Generational Fairness and Sustainability of Funded Defined Benefit Plans

Principal Netspar investigator:
Eduard Ponds (ABP Pension Fund)

Scope

The project considers funded defined benefit plans based on intergenerational risk-sharing. This type of plan can be found for example as industry pension fund in the Netherlands and as public sector pension fund in the United States, United Kingdom and Canada.
The sustainability of these plans critically depends on the willingness of young members to participate. They will have the incentive to withhold themselves when the ex post outcome is disadvantageous to them. Usually the participation is mandatory, however the young may evade this by offering their labour elsewhere. In particular, mature pension funds with funding deficits are vulnerable.

Research Goals

The aim of the project is to develop tools for testing pension fund policies for the criteria generational fairness and sustainability. The project makes use of the method of value-based generational accounting. This method enables us to analyze the economic value of the stakes of the different generations and the issue of who gains and who loses in economic value terms from alternative funding and indexation policies.
Two criteria are used to evaluate alternative policies: generational fairness and sustainability. Generational fairness implies that the funding and indexation rules must give an ex ante fair compensation for risk taken by generations. The sustainability of a pension plan must be checked with respect to ex post redistributive effects for the involved generations.

The tools primarily being derived from a theoretical perspective will be assessed in relation to the preferences of the participants of existing pension funds. Results of this evaluation will be used to come to recommendations for pension funds with respect to their pension plan design and their risk-sharing arrangements.