Department
for Work &
Pensions

Reshaping workplace pensions for future generations - Defined Ambition

Contents

Overall strategy

- **Building on the foundation of automatic enrolment and single tier** - More people saving, more employers contributing, but incomes for future generation will be more uncertain
- **Traditional DC** - right product for many, lack of innovation in risk sharing; fails to meet consumers needs for greater certainty
- **Traditional DB** - risk sharing inhibited by regulatory framework; fails to meet employers needs for greater certainty
- **Consultation Paper** - presents range of options, challenges industry to be innovative and creative
- Not for Government to design products, but to create the space for innovation
- Changes are for the long term

Consumer perspective

Individuals

- Need to question whether systemic shift of financial risk solely onto individuals is the best future we can provide for pension savings and income.
- Focusing on likely pension income rather than size of the pot focuses on the right goal and will encourage consumers to engage with pension saving
- Providing more certainty about savings/income in retirement to help earn consumers' trust and confidence

Employers

- There are employers who would like to provide their employees with more certainty than individual DC but can no longer afford traditional DB
- Without additional flexibilities to enable employers to reduce cost volatility, DB pensions will continue to decline
- Employers concerned about generating a pension liability that would have an adverse impact on their accounts

Summary of proposals

- **Create a new permissive regulatory framework** - to enable the market to develop new forms of risk sharing pension providing greater certainty for employer cost compared to DB and greater certainty of outcomes for members compared to traditional DC and more options for consumers
- **Flexible DB pensions** – to enable employers to continue to offer pensions to members with a high level of certainty, but with much greater flexibility over the nature of benefits provided (**past accruals will not be affected**)
- **DCplus –** DA that looks like DC plus guarantees - that provide members with some security against the risks, including more certainty on pension income
- **Collective DC schemes** - that could provide for risk sharing/risk pooling between members that leads to a more stable pension outcome than under DC.

New permissive regulatory framework

- Objectives
  - enable schemes to evolve and innovate
  - ensure proportionate regulation of different types of schemes
  - make the extent of obligations clear for employers/providers
  - avoid being overly prescriptive

- For the first time - clear classification of schemes
  - Defined Benefit: member has complete certainty about benefit in retirement
  - Defined Ambition: some form of guarantee but not complete certainty
  - Money Purchase: all benefits in the scheme MP (no scope for deficit)

- Enable Collective DC schemes

Flexible DB

- Revised, simplified requirements
  - **For employers**: Remove requirements for indexation for future accruals to provide a less costly/volatile foundation on which to build (and building on simplifications already planned as part of single tier reforms to remove requirements for survivor/spouse benefits for future accruals)
  - **For employees**: Benefits accrue on a specified basis (e.g. related to salary)

- Possible features
  - **Ability to pay fluctuating benefits**: 'Light touch' legislation on fluctuating element above the DB 'promise'
  - **Automatic conversion to DC** : employer promises that during the period of employment they will provide pension benefits that accrue at a given level – crystallises/converts to DC on leaving
  - **Ability to change scheme pension age:** Based on the assumed time in retirement not fixed pension age

DCplus – greater certainty for members/employers

- Four models in paper
  - all examples of DA schemes providing more certainty to member without increasing liability on the employer
  - seek to share different types of risk at different points in the savings life cycle - capital, investment returns, conversion risk - all impact on pension income
- Challenge market to be creative in providing security against these risks.
- Particularly interested in models which seek to secure a guarantee on the income that will be received in retirement, that builds up gradually during the savings period and spread the risk of conversion at retirement
- Explore *Pension Income Builder* - a model of collective risk sharing that could provide a guaranteed pension income, and might provide an attractive option for employees and employers
- Proposed new legislative framework would support the operation of these as well as other forms of guarantees
- Continuing work on legislative hurdles e.g. tax rules

Collective DC - Risk sharing between members

- **For employees**: Alternative approach to risk sharing and potential to offer more stable outcomes than individual DC
- **For employers**: Combines certainty of a defined contribution (no risk to balance sheet) with scope to offer employees more certainty at no additional cost
- Explored models with/without guarantee – degree of stability/certainty for members will vary with precise benefit design
- These models work best where there is scale and a steady inflow of members
- Exploring the policy and legal implications of the changes to the legal framework that would be required to enable them to operate in the UK

Key Questions

- Will creating a unified legislative framework bringing together legislation relating to DA schemes, and defining DA, DB and MPS enable innovation?
- Will employers be interested in providing benefits, in addition to a simplified flat rate DB pension, on a discretionary basis? Will options such as automatic conversion and the ability to change scheme pension age enable employers to continue to provide some form of DB?
- Will products that provide more certainty than traditional DC help generate consumer confidence and persistency in saving? Assuming no liability beyond the defined contribution, will employers be interested in offering them?
- Given no UK tradition of risk sharing between pension scheme members, are individuals going to be willing to share the benefits of protection from downturns in the market and increased certainty of outcome, with the potential disadvantages of intergenerational risk transfer?
- Is a CDC scheme designed to manage funding deficits by cutting benefits in payment going to be acceptable in the UK?
- How should scale be achieved in the UK pensions market?

Consultation exercise

- Key aims:
  - To get broader engagement and test views on the ideas set out in the paper, including the possible DA models, how they might work and the legal framework
  - To describe the DA journey and development of ideas, supporting communications and comments from industry stakeholders
  - The consultation is for six weeks and ends on 19 December 2013**.** Please feel free to send any formal consultation responses, preferably by email, to: definedambition.pensionsconsultation@dwp.gsi.gov.uk
  - We have also launched the first DWP blog as part of GOV.UK open policy making. This is to allow informal debate and discussion: https://definedambition.blog.gov.uk