations are not guaranteed and provide the risk sharing mechanism for the collective DC scheme.

B.31 The implication of this is that active and deferred members bear all the risk of lost indexation, with pensioners not bearing any. However, this model has been designed specifically to provide a meaningful comparison with individual DC; in practice the market might develop different risk sharing mechanisms for different situations which would be tailored for specific circumstances.

B.32 Figure B.5 shows the results of modelling that compares outcomes under individual DC and collective DC.

Figure B.5: Distribution of pension outcomes on retirement in individual DC and collective DC schemes with equal expense levels, 2007/08 earnings terms



Source: Hewitt Associates; assumes an expense level of 0.4 per cent per annum.

B.33 Figure B.5 compares the range of pension that might be paid under individual and collective DC for an individual retiring after 30 years in the scheme. The chart is generated by considering 5,000 different scenarios of investment conditions over the next 30 years. For each scenario the pension that would be paid at retirement from both collective and individual DC has been calculated. These outcomes are then corrected for wage inflation over the 30 year period and ranked according to the 'real' size of pension that would result.

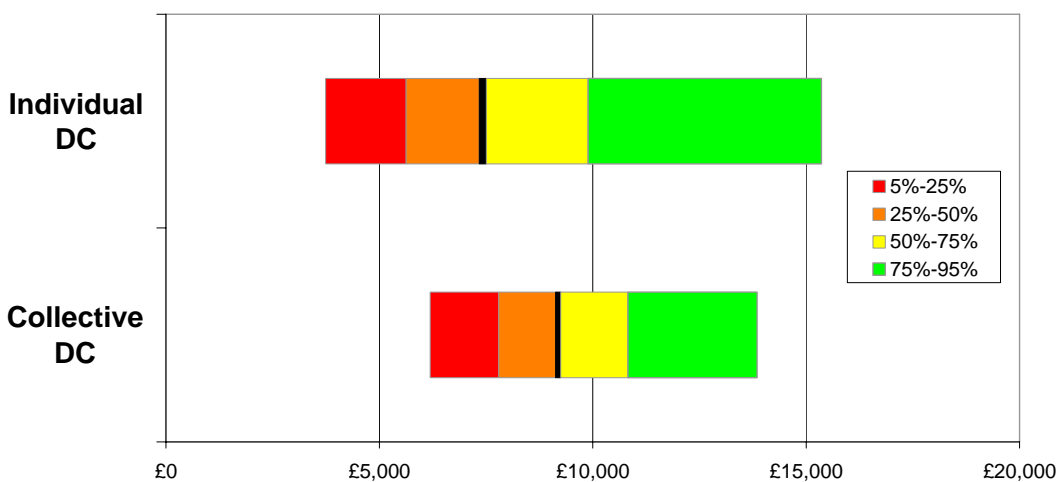
B.34 The thick black line on the chart represents the median pension for individual and collective DC. This is the level of pension a member would have an equal chance of receiving more (or less) than. The bars illustrate the range of outcomes in 90 per cent of the scenarios tested. The chart illustrates that, for this model, collective DC has a higher median level of pension with a smaller range of possible outcomes. The higher median pension reflects the assumption that collective DC schemes would not switch into less risky investments as individuals approach pension age.

B.35 Pension outcomes under collective DC show less variability compared with outcomes under individual DC, reflecting the transfer of risk from members closer to retirement to younger members. This feature would diminish as the scheme matured.

B.36 A further benefit of the collective DC scheme is that, for the majority of members, it would be cheaper to run than individual DC. Individual savings accounts, individual investment decisions and switching would not be needed under collective DC.

B.37 Evidence suggests that, at the moment, individual DC schemes incur expenses that average out at around 0.7 per cent per annum for a typical medium-sized employer⁴. Some larger schemes will be less than this, but personal arrangements with active management and lifestyling options can be considerably more. Multi-employer collective DC schemes would benefit from economies of scale and collective bargaining power and should incur a lower level of expenses that are estimated to be around 0.2 per cent⁵. Figure B.6 illustrates the effect of allowing for this difference in expense levels by repeating the analysis of Figure B.5 above using different expense levels.

Figure B.6: Distribution of pension outcomes on retirement in individual DC and collective DC schemes with different expense levels, 2007/08 earnings terms



Source: Hewitt Associates; assumes an expense level of 0.7% per annum in individual DC and 0.2% per annum in collective DC.

B.38 The chart shows that the impact of differing charge levels is significant. Now the difference in median pension outcomes under collective DC and individual DC is even higher and there is even less variability in comparison to the outcomes under individual DC.

B.39 The analysis demonstrates the three main advantages of a collective DC scheme over an individual DC scheme:

- collective DC schemes can hold assets with a greater risk-reward profile for longer without jeopardising individuals closer to retirement. This in turn generates a higher level of benefits;
- risk sharing allows collective DC schemes to provide members close to retirement with more predictable benefits by transferring risk to younger members; and
- collective DC schemes will normally be cheaper to run than individual DC schemes, as individual savings accounts, individual investment decisions and switching would not be needed.

⁴ Source: Hewitt Associates

⁵ Source: Hewitt Associates

Qualitative assessment of financial impacts for sponsors

- B.40 As with the conditional indexation proposals, the collective DC proposal would involve setting up a new scheme. Thus the sponsor would incur the initial set up costs associated with the new scheme. If these proposals were implemented they would be optional and the costs in this section would therefore only arise if the scheme sponsor chooses to take up the option.
- B.41 The only on-going cost to the employer will be the fixed contribution rate. The employer would not incur the costs associated with running a DB scheme. The key attraction from an employer viewpoint is that collective DC retains the fixed costs and resulting certainty of traditional DC schemes.
- B.42 Administration costs in the collective DC scheme would be borne by the individual member and not the sponsor. As discussed in paragraph B.36, administration costs should be lower in a collective DC scheme in comparison to an individual DC scheme.
- B.43 The conditional indexation element and cuts to accrued benefits bring no financial benefit to the sponsor, who always pays the fixed contribution rate regardless of the scheme's funding position. In this proposal, conditional indexation and the reduction of accrued benefits are used as tools to bring the scheme to a more sustainable funding level – at no point does the sponsor derive any financial benefit from cutting indexation or accrued benefits.