Department
for Work &
Pensions

Public consultation

Reshaping workplace pensions for future generations

Presented to Parliament by the Secretary of State
for Work and Pensions by Command of Her Majesty
November 2013

Cm 8710

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Foreword by the Minister of State for Pensions

2013 has been a year of major progress on the Government's programme of pension reform.

We have introduced legislation this session to bring in the single-tier State Pension and are delighted to be able to report excellent results from the early stages of the Automatic Enrolment Programme.

But we now need to complete our reforms by looking at how we can encourage a flourishing private pensions' market that has the flexibility to respond to consumer needs and make sustainable pension propositions for the future.

The time is ripe for innovation. Traditional final salary defined benefit schemes which give the consumer certainty are in terminal decline. Automatic enrolment means significantly more savers will be joining workplace pension schemes: the market is growing and employers and industry are already thinking about their future pension provision.

In my summer challenge last year, I challenged the pensions industry to look at the market gap in relation to affordable guarantees and to provide the products consumers are seeking. I established an Industry Working Group, and over the year have held extensive discussions with a wide range of providers and employers.

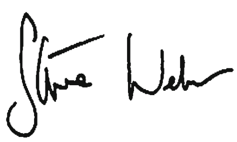
New types of pension provision should evolve. However, employers are most likely to be focused on the shape of their provision in the run up to the ending of contracting out in 2016 and the final staging dates for automatic enrolment for smaller employers.

I believe that new forms of pension – defined ambition pensions – can create high quality provision that will appeal to employees as well as employers.

Removing some of the regulatory constraints imposed in the past will allow new flexible forms of defined benefit pensions, which will 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.

Enabling the development of new models of defined contribution pension with guarantees, will enable new forms of risk sharing and provide more certainty for members. I also believe that focusing on likely pension income rather than size of the pot, although a subtle difference, will encourage consumers to engage with pension saving.

These are changes for the long term. Industry, Government and consumer groups, now have the opportunity to work together to reshape pensions for the future. These are exciting possibilities.



Steve Webb MP
Minister of State for Pensions

Foreword by Andrew Vaughan

When I was asked by the Minister for Pensions to chair the Defined Ambition Industry Working Group last summer I was delighted to accept. It seemed to me this was a timely initiative that would augment the decision to move towards a single-tier pension and provide a firmer basis above which private pensions could be built. And it could offer the opportunity to enhance the auto-enrolment revolution giving employers and employees new pension choices.

For over a decade it has been evident to me that employers, many discouraged by the mounting cost and risks involved in offering defined benefit schemes or concerned by the volatile outcomes of traditional defined contribution, have been searching for new pension models; models that would enable them to cap their costs while also meeting their employees' legitimate calls for greater certainty over the pensions that are delivered. However, those very same employers and their advisers have felt constrained by the limitations placed upon them by existing United Kingdom pensions legislation and to date have been unable to identify practical designs that could meet those aspirations and the legal strictures.

After a year of deliberations within the Industry Working Group, the proposals contained within this paper provide a way forward towards both reshaping and reinvigorating workplace pensions. They offer a range of new options that will be attractive to different employers and their employees – all part of a new framework that looks beyond the current regulatory extremes of defined benefit and defined contribution. Yes, fine details remain to be ironed out, but if these are approached in a constructive 'can do' way and legislation enacted, I am sure the new choices available will take root over time. This consultation offers the opportunity for many more stakeholders to assist in the process of refining policy.

I would like to take this opportunity of thanking my sub-group Chairs, David Fairs (KPMG), David Hutchins (Alliance Bernstein) and Sarah Smart (The Pensions Trust) for their efforts in pulling together models to go forward into this paper and, of course, the individual members of the Group drawn from many areas including the pensions industry trade bodies, consultants, investment houses, insurers and pension lawyers, all of whom have given of their time generously and on a voluntary basis. I would also like to thank Mike Le Brun and his Department for Work and Pensions (DWP) team for working closely with our Group in helping to structure our deliberations and in finalising this paper.

Andrew Vaughan

Andrew Vaughan
Chair of the Defined Ambition Industry Working Group
(Chairman of the Association of Consulting Actuaries)

Executive summary

1. In *Reinvigorating workplace pensions*[1] published last November, the Government set out to explore whether there was scope for a new category of defined ambition (DA) pensions that would complement the defined benefit (DB) and defined contribution (DC) structures that currently dominate the market.

2. The shift away from DB is a long-term trend which, given the very different social and economic environment we are now in, is not going to change, unless we act now.

3. Automatic enrolment and the single-tier State Pension will provide a firm foundation for saving for retirement. But if the current forms of DC pension saving become the default alternative to traditional DB, the pension income of future generations from workplace pensions will be more uncertain than for past generations.

4. We know that individuals worry about the risk of the value of their pension savings falling and want more certainty about their retirement income than provided by the current DC structure.

5. We also know that, while employers are concerned about the funding risks around traditional DB schemes, they continue to see good reasons for providing a quality pension (whether linked to salary or built on a DC foundation).

6. There are ways of sharing risk within the current system, but these are not yet mainstream and can be complex. Without some action to clarify the legal position, lift the current barriers to innovation and enable employers to manage the costs and volatility associated with providing pensions, employers cannot always find the right product for their workforce.

7. Over the last 12 months the DA project – a joint project between DWP and the pensions industry – has been exploring options in a middle ground that do not leave either individuals or employers shouldering the entire risk of pension saving. Although it is not the role of the Government to design commercial products, it is essential that practical models are used to inform the design of the appropriate regulatory framework.

[1] Department for Work and Pensions, 2012, *Reinvigorating workplace pensions*, Cm 8478, TSO.

8. The Government proposes that, in future, the regulation of workplace pension schemes should not focus on the detail of benefit design – that is for the employer or provider to decide – but on what we believe is important to the member: ensuring that any promise or guarantee, whether from the sponsoring employer or scheme provider (such as a commercial or mutual insurer) is delivered.

9. We believe the proposals outlined in this paper will provide the basis for a new regulatory framework for future pension provision. They will create a new pension standard where certainty (about retirement income) and risks (including inflation, investment and longevity) can be shared between a number of parties. Depending on the type of product, this could include employers, members, and insurers and investment managers.

10. **Chapter 1**: looks at the **objectives and principles** underlying the development of DA pensions and describes our working method. This has enabled us to use industry-developed models to explore the legislative barriers that would need to be removed, or the enablers introduced, to create the space for DA pensions to develop.

11. **Chapter 2**: looks at the work we have done to test demand for DA pensions – the **consumer perspective**, including meetings we have held with a wide range of employers to seek their views. It explores the evidence we gathered from our own and the industry's research into individuals' attitudes and expectations from pension saving. It also outlines the further research being undertaken.

12. **Chapter 3:** explores how the Government proposes to **make it easier for employers to sponsor new pension schemes where benefits accrue on a specified basis (e.g. related to salary);** and also to allow additional flexibilities for future accruals only within existing DB schemes, including the possibility of allowing a statutory override to facilitate these changes.

    - We propose to allow for new models of flexible DB, with less cost volatility for employers, which will remove constraints from the existing legislative framework and make it easier for employers to sponsor pension schemes. This will give employers much greater flexibility over the type of benefits they can provide, while still giving employees the certainty of a pension scheme where the benefits are defined (such as in relation to their salary) with the security of the promise being sponsored by their employer.
    - Examples of new flexibilities we propose for future accruals, including in existing DB schemes, include:
        - removing requirements to index-link pensions in payment;
        - making it easier for schemes to change pension age in order to cap costs that stem from improved longevity; and
        - allowing employers to cease to bear the financial costs and risks for people who leave their employment.

13. **Chapter 4**: discusses **providing greater certainty for members in the DC world without any funding liability on the employer's balance sheet**.

    - For many employers and employees the future is DC, and traditional DC can be the right product for them. However, we believe there is space in the market for new types of provision which build on the good things provided by traditional DC and provide new approaches to risk sharing. This chapter sets out a number of models from the Industry Working Group that provide security against the different types of risks in pension vehicles – for example, capital, investment returns, and conversion risk – all of which can have an impact on the pension income.

- This chapter also explores a model of collective risk sharing that could provide a guaranteed pension income. We have called this the pension income builder, and believe it might provide an attractive option for employees and employers.

The Department will continue working with industry and other government departments to explore the regulatory barriers to the development and delivery of these market-based solutions. This includes developing Regulatory Own Funds as a possible regulatory vehicle for collective risk sharing schemes that provide a guarantee.

14. **Chapter 5**: explores options for **collective risk sharing between members without a guarantee or promise**. We consider models close to the traditional Dutch model of Collective DC (CDC). These schemes offer an alternative approach to risk sharing so we propose to explore further the policy issues and legal implications of the changes to the legal framework that would be required to enable them to operate in the UK.

15. **Chapter 6**: considers the **high-level options for legislation to facilitate DA**, and proposes creating a new framework, with DA schemes and DB schemes clearly defined. It assesses the interaction with the planned commencement of the revised definition of money purchase benefits in section 29 of the Pensions Act 2011. Chapter 6 also explores the options for legislation to enable CDCs, with and without guarantees, and considers how best to provide reassurance over concerns of future regulatory creep.

16. **Chapter 7:** sets out the formal consultation process. This will last six weeks, so responses need to reach us by 19 December 2013.

17. We will publish a summary of the responses to the consultation in a report. The report will set out the action we will take as a result. We aim to consult on draft legislation in the New Year.

Defined ambition objectives and principles 1

This chapter looks at the objectives and principles underlying the development of DA pensions, and describes our working method. We have used industry-developed models to explore the legislative barriers that would need to be removed, or the enablers introduced, to create the space for DA pensions to develop.

Introduction

1. In November 2012 the Department published its strategy for reinvigorating workplace pensions[2], which examined the case for greater risk sharing in pension schemes. It outlined the scope for a new concept of DA pensions to complement the traditional DB and DC structures that dominate the market.

   - DB – typically takes the form of an occupational pension scheme in which an employer promises an income in retirement, or a specific level of pension savings, based on a formula related to the person's salary and/or the length of time they have been in the scheme.
   - DC – a pension scheme that provides benefits based on the contributions invested, the returns received on that investment (less any charges incurred) and the rate at which the final pension fund is converted into a retirement income.

2. One critical difference between the two scheme types is who bears the risk regarding the level of savings and/or income in retirement. The economic risks that all forms of pension savings need to deal with are, broadly speaking, investment, inflation and longevity.

3. In traditional DB schemes the employer, rather than the individual, bears the risks of longevity, investment and inflation (at least up to the statutory minimum or the level specified in scheme rules), all of which affect the cost of meeting their obligations.

[2] *ibid*.

4. In DC schemes, the individual bears all the risks associated with pensions saving (investment and inflation) as they save in their pension. The individual then bears the risk of the conversion rate – which is informed by the economic and longevity risks at the point the individual buys their pension income. If the individual buys an annuity, longevity and investment risks are passed on to an insurer – inflation risks can also be passed on.

5. In *Reinvigorating workplace pensions*[3] we said that the aim of a DA pension would be to create greater certainty for members than is provided by a pure DC pension. It would also seek to ensure less cost volatility for employers than current DB pensions.

6. The name defined ambition is intended to provide a similar short-hand title to encapsulate the many models that could deliver this concept. The term is intended to reflect a greater focus on outcome than DC, but also to reflect a difference in the nature of the risk bearer compared to DB.

7. Many of the ideas in *Reinvigorating workplace pensions* were from the Defined Ambition Industry Working Group set up in August last year. Since then we have continued to work closely with the working group, other providers and consumer bodies to develop possible models for DA pensions.

The DA challenge

The problem definition – the challenges DA is responding to.

- **Structural**: the polarisation of risks represented by traditional DB and DC pension schemes creates the perception of an incomplete system, with the burden of risk falling wholly on the employer or, increasingly, being placed on the individual. DA should provide the space for a greater amount of risk sharing.
- **Regulatory**: the criticism that the DB promise brings too great a regulatory and funding burden to the employer. DA should consider reducing some of the regulatory requirements on DB and any new DA framework should be clear about the limits of employer liabilities, and avoid creating new regulatory burdens.
- **Supply/demand**: demand from employers and employees for something between DB and DC is not being met by the market. There is a need to examine the extent to which Government intervention is needed to stimulate innovation.
- **Member-driven product design**: the extent to which uncertainty about pension savings and retirement incomes from a DC scheme (however good) is a disincentive to save in a pension.

8. The starting point for DA is, therefore, how to share the costs and risks associated with pension saving, providing greater certainty to the member, but less cost volatility for the employer. The solutions must work for all consumers, whatever the level of engagement the individual chooses to take, and be affordable.

9. The objective is to create a space between traditional DB and DC pensions which, through market innovation, could be filled by a wide range of designs and products which could address one or more of the above challenges. They could also be aimed at different types of consumer, although we would expect the focus to be on middle to low income pension savers, as higher earners already have access to a much wider range of pension products.

[3] *ibid*.

Principles for development of DA pensions

Reinvigoration objective

Enable industry innovation and development of new products including those which will give people more certainty about their pensions and encourage more risk sharing.

A DA scheme should be:

- **Consumer focused** – address consumer needs (members and employers).
- **Sustainable** – affordable to the stakeholders (employers/pension providers/members) over the long term.
- **Intergenerationally fair** – not biased to pensioners, but also take on board needs of future pensioners.
- **Risk sharing** – incorporate genuine risk sharing between stakeholders.
- **Proportionately regulated** – the regulatory structure needs to be permissive to enable innovation in risk sharing, while protecting member interests.
- **Transparent** – there should be high governance standards with clarity for members about any promise made and any associated risks.

DA spectrum

10. Working with the Industry Working Groups, the Department has explored a wide range of options that represent steps from each of the two extremes on the risk sharing spectrum.

11. Focusing on specific models has enabled us to tease out broader issues and identify barriers and the legislative change that might be needed. These exploratory models inevitably reflect the current patterns of employer sponsorship (standing behind promises in DB, but not DC).

12. The DC models have no requirement for employers to stand behind a promise, or to reflect pension liabilities on their balance sheet. However, we believe there should be nothing to stop employers from choosing to stand behind promises and some of the risks in the DC models should they wish to do so. Similarly, there should continue to be no barrier to employers using insurance products to protect themselves from some risk in DB.

Role for Government

13. The Government's role in private pensions involves regulating schemes, products, providers and employers in a number of ways – with member protection at the heart of these activities.

14. With automatic enrolment into workplace pensions, the Government is intervening to address the need for more people to be saving for their retirement, recognising that inertia can lead to individuals not saving.

15. With DA, the Government proposes to review the regulatory structure where it inhibits employers, or the wider market, innovating and providing pensions which meet consumer needs, while providing a more equitable sharing of risk and ensuring where promises are made, they are kept. This balance should ensure the voice of the consumer is heard while there is less prescription about the offer that employers or the market should make.

The demand for defined ambition – the consumer perspective 2

The drivers for DA pensions are the assumptions that:

- some employers would like to provide their employees with more than individual DC but find traditional DB too costly, and current options in the middle space are too complex to set up and run; and
- there is demand from some individuals for more certainty about what they get back for the money they put into their pensions compared to what DC can offer.

This chapter sets out high-level findings from the work we have done to explore the needs and wants of consumers and test these assumptions. We have considered both the employer, who selects the scheme, and the individual saver perspectives. We also outline the further research we are undertaking.

Introduction

1. In the DA project we have explored the nature of individual and employer demand for greater certainty and less cost volatility respectively. This has involved exploration of risk sharing at the conceptual level as well as the type of the risk being shared and the certainty provided.

2. In December 2012 the Department set up a Consumer Perspective Group, with representatives from the pensions industry and consumer groups (employer and employee/scheme members) to consider potential DA models. We have considered consumers as being both employers – those who select and contribute to the scheme – and individuals – those who may become members of the scheme and who we want to support and engage in planning and saving for their retirement.

3. We sought evidence and feedback on:

   - member and employer wants and needs in respect of the risks associated with pension savings, to inform, support or challenge particular risk sharing features within DA models;
   - the level of member and employer engagement required and possible, and potential proxies for that engagement, and identify potential governance issues and solutions;
   - to test the feasibility of DA models; and
   - using the Department's principles for pensions information to inform development of communications to defined ambition pension members.

4. The evidence and lessons we learned (outlined in Annex B) have been used to inform our consideration of the models described in the following chapters. A summary of these findings and other discussions with employers is given below. We then set out the gaps in the evidence and the further research we are undertaking.

Current findings

Employer perspective

5. We have held discussions with a wide range of employers – both large FTSE firms and small- and medium-sized employers (SMEs). These have shown that employers are generally positive about offering pensions to their employees and they acknowledge them as an important tool in recruiting and retaining staff. For many employers, pensions are also important in enabling employees to retire[4]. However, employers do not want to incur significant costs when setting up a pension scheme. They want schemes that are simple to set up, where costs will not increase in future[5].

6. Many employers with DB schemes continue to see providing a traditional DB pension as an important part of their employee benefits package, although some are reviewing their existing arrangements because of economic pressures and volatility of costs. Employers with DC schemes, or no scheme yet, would like to offer more than individual DC to their employees. Some also have experience of employees being unable to afford to retire – the lack of certainty in DC leading to lack of engagement and financial planning for retirement – creating a workforce management issue. However these employers are concerned about generating a pension liability that would have an adverse impact on their business accounts.

7. It is clear that in some sectors a major factor influencing decisions on pension provision is what competitors are offering. Employers often position themselves to match the market rather than lead it.

8. As well as employer appetite, the willingness of employee benefits consultants to advise and recommend new products, and the willingness of established providers of pensions administrative systems to support them, is key to these products becoming established in the market. From discussions with providers, it is apparent that both aspects can prove a barrier to new products becoming established.

[4] Johnson P, Yeandle D, and Boulding A, 2010, *Making automatic enrolment work: A review for the Department for Work and Pensions*, Cm 7954, TSO.

[5] Thomas A and Allen A, 2008, *Employer attitudes to risk sharing in pension schemes: a qualitative study*, Department for Work and Pensions Research Report No 528, Department for Work and Pensions.

9. Although our findings suggest that the proposals on DC and CDC are likely to be of interest to the majority of employers, there are a smaller number of large employers with existing DB schemes – with significant numbers of members – who would be interested in proposals that would allow them to retain DB while reducing cost volatility and uncertainty.

Large employers and Flexible DB

10. We have held a number of meetings with different sized firms from across different sectors that sponsor DB pension schemes. The meetings were with a range of senior managers, including those in HR, Pensions and Finance. They included employers that sponsor some of the largest DB schemes still open to new entrants or future accrual as well as some with schemes that are completely closed.

11. There were an extremely wide range of views expressed, on such issues as the purpose of pension arrangements, future pension provision and the factors that inform their pension decisions, such as trade union involvement and workforce management.

12. However, a common message was that, without additional flexibilities to enable employers to reduce cost volatility, DB pensions will continue to decline. A large proportion of the employers said they are likely to take steps to reduce their DB pension provision or move away from DB completely in the future if the Government does not provide for greater risk sharing in pensions with a DB element.

13. Employers were also clear that increased regulatory requirements on DB schemes over the years have made them too costly to run and contributed to their decline.

14. The majority of employers said they would welcome the emerging Flexible DB scheme design features (described later), aimed at making it easier for employers to sponsor pension schemes. While not in a position to prejudge future pension decisions, the majority thought that these designs could help enable them to sponsor a DB scheme in the longer term.

Individuals' perspective

15. *Reinvigorating workplace pensions*[6] set out the Government's intention to increase the amounts people are saving in pensions and to build public trust, confidence and engagement in pension saving as the norm. DA pensions need to support these objectives, and address some of the aspects of existing models that might put people off pension saving.

16. We know that individuals often put off making long-term saving commitments, and instead place greater value on short-term benefits from their income[7].

17. When considering saving into a pension, the key questions individuals ask are: "How much will I put in?" and "How much will I get out?"[8]. The findings from research already available confirm individual consumers are concerned about the value of their pension in retirement. Although pensions are considered as a safe way to save, people do not necessarily consider that paying into a workplace pension would make the most of their money[9].

[6] *ibid*.
[7] Thomas *et al.*, 2009, *Individuals' attitudes and behaviours around planning and saving for later life*, Department for Work and Pensions Research Working Paper No 72, Department for Work and Pensions.
[8] The Futures Company, 2011, *Automatic enrolment – information for workers qualitative research*, Department for Work and Pensions Communications Research Report No 2, Department for Work and Pensions.
[9] MacLeod *et al.*, 2012, *Attitudes to Pensions: The 2012 survey*, Department for Work and Pensions Research Report No 813, Department for Work and Pensions.

18. Evidence suggests that consumers can feel strongly about financial loss: it provokes feelings of anger and frustration and can lead to loss-aversion behaviour. Preservation of contributions is of paramount importance to some members and, at retirement, they expect to get back at least what they put in[10].

19. This suggests that a pension saving product that could provide more certainty about savings or about income in retirement may be better able to earn consumers' trust and confidence than individual DC products, that are less able to answer this concern for certainty about returns.

Further research

20. The Department continues to build the evidence base around DA. We have commissioned further research on the consumer perspective, with findings expected in late 2013. We also continue to work with stakeholders to gather further analysis.

21. Information we are gathering includes:

- Consumer views on risk sharing within pension schemes and the appetite for providing greater certainty compared to DC – for example, a guaranteed level of income in retirement and offering an alternative type of pension scheme to individuals. We will publish the results in winter 2013/14.
- Evidence from intermediaries and providers on how providing consumers with a guaranteed income in retirement may work. The Department expects to be able to share this information in winter 2013/14.
- Employer views on their current pension arrangements and how they may like to change these in the future.
- Information on what individuals want from a pension, including further exploration of the level of certainty people would like over their retirement income and how they may be prepared to fund this.
- Analysis and evidence from the pensions industry who are consulting with consumers, providers and intermediaries. We expect further details on this to be available towards the end of 2013.

Questions

1. Do you agree that a greater focus on providing members with more certainty about savings or preferably income in retirement may increase confidence in saving in a pension?
2. As an employer, do you have experience of, or can you envisage any issues with, employees being unable to retire due to DC pension income levels or certainty about income levels?
3. Do you have any further evidence or research planned which might help inform the development of DA pensions?

[10] Opinion Leader, 2010, *Understanding reactions to volatility and loss*, National Employment Savings Trust.

Flexible defined benefit – making it easier for employers to sponsor schemes where benefits accrue on a specified basis 3

This chapter sets out proposals for how it could be made easier for employers to sponsor pension schemes. The Department proposes to lift some of the constraints in the existing legislative framework to make it easier for employers to provide schemes other than traditional DB, creating a new Flexible DB model.

Introduction

1. The number of employers offering DB pensions is in long-term decline. Figure 1 shows the picture since the mid-1990s, although the decline has been going on for much longer.

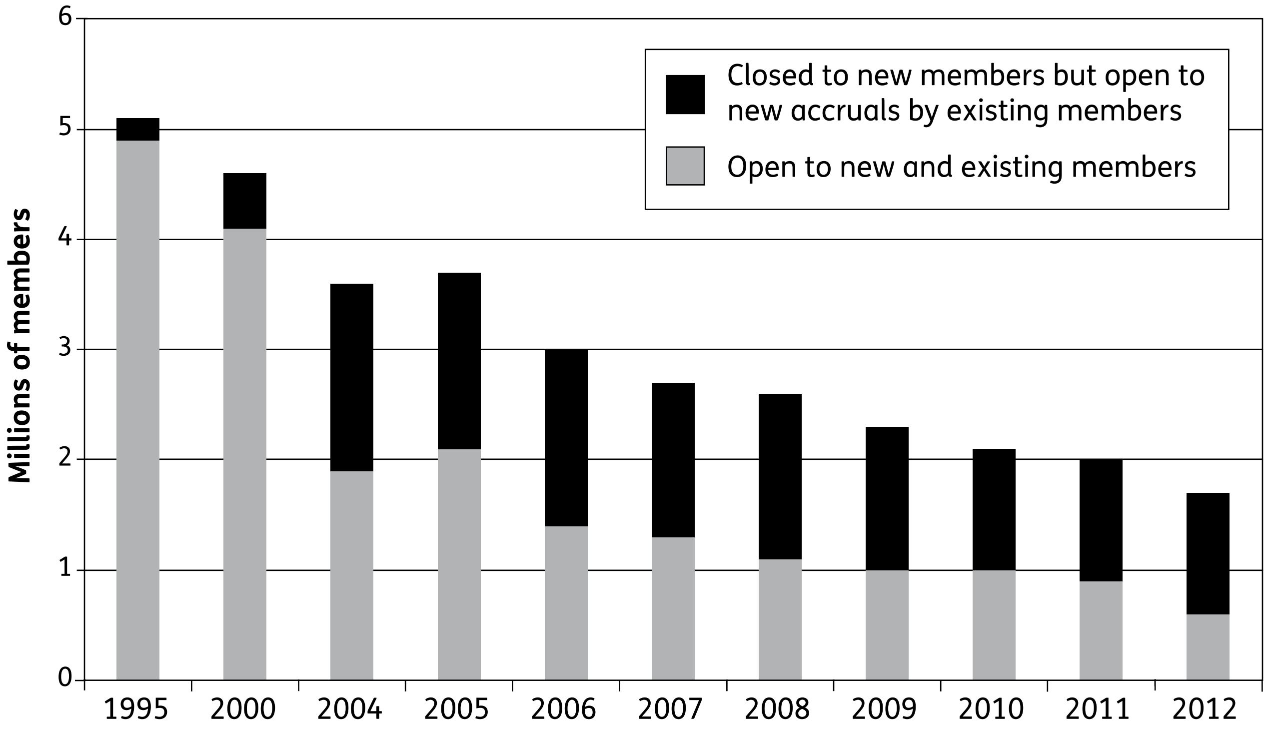
2. There are no signs of this decline abating. Without government intervention to allow more flexibility and reduce constraints for employers sponsoring DB pensions, DB is likely to disappear almost completely from future pension arrangements.

3. To facilitate DB pension provision for the longer term, regulatory constraints must be reduced as far as possible, while continuing to sufficiently protect members so they can have confidence in the pension promises made to them.

4. Our proposals would mean that members can continue to have the certainty of a pension where the benefits accrue on a given basis and the security that comes from the pension promise being sponsored by their employer.

5. Members would have more certainty than traditional DC arrangements but bear more risk than in current DB, while employers would have greater design flexibility and the ability to reduce cost volatility. This greater sharing of risks between employers and members should provide employers with more of an opportunity to offer pensions with some element of DB in the future, rather than DC being seen as the only alternative.

Figure 1: Active membership of private sector DB schemes by scheme status



Source: Occupational Pension Schemes survey

Target employer audience

6. Although reform of DB pensions is of interest to a limited number of employers, such employers are likely to have pension schemes with large numbers of members. The Occupational Pensions Schemes Survey 2011 showed that there were 1.6 million members in contracted-out DB schemes, 1.2 million of who are in large schemes with over 5,000 members. The survey also showed that of the 3,290 DB schemes, 140 schemes had a membership of over 5,000 and 1,600 schemes had a membership between 100 to 1,000 members.

7. A clear message from our discussions with employers is that, unless options to reduce cost volatility are introduced, the case for maintaining DB schemes will continue to weaken and they would have to consider moving away from DB completely.

8. We have focused on proposals to enable these employers to continue to provide schemes with a DB element. However, this kind of scheme could become important again in the future for employers who want to differentiate their pension offer among different parts of their workforce, or from their competitors.

Simplified DB – the foundation for Flexible DB schemes

9. The introduction of the single-tier State Pension means that contracting out will end. Formerly contracted out DB pension schemes will no longer have to provide specific benefits for future accruals and this will mean that requirements to automatically provide rights for survivors on future accruals will fall away. This provides an opportunity to simplify the administration of DB pensions.

10. We propose to build on this development by removing, for future accruals only (including in existing DB schemes), the statutory requirements for the indexation of pensions in payment. Indexation would no longer be compulsory, enabling employers to provide a slimmed-down, reformed DB scheme. In effect this would enable a new form of risk sharing, with the employer continuing to bear the risks associated with providing the new, simplified DB pension promise, while in future the member would bear the risks arising from future inflation[11].

11. Of course, employers could continue to offer schemes that include index-linked benefits and survivor rights if they so choose, but it would no longer be a statutory requirement.

12. This would create a more affordable, simplified statutory DB framework upon which employers could then choose additional design features to meet their individual requirements so that their pension arrangements, while continuing to include a DB element, are tailored and flexible for their own circumstances.

13. While from the employee perspective this type of scheme would involve them bearing more risk than with current DB, the Industry Working Group believes that employers who currently provide DB pensions and are committed to retain some form of DB in the future would still want to offer schemes that provide benefits in addition to the minimum that a simplified DB regulatory framework would require.

14. The following scheme designs and features are an indication of what might be possible under our DA proposals, building on the simplified DB framework. They are not intended to be mutually exclusive. For example, employers who adopt Design 1 (the ability to pay fluctuating additional benefits) could also choose other design features such as Design 2 (the ability to change their scheme's normal pension age).

15. There are other design features already available to employers that contribute to reducing potential liabilities in DB, such as switching to career average or cash balance schemes. Employers can already cap pensionable earnings, where employee earnings above a specified amount are disregarded when calculating the pension. However, these features are not in widespread use and so we want to give employers a wider range of choices, with greater legal certainty and assurance, to enable greater risk sharing.

Overview of Flexible DB scheme designs

Design 1: Ability to pay fluctuating benefits

Overview

16. This proposal combines two separate ideas described in *Reinvigorating workplace pensions*[12] (simplified/core DB and fluctuating pensions).

17. Employers could choose to provide additional benefits above the simplified DB level when the scheme funding position allowed. For example, they might choose to provide indexation on a purely discretionary basis, which could fluctuate in payment from year to year. This would give employers the ability to determine whether, and to what extent, the additional benefits should be paid, according to the financial position of the scheme at the time.

[11] Under existing legislation, the member already bears some inflation risk due to the 2.5 per cent cap on statutory Limited Price Indexation.
[12] Department for Work and Pensions, 2012, *Reinvigorating workplace pensions*, TSO.

18. Another approach would be for the employer to provide a discretionary, one-off additional payment in any year, on top of the simplified DB level. This might be provided for in a number of ways, such as an index-linked uplift of benefits for a particular year, or simply an additional benefit or bonus amount provided to pension members by way of an extra top up. The employer would not be obliged to pay the same additional amount in future years: they could revert back to the simplified DB level, unlike now where any non-statutory increases need to be maintained. As the additional payments would be discretionary we intend to keep regulatory requirements on these to a minimum.

Legislative requirements

19. We envisage changing the legislation on requirements such as preservation, revaluation, scheme funding, employer debt and the Pension Protection Fund levy so that they would only apply in respect of statutory provisions and benefits which are required to be paid under the scheme rules, and not in relation to any benefit which is paid on a fluctuating discretionary basis only.

20. We want to avoid setting requirements around how the discretionary element should be exercised. However, there is likely to be a need to ensure that the security of the funding for the non-discretionary DB benefits is not put at risk. There may also be a case for reviewing governance requirements to ensure that employers, trustees and scheme managers are properly equipped to deal with such discretion. We believe that key to the acceptability of fluctuating pensions will be clarity of communications to ensure that members understand the nature of the benefits they will receive or are receiving, and that payments could go down in some years.

21. With respect to existing DB schemes, it is possible that some schemes have provisions relating to survivor benefits and indexation ‘hardwired’ into scheme rules. We will consider whether we should provide a statutory override to enable existing schemes to change the rules in relation to future accruals more easily.

22. We are also exploring whether there are any other constraints on an employer’s ability to offer fluctuating benefits, for example in relation to tax rules.

Questions

4. What are your views on the feasibility of this scheme design?
5. Are employers likely to be interested in providing benefits in addition to a simplified flat-rate DB pension on a discretionary basis or otherwise?
6. What role do you see for scheme trustees in relation to discretionary payments? For example:
   - Should they be involved in deciding whether a discretionary payment is made at all?
   - Should they be involved in setting out how these payments are apportioned to members or should this be down to the employer?
7. Do you agree that our starting point should be to keep regulatory requirements around discretionary benefits to a minimum?
8. How do you see funding for the non-discretionary DB element being sufficiently protected while allowing for extra discretionary benefits? For example, is there a risk that paying discretionary benefits could threaten the funding for non-discretionary DB benefits for younger scheme members?

Design 2: Automatic conversion to DC when member leaves employment

Overview

23. In this scheme design, as with current DB, the employer promises that during the period of employment, they will provide the employee with pension benefits that accrue at a given level. While the employment continues the employer bears the investment risk associated with providing what is in effect a defined benefit.

24. However, if the employee **leaves their employment before retirement**, the amount of pension benefit they have accrued in the scheme is crystallised and the cash value transferred to a nominated DC pension fund.

25. Where they **die in service** or **retire**, normal scheme rules would apply. For example, where an employee retires, the employer might provide a pension directly from the scheme which pays the member's pension as it falls due from scheme assets. In effect this is the typical arrangement for current DB schemes.

26. We have also explored whether to extend the option of converting the pension into a cash value to members at retirement beyond what is already permissible. The employer could convert the accrued benefit to an equivalent amount in cash terms which is then used to secure an annuity at current market rates. We are, however, concerned this would expose the member to a high level of uncertainty, as they would not receive the level of benefit described in the accrual phase, even if they retired from active service with the employer.

27. The intention is that such an arrangement would only apply to future benefits that accrue after the implementation of this scheme design.

Examples

28. Below are two scheme designs to illustrate how the automatic conversion model might work, although other variations would also be possible:

- For a pension scheme that offers 1/60th of salary for each year of service:
  - Where a member leaves the employer after ten years' service and before retirement, the accrued pension is 10/60th. That accrued pension would be converted to a DC benefit of equal value at present market rates.
  - For death in service, if the scheme chooses to provide these benefits they would be similar to those provided by a traditional DB arrangement.
  - If the member retired after 40 years, they would have accrued 40/60ths having continued to work for the employer to that date. The scheme pays this level of pension (which could be done by payment directly from the scheme or by purchasing an annuity).
- For a scheme providing a lump sum benefit of 20 per cent of salary for each year of service:
  - Where a member leaves the employer before retirement, depending on scheme design, the member could have 20 per cent of salary for each year worked transferred into a DC arrangement or the net present value of the lump sum could be calculated with the amount reduced to take account of how many years the member is away from the scheme's normal pension age.
  - For death in service, if the scheme chooses to provide these benefits they might be based on accrued service or prospective service, for example, if the member died after 20 years' service, the death in service would be four x salary if based on accrued service or eight x salary if based on prospective service.

– If the member retired after 40 years, having continued to work for the employer, they would have accrued a lump sum of eight x salary. As is possible now, the scheme could convert the lump sum into a pension and pay it directly. Alternatively the scheme could provide for the lump sum to be used to purchase an annuity from a third party (for example, an insurance company). The amount of pension secured at retirement would depend on market conditions at that time.

How benefits are accrued and valued

29. To make this scheme design acceptable to employees there would have to be a very clear explanation of how benefits are accrued, valued at crystallisation and converted. There are a variety of ways that a value could be calculated when a member leaves:

- On a Cash Equivalent Transfer Value (CETV)[13] basis, which is already provided for in legislation. However, this would mean extending the scope of CETV rules. The CETV is normally used for member-initiated transfers and so looks to protect those members remaining in the scheme. The assumptions used are normally a best-estimate which places little value on the risk being transferred and it is unlikely to be seen as a fair value when applied to these circumstances.
- If the promise is expressed as a pension, the value could be calculated as the value of the fund needed to buy an annuity of that level (full buy-out value). We would expect this to usually be higher – in certain cases significantly higher – than the CETV basis.

30. Other ideas being considered with the Industry Working Group are:

- Following the cash-balance approach for accruals (for example, a lump sum based on a proportion of salary each year) and treating that as the transfer value. However, if a scheme is not fully funded, this could give early leavers a disproportionate share of the fund and be more expensive for the sponsoring employer.
- Devising another formulaic method to calculate the value of the accruals depending on when a member leaves. Affordability for schemes will need to be balanced with being fair to members.

Leaving employment before retirement – transfer process

31. Work is ongoing to develop how the transfer process would work where a member leaves employment before retirement and the pension benefit is transferred to a DC pension fund.

32. Broadly we envisage that, at the outset, the employer would be required to nominate a default DC scheme that members would be transferred to upon leaving employment. The member could, however, nominate an alternative scheme (for example, the new employer's scheme if they are moving to new employment) providing that the alternative scheme would accept the transfer.

Legislative requirements

33. We anticipate some changes will be required to enable employers to adopt this model, including for future accruals in existing DB schemes. Although we would want it to be as flexible as possible for employers, there is likely to be a need for some regulatory protection for members and to address risks of avoidance activity, for example, to set out the time by which employers would be required to calculate and transfer benefits when a member leaves employment.

[13] A transfer value in respect of defined benefits is calculated on actuarial principles as the capital sum which, if invested appropriately, is expected to provide the relevant member's benefits as they fall due. The calculation requires assumptions to be made about many factors, including investment returns, mortality rates, inflation rates and the relative age of any dependant(s).

Questions

9. What are your views on the feasibility of this scheme design?
10. If employers are able to use scheme designs 1 and 3, do you think it is still helpful for legislation to allow for this scheme design?
11. Do you think this scheme design could be extended to permit employers to automatically transfer members out of the scheme at retirement?
12. What would be the most suitable way for benefits to accrue under this model? And how might this best be communicated to ensure members understand the value of their pension benefits?
13. Assuming a CETV would not represent 'fair value' for the accrued rights when the member leaves or retires, how might it best be calculated? Should the basis for calculation be different when the transfer is initiated by the employer (for example on redundancy)?
14. For schemes providing a lump sum benefit, what are your views on how the cash value should be calculated for members who leave before retirement? Should the net present value of the lump sum be calculated on how many years away from pension age they are?
15. Could the accrual rate and pension value be along similar lines to existing cash balance arrangements?
16. What forms of regulatory requirements would be needed to:
    - prevent avoidance activity?
    - ensure the scheme has access to sufficient funds to enable a transfer when a member leaves?

Design 3: Ability to change scheme pension age

Overview

34. Design features are already available that enable risk sharing between employers and scheme members in relation to longevity, for example, life expectancy adjustment factors (LEAF) where the pension payable at retirement is reduced in proportion to the impact of any improvements in life expectancy. We propose to provide employers greater flexibility to manage their risks in this area by adjusting their schemes' normal pension age (NPA).

35. This would enable future pension provision to be based on the projected number of years in retirement, rather than being tied to a fixed age that does not take into account changes to longevity. From the date the model is implemented, the age at which members are entitled to the full scheme pension could be adjusted in line with changes to longevity assumptions, so that members would be expected to spend broadly the same length of time in retirement, regardless of changes to life expectancy.

36. For example:

    - When the employer introduces this design, the scheme has an NPA of 65. Average life expectancy is 85 years, and therefore the average member receives a pension for 20 years.
    - Five years later, average life expectancy increases by two years to 87 years. The employer is able to amend the NPA to 67. The average member would still expect to receive the same total amount of pension over the same number of years, based on the revised longevity assumptions; but the start and end dates of pension payments have moved forwards by two years, so the costs for the employer are similar.

Longevity assumptions

37. We have considered whether there needs to be legislation to further facilitate options to automatically link scheme NPA to future changes to State Pension age[14]. However, we are not convinced this is a sensible step. In line with our general approach, we do not want to prescribe how private sector schemes reflect State Pension arrangements. In addition, the view of the Industry Working Group is that many employers would be very cautious about having a direct and automatic link between State and private pension ages. Concerns include: the complexities of following the proposed transitional arrangements for increasing State Pension age; the possible long lead-in times for future changes and the potential for other factors in addition to longevity assumptions to impact future changes to State Pension age.

38. We therefore propose:

    - to make it easier for schemes to link their NPA with changes to State Pension age if they so choose; but
    - to require the Government Actuary's Department (GAD) to publish, at predetermined intervals (say every three years), an objective index on pension ages based on the latest longevity assumptions. Schemes would then be able to increase their NPA in line with any increases in this index.

39. Should longevity assumptions reduce at some time in the future and a scheme has chosen to use the GAD index to increase its NPA, it would seem reasonable to expect it to reduce its NPA. However, we envisage that a lower age limit could be needed to assure employers that the NPA could not reduce below a fixed point.

Different pension ages in same scheme

40 We envisage the GAD index providing one set of national ages and changes to longevity assumptions, rather than a range of ages and longevity assumptions based on factors such as type of employment or location. Employers would be free to use their own mechanisms to set their scheme's starting NPA to reflect the longevity expectations of their workforce. For employers who choose to follow the GAD index, once they have set their NPA at the point they introduce this new scheme design, any future changes to their NPA would then be in line with the changes to the GAD index.

Early retirement options

41. It is assumed that existing rules governing early retirement and minimum retirement ages would not need to be amended. Pension benefits would be calculated on the assumption that the member works until the current scheme NPA, with the pension potentially being actuarially adjusted if they retire before or after this age, within the parameters Government has set for the minimum age at which a pension can be drawn (currently 55).

[14] The Pensions Bill 2013 contains provisions for a regular review of State Pension age, to take place once every Parliament. Any decisions to increase State Pension age as a result of the review will need to be set out in primary legislation and receive Parliament's approval before becoming law. The Government has stated that it expects the review to give individuals affected by future changes in State Pension age at least 10 years' notice.

Protected members

42. Affected members would have to work for longer than they had expected to receive their full benefit at retirement. Pensioner members would not be affected, and those nearing retirement will need protection to ensure they have reasonable time to adjust their plans to reflect the new NPA. Our current thinking is that employers would not be able to adjust the NPA of anyone within 10 years of the existing NPA in the scheme.

Accruals in scope

43. Our proposal is that any accruals earned after the date the scheme implemented this adjustment would be affected.

44. For example, the employer introduces this design feature in July 2016, when the scheme has an NPA of 65. Five years later, in July 2021, longevity improvements lead to the NPA being increased to 67:

    - The age at which members are entitled to full pension would be 67 for all benefits accrued since the new arrangement was introduced in July 2016, not just accruals made after the pension age increased in July 2021.
    - Pensioner members and members aged 55 and over at July 2021 would not be affected, maintaining an NPA of 65.
    - Any benefits accrued prior to the design feature being introduced in July 2016 would be payable at age 65 for all members.

Legislative requirements

45. The purpose of this scheme design is to limit the risk of increases in employer costs caused by improvements in longevity. There will need to be some requirements on schemes which choose to change the NPA in line with the GAD index, for example to limit the extent to which they can increase the NPA in one step, to avoid situations where a scheme which has not utilised the design feature seeks to catch up. We will consider whether there is a need for a statutory override to enable schemes to change their rules going forward to take advantage of this new scheme design, without requiring member or trustee consent.

Questions

17. What are your views on the feasibility of this scheme design?
18. It could lead to more schemes having proportions of accrued pension payable at different pension ages. Would this further complexity outweigh the benefits?
19. What role do you see the scheme trustees playing? Should they be involved in setting a new NPA, or should this be down to the employer and the employer's actuary?
20. What are your thoughts on how future pension ages are set?
    - For GAD to publish a standard index based on longevity assumptions?
    - Or do you prefer schemes linking their NPA with the State Pension age, so that when the latter changes, the scheme's pension age automatically changes in line with this?
21. How might the decision to change the NPA work in multi-employer schemes?

Amending an existing scheme or creating a new one?

46. A question spanning all these scheme design features is the extent to which employers should be able to apply them to their existing DB scheme in relation to future accruals, rather than needing to open a new scheme. We have already indicated that we would consider providing a statutory override to enable employers to amend scheme rules to remove requirements to pay survivor benefits and indexation for future accruals and to change NPA in line with changes to longevity.

Including past accruals

47. The Government believes that employers should not have the power to transfer or modify accruals built up under previous arrangements into new arrangements, beyond what is allowed under current legislation, otherwise there is a risk that members could lose out on their legitimate expectations.

48. This means that deferred and pensioner members, and the past accrued benefits of active members, would not be affected as a consequence of introducing DA pensions.

49. We do, however, want to support employers, scheme trustees and members who, properly advised, wish to alter the shape of past accruals through options that already exist, such as incentive transfer exercises and changes made with member consent. Such options are legitimate ways for employers to manage their risks as long as they are well run in line with best practice.

50. In order to protect members we believe the principles set out in the Incentive Exercises for Pensions: A Code of Good Practice[15], published in June 2012, should broadly apply in these circumstances. In addition, we are considering whether there should be a requirement to provide independent financial advice in all cases where an employer offers to transfer a member's accrued rights from a traditional DB scheme to a new arrangement.

Questions

22. As an alternative to opening a new scheme, do you agree it should be possible for an employer to modify the rules of an existing scheme so that it can be re-designed as a Flexible DB scheme in relation to new accruals, for example, it is possible to change the NPA and/or introduce automatic conversion to DC when a member leaves?
23. Do you agree that employers should not have the power to transfer or modify accruals built up under previous arrangements into a new arrangement, beyond what is allowed under current legislation?
24. Should there be a requirement to provide independent financial advice in all cases where an employer offers to transfer a member's accrued rights from a traditional DB scheme to a new arrangement?

[15] Snowdon *et al.*, 2012, *Incentive Exercises for Pensions: A Code of Good Practice*, www.incentiveexercises.org.uk

Providing greater certainty for members in the defined contribution world

4

This chapter sets out proposals for providing greater certainty for members in the defined contribution world. For many employers and employees, traditional DC can be the right product. However, we believe there is space in the market for new types of provision, building on the good things provided by traditional DC but with greater certainty for the consumer and without any funding liability on the employer's balance sheet. Rather than focusing on just contribution levels and the size of the DC pot, we believe products should focus increasingly on providing more certainty for the member.

This chapter does not consider general DC quality standards, as these have been considered in a call for evidence issued in July 2013[16].

Introduction

1. The second strand of the DA project has been considering proposals for providing greater certainty for the consumer in DC pensions. We have to be clear, firstly, whether certainty is about hard guarantees or a target (for example, of pension income) or if using investment strategies to manage risk is sufficient; and secondly, what aspect of pensions we should be seeking certainty about and how it can be delivered.

2. The primary focus for DA is hard guarantees. Although we recognise that targets and appropriate use of investment strategies have an important role to play in future DC schemes, we think the distinctive element DA needs to add to the landscape is the type of certainty that hard guarantees provide.

[16] Call for evidence on quality standards in workplace DC pension schemes. https://www.gov.uk/government/consultations/quality-standards-in-workplace-defined-contribution-pension-schemes

Targets and investment strategies

- We welcome products and platforms that seek to manage risk through investment strategies and/or to target a certain income based on various assumptions. However, as no legislative changes are required to enable them to be delivered, we have not dealt with them here.
- Traditional DC products do not usually set a target, although members are provided with yearly statements. These provide clarity about the current value of the fund and an indication, based on assumptions, about the potential pot (and hence income) in retirement, but do not offer the additional fund management needed to keep a certain projection on track.
- In contrast, existing models such as Managed DC generally engage with the member early on to set parameters and manage expectations about outcomes. Fund management activities are aimed at maintaining a high likelihood of achieving a realistic target.
- Other types of DC use investment strategies to manage risk. For example, Target Date funds are a mechanism for matching investment and interest rate risk exposure with the individual's intended retirement date. Diversified Growth Funds aim to meet a benchmark return over a period of time – typically equity-like, but with lower volatility.

3. On guarantees – we have explored a number of proposals from the Industry Working Group and others for different types of guarantee which could be delivered either by a Government body or the insurance industry. The models explore the feasibility of providing guarantees on different aspects of the pensions saving lifecycle: contributions made to the scheme; part of the capital or investment return; or on income before reaching retirement.

Target employer audience

4. These models may be of interest to employers who would like more certainty for their employees but do not want to take on any risk or make a promise they would have to fund and have that liability reflected in their balance sheet.

5. For many employers their primary concern at present is implementation of automatic enrolment and the imperative of identifying a suitable pension scheme. However, we believe that in the future, as the amount of capital they have invested in their DC scheme builds up, employers will increasingly become more interested in what the scheme offers back to their employees. In addition, the ending of the employer's right to compel a specific retirement age is leading employers with DC schemes to focus on ensuring employees can afford to retire. Employees having greater certainty about the outcome of pension saving will be a valuable commodity in this context.

Target employee audience

6. From the employee perspective, our discussions clearly indicate the desire for products that provide certainty but do not require high levels of consumer engagement to manage and understand investment risks. We would see this market including individuals automatically enrolled into their employer's pension scheme.

Guarantees

7. Some commentators do not support any form of guarantee due to the impact on the investment strategy, and consider the correct approach to pensions savings is to seek maximum financial gain (within risk parameters) and to educate members to understand why this should be the case.

8. However, we believe that behavioural economics, consumer understanding and financial engagement within our target audience for automatic enrolment, indicates that many consumers are unlikely to respond to education or information alone. Rather they may respond to the certainty that only guarantees can offer. In addition, by offering consumers a greater level of certainty (at an appropriate cost) we can reduce the anxiety sometimes induced by investments and prevent consumers viewing pensions as a gamble[17]. In a system where people can opt out of workplace pension saving, should industry be offering more to employers and more to consumers to persuade people to stay in?

9. All forms of guarantee raise common challenges, including:

   - **Cost to the provider and ultimately the member**. Guaranteeing capital, returns or an income stream brings with it a number of solvency or funding requirements to provide protection for the consumer to ensure the provider remains in a position to meet its guarantee. But they come at a significant cost. Although these costs are borne by the provider, ultimately they are passed on in some form to the employer or the individual.
   - **Impact of the guarantee on investment strategy**. There is a risk that the guarantee ends up driving the investment strategy. If the fund manager and guarantor are the same, there is a strong incentive to manage the fund solely to meet the guarantee rather than to maximise the fund value. In theory, separating out these two functions could help create the right incentives for each party, but even then, there is a risk that insurers will only guarantee funds that meet the level of investment risk they wish to insure.
   - **Counterparty risk**. Any guarantee is only as good as the solvency of the guarantor. Therefore the provision of a guarantee opens up the beneficiary to a risk that their counterparty might not be able to meet their commitment, in the event of the guarantee being invoked.
   - **Trade off between financial and behavioural value/consumer preferences**. It is important that we recognise guarantees come at a cost to the member, which will reduce the value of their fund relative to a guarantee not being purchased. However, the intention of a guarantee in a DA scheme is not to maximise financial returns for the individual: it is to provide greater certainty and confidence to the consumer. This implies a low-level guarantee, the intention of which is to encourage people to stay in pension saving, which is particularly important in a pension system where there is no compulsion to save.

10. Some, but not all forms of guarantee in the models we explore, would mean that the member would see the value of part of their pension savings, or part of an income, increase year on year. With what we know so far about consumer preference and behaviour, we believe this would help keep people paying into their pensions, and may make increasing contributions appear worthwhile to the consumer. However, the trade-off between the impact on returns, the cost of the guarantee, and the likelihood of its being invoked need to be held in a healthy balance.

[17] Opinion Leader, 2010, *Understanding reactions to volatility and loss*, National Employment Savings Trust.

Models

11. We asked the Industry Working Group to explore what forms of guarantee within DC schemes, which take account of the above challenges, would be feasible. Also, to advise what UK legislative and regulatory changes would be needed. The Group focused on insurance-backed solutions. They developed three concepts that seek to address consumer uncertainty at the three key points in the pension saving life cycle. They suggested most would be delivered though the market, apart from a variant of the money-back guarantee option (a guarantee of nominal contributions on retirement) which the group considered would need Government support.

12. The concepts do not require members to engage with complex investment decisions – a fiduciary would make such decisions on the member's behalf. However, we do anticipate that greater certainty about what their saving is achieving will encourage member engagement.

13. As well as the contribution from the Working Group, we have discussed the feasibility of guarantees directly with other providers, whose input is also reflected in our assessment. We also received contributions from international consultants.

14. Our intention in exploring models is to ensure proposals for the legislative framework create the right type of space for innovation, while also providing appropriate member protection. Our conclusion is there are a number of UK legislative and regulatory issues for us to explore, but that the key enablers would be creating a DA space within the legislation, and supply-side appetite.

Table 1: Summary of Industry Working Group models

Model	Which uncertainty?	Delivery	Key issues
Model 1 Money-back guarantee	*"Will I get my money back?"* First stage in pension saving life cycle, particularly relevant to those new to automatic enrolment.	Market-based or via a Government or arms-length body.	Whether market could deliver – if not, justification for Government involvement. Does it focus on the right issue in the right way? Trade-off between benefits to member and impact on returns.
Model 2 Capital and investment return guarantee	*"I don't want to lose the investment returns I've built up, and want some security about returns in the future."* Second stage in the life cycle, uncertainty in the middle of the accumulation phase, balanced with need for continued fund growth.	Market-based, and requires industry standardisation.	Cost/pricing. Insurer appetite to provide. Insurer/investor/scheme interface. Trade-off between benefits to member and impact on returns. Access to illiquid investments. Ensuring fit with Her Majesty's Revenue and Customs (HMRC) regime.
Model 3 Retirement income insurance	*"I want to be surer about what income I will get when I retire."* Third stage in the life cycle, creating certainty about income before reaching decumulation.	Market-based and requires industry standardisation.	Works in the US but, due to solvency rules, would cost more in the UK. Requires scale to deliver. Trade-off between benefits to member and impact on returns. Compatibility with HMRC decumulation regime.
Model 4 Retirement income builder	As above.	Market-based, collective self-annuitising scheme.	Similar to Danish ATP scheme. Setting up an appropriate regulatory vehicle.

Model 1: Money-back guarantee

Overview

15. The money-back guarantee is intended to ensure that the amount of the accumulated savings at retirement or at the point of transferring out of the scheme does not fall below the nominal value of contributions made to the scheme. In general the probability of such a low-level guarantee being exercised is small; modelling has shown this is typically less than 10 per cent and close to zero for long periods of saving. However, when the guarantee is exercised, it could have real value for the individual.

16. We also believe that for new pension savers (particularly when automatically enrolled) this type of guarantee would help address the risk that in the early years they might be more likely to opt-out if their annual statements show no growth or equate to less than the amount contributed. With money-back, if contributions continue, the statement would show a rising guaranteed balance.

17. We have explored options for delivery by both the market or by the public sector (see below). Our conclusion at this time is to not pursue public sector delivery of a money-back guarantee. We also consider that the case has not been made to warrant new legislation for regulatory enablers that have been suggested, such as including a safe harbour for trustees, employers and providers against mis-selling or compulsion, or money back as a default fund.

Market-based option

18. There are a number of variations that could be explored in a market-based money-back guarantee model and precise product designs could vary according to the provider.

19. The main factors affecting the cost of a money-back guarantee are:

    - the term of the guarantee: the longer the term, the lower the cost;
    - the risk characteristics of the fund being insured: the greater the risk profile of the fund being insured, the greater the cost;
    - market volatility and interest rates;
    - regulatory requirements on capital.

20. We have not identified any legislative barriers to market provision of a money-back guarantee, so the issue seems largely one of provider appetite for designing a product that is attractive to consumers at a price that is acceptable to both parties.

Non-market-based option – a defined contribution protection fund

21. The Industry Working Group considered that the market was unlikely to offer this type of product. We therefore explored providing a money-back guarantee through a public sector body, akin to the Pension Protection Fund. This body would provide a remote guarantee (i.e. outside of the individual's scheme).

22. Modelling from the Pension Protection Fund suggests that premiums for such a guarantee could be very low under certain circumstances, the main one being a long and sustained period of saving (typically the case of a member joining a scheme when young and staying in it for life). In general, the longer the time period covered by the guarantee and the lower the risk level of the fund being insured, the cheaper the guarantee.

23. However, such modelling depends on the ability of the provider to operate outside the commercial prudential rules for insurance and so offer the guarantee more cheaply than a private provider, raising potential State Aid issues. The fund might also be more volatile and need to be controlled by variable charges to avoid exploding deficits or surpluses.

24. While lower cost might be a strong argument for public provision, there are a large number of practical concerns and, fundamentally, the fact that market provision appears possible removes a key justification.

Model 2: Capital and investment return guarantee

Product description

25. This option is intended to offer guarantees at the mid-point of the pension life cycle: when a member has built up a sum and their primary focus shifts from protecting contributions to preventing loss of capital, while still maintaining a need to grow the fund further. The guarantee would be purchased by a fiduciary on behalf of the member to secure a guarantee against part of the capital and possibly an investment return, for a fixed period.

26. It would have the following key features:

- the cost of the guarantee would be kept low by the ability of the scheme to purchase in bulk;
- a fiduciary would make the decision on when to purchase, minimising administrative costs and requirements for consumer engagement;
- the opportunities for the fiduciary to purchase such a guarantee would be increased, compared to current practice. This would be achieved by the introduction of standardised insurance terms and conditions for this type of guarantee, which providers would need to adhere to. This would make it simpler to achieve best execution[18], and enable purchasing on a group basis;
- as there would be a medium-term lock-in period for the guarantee, this would create a new investment opportunity in illiquid assets. This should be an ideal match for a pension saver who is still far from retirement, as liquidity should not be their primary concern, so they should look to benefit from their long-term outlook. At a macro-economic level, this could allow significant funding to be made available to, for example, infrastructure projects.

27. Should this option be pursued further, there are a number of detailed design issues, such as the:

- ability of the scheme to hedge the guarantee, and the feasibility of doing this with illiquid investments such as infrastructure projects (for example, what if the member wants to transfer out before the lock-in period is over?);
- feasibility of introducing standardised terms and conditions: whether these are really necessary; if so, would they ultimately be unattractive to insurers; and what would be the competition law issues;
- potential for this product to operate on a cohort basis, and whether this provides enough smoothing over the period;

[18] Best execution refers to the obligation of an investment services firm executing orders on behalf of customers to ensure that the prices those orders receive reflect the optimal mix of price improvement, speed and likelihood of execution.

- cost of the guarantee. The cost would be managed via the fiduciary – for example, the fiduciary could seek the best value guarantee at a fixed cost, which would vary with market conditions, and could decide whether it was worth purchasing or not;
- fit with the tax regime – treatment of the guarantee as a return on investment rather than an unauthorised contribution.

28. Based on our analysis to date, the biggest barriers to feasibility would appear to be access to illiquid investments; governance and fiduciary elements; and the interface between insurers or trustees and investment opportunities.

Model 3: Retirement income insurance

Overview

29. This model is intended to provide certainty about income in retirement before the member retires, to address the single event conversion risk associated with buying an annuity, and seeks to maximise the investment returns on the member's fund. Each year from, for example, age 50, a fiduciary would use a portion of the member's fund to buy, on the member's behalf, an income insurance product that insures a minimum level of income, which grows each year as further insurance is purchased. At retirement, the saver draws their pension directly from their fund and only if their fund is reduced to zero does the income guarantee insurance kick-in.

30. It would have the following key features:

- The individual would see a guaranteed minimum income they will receive in retirement for that portion of the fund invested in the guaranteed fund.
- This income guarantee would grow each year as the investments in the guaranteed fund grow via new contributions, the transfer of existing funds and as those funds already in the guaranteed fund grow with investment returns.
- When the saver reaches retirement the guarantee would remain in place in full, so long as the individual does not draw more than the guaranteed income from their fund (reducing proportionally should they withdraw more).
- The saver would retain full ownership of their fund, continuing to benefit from any growth, with the insurer(s) stepping in and continuing the income for the rest of their life only if the fund falls to zero.
- The insurance would be paid for via an annual management charge levied on the proportion of the funds invested in the guaranteed fund. Normally the cost would be agreed in advance, with the level of new income guaranteed each year being dependent on prevailing market conditions (i.e. the same level of premium may buy a greater or lesser amount for that year's guarantee compared to previous years).

31. While this looks like an income drawdown product, it is also an annuity, because the insurance payouts will begin if the fund is exhausted, so there is no risk of the individual exhausting their fund and having to fall back on the State.

32. Products of this type already exist in the US, but there are some barriers to its adoption in the UK. Should this option be pursued, detailed design issues include:

- HMRC income drawdown rules are designed to protect against individuals falling back on State benefits by ensuring that the individual never exhausts their fund. Although this model has an alternative approach to guard against that risk, it would not fit into the current decumulation regime. We are working with HMRC to explore this in more detail – consideration will need to include likelihood of take up and security of the insurance product.
- It requires insurers to be willing to offer standardised and transparently-priced products. All else being equal, the greater price pressure exerted by this approach makes it less attractive to insurers. In the US, the scale of the plans on which this insurance is sold compensates insurers for the relatively low prices.
- Scale is a significant barrier. As it works in the US, a panel of insurers competes to supply standardised income insurance. In such an arrangement, insurers typically want to deal with plans with large enough asset bases to make the business profitable for them. The fragmented nature of the UK market means that this scale is not achieved. It may work on a smaller scale but only if business was limited to one insurer – in which case the benefits of competitive pressure on pricing disappear, with the outcome being worse for members.
- Prudential regulation of insurance companies is more exacting in the UK than the US and, combined with the costs of hedging such insurance, these products end up costing significantly more in the UK than the US, for the same level of guarantee.
- There is an administrative burden to this proposal since it involves significant data requirements: at a minimum, insurers need data over time on members' ages, fund choices, contributions and incomes drawn from the fund.

33. All of this suggests that introduction of this potentially attractive option seems unlikely in the short to medium term. Moves to drive scale in pension provision may help, as well as changes to the decumulation rules (an issue more generally for hybrid decumulation products that are neither straightforward drawdown nor annuities), but the issues around capital requirements make this problematic in the current climate.

Model 4: Pension income builder

34. This model is similar in structure to the Dutch General Practitioners' pension fund (SPH) and the mandatory ATP scheme in Denmark[19]. Although similar in some respects to the CDC schemes explored in the next chapter, it is considered here as the concept has as much in common with the other models explored in this chapter.

Product description

35. In this model contributions are used for two different purposes. A proportion is used to purchase a deferred nominal annuity, payable from the current pension age. For every year of contributions each individual has a pension made up of a series of these deferred annuities. Thus the individual can see their pension income increasing over time (albeit at different rates depending upon the cost of each year's deferred annuity, which varies in line with market interest rates and market expectations of future longevity).

[19] ATP Livslang Pension is a lifelong supplementary funded DC pension plan which forms part of the first pillar of the Danish pension system. By Danish law, anyone who works pays into the scheme and builds up a pension which is taken at pensionable age.

36. The residual proportion of contributions is invested into a collective pool of risk-seeking assets along with the residual proportions of other scheme members. This could be done on a single collective basis or among smaller cohorts (although these do need to be large enough to allow for enough variation in investment experiences among members such that there is potential for smoothing). This pool is used to provide future indexation on a conditional basis, with rights adjusted by way of bonus allowances based on the financial status of the scheme.

37. As a result the individual has a degree of pre-retirement certainty over their retirement income and can always see some benefit for each additional year of contributions, as the guaranteed element increases (although clearly the cost of an additional year's annuity may vary, potentially affecting the individual's perception of value for money). In general this year-on-year increase should be confidence-inspiring for members.

38. The DWP has received technical assistance with modelling this option from the risk manager and investment adviser Cardano to understand what outcomes might look like for the individual. Table 2 provides an illustration of the potential costs of these deferred annuities at different ages, and what a pension contribution of £100 at these ages would buy in terms of nominal income at the scheme's normal pension age, assuming it was used entirely to purchase nominal rights.

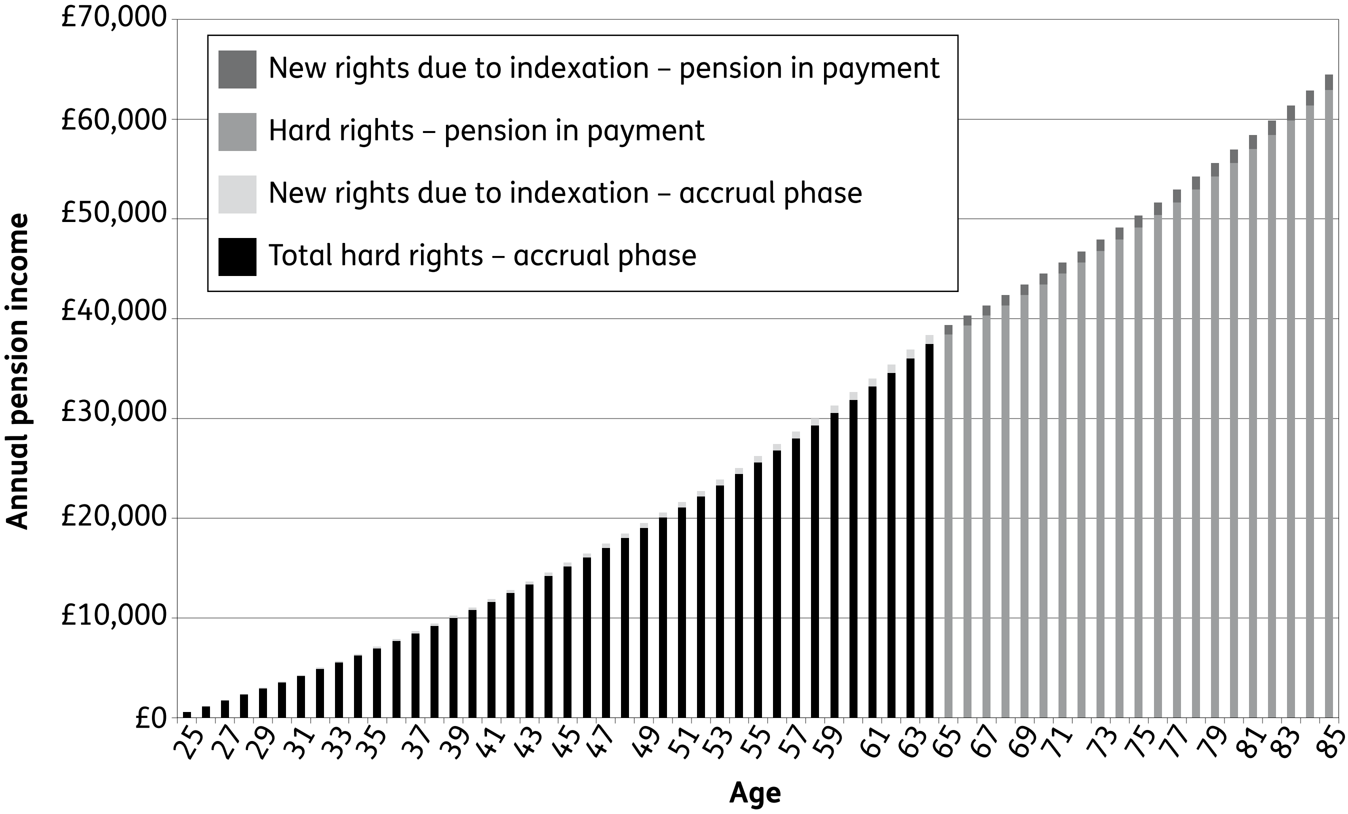
Table 2: An illustration of the cost of deferred annuities at different ages

Age	Market value of £1 of deferred annuity payable from age 65	Annual guaranteed income at age 65 from £100 of pension contribution
25	£4.76	£20.99
35	£6.43	£15.55
45	£8.68	£11.52
55	£11.72	£8.54
64	£15.35	£6.52

Source: Cardano.
Note. Figures are illustrative only and based on an assumed flat interest rate of 3 per cent and the assumption that people are expected to live until age 85 on average. This illustration assumes that the entire pension contribution is used to purchase a nominal deferred annuity.

39. The individual would also be expected to benefit through the collective asset pool to fulfil the ambition of future indexation payments. This indexation would be granted where the scheme's funding position allowed and would become a guaranteed right once granted. The aim would be to grant indexation on nominal rights in accrual (effectively revaluation) as well as once the pension is in payment. Figure 2 provides an illustration of what such a pension might look like in both the accrual and decumulation phase.

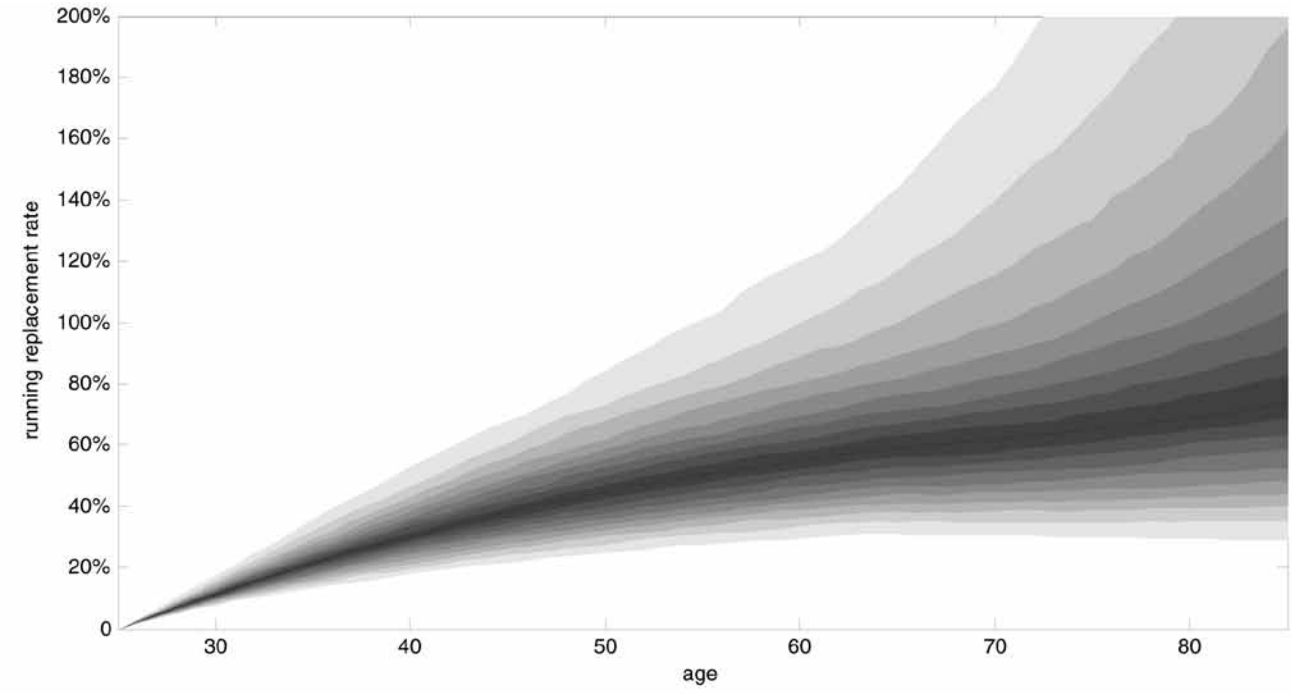
Figure 2: Illustration of a pension income generated by the Pension Income Builder



Source: Cardano.
Notes: This illustration is based on deterministic assumptions; an individual age 25 with a starting wage of £20,000 saves 20 per cent of salary p.a. into the scheme. Two-thirds of the annual contribution is allocated to nominal deferred annuities, with the remainder going into the collective indexation pool. The individual receives annual wage growth of 3 per cent and stays in the scheme until retirement at age 65; they receive a pension until death at age 85. Indexation (pre and post retirement) is 2.5 per cent per annum.

40. The chart illustrates a particular pension outcome as a means of showing very simply how the scheme might work for an individual. A more realistic outcome would allow for uncertainty in financial markets, which would affect both the market value of nominal deferred annuities and the degree to which indexation is paid, both pre and post retirement. This is illustrated in Figure 3, which shows the distribution of outcomes in terms of the real replacement rate.

Figure 3: Projected distribution of the real replacement rate for an individual saving in the Pension Income Builder for life



Source: Cardano.

41. The black line shows the median outcome over time, while the shaded lines above and below the median line show the remainder of the distribution (excluding the extreme tails). There is a 90 per cent likelihood of ending up somewhere along this distribution. The key point, and the main benefit for the individual, is the reduced spread of outcomes on the downside (the bottom 50 per cent of outcomes). This is the effect of the hard guarantees (with the variation being explained by changes in the cost of the deferred annuities).

42. A final useful illustration of this model is in comparison to a traditional DC scheme. Table 3 shows how the two models compare in terms of replacement rates on retirement:

Table 3: Comparison of on-retirement replacement rates under pension income builder and traditional DC

	Pension income builder	DC
Mean	0.55	0.59
Standard deviation	0.35	0.58
5th percentile	0.24	0.16
25th percentile	0.34	0.29
Median	0.46	0.43
75th percentile	0.63	0.68
95th percentile	1.12	1.48

Source: Cardano.
Notes: Based on an individual age 25 with a starting wage of £20,000 saving 20 per cent of salary per annum into the scheme. Two-thirds of the annual contribution is allocated to nominal deferred annuities, with the remainder going into the collective indexation pool. The individual receives annual wage growth of 3 per cent and stays in the scheme until retirement at age 65; they receive a pension until death at age 85. Both scheme types operate with an annual cost of 30 basis points. Individual DC operates with a life cycle strategy whereby the fund is invested in 90 per cent equities, 10 per cent bonds for individuals below age 40. Above age 60 the fund is invested in 10 per cent equities, 90 per cent bonds. Between ages 40 and 60 there is a linear glidepath between these positions.

43. These results are assumption-driven, so should only be viewed as an indicative comparison between the scheme types. They show that on average the pension income builder and DC produce similar outcomes (the mean and median are similar in both cases) but the former:

- provides a smaller range of outcomes (as captured by the lower standard deviation of outcomes);
- provides more protection than DC in the worst outcomes (the 5th and 25th percentile outcomes are better than DC); and
- reduces the potential for the upside in comparison to DC (the 75th and 95th percentile outcomes are better under DC).

44. Although results are not shown here, this scheme design would be expected to significantly out-perform any DC plan where a nominal annuity was used to provide a retirement income, since this model is designed and run to provide for post-retirement pension increases which will provide some protection against inflation. Although comparing this scheme to a nominal DC annuity is clearly not a like-for-like comparison, it does reflect observed behaviour on annuity purchases. According to the Association of British Insurers (ABI), the vast majority of annuities purchased annually are nominal[20] so it is therefore a useful comparison to make.

45. For employers the attraction is that even though a guarantee is being provided for the member, it is a traditional DC scheme in so far as it only requires fixed contributions and no obligations to be funded for and reported on the corporate balance sheet. So employers bear no risk under this arrangement.

[20] See for example Association of British Insurers, 2010, *Annuity Purchasing Behaviour*, No 23; Association of British Insurers, 2008, *Pension Annuities*, No 8 and Association of British Insurers, 2002, *Annuities: The Consumer Experience*.

46. The provider has the obligation to pay out the guaranteed nominal pension income from pension age and is exposed to the risk of insolvency if it is unable to meet these liabilities (which could arise from losses on investments, adverse interest rate movements or longevity assumptions being too optimistic). However, the annual purchase of an individual deferred annuity allows the latest market prices and expectations of asset values, interest rates and future longevity to be captured in the price of the deferred annuity, so there is an automatic transfer of longevity risk and investment risk to individual members, who then partially share these risks among themselves. The solvency of the guarantee provider will of course be subject to appropriate regulation (discussed further below).

47. The provider bears no inflation risk in relation to retirement income, which is instead borne by members. However, they in turn share this risk among themselves by virtue of the collective asset pool. By continuing to invest in risk-seeking assets[21] members would expect to at least partially mitigate this inflation risk through the chance of receiving some bonus top up, although it should be noted that once indexation is granted the fund will need to move to matching assets to protect this increased benefit level, so the allocation to risk-seeking assets will drop over time. The sharing of the assets among other members may allow for some smoothing of returns over time, especially at and through decumulation.

48. This model therefore entails genuine risk sharing which, when balancing the interests of both employers and members together, is a better distribution of risks than any one party bearing all pensions risk in its entirety.

Issues to consider

Scale

49. The model needs to operate at a large scale in order for some of the key benefits to be realised:

- A greater pool of assets will bring down investment costs (this is of course also the case with a large DC plan).
- A larger number of members increases the pool with which any individual member can share risks. Given the self-annuitising nature of the scheme, the larger the number of members, the greater the potential to reduce individual mortality risk.
- A larger membership increases the funds available to be invested with the ambition of providing future top-up bonuses on pensions in payment.

50. The issue in the UK is how to achieve this scale. In the Netherlands, the CDC schemes to which this model is similar are sector based, suggesting that within the UK context it might work well as a multi-employer scheme. However, it might also be feasible for a single employer, with a large and relatively stable workforce. The scheme could be run on a commercial basis or as a mutual, which might also prove attractive to the trades unions and other social partners.

[21] Note that this is not a feature unique to this scheme design – it can also be achieved in traditional DC.

Who is the guarantor?

51. The key to this model is the presence of an appropriate guarantee provider. This will not be the sponsoring employer, whose role is limited to paying in a fixed contribution. Instead the risk is shared between the members who effectively underwrite the deferred annuities. Any necessary capital buffer would then in effect be provided by the members for themselves. The key issue then is how to raise the working capital needed to set up and operate the vehicle.

52. Alternatively, the annual deferred annuities could be written by a conventional insurer, with the scheme purchasing these in the name of each member. This would be expected to cost the member more due to the regulatory framework for insurers and their commercial nature.

53. In addition, by buying out deferred annuities on a commercial basis, the scheme would be transferring assets to the annuity provider. This lower level of assets would reduce the expected returns from the collective risk-asset fund used for future indexation payments, although in principle the remaining assets in the fund could be leveraged to achieve the same position.

Intergenerational fairness

54. One potential advantage of this model is that it allows for collective assets to be pooled either among all members or among smaller cohorts of members. The latter would allow for intra-cohort risk sharing, but not risk sharing between cohorts. This obviates the need for subjective intergenerational transfers and makes it easier to sell the collective benefits of the scheme to individual members. However, it should be noted that in general terms, the larger the pool of membership that is sharing risks, the greater the opportunities for risk sharing.

55. A second way in which this model is intergenerationally fair is that it clearly calculates the value of individual benefits (of both the guarantees and any surplus – the latter on a unitised basis) through the use of arbitrage-free valuation of benefits based on market-observable data; in other words, appropriate market interest rates are used to discount the future cash flows owed to a member. This always allows for the calculation of a fair transfer value and hence it is always known precisely what a member has built up – this transparency means that opaque inter-generational transfers can be avoided.

Appropriate governance

56. This scheme would require a strong governance framework and regulatory oversight. The trustees would need to constantly monitor the scheme's funding ratio and take any corrective action where necessary to avoid any deficits arising.

57. A regulator would need to oversee a strong supervisory regime, from perhaps approving such schemes being set up; through ensuring they did not over-compete on guarantees (driving them up to unsustainable levels); and ensuring adherence with the principle of arbitrage-free valuation of benefits.

Hedging guarantees and counterparty risk

58. In the self-annuitising variant of this model (which would be expected to deliver superior returns for the member since the scheme keeps the assets) it is expected that the scheme would hedge the entitlements generated by the deferred annuities using sovereign bonds and standard derivatives. Although the latter exposes the scheme to counterparty risk, regulation of derivatives markets already takes account of this risk.

Legislative requirements

59. The Industry Working Group has suggested that the following areas should be considered for new or amending legislation to enable the market to deliver models 1, 2 and 3:

- **Decumulation rules** – primarily in relation to model 3 where the scheme provides a drawdown function with the guarantee kicking in when the fund is exhausted. This would not fit with the current tax decumulation regime, which we are exploring further.
- **Access to illiquid investments/daily pricing requirements** – primarily in relation to models 2 and 3. The Industry Working Group suggested that the regulatory requirements on daily pricing for contract-based DC investments may make it difficult for investment managers and insurers to place funds in illiquid investments such as infrastructure. We are exploring this with other government departments and regulatory partners.
- **Standardisation of insurance terms and conditions** – primarily in relation to models 2 and 3. The Working Group suggested that best execution could be achieved via a fiduciary purchasing the guarantees on behalf of the member and that standardisation could better facilitate the interface between the scheme fiduciary and the guarantee provider market. However we also want to explore whether the same effect could be achieved within the market without legislation or Government regulation.
- **Additional fiduciary requirements for purchasing insurance products on the member's behalf** – we explore some of the governance questions in Chapter 6.
- **Safe harbours** – this has been raised as a suggestion by wider industry, to prevent the risk of mis-selling accusations later down the line. Our initial view is that this would not be a healthy approach to stimulating the supply side of the market due to member protection issues, but we do explore appropriate fiduciary oversight via governance requirements in Chapter 6.

60. In respect of model 4: the Department has held discussions with the Dutch pensions industry and regulators, who have significant expertise in the running of collective schemes, including this model, which operates there as a Regulatory Own Fund. These are institutions that themselves – rather than a sponsoring employer – underwrite the liabilities or guarantees investment performance or benefit level. Such schemes are required to hold additional assets above the level of technical provisions to serve as a buffer.

61. If an institution could be set up so that its technical provisions were defined by the purchased nominal deferred annuities (with the scheme being self annuitising), the collective asset pool could then act as a buffer to cover against the potential insolvency of the vehicle. We would be interested in views on what an appropriate level of funding should be for such an arrangement. We explore the wider legal issues relating to Regulatory Own Fund vehicles further in Chapter 6.

62. It is envisaged that such a vehicle could be run either on a commercial basis for profit or by a mutual insurance company. Under a mutual model all excess benefits from the collective asset pool would go to scheme members in the form of indexation or bonus top-up payments; in a commercial model some of this would go to the provider in the form of profits. In either case the employer would not be liable to increase contributions in the event of any under-funding against the promises inherent in the deferred annuities.

Overall assessment of DC models

63. The consumer perspective is a key consideration. Our discussions suggest that a money-back guarantee is the least favoured model because of the low number of scenarios in which the risk could occur, and because of the emphasis on the savings pot rather than the actual income that will be received.

64. We therefore favour models which seek to secure a guarantee on the income that will be received in retirement, that builds up gradually during the savings period. This approach has the benefit of allowing the member to see ongoing growth, combining certainty with a focus on the primary objective of pension savings – retirement income. It also assists employers' needs in respect of workforce management. We also favour models that spread the risk of conversion at retirement.

65. A focus on income also works well with the change to a single-tier State Pension, giving the consumer a clearer understanding of what their income in retirement will be and how their private saving will build on the State foundation.

66. From the supply side, it is clear that at present UK insurers have little appetite for providing guarantees. The ABI in their recent publication, *Identifying the Challenges of a Changing World*[22], questioned whether customers would be prepared to meet the premium required to provide guarantees. They also raised concerns about increasing pressures from conduct and prudential regulators to avoid policyholder detriment.

67. On the money-back guarantee model, we have considered whether the Government should intervene directly and concluded that, in light of the significant hurdles that would need to be negotiated, we can not justify direct Government intervention in providing money-back guarantees. We will however, continue working with providers, who have modelled the possibilities and found some market-based models affordable.

68. In relation to models 2 and 3 we are continuing to work with industry on the legislative areas highlighted above to enable these models to work within the market. We also outline in Chapter 6 how we propose to establish a new legislative framework to support the operation of these, as well as other forms of guarantees.

69. On the pension income builder (model 4), it is legitimate to debate whether members would be better served by using their contributions to seek higher returns through their pensions, rather than using it to guarantee their own entitlements. However, given the consumer demand for guarantees and the unwillingness of employers and insurers to provide them, this model could represent a creative way of meeting a consumer desire and help to engage members with pension saving.

[22] Association of British Insurers, 2013, *Identifying the Challenges of a Changing World*, Association of British Insurers.

Questions

25. Do you think having more certainty than traditional DC would be welcomed by members, and help generate consumer confidence and persistency in saving?
26. As an employer, if these products mean there is no funding liability, only the requirement to contribute as for a traditional DC scheme, would you be interested in offering these products to employees?
27. In relation to medium- and long-term guarantees outlined in model 2 (capital and investment return guarantee), and model 3 (retirement income insurance), would removal of the legislative barriers be sufficient to stimulate the development of market-based solutions?
28. As insufficient scale has been identified as a barrier to providing affordable guarantees, is there a role for the Government in facilitating different types of pension vehicles that would create greater scale for this purpose?
29. Are there any additional legislative barriers that stand in the way of innovation of products with guarantees?
30. Do existing protection arrangements for DC products provide sufficient protection for members in the event of provider insolvency?
31. Would any protection mechanism need to apply in order to provide extra security for members and reassurance for the employer that it would not be liable in the event of any deficits arising?
32. Are these models likely to be an attractive option for employers and members?
33. On model 4 – pensions income builder – what are your views on this model in which members are in effect deploying their own capital to guarantee their own entitlements?

Collective defined contribution schemes

5

This chapter looks at what we might mean by Collective Defined Contribution schemes (CDC) in the UK context. We also review lessons learned from recent experience in the Netherlands.

CDC models, even where there is no promise or certainty about the pension, including the pension in payment, do offer an alternative approach to risk sharing and pooling the assets, and sharing risks amongst members does seem to create more stable outcomes than are possible in an individual DC scheme. We therefore propose to explore further the policy issues and legal implications of the changes to the legal framework that would be required to enable them to operate in the UK.

Introduction

1. In *Reinvigorating workplace pensions*[23], we outlined the third strand of the DA project exploring with the Industry Working Group whether elements of CDC pensions could inform the development of DA.

Target employer audience

2. We know some DB employers are interested in CDC as an alternative to DB schemes, rather than moving into individual DC schemes. CDC schemes may also be feasible as multi-employer schemes, perhaps sector based as in the Netherlands. Longer term, once established, they might enable smaller employers to participate, offering them and their employees the benefits of scale.

[23] *ibid*.

Overview of the models

What we mean by CDC

3. Given the different models of CDC, it is important to be clear about the core characteristics of the models we are discussing, as well as potential advantages and disadvantages of these characteristics.

Fixed employer contributions

4. A key feature for a CDC is that it provides certainty for the employer who pays a fixed rate of contributions and has no liability to the scheme (unless they choose to support it further) and no balance-sheet risk.

Collectivisation

5. Rather than being retained in an individual fund for each member, or each member having rights to their own specific contributions and investment returns attributable to those contributions, in a CDC scheme assets are pooled. When they retire, members do not select an individual retirement income product, rather the income is paid from the asset pool. The rights of the member in a CDC scheme are therefore not solely related to the contributions made by or on behalf of that member.

6. This arrangement can provide some advantage to the member, since a CDC scheme, by virtue of the pooled nature of assets, can arguably access a wider range of investment opportunities than traditional DC. It also smoothes the return: individual members are not exposed to downturns in the market in the same away as in individual DC. We explore some modelling on member outcomes later in this chapter. A potential disadvantage of this collectivisation is intergenerational risk transfer – explored below.

Scale

7. CDC schemes perform better on a larger scale: in the Netherlands this is on a multi-employer basis. Scale can provide the potential for efficiencies in the costs of administration and investment management. However, these advantages apply equally to other forms of pension scheme, and it is important to note that while CDC needs scale, it does not provide it automatically. The other benefit of scale for CDCs is that it enables the collective element to function more efficiently – very simply, for a scheme that shares risks among members, the more members there are, the greater the opportunities for risk sharing.

Benefit design

8. In one of the main models of this type of scheme, individuals are provided with a target pension income they might receive in retirement. This often includes a fluctuating conditional indexation payment.

9. The actual pension income received is dependent on the available assets in the scheme. If the funding is not sufficient, there are a number of pressure valves to enable the scheme to continue to deliver benefits, such as not paying the conditional indexation element or reducing the target pension income for members, with a decision to be made on how the risks are shared between different classes of members.

10. One form of CDC also includes the possibility of benefits in payment being reduced in order to manage the fund. An alternative would be to fix a core part of the pension which cannot be changed once its in payment, so it would be only the conditional indexation payments that could be cut.

Intergenerational risk sharing

11. CDC schemes share risk between members. Scheme design governs which members bear risk and how much of it. For example, in a scheme where the design reduces the benefits of active and deferred benefits before it does so for pensioners, the risk in relation to investment returns and funding position is borne to a greater extent by younger members where the target is reduced. The variation on this design – to make a promise on the pension in payment – would increase the element of intergenerational risk transfer further. This intergenerational risk sharing, which arises from collectivisation, requires a considerable increase in the level of trust required from members of those running these schemes in comparison to traditional DC.

12. In the Netherlands and Denmark, membership is compulsory, which has enabled intergenerational risk sharing as a natural part of the social contract in a way that is not the norm in the UK, where employee participation in workplace pensions is voluntary.

13. Our DA principles include a criterion on intergenerational fairness. The nature of the intergenerational risk transfer in these models would not necessarily be compatible with that principle.

Perceived advantages of CDC – member outcomes

14. There is a lively debate within the industry around the theoretical benefits of CDC plans compared to individual DC plans; in particular, the extent to which CDC outperforms DC. This was explored by the DWP and GAD in 2009[24]. The modelling indicated that there was a good likelihood of better outcomes compared to individual DC, although this arose from CDC following a more aggressive investment strategy over time, which is not inherent in the design, and the same strategy could be replicated in DC. It also indicated that a stable active membership was required to keep the scheme sustainable. The modelling also indicated this effect was radically diminished where there was no continuing stream of new member contributions.

15. As part of the Department's current work on CDC, consultants Aon Hewitt have modelled the position of an individual who for 25 years set aside 10 per cent of their salary for a pension. It then looked at how they would have fared had they retired in 1955, and then in every other year up until the present.

16. The median of the average salary replacement has been compared for the following; (i) a CDC plan invested 80 per cent in equities and 20 per cent in bonds; (ii) an all equity individual DC plan; and (iii) a lifestyle individual DC plan. In Aon's results the average replacement rate for the CDC plan is 32 per cent, for DC equity it is 27 per cent, and for lifestyle it is 22 per cent. The dispersion of the individual DC plans is significantly greater than for the CDC.

17. Our understanding is that out-performance is driven primarily by lower costs and remaining invested for longer in risk-seeking assets. Neither of these is inherent to CDC schemes and it is possible to achieve both low costs and to hold risk-seeking assets for as long as desired in individual DC schemes.

[24] Department for Work and Pensions, 2009, *Collective Defined Contribution Schemes*, and Department for Work and Pensions, 2009, *Modelling Collective Defined Contribution Schemes*.

18. However, the ability to share risks amongst members does seem to create more stable outcomes than are possible in an individual DC scheme and the more the members, the greater the ability to share risk and so the lower the dispersion in outcomes.

Lessons learned from the Netherlands experience

19. Although historically schemes in the Netherlands have been described as CDC, they were presented to the members as DB, with members developing expectations that pensions were guaranteed, when in practice there was scope within the rules for pensions (including those in payment) to be reduced in the event of under-funding. Employers viewed them as defined contribution, so considered they had more control over their costs than under DB.

20. Whilst the model seemed sustainable during a period of strong economic growth, the downturn and the resulting pressure on scheme funding has led to benefits being reduced and to the structure of the schemes being reviewed, with a new pensions contract being introduced in 2015. As well as being explicit that there are no guarantees, a new funding regime is being introduced. The changes are expected to lead to a significant consolidation in the number of schemes.

21. It is worth noting that in the case of both Denmark and the Netherlands, CDC arrangements are an integral part of pension systems that are recognised world-wide as being high quality. According to the 2012 Melbourne Mercer Global Pension Index[25], the Danish pension system was ranked number 1 on a list of 18 countries that fully reflect the significant range of different pension systems around the world. The Netherlands was ranked second on this list, which takes into account the adequacy, sustainability and integrity of a pension system. We believe that the UK can learn some positive lessons from these high quality pension systems and the CDC schemes that are integral to them.

Conclusion

22. For the employer and scheme, the benefit of CDC where there is no promise is that theoretically there is no liability which could create a funding debt. For the member there is a target, but no guarantee or absolute certainty, and there is a question about intergenerational fairness. Where the pension in payment is guaranteed, this certainty is not greater than what individual DC currently offers, and may increase the risk of intergenerational unfairness.

23. However, assuming a sufficient inflow of new members, there is likely to be a more stable outcome due to collective risk sharing compared to individual DC. It is important to stress that our analysis shows that the DC models explored in the previous chapter, and other DC options, might also have the potential to demonstrate some of the same attractions as CDC.

24. Given that we believe CDC schemes offer an alternative approach to risk sharing and have the potential to offer more certain outcomes than individual DC, we propose to explore further the changes to the legal framework that would be required to enable them to operate in the UK. This is considered in the next chapter.

[25] Australian Centre for Financial Studies and Mercer, 2012, Melbourne Mercer Global Pension Index.

Questions

34. Do you agree that CDC schemes have the potential to provide more stable outcomes on average than traditional DC schemes?
35. Given there is no tradition of risk sharing between pension scheme members in the UK, 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?
36. Is a CDC scheme designed to manage funding deficits by cutting benefits in payment going to be acceptable in the UK where traditionally maintaining the value of benefits in payment has been an overriding priority?
37. What levels of funding do you consider would be appropriate to ensure that a CDC scheme has sufficient capital to meet the liabilities and minimise the risk of benefits in payment being cut?
38. Given the need for scale and an ongoing in-flow of new members to ensure the sustainability of a CDC scheme, will it be possible to set up a scheme without some form of Government intervention?
39. As a mutual model, it has been suggested that CDC schemes might prove attractive to the trades unions and other social partners – might this be an option worth exploring?

Enabling innovation – legislative approach 6

This chapter considers what we want to achieve in legislating to enable the development of a DA pensions market, and the implications for schemes changing status to a DA scheme where changes are made in respect of future accruals. It also explores the possibility of legislation to enable CDCs with and without guarantees.

We look at some specific challenges, including:

- the relationship of our proposals to the proposals to implement the new definition of money purchase benefits arising from the Bridge case[26];
- the interrelationship between our proposals for DA and ongoing work on DC pension quality; and
- managing regulatory expectations for the future.

Introduction

1. In previous chapters we identified the regulatory enablers that will be needed to allow for innovation in risk sharing. In framing our legislative approach our objectives are to:
   - enable schemes to evolve and innovate;
   - ensure proportionate regulation of different types of schemes;
   - make the extent of their obligations clear for employers and providers;
   - avoid being overly prescriptive.
2. We have considered a minimalist approach which would simply amend existing legislation (repealing provisions such as indexation requirements) and make specific provision for particular models of pension scheme. The risk of this approach is that the resulting legislation is likely to be piecemeal, making it difficult for scheme providers, trustees and employers to understand their obligations and how the legislation applies in relation to their scheme. In addition, it is unlikely to provide the regulatory certainty employers and providers will need to innovate and enable existing schemes to evolve.

[26] Houldsworth and another v Bridge Trustees Limited and another, and the Secretary of State for Work and Pensions. Judgment given on 27 July 2011.

3. Historically, pensions legislation has broadly classified schemes as either money purchase or non-money purchase, with a money purchase scheme being one which only offers money purchase benefits. Although money purchase schemes are commonly referred to as DC, they are not defined as such in legislation.

4. With the introduction of DA there is the opportunity to recast the legislation, distinguishing between DB and DA schemes in the non-money purchase space. We therefore propose to create a specific DA space in the legislation, taking the opportunity to move away from the polarity created by the existing definitions and giving explicit recognition in legislation to the potential for innovation in risk sharing in the middle ground.

5. At the same time, we propose to define DB schemes in their own right. With the creation of new definitions of DA and DB schemes, distinct from each other and from money purchase schemes, we can more easily provide clear and proportionate regulation according to scheme type, giving clarity and reassurance to employers and providers.

6. To enable schemes to evolve and change, we do not propose to create entirely new and separate legislative regimes for the different types of schemes, but instead will use the new definitions to help make clear the distinct requirements that apply to each type of scheme. We see ease of transition as vital to make DA attractive to employers.

7. The aim would be to create a conceptual linkage for the different types of pension scheme that would fall within the DA space and set out the common requirements that recognise their characteristics as distinct from DB and money purchase schemes.

8. It would represent a shift in the legislation, setting out an approach based on the scheme as a whole. This could encourage innovation and act as a greater incentive for schemes to offer a mix of benefits. It would also provide a very clear space for us to set out the characteristics of being a DA scheme, and make it easier for existing schemes to change shape in relation to future accruals.

9. While we will still have to amend existing legislation to remove, for example, the requirement to provide indexation for pensions in payment in respect of future accruals and to enable specific models where legislative barriers have been identified, such changes should be more coherent in the context of the creation of new types of pension scheme.

10. Creating a new DA space should also make it easier to set the right context for enabling CDC schemes that might provide forms of guarantee and operate as Regulatory Own Funds.

11. We envisage that primary legislation would be used to set out the new definitions, with the specific requirements attaching to the different types of schemes being set out in regulations.

Defining the different types of scheme

DA schemes

12. A DA scheme would be a scheme under which members are given some form of guarantee in respect of their pension, but not complete certainty of the level of income that they will receive from it in retirement, or when it would be paid.

13. The definition would cover existing scheme designs, as well as some of the new models explored in this paper. It should also provide the space for innovation and development of new DA models in the future. It would need to be made clear that the definition would simply act to bring particular schemes into its scope for the purposes of regulation. For existing schemes which would fall within the definition, being a DA scheme would not imply any change in scheme design.

14. The definition would include (among other things):

- any DB scheme which offers anything on a discretionary or uncertain basis;
- any DB pension where the NPA can be changed to reflect future longevity changes without member consent;
- cash balance schemes;
- schemes with an underpin or 'better off' schemes;
- the automatic-conversion model explored in Chapter 3;
- all DC pensions with a guarantee built in or provided alongside; and
- all hybrid schemes under which the member is entitled to both DB and DC benefits.

How the DA definition would work – some examples

- A scheme that provides discretionary indexation gives its members 'some form of guarantee but not complete certainty on the level of income', because:
  - the member has a level of guarantee in respect of their pension (that it will be a certain percentage of their salary, depending on length of service, for example);
  - the actual amount of income that they will receive in retirement is unknown because there may be some indexation provided, but
    - this is not promised; and
    - the level of any indexation paid may fluctuate throughout payment.
- A cash-balance scheme gives its members 'some form of guarantee but not complete certainty on the level of income', because:
  - the sum accrues on a defined basis;
  - the actual amount of income that the member will receive in retirement is unknown because it will depend on market factors at the time the sum is used to purchase an annuity.
- The pension income builder will provide some certainty of pension income, but not complete certainty over total income from the scheme, because:
  - the member has a guarantee in respect of the deferred annuities that are bought or promised by the scheme each year;
  - the ultimate income from the scheme may be higher than the guaranteed level, because some of the member's contributions remain invested in a collective fund to provide indexation on a conditional basis, and these payments are not guaranteed.

DB and money purchase schemes

DB Schemes

15. DB schemes would be defined in their own right rather than simply by contrast to money purchase. A DB scheme would be one in which the member is given complete certainty about the level of benefit that will be received in retirement, in the sense that it will be calculated by reference to fixed and known factors – for example, proportion of salary x years in service. This would include both indexed DB where indexation is required under the scheme rules and non-indexed DB schemes because the pension benefit (the retirement income) remains one that is defined, i.e. it is certain from the member's perspective.

16. It is important to note that a scheme may be DB regardless of its status as an occupational or personal pension scheme and regardless of who stands behind the promise made by the scheme. So the definition would include personal pension schemes if these provide complete certainty to the member. It might also include schemes in which the scheme itself takes on the risks of funding the promise, without reference to an employer.

Money purchase schemes

17. Subject to one exception, a money purchase scheme would be one in which all benefits in the scheme are money purchase benefits. Further discussion of money purchase benefits and the forthcoming implementation of section 29 of the Pensions Act 2011 are explored at paragraph 47 below.

18. The exception relates to situations in which a guarantee is obtained on behalf of the member, but the liability for meeting that guarantee does not fall on the scheme. This can arise in situations where contributions paid by the member to the scheme go directly towards securing an insurance policy for the member, with the only promise made by the scheme to the member being that they will get whatever the value of the insurance policy is at the relevant time.

19. In such a case the insurance policy is the asset and it directly matches the liability to the member. Therefore the benefits within the scheme are money purchase benefits because there is no risk of a mismatch between the scheme's assets and liabilities. However, from the member's perspective, more certainty is being offered. As a result, we would want such schemes to meet the requirements that we propose to attach to DA schemes in terms of information and governance (see paragraphs 33 to 39 below), and we would also want to exempt such schemes from automatic transfer requirements and from some of the other requirements relating to charges and scheme quality that will attach to money purchase schemes (see paragraphs 47 to 50).

20. Our current thinking is that we would carve such schemes out as an exception to the definition of money purchase schemes. There is no intention that such schemes should be subject to any scheme funding requirements in respect of the benefits being offered and we would not wish to cast doubt on the status of the benefits within the scheme.

21. As well as providing clear definitions for different types of scheme, it will be important to ensure it is relatively straightforward for schemes to evolve in relation to future accruals and change status under the proposed new definitions. Paragraphs 43 to 46 below explore the implications.

Collective DC schemes: The scope for legislation

22. CDC schemes can take different forms. Some could potentially operate within the existing legal framework in the UK; others, where there is no guarantee or promise, are more difficult to reconcile with it, and may require a new regulatory vehicle. We examine below the scope for legislating to enable the models explored in Chapters 4 and 5.

CDC schemes that provide a promise or guarantee

23. CDC schemes that provide the member with some form of promise or guarantee, such as the pension income builder explored in Chapter 4, could operate within the proposed DA regulatory framework. As with any other scheme containing a promise, they would need to be funded on a technical provisions basis and meet the appropriate solvency requirements.

24. However, the means by which these funding requirements can be satisfied are likely to be different from traditional DB arrangements where a sponsoring employer stands behind the arrangement (and is effectively responsible for any deficit that arises in the scheme).

25. The primary option for a CDC scheme providing some form of promise or guarantee would be a vehicle set up as a Regulatory Own Fund. As a first step, we would need to modernise the current Regulatory Own Funds legislative requirements, not least to bring them into line with the other DA reforms and to ensure that they work from a practical perspective.

26. In European terms, such schemes fall within the terms of Article 17 of the Institutions for Occupational Retirement Provision (IORP) Directive. This sets out requirements for institutions that themselves – rather than the sponsoring employer – underwrite the liabilities or guarantees investment performance or benefit level.

27. Besides setting out the regulatory vehicle for these schemes we will need to consider whether the framework should include other requirements to enable them to provide the high levels of governance that would be needed to protect member interests. For example, there may be a case for a more formal approval arrangement on set-up, possibly by requiring schemes to obtain a licence from a regulator, as well as being subject to regulatory oversight of their funding levels.

28. While we have identified Regulatory Own Funds as a potentially suitable vehicle there may be other vehicles (which emerge either now or in the future) which could also provide this type of collective arrangement. We are therefore not looking to restrict the types of vehicles that could be used, simply to provide an enabling framework.

Enabling legislation for CDC schemes which do not provide a guarantee or promise

29. Under this type of model, although when a member reaches retirement they receive a pension directly from the scheme, up to the point that they take their pension there are no funding commitments other than contributions, and benefits are defined solely by the amount of money in the fund. Post-retirement, indexation may be conditional on the funding position of the scheme and, in worst case scenarios, benefits in payment may be cut.

30. Regulatory Own Fund requirements apply where the scheme and not the employer underwrites biometric[27] risks, and/or provides guarantees. They do not therefore apply to models of CDC that do not underwrite biometric risks or provide any guarantees.

31. We are therefore exploring with the Industry Working Group where such schemes should sit within our legislative framework, and the extent to which legislation would be needed to enable this type of scheme to operate in the UK.

32. We envisage that these schemes should be subject to the same high levels of governance and regulatory oversight outlined in paragraph 27 above.

Exploring the detailed legislation governing DA schemes

33. As already outlined, defining DA schemes in their own right would enable us to set out cross-cutting requirements that would apply to all such schemes. We believe that the areas of governance, member communications and funding will need special attention, because in DA schemes where some benefits may be discretionary or where the outcome for the member is less certain than in DB schemes but more complex than in money purchase schemes, there will be new responsibilities for the trustees or those running the schemes, and a need to explain to members clearly what the benefits and risks of the schemes are, and what any guarantee means.

Governance

34. Where models involve discretion over the level of benefits to be provided, our thinking is that the legislation must necessarily avoid prescribing conditions about how that discretion be exercised. In line with our aim to allow more flexibility in scheme design and enable innovation, we consider it should be for schemes (and the scheme rules) to set any conditions. However, there could be a case for introducing requirements to ensure that where there is discretion in a scheme, trustees or scheme managers give proper and regular consideration to the exercise of that discretion.

35. In addition, given the extra responsibilities on those running such schemes, there is a strong case for imposing different requirements to reflect the greater emphasis on discretion and risk sharing – for example in relation to the levels of knowledge and understanding required and internal controls and processes. There may also be a need to make clearer the expectations about how trustees should manage DA schemes as long-term propositions – with appropriate mechanisms for allowing schemes to evolve.

36. In introducing any such requirements, our overriding aim will be to ensure proportionality and the need to avoid being overly prescriptive.

[27] Risks linked to death, disability and longevity.

Member communications

37. The nature of DA schemes may mean there is a clear case for a common set of information requirements distinct from those for DB and money purchase schemes. The fact that DA provision will offer members some degree of guarantee but not absolute certainty about their pensions means that the nature of the pension promise may be harder to understand and more complex to communicate without being misleading. As a result, we would consider the need to set out specific disclosure and information requirements for DA schemes ensuring that members receive clear and consistent explanations of their pension rights in the scheme.

38. We would look to ensure the approach to what we require is consistent with the principles behind the new harmonised disclosure regulations which comes into force in April next year. We expect that many of the elements of disclosure required for DB and money purchase schemes may also be applicable and will ensure it is clear and easy to identify what disclosure is required for DA.

39. As with governance requirements, our overriding aim will be to ensure that any such regulation is proportionate.

Scheme funding

40. As set out above, in general terms, we would aim to regulate schemes depending on whether they are DA, DB or money purchase. However, given the element of guarantee inherent in a DA scheme and our obligations under European law to protect members, there will inevitably be some degree of overlap between DB and DA schemes in relation to scheme funding requirements.

41. Schemes which make a promise in relation to the benefit will need to be funded to be able to meet that promise, but funding requirements should only apply to the extent of the promise or guarantee, and the nature of the funding obligation will depend on who is standing behind the promise.

    - An employer-sponsored occupational pension scheme which offers a salary-related pension with discretionary indexation would need to be funded in accordance with the current scheme funding requirements which apply to occupational pension schemes, equal to the technical provisions – but only to the levels needed to cover the basic pension liability.
    - A Regulatory Own Fund vehicle offering deferred annuities and discretionary benefits would need to be funded to the level required to meet the discounted capital value of the liabilities (technical provisions) plus an appropriate buffer.

42. Where the employer stands behind the promise in an occupational pension scheme, Pension Protection Fund protection and employer debt obligations would continue to apply as now. These provisions will however need amendment to reflect the different structures of DA schemes and to take account of altered employer obligations. While Pension Protection Fund levies would continue to apply, they would need to be calibrated to reflect the liability accruing as a result of the given promise.

Changing scheme status

43. In line with our aims to ensure proportionate regulation and enable schemes to change shape and move into the DA space, we are not creating entirely separate legislative regimes, but using the new definitions to ensure that distinct requirements can be applied to the different types of scheme where appropriate. While a change in status will result in schemes becoming subject to different requirements, this in itself should not be a barrier to the changes being made as it will not require fundamental changes to the scheme.

44. Some regulatory requirements will continue to apply to schemes regardless of their status as DA, DB or money purchase, for example basic disclosure requirements. However, where employers and providers choose to change scheme shape and this results in a change in scheme status – for example, from DB to DA – any DB-specific requirements will cease and the scheme will become subject to DA-specific requirements on information and governance instead.

45. For example, where an employer offering a salary-related pension scheme without indexation decides to provide discretionary indexation, the scheme will change from a DB scheme into a DA scheme. In practice, this change in categorisation will not result in major changes to the scheme. Scheme funding requirements will remain unchanged. The employer will only be required to fund for the promised flat-rate salary-related benefit. The trustees will, however, need to meet the DA information and governance requirements, ensuring that members understand what the new scheme offers and the trustees are properly equipped to manage the new scheme properly.

46. Similarly, where a scheme changes from offering purely money purchase benefits to securing some form of guarantee for its members, it will no longer be subject to the money purchase scheme-specific requirements that we intend to make in relation to quality standards, charge caps and pot-follows-member, but it will be required to meet the new information and governance requirements for DA schemes. The impact on scheme funding will depend on the nature of the guarantee offered. For example, if the guarantee is offered and fully backed by an insurer, the scheme-specific funding requirements in the Pensions Act 2004 would not bite on the employer.

The DA spectrum and how this links to the revised definition of money purchase benefits in the Pensions Act 2011

47. The revised definition of money purchase benefits in section 29 of the Pensions Act 2011 was enacted to overturn the Supreme Court judgment known as the Bridge judgment[28]. The Court decided that certain benefits should be treated as money purchase benefits, even though it was possible for them to develop funding deficits. The revised definition aims to restore the law to the position it was widely understood to be prior to the Supreme Court's judgment, ensuring that only benefits which cannot develop a deficit in funding can be money purchase benefits. The Department is currently consulting on the draft regulations that will provide transitional measures for the commencement of section 29[29].

48. As set out earlier in this chapter, in legislating to enable DA schemes we propose to create a new definition for DA schemes – distinct from money purchase schemes; and for the first time provide a definition for DB schemes in their own right.

49. This new regulatory framework will therefore set out three different types of scheme (DB, DA and money purchase), with these terms being mutually exclusive, allowing for proportionate regulation according to scheme type – with explicit recognition of the middle ground in the form of DA.

50. An aim will be to provide greater clarity in relation to the responsibilities biting on each type of scheme. In particular, for DA schemes, to ensure that funding requirements and pension protection levies are proportionate to the extent of the guarantee given, dependent on who stands behind the guarantee, and taking account of the risks of not being able to meet the liabilities.

[28] Houldsworth and another v Bridge Trustees Limited and another, and the Secretary of State for Work and Pensions. Judgment given on 27 July 2011.

[29] Department for Work and Pensions, 2013, *Definition of money purchase benefits in occupational pension schemes*. This consultation seeks views on 'Pensions Act 2011 (Transitional and Consequential Provisions) Regulations 2014' and closes on 12 December 2013.

The relationship between DA schemes and ongoing initiatives on DC pension quality, automatic transfers and automatic enrolment

51. As was made clear in the passage of the Pensions Bill 2013, the Government is keen to ensure that there are appropriate minimum standards for workplace DC schemes – particularly as they will be heavily used for automatic enrolment.

52. However, requirements that might be applied to money purchase schemes, such as bans or caps on certain types of charge currently being consulted on[30] will not necessarily be appropriate for DA schemes in the same way. This reflects the fact that a partial guarantee offers a degree of protection over pot erosion and that DA schemes may be more complex (and hence involve additional cost).

53. In a similar vein, and given the potential variety of DA schemes, we anticipate we would not necessarily propose to impose the same quality standards on DA schemes as those on which the Government issued its call for evidence in July[31], especially since some aspects (such as governance) will be covered under specific DA requirements.

54. It is also our current intention that DA schemes would be outside any system of automatic transfer (pot follows member) since this would involve transfers of incommensurable benefits.

55. We will however, need to ensure that DA schemes are able to be qualifying schemes for automatic enrolment purposes, which may require amendments to the automatic enrolment legislation, certification guidance and regulations.

Managing regulatory expectations for the future

56. One of the concerns raised by employers in particular in discussing DA, has been that although Government might set a deregulated framework now, there is nothing to prevent future regulation potentially adding further responsibilities and costs to all the parties involved in providing workplace pensions.

57. We have considered whether there is any specific way of providing some kind of future-proofing in the legislation that might give people confidence in setting up DA schemes. However, given that future Governments will always have the prerogative to change legislation introduced by their predecessors, it is not apparent that we could make any statutory provision that would achieve this in practice.

58. However, the proposed framework for DA – clearly distinguishing between DB and DA – may, in itself, help to ensure that regulation is and remains proportionate to the type of scheme in question.

[30] Department for Work and Pensions, 2013, *Better workplace pensions : a consultation on charging*, Cm 8737.
[31] *ibid*.

Questions

40. Do you agree that creating a unified and identifiable legislative framework that brings together the legislation relating to DA schemes would be preferable to simply amending existing legislation?
41. Do you have any comments on how to characterise the defining characteristics of DA pensions?
42. Do you agree that it makes sense to define DB schemes in their own right rather than simply by contrast to money purchase?
43. Do you agree that defining DA, DB and money purchase schemes should facilitate clear and proportionate regulation according to scheme type?
44. Do you have any comments in relation to the suggested definitions of DA, DB and money purchase schemes?
45. Are you aware of any schemes operating in the UK under the Regulatory Own Fund provisions?
46. Aside from Regulatory Own Funds vehicles, are there any other vehicles which might be appropriate for the provision of collective CDC which offers some form of guarantee or promise?
47. Do you think that setting up a CDC scheme should be subject to formal approval, for example licensing by a regulator?
48. Do you think that CDC schemes which do not provide a guarantee or promise should also be licensed?
49. Do you agree that such CDC schemes should also be subject to DA requirements on governance and member communications?
50. Should there also be an option for schemes that currently offer DC to convert to CDC?
51. In the absence of both a guaranteed pension entitlement and an individually defined pool of assets, how should assets in a CDC scheme be apportioned such that pension accruals can be measured for tax purposes against the Annual Allowance and the Lifetime Allowance?
52. What specific areas should we address in relation to governance and member communications for DA schemes?
53. Do you have any comments on the assumptions in relation to scheme funding requirements?
54. What specific areas should we address in relation to governance and member communications for DA schemes?

How to respond 7

Scope of consultation

1. This consultation applies to England, Wales and Scotland.

Duration of the consultation

2. The consultation period begins on 7 November 2013 and runs until 19 December 2013.

3. Please ensure your response reaches us by that date as any replies received after this may not be taken into account.

4. The Government's new Consultation Principles were introduced on 17 July 2012. The new Principles are at http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance

How to respond to this consultation

5. Please send your consultation responses, preferably by e-mail, to:
definedambition.pensionsconsultation@dwp.gsi.gov.uk

   Or by post to:

   Defined Ambition Team
   Private Pensions Policy and Analysis
   1st Floor, Caxton House,
   6-12 Tothill Street
   London
   SW1H 9NA

6. When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents, and where applicable, how the views of members were assembled. We will acknowledge your response.

7. We have sent this consultation document to a number of people and organisations who have expressed an interest in these issues. Please do share this document with, or tell us about, anyone you think will want to be involved in this consultation.

8. We will publish the responses to the consultation in a report on the consultations section of our website. The report will summarise the responses and the action we will take as a result.

Online blog

9. We have set up an online blog at **https://definedambition.blog.gov.uk** where you can discuss with others the pension models described in this consultation document and how they might work in practice. The blog is an informal way of exchanging views on the consultation document so please also remember to submit your views formally via the email address or postal address above.

Queries about the content of this document

10. Please direct any queries about the subject matter of this consultation to the e-mail address given above.

How we consult

Freedom of information

11. The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published consultation report.

12. All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

13. To find out more about the general principles of Freedom of Information (FoI) and how it is applied within DWP, please contact:

    Freedom of Information Team
    Caxton House
    6-12 Tothill Street
    London
    SW1H 9NA

    Email: Freedom-of-information-request@dwp.gsi.gov.uk

14. The Central FoI team cannot advise on specific consultation exercises, only on Freedom of Information issues. More information about the Freedom of Information Act can be found at: www.dwp.gov.uk/freedom-of-information

The consultation criteria

15. The consultation is being conducted in line with the new Cabinet Office consultation principles. The key principles are:

    - departments will follow a range of timescales rather than defaulting to a 12-week period, particularly where extensive engagement has occurred before;
    - departments will need to give more thought to how they engage with and consult with those who are affected;
    - consultation should be digital by default, but other forms should be used where these are needed to reach the groups affected by a policy; and
    - the principles of the compact between government and the voluntary and community sector will continue to be respected.

Feedback on the consultation process

16. We value your feedback on how well we consult. If you have any comments on the process of this consultation (as opposed to the issues raised) please contact our Consultation Coordinator:

    Elias Koufou
    DWP Consultation Coordinator
    2nd Floor
    Caxton House
    Tothill Street
    London
    SW1H 9NA

    Phone: 020 7449 7439

    Email: elias.koufou@dwp.gsi.gov.uk

17. In particular, please tell us if you feel that the consultation does not satisfy the consultation criteria. Please also make any suggestions as to how the process of consultation could be improved further.

18. If you have any requirements that we need to meet to enable you to comment, please let us know.

Annex A
Defined Ambition Industry Working Group membership

The following are currently involved in the Industry Working Group, three sub-groups looking at DB, DC and CDC, and the Consumer Perspective Group. Everyone who has been involved over the last 12 months is thanked for their support and contribution, and particular thanks go to the Chair Andrew Vaughan, and the Chairs of the sub-groups. Thanks also to the Pension Protection Fund, Cardano and Aon Hewitt for their help with modelling.

Industry Working Group

Andrew Vaughan	Industry Group Chair and ACA Chair
David Fairs	DB Sub-Group Chair and KPMG
David Hutchins	DC Sub-Group Chair and Alliance Bernstein
Sarah Smart	CDC Sub-Group Chair and The Pensions Trust
Philip Bennett	Slaughter & May
Derek Benstead	First Actuarial
Craig Berry	Trades Union Congress
Jane Beverley	Punter Southall
Rob Booth	NOW Pensions
Adrian Boulding	Legal and General
Duncan Buchanan	Hogan Lovells
Claire Carey	Sackers
Peter Cottingham	Prudential
Charles Cowling	Jardine Lloyd Thompson
Edmund Downes	Aviva
Melanie Duffield	National Association of Pension Funds
Awhina Fleming	Association of British Insurers
Gillian Foroughi	Institute and Faculty of Actuaries

Continued

Helen Forrest	National Association of Pension Funds
Maddi Forrester	Axa Investment Management
David Hardern	Aon Hewitt
Kevin Legrand	Buck Consultants
Catherine Love Soper	Punter Southall
Stefan Lundbergh	Cardano
Iain McClay	Aviva
Russell Owen	B&CE
Barry Parr	Association of Member Nominated Trustees
David Pitt-Watson	Royal Society of Arts
John Quinlivan	Aegon
Darryl Pye	Met Life
Kate Smith	Aegon
Giles Wade	Prudential
James Walsh	National Association of Pension Funds
Kevin Wesbroom	Aon Hewitt
Mark Yeates	Axa Investment Management

Consumer Perspective Group

Alison Bailey	The Pensions Advisory Service
Craig Berry	Trades Union Congress
Mel Duffield	National Association of Pension Funds
Phil Doggart	Institute and Faculty of Actuaries
David Fairs	KPMG
Steve Gay	Association of British Insurers
Debbie Harrison	Financial Services Consumer Panel
Judith Hogarth	Engineering Employers' Federation
David Hutchins	Alliance Bernstein
Barbara Limon	Age (UK)
Iain McClay	Aviva
Rachel Mahon	National Employment Savings Trust (NEST)
Russell Owen	B&CE
David Robertson	Association of Consulting Actuaries
Sarah Smart	The Pensions Trust
Doug Taylor	Which?
Andrew Vaughan	Barnett Waddingham
Neil Walsh	Prospect

Annex B
Evidence and lessons from consumers and market participants

Introduction

1. This annex provides an outline of the evidence that has been used to inform the discussion of the demand for DA pensions in Chapter 2. It includes material from a wide range of sources and has highlighted gaps in our evidence base. This material has informed further research being undertaken on behalf of the Department, the findings of which are due to be published in late 2013.

Individuals

Individuals are concerned about the value of their pension in retirement. Although pensions are considered as a safe way to save, members do not necessarily consider pensions as a means of providing a guaranteed income in retirement.

2. Individuals consider pensions, in particular workplace pensions, the safest way to save for retirement. In 2012, 25 per cent considered paying into an employer scheme to be the safest way to save for retirement compared to 18 per cent who felt that investing in property was the safest way to save for retirement. This view has remained steady over recent years, with the exception of investing in property which saw a decline between 2006 and 2009. Individual feelings differ when they consider which type of investment would make the most of their money. Sixteen per cent of individuals considered that paying into a workplace pension scheme would make the most of their money, compared to 28 per cent who felt that investing in property would make the most of their money[32].

[32] MacLeod *et al.*, 2012, *Attitudes to Pensions: The 2012 survey*, Department for Work and Pensions Research Report No 813, Department for Work and Pensions.

Table B1: Ways to save for retirement and making the most of money

	Safest way to save for retirement			The way to make the most of your money		
	2006	2009	2012	2006	2009	2012
Paying into an employer sponsored pension scheme	26	26	25	9	16	16
Paying into a personal pension scheme	17	19	18	6	8	10
Investing in the stock market by buying stocks or shares	–	–	1	8	9	7
Investing in property	26	19	18	47	31	28
Saving into an ISA (or other tax-free savings account)	15	19	17	13	15	13
Saving into a high rate savings account	10	9	8	10	13	10
Buying premium bonds	2	3	3	1	1	2
Other	12	2	–	1	1	–

Source: Department for Work and Pensions', *Attitudes to Pensions*, the 2006, 2009 and 2012 surveys.

3. As Table B1 shows, there has been a small decrease, three per cent, between 2009 and 2012 in the proportion of individuals who see investing in property as a way to make the most of their money, while there has been no change in the proportion of members who see paying into a workplace pension scheme as a way to make the most of your money.

4. Individuals with household incomes of less than £12,000 or between £12,000 and £25,999 are the least persuaded about saving in a pension. In households with incomes of less than £12,000, 46 per cent of members reported that they are not keen on saving in a pension as they do not know how much they will get back. This is compared to 33 per cent of members in households with income of £26,000–£43,999[33].

5. Uncertainty over the retirement income a pension can provide may arise from a lack of knowledge of pensions. Individuals – particularly those with no pensions experience – often perceive pensions to be a savings pot which gradually builds up over time. There is a general lack of understanding of pensions as investments that can fluctuate over time. Although there is some familiarity that pensions make gains people do not understand where they come from[34]. Often individuals have little knowledge of where the pension is invested. They are unable to distinguish the difference between the various funds that may make up their pension and the pension scheme itself[35].

6. Anxiety about a pension's final outcome may discourage individuals from saving in them. Sometimes individuals feel they have no personal control over a pension's performance which can lead to members feeling aggrieved in relation to losses[36].

[33] MacLeod *et al.*, 2012, *Attitudes to Pensions: The 2012 survey*, Department for Work and Pensions Research Report No 813, Department for Work and Pensions.
[34] Opinion Leader, 2012, *Member Research Brief*, National Employment Savings Trust.
[35] IFF Research, 2007, *Investment Risk Rating: Consumer attitudes towards risk*, for the Financial Services Authority, Financial Services Consumer Panel.
[36] Opinion Leader, 2010, *Understanding reactions to volatility and loss*, National Employment Savings Trust.

Loss aversion

Individuals feel strongly about financial loss. It provokes feelings of anger and frustration and can lead to loss aversion actions.

7. Unsurprisingly, people feel very strongly about financial loss. Research with individuals on hypothetical investment scenarios provoked different reactions, depending on the amount lost and the time period over which the loss was incurred. Negative emotional reactions such as hurt, anger and frustration were experienced in all scenarios, yet some loss scenarios were seen as more acceptable than others. Stronger objection was expressed in response to repeated loss over a three-year period than a loss of the same amount in one year[37].

8. Individuals viewed repeated loss as a downward trend that they had no chance of stopping. When faced with this type of loss, nearly all individuals indicated they would cease contributing to the pension. Three years of consecutive losses was seen as the tipping point and as an indication the scheme was failing[38].

9. While intermittent loss, such as losing in three out of five years, is considered disappointing, individuals remained hopeful for the pension to improve. This leads to fewer indications of loss aversion behaviour. The years where gains occurred softened the blow of losses in other years and the pension was seen as not all bad.

10. When faced with pension losses, individuals may take action to prevent further loss. Such action includes: stopping contributions; actively considering alternatives; giving the pension more time; and seeking advice and information from pension providers, Independent Financial Advisers and the Citizens Advice Bureau.

11. It is important to remember that not all individuals would take loss avoidance measures. Other behaviours such as procrastination and poor engagement levels, including not reading or understanding pension statements, may reduce loss aversion actions. Automatic enrolment, alongside such behaviours, aims to utilise the inertia around pension saving to encourage a higher number of people to remain in a pension unless they opt-out. Such inertia may continue for long enough to keep individuals contributing to schemes, in spite of interim losses to the pension fund[39].

[37] Note: This research involved deliberative approaches, giving participants more time and information on the subject area than traditional qualitative research. As such it may not be possible to generalise the findings to the whole population.
[38] Opinion Leader, 2010, *Understanding reactions to volatility and loss*, National Employment Savings Trust.
[39] ibid.

Concern about contributions protection

Preservation of contributions is of a paramount importance to individuals. At retirement, they expect to get back at least what they put in.

12. Preserving the value of their own contributions is paramount to individuals. They feel a greater sense of attachment to the contributions they have made, over and above any investment gains on the pension fund. A deeper sense of loss is felt if there is a decrease in the individual's contributions value. This is viewed as a loss made by someone else and is taken personally as if "someone has lost my money". As pensions are often seen as saving pots, individuals identify such losses as someone taking money out of such pots. A loss of this nature is most likely when loss aversion behaviour would begin[40].

Guarantees

Individuals desire greater certainty over what they will get in retirement. A guarantee may answer one of individuals' key concerns: What will I get at the end?

13. Individuals' desire for a guarantee could be to protect their pension and themselves from any negative affects they, or others, may have experienced with pensions. The lack of a guarantee may discourage more anxious individuals from saving in a pension. In turn, this may prompt such members to opt for alternative forms of saving, such as Individual Savings Accounts (ISAs), which offer interest on the amounts saved.

14. Individuals seek a clearer understanding of what a pension will provide in retirement. When saving in a pension, individuals seek answers to two key questions: where does my money go; and how much will I get at the end?[41]

15. A guarantee may answer one of individuals' key concerns: "What will I get at the end?" A higher proportion of individuals may be encouraged to save if clearer information on the pension's performance was available. Individuals desire clearer information on the fluctuating nature of pensions. An explanation that the fund can go up as well as down may offer individuals some reassurance. A guarantee that no further losses could be incurred is less desired by individuals[42].

[40] Opinion Leader, 2010, *Understanding reactions to volatility and loss*, National Employment Savings Trust.
[41] Opinion Leader, 2012, *Taking the temperature of automatic enrolment*, National Employment Savings Trust.
[42] Opinion Leader, 2010, *Understanding reactions to volatility and loss*, National Employment Savings Trust.

Limited risk exposure, although desire for some gain/benefit

Although individuals seek greater certainty over their retirement income, there is appetite for investment gains.

16. People are uncomfortable with financial uncertainty. The term risk can scare people, as it opens up the potential for things to go wrong. When considering pensions, risk may be viewed as losing[43]. In 2012, 46 per cent of individuals reported they were not really willing to take any risks with money, yet a quarter (24 per cent) said they were willing to take calculated risks with money as long as there is potential for a good return[44]. This suggests that risk offered alongside a potential gain, may increase individuals' interest in risk taking.

17. Although there is an aversion to taking risk with finances, there is appetite among individuals for increasing gains on their pensions. When presented with three possible investment strategies: low-risk, low-gain; medium-risk, medium-gain; and high-risk, high-gain, individuals were most likely to select the medium option. Individuals then preferred the least risky option over the high risk option[45]. This suggests that individuals are interested in making profit, yet maintain interested in protecting their pension fund.

18. There are noticeable differences in risk preferences by individuals' household income. Those on lower incomes tend to be more risk averse than those on higher incomes[46]. Research on options for State Pension reform found that lower income groups favour clarity in the form of a universal safety net. Higher earners feel they would achieve a greater number of qualifying years and were willing to trade certainty off against the potential to get a higher State Pension in retirement[47].

Employers

Employers are positive about offering pensions to their employees. They acknowledge them as an important tool in recruiting and retaining staff.

19. In general, employers value offering pensions to their employees and acknowledge their role in recruitment and retention and maintaining parity with competitors[48]. They also acknowledge the employer role in supporting employees to save for their retirement and see the benefits to employees of contribution costs. Employer contributions are also a major factor in determining whether members choose to save in a workplace pension[49].

[43] Opinion Leader, 2010, *Understanding reactions to volatility and loss*, National Employment Savings Trust.
[44] MacLeod *et al.*, 2012, *Attitudes to pensions: The 2012 survey*, Department for Work and Pensions Research Report No 813, Department for Work and Pensions.
[45] Opinion Leader, 2010, *Understanding reactions to volatility and loss*, National Employment Savings Trust.
[46] Opinion Leader, 2012, *Member Research Brief*, National Employment Savings Trust.
[47] Thomas *et al.*, 2012, *A simpler State Pension: A qualitative study to explore one option for State Pension reform*, Department for Work and Pensions Research Report No 787, Department for Work and Pensions.
[48] Thomas A and Allen A, 2008, *Employer attitudes to risk sharing in pension schemes: a qualitative study*, Department for Work and Pensions Research Report No 528, Department for Work and Pensions.
[49] Bryan *et al.*, 2011, *Who Saves for Retirement?*, Strategic Society Centre.

20. There are, however, some differences between employers in their thoughts on providing pensions. Some employers only want to do the bare minimum on pension provision, in order to meet their duties. This may be because they have little knowledge or interest in pensions or have limited access to specialist support. Other employers have higher organisational belief in pensions and want to do their best for their employees. This may be due to: a paternalistic nature; knowledge of pensions; and well-established systems for administering employee pension requirements[50]. Pension schemes, and their communication, should appeal to employers across this diverse group.

Not putting extra burden on employers

Employers do not want to incur additional costs in setting up a pension scheme. They also seek assurance that the costs will be similar to schemes already out there.

21. Complexity in introducing pensions should be minimised. As noted in the Department's preparations for automatic enrolment, employers may struggle with changes that require a large amount of paperwork and legal advice that cannot be generalised to all employers. The more complex they find any changes, the more the cost of dealing with the changes could increase as employers spend more time implementing and communicating them. There is also a greater likelihood of them having to seek external advice[51].

22. Through automatic enrolment, many small employers will be offering a pension for the first time. They will be required to make decisions about qualifying schemes and obtain information on how to comply with their duties as an employer. All employers will also experience a high degree of employee churn, which might be more burdensome for small and micro employers than other employers. There is concern to limit the regulatory burden on employers, particularly smaller and micro organisations. The overall costs should not outweigh the benefits of providing a pension to their employees[52].

23. Employers with DC schemes appear satisfied with them. As the costs of such schemes are predictable, there is limited financial exposure for the employer. In setting up a pension scheme, key concerns for employers are minimising the possibility of future funding risks and moving to a position where their financial contribution is defined, with the least financial risk[53].

24. There is a perception that shared risk pension schemes may be expensive compared to DC and GPP schemes. Employers are concerned that a risk-sharing approach may be more complex, with additional burden on them to complete administrative processes and calculations, over and above those for a DB scheme. With DC schemes, insurance companies are thought to undertake the majority of administrative tasks, thus minimising the burden on the employer[54].

[50] The Futures Company, 2012, *Automatic Enrolment Information Materials Research*, Department for Work and Pensions.
[51] Opinion Leader, 2010, *Understanding reactions to volatility and loss*, National Employment Savings Trust.
[52] Johnson P, Yeandle D, and Boulding A, 2010, *Making automatic enrolment work: A review for the Department for Work and Pensions*, Cm 7954, TSO.
[53] Thomas A and Allen A, 2008, *Employer attitudes to risk sharing in pension in pension schemes: a qualitative study*, Department for Work and Pensions Research Report No 528, Department for Work and Pensions.
[54] *ibid*.

Simplicity

Employers appreciate schemes that are simple to set up and do not increase costs.

25. Employers are most concerned about the set-up costs associated with putting qualifying pension schemes in place. Making changes to administrative systems and providing information to employees is perceived to be expensive. There is also anxiety about the burden of choosing a scheme and giving the right advice to employees[55]. As such, communicating pensions to employees is a key concern for employers. The additional flexibilities that may be available in DA may generate further concern that communications to employees may become difficult[56].

26. Given employer concerns around the costs of setting up pension schemes, this suggests that employers would like the communication of pensions to employees to be straightforward. Pre-prepared communication materials are appreciated by employers, including templates that can be altered to meet the needs of different employer types. The availability of user-friendly communication materials reduces employer anxieties and the burden of sourcing suitable communication materials. They also assure the employer they are giving correct information to their workforce[57].

Communicating pensions to employers

27. The Department is continuing to consult the pensions industry and intermediaries to gather further detail on the communication of pension products to employers. We will publish this information in due course.

[55] Thomas A and Allen A, 2008, *Employer attitudes to risk sharing in pension in pension schemes: a qualitative study*, Department for Work and Pensions Research Report No 528, Department for Work and Pensions.
[56] *ibid*.
[57] The Futures Company, 2012, *Automatic Enrolment Information Materials Research*, Department for Work and Pensions.

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