A UK white paper compares public pension funds to Ponzi schemes

By Editor Test *Wed, Feb 16, 2011*

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A new report on the sustainability of the UK's pension system urges that public sector defined benefit (DB) plans should be closed and replaced with defined contribution (DC) schemes by the end of the decade.

The report, *Self-sufficiency is the key – Addressing the public sector pensions challenge was* published by the Centre for Policy Studies, a Conservative party think tank. It suggests that all public sector workers earning over £10,000 a year be encouraged to enroll in the National Employment Savings Trust (NEST).

In the report, Michael Johnson, a former JP Morgan investment banker and consultant at Towers Watson, argues that public sector pensions are unaffordable, unsustainable and unfair, likening the current situation to a Madoff-style pyramid, collapsing under the pressures of underfunding and demographic change.

He suggested that all currently unfunded pensions, such as the National Health Service's pension fund, should be closed by 2020 and replaced with nominal DC schemes.

The government should take advantage of the imminent retirement of baby boomers to phase in new DC retirement offerings as replacements for the aging workforce are hired, he said.

"Moving to a DC basis would have to be on an unfunded basis, i.e. notional DC," the report said. "There would be no underlying assets, and contributions would continue to flow to the Treasury to be available to pay pensions in payment."

To address the lack of underlying assets, a system of indexation should be developed, the report says. "In the interests of simplicity and transparency, the government should seed the accounts with index-linked gilts (issued on a cashless basis) in an amount that reflects the annual increase in the state's liability," it says.

However, the report stresses that the scheme would not be linked to longevity expectations, allowing the government to avoid additional longevity risk. Members wishing to pursue an investment strategy outside of simple gilt [British Treasury obligations] exposure would be allowed to do so, but at their own risk, with the government's sole obligation being the servicing of the gilts.

A more cautious approach would see a shift to career-average pensions, with a salary cap in place, with NEST and the notional DC scheme described above providing additional retirement income.