Defined Ambition

Consumer evidence summary

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Executive summary

This report synthesises evidence on Defined Ambition. It brings together a range of existing and new material from sources relevant to the aims and objectives of Defined Ambition. It builds on existing data sources, such as the Attitudes to Pensions and the Wealth and Assets surveys; explores new data obtained through the Department for Work and Pensions' (DWP) 2013 Employers' Pension Provision survey and 2013 Landscape and Charges survey. Alongside this evidence, the Department for Work and Pensions commissioned independent research on Defined Ambition and consumers.

At the time of the research, we were keen to understand what level of consumer demand there would be for different types of risk sharing, and for a number of high level concepts about the forms of guarantee - such as between members, between employers and members, or via insured guarantees. This research did not include detailed explanations of how such products would work in practice and we cannot rule out that respondents made assumptions about how the models may work in practice. This report does not seek to give definitive answers on what Defined Ambition pensions will look like or how many people may be likely to be involved in them. Other evidence and research was also submitted in response to the government consultation Reshaping workplace pensions for future generations, which the Department has considered as it developed Defined Ambition pensions policy.

This paper suggests consumers (employers and individuals) are interested in greater certainty of the costs of providing a pension and greater certainty of their income in retirement. A quarter of individuals reported they are worse off in retirement to what they expected. When presented with hypothetical situations about different types of pension schemes, over a quarter of employers indicated they may be interested in offering an alternative type of pension where the risk is shared with their employees. The evidence gathered on individuals indicates a clear preference for greater certainty over their finances. However, discussions with intermediaries and pension providers suggest they are more sceptical of Defined Ambition, although this group also acknowledged the psychological benefits greater certainty of retirement income may bring.

This paper adds to our evidence base on Defined Ambition. It will be used alongside other research undertaken on Defined Ambition and consumers as we continue to develop this area of pensions policy.

Overall the evidence demonstrates demand from consumers for Defined Ambition concepts. On the supply side, pension providers and intermediaries showed least appetite, but recognised guarantees and other similar products may be useful for particularly risk averse individuals. The evidence clearly demonstrates that individuals like certainty, do not like taking risks, and that they want certainty in what their retirement income may be. It also shows employer appetite for alternative pension provision.

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About the author

Michelle Harrison is a researcher in the Department for Work and Pensions.

Abbreviations

ACA – Association of Consulting Actuaries

CDC - Collective Defined Contribution

DA – Defined Ambition

DB – Defined Benefit

DC – Defined Contribution

DWP – Department for Work and Pensions

EBC – Employee Benefit Consultant

IFA – Independent Financial Advisor

NAPF – National Association of Pension Funds

SPA – State Pension Age

Glossary

Annuity	In the context of a defined contribution (DC) pension, an annuity is usually a contract based product with an insurer, purchased with DC pension savings, to provide a series of pension benefit payments, which may be subject to increases, made at stated intervals until a particular event occurs. This event is most commonly the end of a specified period or the death of the person receiving the annuity.
Automatic Enrolment	Pension scheme enrolment technique whereby an employer enrols eligible jobholders in the workplace pension scheme 'automatically' – i.e. without the jobholder having to make a separate application for membership. Individuals who are automatically enrolled are free to opt out or cease active membership at any time, but need to take action to do so.
Defined Ambition	A new concept of pensions the government would like to introduce that will enable a greater range of products to be developed which are designed to encourage greater certainty for individuals over their retirement income compared to pure DC schemes and encourage greater risk sharing.
Defined Benefit	Usually an Occupational pension scheme which specifies on joining what benefits are to be paid on retirement (e.g. a fraction of salary for each year of service). Also known as a 'salary-related' scheme.
Defined Contribution	A pension scheme where the amount of pension is determined by contributions paid into the scheme and investment returns. Also known as a 'money purchase' scheme. These can be occupational or personal pensions – the latter can be set up via the workplace or separately from the workplace.
Employee Benefit Consultant	An adviser, or firm of advisers, that advises employers on employment benefits packages that it might offer to its employees, including pensions and other benefits.
Independent Financial Advisor	An adviser, or firm of advisers, that is in a position to review all the available products and companies in the market as the basis for recommendations to clients. All IFAs are regulated by the Financial Conduct Authority.

State Pension Age	The age at which a person can claim their State Pension as laid down by legislation

1. Introduction

This paper synthesises evidence and research pertinent to Defined Ambition. The evidence discussed has been collected through a range of sources. Some of the material reviewed has been published previously; other sources are new to this document. In some cases the sample and data collection methods used differ, which may mean the results are not directly comparable. This paper is a summary of these sources, discussing consumer views on Defined Ambition pensions and attitudes to risk sharing in finance and pensions.

In addition to the evidence discussed in this paper, the Department for Work and Pensions (DWP) commissioned further research to explore consumer thoughts on Defined Ambition pensions. Findings from this research will be available in summer 2014.

2. Background

2.1 Rationale for Defined Ambition

Defined Ambition pension is a term used to describe a variety of pension scheme designs that Government would like to encourage the market to develop which would complement the two dominant forms of pension - Defined Benefit (DB) and Defined Contribution (DC). Through collaboration with the pensions industry[1] in developing concepts and potential models, an overarching legislative framework will be developed that will enable a greater range of products to be developed which are designed to encourage greater certainty for individuals over their retirement income compared to pure DC schemes, less costs volatility or employers, encourage greater risk sharing and provide more choice for consumers.

The intention is that Defined Ambition pensions should share the economic risks associated with long term pension saving and income, rather than leaving one party – the employer or the member – shouldering all of the risks. They aim to create greater certainty for members about the final value of a pension pot than is provided by a pure DC pension and would also seek to ensure less cost volatility for employers than pure DB pensions.

The ideas put forward as part of Defined Ambition consultation paper *Reshaping workplace pensions for future generations* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255541/reshaping-workplace-pensions-for-future-generations.pdf included:

- **Flexible Defined Benefit** – reducing cost volatility for employers sponsoring schemes which accrue on a specified basis - enabling new schemes which would include the ability to pay fluctuating benefits; automatic conversion to a Defined Contribution scheme when a member leaves employment; and the ability to change scheme pension age.

[1] Here, the pensions industry refers pensions experts, pension providers, advisers, employee benefit consultants and those involved in the provision, administration and regulation of pensions.

- **Defined Contribution Plus** – to provide greater certainty for individuals in defined contribution schemes including; providing a money back guarantee; offering a capital and investment return guarantee; the provision of retirement income insurance; and, a pension income builder[2].
- **Collective Defined Contribution** - rather than having an individual fund for each member, the risks are pooled, members have a targeted pension, and the pension can be paid out of the scheme. CDC schemes provide certainty to the employer who pays a fixed rate of contributions, while risk is shared between members protecting them against the worst of the downside volatility in the market providing more stable outcomes than individual DC.

2.2 Current pensions landscape

Within the current range of DB and DC pension schemes available, the risk rests with only one party - employers or individuals. In DC schemes, the individual faces uncertainty over the return on their savings, and the retirement income – until they come to the end of the savings period. At that point they can buy an annuity[3] which can provide for an income for life, with the insurer taking on the risk of funding that promise. In DB schemes, the risk lies with the employer who largely bears the risks of longevity, investment and inflation.

Over time, employers have been moving away from DB to DC pension schemes. In the past, many individuals have been able to rely on a DB pension scheme, guaranteeing them a pension based on their final salary or career average earnings and the length of time with their employer. With DC pensions individuals face a less certain retirement income as their overall pension pot depends on the performance of funds invested, and the income depends on the conversion rate at a particular point in time. Automatic enrolment will encourage people to save more, – but future generations saving into DC will face a more uncertain income in retirement[4] compared to those with DB pensions have enjoyed in the past.

Evidence suggests that individuals worry about the value of their pension pot falling each year and want more certainty over their retirement income. While individuals consider pensions to be the safest way to save for retirement[5] , trust and confidence in pensions remains low. Uncertainty over income in retirement and recollections of reports of poor performing pension schemes may have dented some people's confidence. Low levels of knowledge of pensions, particularly among individuals who have no experience of saving in them, show that people perceive pensions generally,

[2] More detail on Defined Ambition scheme ideas is available here: https://www.gov.uk/government/consultations/reshaping-workplace-pensions-for-future-generations

[3] At the time of the research, purchasing an annuity, which offers an income at retirement for the rest of the individual's life, was the option taken by the majority of DC pension pot holders. From April 2015, from age 55, DC pension pot holders will be able to withdraw their pension to suit their needs, subject to their rate of income tax in that year. This may be purchasing an annuity or drawing down a pension as they choose.

[4] Scottish Widows (2013) Annual Pensions Report http://reference.scottishwidows.co.uk/docs/46273-2013.pdf

[5] MacLeod. P, Fitzpatrick. A, Hamlyn. B, Jones. A, and Page. L (2012) Attitudes to pensions: The 2012 survey Department for Work and Pensions https://www.gov.uk/government/publications/attitudes-to-pensions-the-2012-survey-rr813

including DC 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[6]. As a result, some individuals are anxious about saving into a pension. Such anxiety about a pension's final outcome may discourage members from saving into them.

Since automatic enrolment began in October 2012, more people are saving for their retirement; more than 3.6 million workers have been enrolled and around 9 in 10 have stayed in a workplace pension. Findings from research with large employers estimated that where a workplace pension scheme was in place but workers had previously been required to actively join, participation in pension saving increased as a result of automatic enrolment from 36% to 71%[7]. Across private sector employers of all sizes, the percentage of employees who were members of a pension scheme increased, from 26% in 2011 to 35% in 2013. This was the first increase for a decade and shows early signs that automatic enrolment is increasing the proportion of people saving into a pension[8].

Employers value offering a pension to their employees, yet can sometimes struggle with the costs of providing certain types of schemes where they take on the funding risks associated with providing a guarantee. Without action to remove barriers to innovation and to manage the volatility around providing a pension with a guarantee, some employers may struggle to find a suitable scheme that meets their aspirations.

3. Research objectives

This synthesis paper seeks to address the following research objectives:

1. To understand individuals attitudes to financial risk and uncertainty.
2. To understand how employers feel about risk sharing and their potential appetite for providing risk sharing or Defined Ambition pensions for their employees.
3. To explore intermediaries and pension providers thoughts on offering greater certainty to consumers than DC and the principles of offering a guarantee on retirement income.

4. Methodology

This is a synthesis paper, combining a range of evidence collected on Defined Ambition. The data collection methods differed between sources. Each method is outlined in more detail below.

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[6] NEST (2012) Member research brief http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/member-research-brief,PDF.pdf

[7] Department for Work and Pensions (2013) Automatic enrolment opt out rates: findings from research with large employers https://www.gov.uk/government/publications/automatic-enrolment-opt-out-rates-findings-from-research-with-large-employers

[8] Department for Work and Pensions (2014) Employers' Pension Provision survey 2013: Preliminary findingshttps://www.gov.uk/government/uploads/system/uploads/attachment_data/file/301934/employers-pension-provision-survey-2013.pdf

- Secondary analysis of survey data including the Attitudes to Pensions 2012 survey – a telephone survey of 1,949 adults in Great Britain.
- Secondary analysis of the Wealth and Assets survey Wave 1 2006 – 2008 and Wave 2, 2008 – 2010.
- Analysis of the Employer Pension Provision survey 2013 – a representative telephone survey of 3,079 private sector employers in Great Britain.
- Interviews with pension providers and intermediaries, undertaken as part of the Department's external research into Defined Contribution (DC) charges and scheme quality study[9].

In addition to some of the new material gathered on behalf of the Department, this paper also discusses evidence from other sources. They are referenced in more detail at the end of the document.

5. Individuals

This section discusses individuals' attitudes and thoughts about risk and uncertainty over their finances and money. The findings are based on questions exploring what individuals would do, if faced with particular situations. These give a broad indication of individuals' actual behaviour and an idea individuals' risk aversion, although they should not be taken as a perfect guide to what individuals would do if faced with real-life decisions.

5.1 Attitudes to risk and uncertainty

When considering ways to save for retirement, individuals consider pensions, particularly workplace pensions, as the safest way to safe for retirement. As Table 1 shows, 43% consider paying in to an employer pension scheme or a personal pension scheme is the safest way to save for retirement. Lower proportions consider investing in property (18%) and saving in an ISA (17%) as the safest way to save for retirement. However, while pensions are considered safe ways to save for retirement, they are not considered the most suitable vehicle for making the most of individual's money. When saving for retirement, the highest proportion of respondents (28%) considered investing in property would make the most of their money, compared to 16% who felt paying into a workplace pension would make the most of their money[10].

Table 1: Ways to save for retirement and making the most of money, 2006 - 2012

	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	17	16

[9] A full report from this research is available here: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193451/rrep804.pdf

[10] MacLeod. P, Fitzpatrick. A, Hamlyn. B, Jones. A, Kinver. A and Page. L (2012) *Attitudes to pensions: The 2012 survey,* Department for Work and Pensions https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193372/rrep813.pdf

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	1

Source: Attitudes to pensions survey 2006, 2009 and 2012

Similar findings were reported in the 2012 National Association of Pension Funds (NAPF) workplace pensions survey. Nearly half (48%) of respondents who worked full or part time considered they would fund their retirement through a workplace or private pension. This is followed by 41% who also reported they would fund their retirement through the State Pension; 32% who stated they would use an ISA or other savings; and 26% who replied they would use property to fund their retirement.

As Table 2 shows, nearly half (47%) of all individuals say they are not willing to take any risks with money. Individuals in households with less than £12,000 income appear the least likely to take risks with money, with 59% stating they were not really willing to take risks with money. Such views do not differ significantly among individuals as household income increases. Among individuals with household income of between £12,000 and £25,999, a similar proportion 56%, also reported that they were not really willing to take any risks with money. Individuals with household income between £26,000 and £43,999 were less averse to taking risks, with 44% indicating they were not really willing to take any risks with money. Individuals with a household income of £44,000 or more appeared the least uncomfortable with taking risks with money; just over a quarter (28%) in this group reported they were not really willing to take risks with money. Overall, it appears individuals do not like taking risks with money, although those with household income of £44,000 are more willing to take risks with money.

Where the potential for a good return is available individuals appear more interested in taking risks. Nearly a quarter, (24%), of all individuals say they are willing to take calculated risks with money as long as there is a potential for a good return, with 27% of individuals with household income of between £26,000 - £43,999 and 46% of individuals with a household income of over £44,000 reporting this. This may suggest that there is some interest from individuals in taking risks when they have a greater likelihood of a gain.

Table 2: Individuals'attitudes to risk, by household income, 2012

	Household income				
Attitude to risk	**Less than £12,000**	**£12,000 - £25,999**	**£26,000 - £43,999**	**£44,000+**	**Total (all income groups)**
I'm not really willing to take any risks with money	59	56	44	28	47
I used to be willing to take more risks with money than I do now	9	15	16	15	13
I would be willing to take more risks with money if my income was higher	12	15	23	24	17
I'm willing to take calculated risks with money as long as there is potential for a good return	14	19	27	46	24
I'm willing to take risks with money and don't think about a return	3	1	1	2	1
I'm willing to take risks with money over the longer term	4	6	9	15	8
I'm willing to take risks with money in the short term as well as over a longer period	5	4	5	8	6
None of these	11	6	4	2	8
Don't know	1	-	-	-	

Source: Attitudes to Pensions 2012 Base: 1949

When exploring individuals' attitudes to risk and uncertainty, individuals prefer certainty and guaranteed payments over the opportunity to receive a higher amount of money the following year. Findings from the Wealth and Assets Survey (WAS) 2008-2010, Table 3 below, show individuals' preference for certainty over their finances now, across all household wealth groups. Three fifths (80%) of individuals say they would prefer a guaranteed payment of £1,000 today over and above £1,100 the following year. The results are broadly similar across all income groups, with 81% of individuals with household wealth of £1 million or more reporting they would prefer £1,000 today rather than waiting for £1,100 a year later compared to 79% of individuals with household wealth of less than £12,500.

Table 3: Individuals' total household wealth and if they would prefer £1,000 today and £1,100 next year, 2008 – 2010

Total household wealth	£1,000 today	£1,100 next year	Don't know/no opinion
Less than £12,500	79	19	1
£12,500 <£40,000	79	20	1
£40,000 <£100,000	82	18	1
£100,000<£150,000	80	19	1

£150,000 <£250,000	79	20	1
£250,000 <£300,000	80	19	2
£300,000 <£450,000	79	20	1
£450,000 <£600,000	80	19	1
£600,000 <£1 million	80	19	1
More than £1 million	81	18	1
Total	80	19	1

Source: Wealth and Assets survey, Wave 2 (2008 – 2010) Question: Qriskc *If you had a choice of receiving a thousand pounds today or one thousand one hundred pounds in a year's time, which would you choose?*

As with the previous enquiry on attitudes to risk, there was increase in the proportion of individuals saying they would prefer a guaranteed payment of £1,000 over a one in five chance of gaining £10,000 occurred between the two survey waves. Regardless of household wealth, individuals say they would prefer a guaranteed payment over and above a one in five chance to win a higher amount of money.

Across all household wealth groups, there was a small increase (3%) in individuals reporting they would prefer the guaranteed payment compared to two years earlier; with 80% of all individuals stating they were prefer the guaranteed payment of £1,000 in 2008-2010 compared to 77% in 2006-2008. Individuals with a household wealth of £1 million were the most likely to report they would prefer the guaranteed payment of £1,000 over the opportunity to gain more; 83% of this group stated they would prefer the guaranteed payment. The high proportion of preference for a guaranteed payment alongside the increase across all household wealth groups who prefer a guaranteed payment, over the opportunity to gain more, may reflect current general attitudes towards finances. Turbulence in financial markets over recent years may have influenced individuals' thoughts on taking risks with money, and may explain the increase in preference for certainty and a guaranteed payment.

Table 4: Individuals' household wealth and if they prefer a guaranteed payment of £1,000 or risk a one in five chance of gaining £10,000, 2008-2010.

Total household wealth	Guaranteed payment of £1,000	One in five chance of £10,000	Don't know/no opinion
Less than £12,500	79	20	2
£12,500 <£40,000	80	19	1
£40,000 <£100,000	79	21	1
£100,000<£150,000	81	18	1
£150,000 <£250,000	80	19	1
£250,000 <£300,000	82	17	1
£300,000 <£450,000	80	19	2
£450,000 <£600,000	79	20	2
£600,000 <£1 million	79	20	2

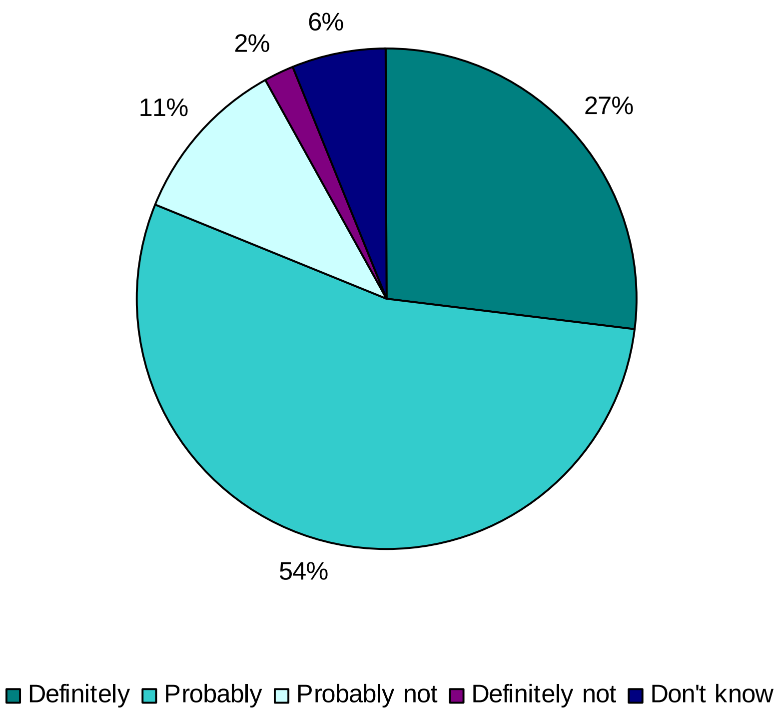
More than £1 million	83	16	1
Total	80	19	1

Source: Wealth and Assets survey, Wave 2 (2008 – 2010): Question Qriska: *If you had a choice between a guaranteed payment of one thousand pounds and a one in five chance of winning ten thousand pounds, which would you choose?*

5.2 Individuals' confidence in retirement income

Evidence has also explored how confident individuals feel that they will have enough to live on in retirement. In 2012, over half (54%) of all individuals thought they would probably have enough money in retirement to cover basic costs such as housing, heating and food. Just over a quarter (27%) felt more certain they would have enough to cover these basic costs.

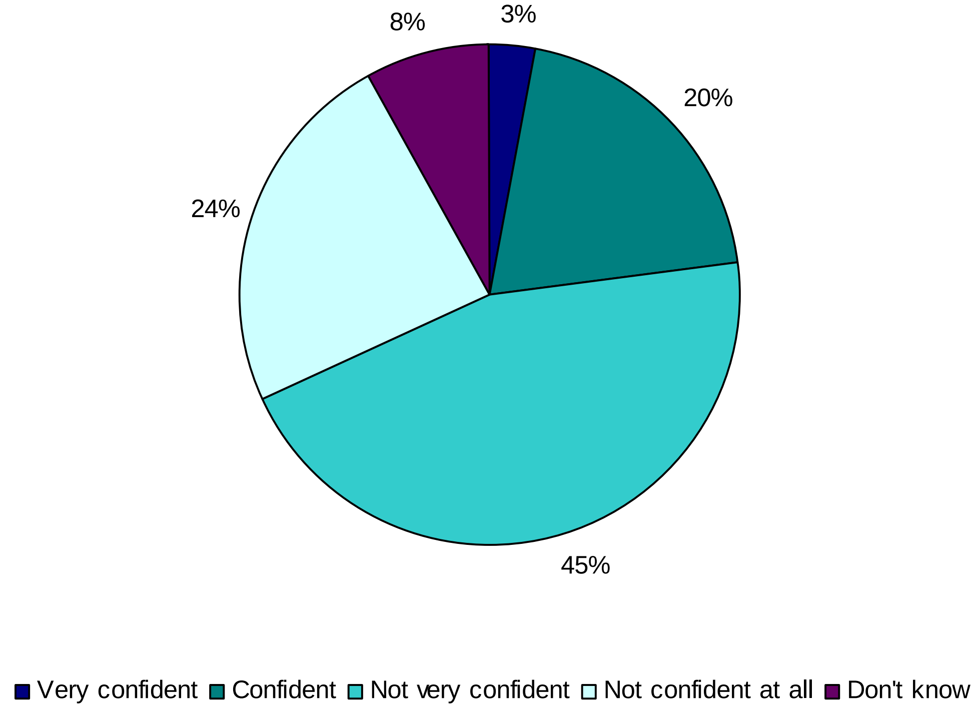
Figure 1: Whether individuals think they will have enough to cover basic costs in retirement.



Source: Attitudes to Pensions 2012. Question: RETMON; Whether you think you will have enough money to cover basic costs such as housing, heating and food? Base 1949

We can compare this analysis to findings from other surveys. As Figure 2 shows, NAPF found that nearly half (45%) of respondents felt 'not very confident' that their pension would give them enough to live on in retirement. This is compared to a fifth (20%) who felt confident their pension would give them enough to live on in retirement.

Figure 2: Individuals' confidence that their pension will give them enough to live on in retirement



Source: National Association of Pension Funds: Workplace Pension Survey 2012. Question: How confident are you that your pension will give you enough to live on in retirement? Base: All responding employees

Retired individuals also considered if they were better off, worse off or about the same in retirement compared to what they expected. Over half (58%) considered they were 'about the same', although a quarter (25%) reported they were worse off compared to what they were expecting in retirement[11]. Defined Ambition pensions offer the potential to provide more certain incomes in retirement than Defined Contribution Schemes.

It is not possible to understand if this group were worse off compared to their expectations due to unrealistic expectations of retirement income; insufficient savings through their working life; or unexpected expense incurred during their retirement. However, this may suggest that had individuals had a greater level of certainty of what their retirement income may be, they may have taken action earlier to secure a higher level of income in retirement.

[11] MacLeod. P, Fitzpatrick. A, Hamlyn. B, Jones. A, Kinver. A and Page. L (2012) *Attitudes to pensions: The 2012 survey,* Department for Work and Pensions https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193372/rrep813.pdf

6. Employers

Employers' attitude to sharing risks and their views on offering alternative types of pension schemes, if they were to set up a new scheme, were explored in the 2013 Employer Pension Provision (EPP) survey. Employers were informed that in a Defined Benefit scheme the employer bears the risk that the fund will be sufficient to meet pension payment requirements while in a Defined Contribution scheme, the employee bears all the risk. They were then asked if they would be interested in offering their employees a pension where the risk was shared between employer and employee. They were also asked to consider if they were setting up a new pension scheme, how likely would they be to set up a scheme like a;

- Defined Benefit scheme but where some of the cost for the employer is more limited than in traditional final salary schemes;
- Defined Contribution scheme, where the employer bears no additional funding liabilities but there is greater certainty over retirement income for the employee; and
- Defined Contribution scheme that is part of a much bigger scheme that other employers also belong to.

Findings from these questions are presented below[12]. Full findings from the EPP 2013 will be available in summer 2014. Alongside this, we also discuss other available survey evidence that explores employer interest in offering alternative types of pension provision.

6.1 Interest in offering an alternative pension, where the risk is shared between employer and employee

Employers were asked if they were willing to offer their employees an alternative pension, where the risk is shared by the employer and employee. As Table 7, below shows, over a quarter (28%) of employers said they would be interested in offering an alternative pension, where the risk is shared between the employer and employee[13]. This could mean a scheme which offers greater certainty for the employee when compared to Defined Contribution or lower cost volatility for employers compared to Defined Benefit or being part of a larger scheme, such as a collective. Of the employers who considered they had enough information to express an opinion, 37% said that they would be interested in offering an alternative pension where risks are shared between employers and employees.

[12] Findings from EPP are weighted by firm weight. This provides the percentage of employers' interest in offering alternative types of pensions.
[13] This figure is based on all employers who reported they had an occupational scheme; a closed or frozen occupational scheme; access to a group personal pension; stakeholder pension or contributed to employees' personal pension plans.

Table 7: Employer interest in offering an alternative pension, where the risk is shared between employer and employee, 2013

Whether interested in offering an alternative type of pension where the risk is shared between employer and employee	
Yes	28
No	48
Not sure/ need further information	25
Total	100

Source: EPP 2013, Question QDA

Findings do not differ significantly when we consider employers who offer access to a stakeholder pension schemes. Over a quarter (27%) of employers who currently offer access to this type of pension were interested in offering an alternative type of pension where the risk is shared, compared to 29% of employers who do not offer access to this type of scheme.

Table 8: Employer access to stakeholder pension and interest in offering an alternative type of pension, 2013

Whether interested in offering an alternative type of pension where the risk is shared between employer and employee					
		Yes	**No**	**Not sure/need further information**	**Total**
Employer offers access to a stakeholder scheme	**Yes**	27	56	17	100
	No	29	46	26	100
	Total	29	47	25	100

Source: EPP 2013, Question QDA and HasSHP.

Attitudes to offering an alternative type of pension where the risk is shared between employer and employee are similar among employers who contribute to employees personal pensions. As Table 9 shows, a quarter (25%) of employers currently contributing to employees' personal pensions reported they would be interested in offering a scheme where the risk is shared between employer and employee. A higher proportion, 29%, of employers who do not currently provide contributions to employees' personal protection reported they would be interested in offering an alternative type of scheme in the future.

Table 9: Employer contributions to employee personal pensions and interest in offering an alternative type of pension, 2013.

Whether interested in offering an alternative type of pension where the risk is shared between employer and employee					
		Yes	**No**	**Not sure/need further information**	**Total**
Employer contributes to personal pension plans	**Yes**	25	52	23	100
	No	29	46	25	100
	Total	28	48	25	100

Source: EPP 2013, Question QDA and HasApp.

Among employers who offer an occupational scheme, a quarter (25%) of employers offering an occupational pension indicated they would be interested in offering a pension where the risk is shared between employer and employee. Among employers who do not currently offer an occupational pension, a similar proportion, 28%, reported they would be interested in offering an alternative type of pension.

Table 10: Employers offering an occupational pension and interest in offering an alternative type of pension, 2013

Whether interested in offering an alternative type of pension where the risk is shared between employer and employee					
		Yes	**No**	**Not sure/need further information**	**Total**
Employer offers an occupational scheme	**Yes**	25	68	7	100
	No	28	47	25	100
	Total	28	48	24	100

Source: EPP 2013, Questions: QDA and OccSchme:

A smaller proportion (19%) of employers with closed or frozen occupational schemes suggested they would be interested in offering an alternative type of pension where the risk is shared between employer and employee.

Table 11: Employers with closed or frozen occupational schemes and interest in alternative type of pension, 2013

Whether interested in offering an alternative type of pension where the risk is shared between employer and employee					
		Yes	**No**	**Not sure/need further information**	**Total**
Employers with closed or frozen occupational	**Yes**	19	74	7	100
	No	28	47	25	100

schemes					
	Total	28	47	25	100

Source: EPP 2013: Questions: QDA and NoNewOcc[14]

Among employers currently offering a group personal pension (GPP) interest in offering an alternative type of pension appeared lower than other open schemes, with around a fifth (22%) of employers reporting they were interested. A higher proportion (29%) of employers who currently do not offer a GPP reported they would be interested in offering a pension where the risk is shared between employer and employee.

Table 12: Employers offering a group personal pension scheme and interest in offering an alternative type of pension, 2013.

		Whether interested in offering an alternative type of pension where the risk is shared between employer and employee			
		Yes	**No**	**Not sure/need further information**	**Total**
Employer offers access to a group personal pension scheme	**Yes**	22	63	15	100
	No	29	47	25	100
	Total	24	47	28	100

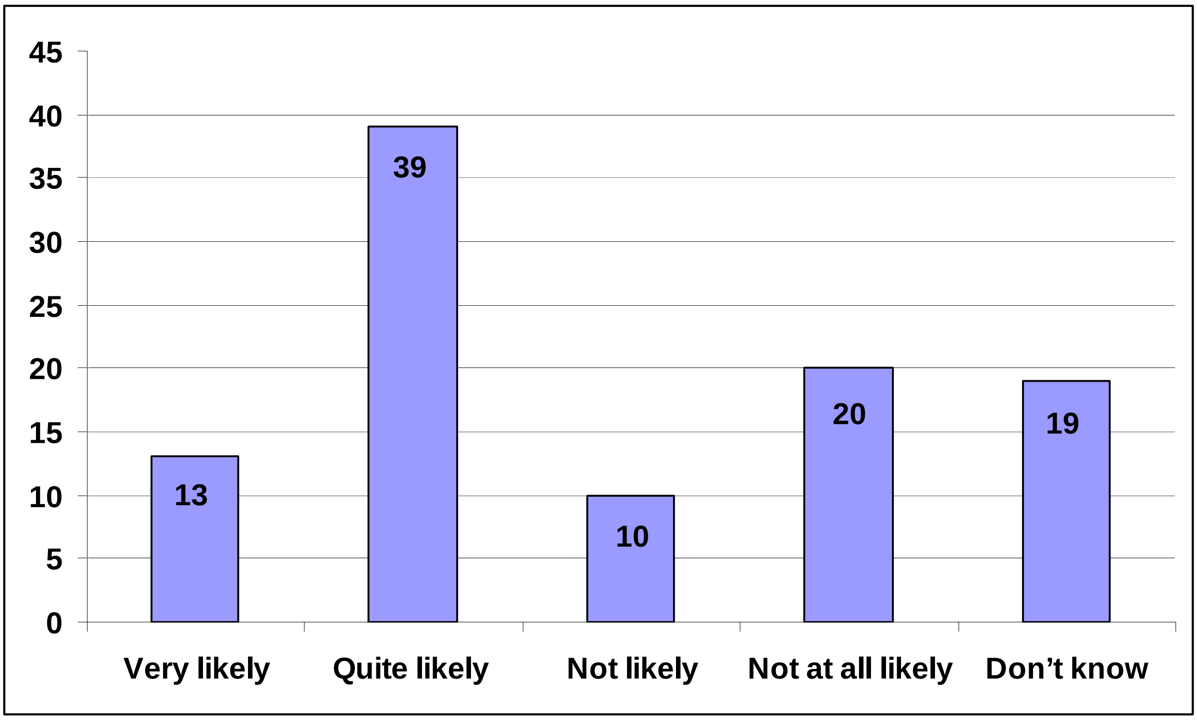
Source: EPP 2013, Questions QDA and HasGpp

6.2 Setting up schemes like Defined Contribution, where there is more certainty of retirement income for the employee

When asked to consider if setting up a new pension scheme and how likely they may be to set up a scheme like a Defined Contribution scheme where the employer pays fixed contributions but bears no additional funding responsibility and where there is more certainty for the employee, such as DC Plus[15], over half (52%) of employers said they were very likely (13%) or quite likely (39%) to offer such a scheme. As Figure 3 shows, nearly a third (30%) of employers considered they were not very (10%) or not at all likely (20%) to set up a scheme with more certainty when compared to Defined Contribution, such as a money back guarantee, if they were setting up a new scheme.

[14] The proportion of respondents who reported they had a closed or frozen occupational scheme was small. These findings should be treated with caution.
[15] Further detail on DC Plus can be found here: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255541/reshaping-workplace-pensions-for-future-generations.pdf

Figure 3: Employers views on setting up a scheme like Defined Contribution, where there is more certainty for the employee



Source: Employer Pension Provision Survey 2013, QDA1 If you were setting up or offering a new pension scheme to your employees how likely would you be to offer your employees a pension like a DC pension whereby the employer pays fixed contributions and bears no additional funding responsibility - but there is more certainty for the employee? (for example, the scheme may offer a guaranteed income in retirement)

While a large proportion (42%) of employers with 500+ employees indicated an interest in this type of scheme, just under a third (29%) also indicated they were not very likely to offer a scheme of this kind. Higher levels of interest were reported among employers with 100-499 employees, with 47% reporting they would be very or quite likely to set up a scheme of this type. The lower levels of interest in alternative pension schemes which may offer greater certainty for the employee but ensure the employer has no additional funding responsibilities among larger employers may be due to long standing commitments to offer Defined Benefit schemes and the employers do not foresee any changes to that regime.

This can be compared with other evidence on offering schemes like Defined Contribution schemes but where there is more certainty of the outcome for members[16]. In 2013, the Association of Consulting Actuaries (ACA) undertook an online survey of employers and asked if a money back guarantee on member contributions would make a significant difference to the number of employees who may join a scheme, 17% of employers felt such a guarantee would make a significant difference. A higher proportion of employers (39%) felt a money back guarantee of total contributions would make a significant difference to the number of employees

[16] Different sample and data collection methods were used in the surveys discussed in this paper. As such, the findings may not be directly comparable.

who would save in a pension scheme. A guaranteed pension income that built year by year was considered by 61% of all employers in this survey to make the most significant difference in the number of employees who would save in a pension[17].

Table 13: Employers' views on setting up a scheme like a Defined Contribution scheme, where there is more certainty for the employee, by employer size

	Likelihood of offering a scheme like a Defined Contribution scheme, if setting up a new scheme				
Size of organisation	**Very likely**	**Quite likely**	**Not very likely**	**Not at all likely**	**Don't know**
1-4 employees	13	40	7	21	19
5 – 12 employees	10	34	17	18	21
13-19 employees	17	44	13	17	10
20-49 employees	14	31	21	17	18
50-99 employees	17	31	17	17	17
100-499 employees	17	30	22	17	13
500+ employees	14	29	29	14	14
Total	19	13	39	10	20

Source: Employer Pension Provision survey 2013, QDA1.

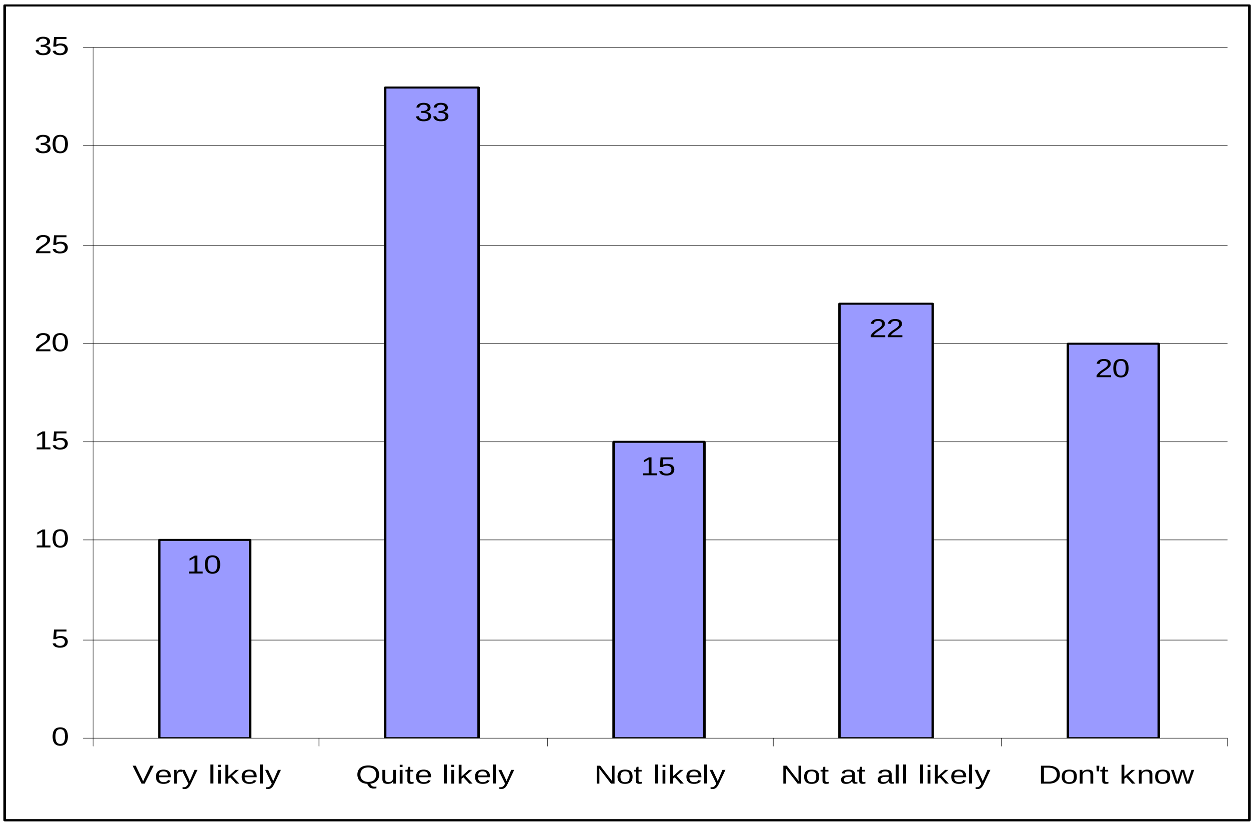
6.3 A scheme like Defined Benefit, where the cost volatility for employers is more limited

Employers were asked to consider how likely they may be to set up a scheme that is like a Defined Benefit scheme but where the cost volatility for employers is more limited than in traditional final salary schemes, such as Flexible DB. This may involve a scheme where employers could transfer employees out of the scheme if they moved employer or where scheme pension ages could be altered in line with changes to State Pension age (SPa). As Figure 4 shows, 43% of employers indicated they were very and quite likely to offer a DB type of scheme, such as Flexible DB, if setting up a new scheme in the future. A third (33%) reported they would be quite likely that they would offer a Flexible DB scheme, when asked to consider hypothetically if they were to set up a new scheme. Smaller proportions of employers reported that they were not very (15%) or not at all likely (22%), to offer a Flexible DB scheme in the future. One in five (20%) employers said they did not know[18].

[17] Association of Consulting Actuaries (2013) The unfinished agenda: Growing workplace pensions fit for purpose http://www.aca.org.uk/files/ACA_2013_survey_report_-_the_unfinished_agenda-7_November_2013-20131107102735.pdf

[18] At the time of the research, Flexible DB was a range of options included in Defined Ambition. Although, employers reported they may be interested in these hypothetical suggestions, responses to our consultation revealed a lack of interest from employers about the proposed scheme designs around Flexible DB. This option is no longer being pursued as part of DA.

Figure 4: Employer views on offering a scheme like a Defined Benefit scheme in the future but where the cost volatility is more limited



Source: Employer Pension Provision 2013, QDA 2. If you were setting up or offering a new pension scheme to your employees how likely would you be to offer your employees a pension which is more like a DB scheme, but where some of the cost volatility for the employer is more limited than in traditional final salary schemes - for example by enabling retirement dates to change, or by transferring employees out of the scheme when they move employer.

As Table 14 displays, a high proportion of smaller employers – those with less than 50 employees – reported they were either very likely or quite likely to offer a scheme like a Defined Benefit scheme but where the cost volatility for employers is more limited. Employers with 500 or more were the least likely to say they would offer a scheme like a Flexible DB scheme if they were setting up a new scheme. As the questions explored hypothetical situations, the actual take up may be higher or lower.

Other surveys have revealed different views to those reported above[19]. Research undertaken by the ACA that larger employers are interested in offering alternative types of Defined Benefit pension provision. They found that nearly three quarters (74%) of employers with 500 or more employees reported legislation should be allowed to pass or should be considered on a core type of Defined Benefit scheme, for example, where there is no requirement to index link benefits. When giving a view on adjusting scheme pension age in line with State Pension age changes or another

[19] This may be due to differences in questions given to respondents and differences in data collection methods.

type of objective index, 80% of employers with 500 employees or more reported legislation should be allowed to pass or be considered to offer this type of scheme[20].

Table 14: Employer views on offering a scheme like a Defined Benefit scheme in the future but where the cost volatility for employers is more limited, by employer size

	Likelihood of offering a scheme like a Defined Benefit scheme, if setting up a new scheme				
Size of organisation	**Very likely**	**Quite likely**	**Not very likely**	**Not at all likely**	**Don't know**
1-4 employees	11	33	14	23	19
5 -12 employees	7	30	15	22	26
13 – 19 employees	8	38	22	13	18
20 – 49 employees	7	33	22	22	16
50 – 99 employees	6	22	25	19	28
100 – 499 employees	4	26	30	26	13
500+ employees	0	14	43	29	14
Total	10	33	15	22	20

Source: Employer Pension Provision 2013, QDA 2.

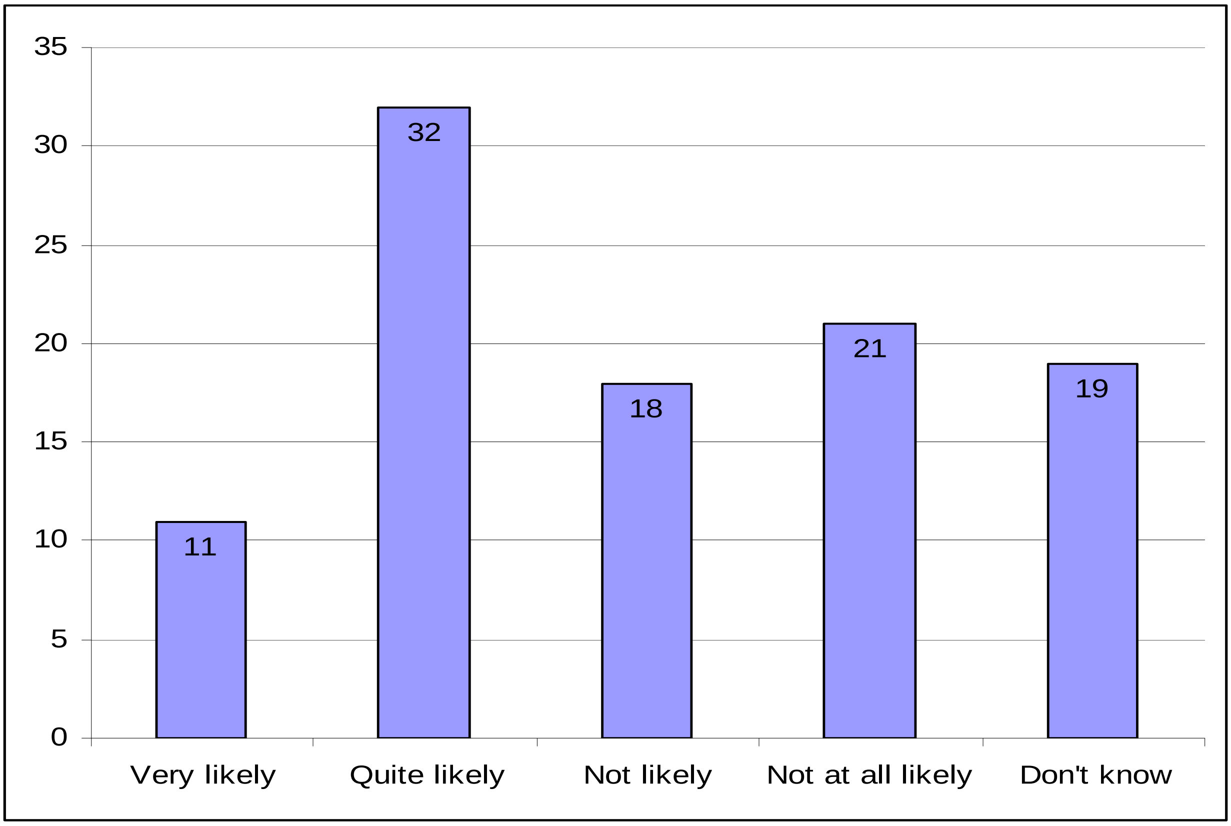
6.4 Being part of a larger scheme, that other employers also belong to

Among all employers, 43% considered they were very likely (11%) or quite likely (32%) to offer a scheme which is part of a bigger scheme that other employers belong to, such as a collective. Over a third (39%) suggested they were not very likely (18%) or not at all likely (21%) to offer a scheme that is part of a larger scheme that other employers also belong to, if they were setting up a new scheme. In other evidence, this can be compared to 48% of employers who agreed the government should facilitate and encourage the development of large collective schemes[21].

[20] Association of Consulting Actuaries (2013) The unfinished agenda: Growing workplace pensions fit for purpose http://www.aca.org.uk/files/ACA_2013_survey_report_-_the_unfinished_agenda-7_November_2013-20131107102735.pdf

[21] ACA (2013) The unfinished agenda: Growing workplace pensions fit for purpose

Figure 5: Employers' views on offering a scheme, which is part of much bigger scheme that other employers belong to, if setting up a new scheme



Source: Employer Pension Provision survey 2013, QDA3; If you were setting up or offering a new pension scheme to your employees how likely would you be to offer your employees a pension which is like DC pension, whereby the employer pays fixed contributions and bears no additional funding risk - but which is part of a much bigger scheme which other employers also belong to..

When considering views on being part of a bigger scheme that other employers belong to by organisation size, Table 15, shows a high level of employers interest in offering a collective pension. The highest level of interest is visible among organisations with 20-49 employees; over half (56%) of this size of employer indicated they would be very or quite likely to set up a scheme that may be part of a collective scheme. Although less interest was reported among larger employees, a considerable proportion (52%) of employers with 100-499 employees and 43% of employers with 500 or more also indicated they would be very or quite likely to set up a scheme that may be part of a collective scheme.

Other evidence also shows there is employer support for a consolidation of pension schemes. In 2013, ACA found that 33% of employers with 249 or less employees considered the Government should facilitate and encourage the development of large collective schemes where, for example, investment, inflation and longevity risks might be shared between members or between members and employers. Half (50%) of employers with 500-999 employers agreed with this statement compared to 62% of employers with 1,000 – 4,999 employees and 58% of employers with 5,000 or more employees[22].

Table 15: Employer views on being part of a bigger scheme that other employers belong to, if setting up a new scheme, by employer size

	Likelihood of offering a scheme that is part of a bigger scheme that other employers belong to, if setting up a new scheme				
Size of organisation	**Very likely**	**Quite likely**	**Not very likely**	**Not at all likely**	**Don't know**
1-4 employees	10	31	18	23	18
5 -12 employees	11	31	14	17	27
13 – 19 employees	14	30	26	12	19
20 – 49 employees	11	45	16	11	16
50 – 99 employees	15	32	21	9	24
100 – 499 employees	17	35	26	9	13
500+ employees	14	29	29	14	14
Total	11	32	18	21	19

Source: Employer Pension Provision survey 2013, QDA 3

6.5 Summary

Overall this evidence suggests employers are interested in offering alternative pensions, such as Flexible DB, DC Plus or collective schemes to their employees. This research explored hypothetical situations and high level concepts, therefore take up rates for specified models could be higher or lower if employers were faced with real-life decisions. The schemes that appear to hold the most appeal are DC Plus and collective schemes – employers of all sizes reported they would be likely to offer such a scheme if they were available. Across all employers, 52% reported they may be interested in offering a scheme, such as DC Plus, if they were setting up a new scheme and 43% suggested they may be interested in offering a scheme that was part of a bigger scheme that other employers also belong to. Flexible DB, appears to hold the least appeal to larger employers in the Department's research, with 14% of employers with 500 or more employees reporting they may be interested in offering such a scheme, although other evidence suggests a high proportion of larger employers think legislation to enable flexibilities to Defined Benefit schemes, such as changing scheme retirement ages in line with changes to SPa should be passed.

[22] ACA (2013) The unfinished agenda: Growing workplace pensions fit for purpose

7. Intermediaries and pension scheme providers

Through the Department's scheme quality and charges research intermediaries and pension scheme providers were asked to consider their views on the principles of offering a guarantee and what, if any, the drawbacks of offering such a guarantee may be. This research also explored these industry representatives' thoughts on hypothetical examples of guarantees. It should be noted this was undertaken during the early stages of Defined Ambition policy development. As such some of the hypothetical scenarios presented below and the context around some of the findings may have changed. The results may also reflect participant's assumptions about how such models might work in practice which were not part of the research materials provided. Since this study was undertaken, the Department has developed its evidence base on consumer certainty over retirement income and Defined Ambition principles have progressed further.

This study was qualitative in nature. The subjects were discussed as part of a programme of in-depth, face-to-face interviews and focus groups with 25 organisations, including:

- 11 workplace pension providers. This included major UK workplace pension providers who participated in this study, including automatic enrolment scheme providers.
- 4 employee benefits consultants (EBCs) that typically advise large employers on workplace pension products
- 10 independent financial advisers (IFAs), that typically advise a range of sizes of employer on workplace pension products

As noted above, the Department further explored EBCs' and IFAs' views on Defined Ambition in other research with pensions consumers. The findings from this research will be available in summer 2014 at: https://www.gov.uk/government/collections/research-reports.

7.1 Responses to the principle of offering a guarantee

Some providers, and a few advisers, expressed sympathy with the desire for some form of guarantee: they recognised that many people distrust pensions and felt that this distrust was caused partly by the greater volatility in financial markets in recent years, as well as recollections of pension mis-selling scandals in the past. These respondents identified two kinds of member for whom guarantees might be suitable:

- **Members that were particularly risk-averse**, and who considered the possibility of losing some or all of the money they had invested as both reasonably likely and beyond their willingness or capacity for risk.
- **Members who were close to retirement**. Since these were members who would usually have built up a larger pot than those who were just beginning to invest, they were likely to have more at stake. Given the shorter time left before they would want to begin drawing their pension, if the value of their pot did begin to fall, there would be less time available to change strategy and recover its value.

> *'It's for people who have gone through the accumulation stage of their pensions and got to the point where they have got retirement in sight and the finishing line is there and they need to conserve what they have built up so far.'*
>
> IFA

Some providers stressed, however, that both of the above groups already have alternatives to guarantees, if they choose simply to invest in safer assets. In the case of older members, this requirement was already met in the market through lifestyling strategies, whereby members' pension pots are gradually transitioned from more risky to less risky investments as retirement approaches. And some pointed out that there had been products in the market in the past designed to meet a latent demand for a kind of guarantee, which had not always been successful – with-profits being the most frequently mentioned example[23].

Providers were supportive of the idea of offering a guarantee, although they also expressed concern around how such a product could be designed.

> *'The actual core idea is actually quite sensible in terms of smoothing returns for members and giving them some sort of downside protection. Some element of that does make sense: but the challenge is how to actually deliver it.'*
>
> Provider

7.1.1 Perceived drawbacks of offering guarantees

Providers and advisers identified a number of disadvantages that they felt applied to any guarantee, regardless of how it was structured. To begin with, they thought that any provider offering even a low-value guarantee would have to restrict a substantial portion of the pension to low-risk assets, such as cash or bonds, in order to protect the contributions.

> *'There are inherent costs to that, because you've got to reserve the capital in order to provide a guarantee. So that comes somewhere out of your performance. It's a drag on performance.'*
>
> IFA

The majority argued that the price of providing a guarantee may erode the value of the pension pot to an extent that members would find unacceptable. Several providers had made internal estimates that the cost of providing even a money-back guarantee – which should be the cheapest kind of guarantee – would be around one to two per cent of the member's pension. They suggested that at this level, the cost of a guarantee plus other annual management charges may eat into the value of the pension at such a rate that growth in the fund would be prevented.

There was also concern that providing guarantees would become more expensive when the market was down, since there would be a greater risk of the value of the pension falling, and providers may have to adopt a more defensive strategy. On the

[23] With-profits are special types of funds that are designed to include a 'smoothing' process, whereby some returns are held back from the fund in growth years, in order to protect against poor performance in bad years.

other hand, if the market was rising, it might be relatively cheap to provide a guarantee, but then members may no longer recognise the value for money of such a guarantee.

> *'The point at which people most want guarantees, they are at their most expensive and then when they are cheaper people say "I don't want them anymore. I don't need them. We are quite happy investing in the market." You don't see an awful lot of appetite for it.'*
>
> Employee benefits consultant (EBC)

A few providers and advisers also raised concerns that the concept of a guarantee could be difficult to explain or justify to members, who would not necessarily fully understand the measures that a provider would have to put in place to secure a guarantee and how much these measures might cost. One provider felt that many people already found pensions difficult to understand, and that building in a guarantee would add a further level of complexity. Although as mentioned above other intermediaries and advisers had also highlighted that a guarantee may be suitable for risk averse customers. If a risk averse individual was identified, it may be possible that the availability of a guarantee on their retirement income may encourage a greater level of pension saving.

> *'Given the fact that most people are not aware enough of what their investment risk is, for them to then take the next step of saying "I want to reduce my investment risk and I am willing to pay that much," that is a step too far.'*
>
> Provider

7.1.2 Responses to specific types of guarantee

The research explored three different types of guarantee with providers and advisers.

> ***Guarantee 1:*** *'A 'money-back guarantee' at retirement of the sum of the contributions paid into the scheme.'*

The money-back guarantee was expected to be relatively cheap, and the majority agreed that this level of guarantee would be the least difficult to deliver; one or two also acknowledged that this would be a relatively easy concept to explain to members.

> *'Members are most interested in the [money-back guarantee] because that is the simplest one for them to understand, because we see that everywhere in the shops, don't we?'*
>
> Provider

However, almost all felt it would be close to impossible to find a way to make it deliver real value for money, as it may only secure an extremely low level of return. The majority argued that the likelihood of a pension's value falling to the point that it is worth less than the amount the member paid in is extremely low. The only circumstances they could imagine in which a money-back guarantee would be worth something to the member were if the financial markets completely collapsed.

> *'The trouble is, you set a target now and who's to say what might happen in the future? If there's a global crash and we have to reduce the value of the guarantees then you've lost the confidence.'*
>
> Provider

Advisers felt that only getting one's money back when drawing one's pension was in any case a very disappointing return. They felt that members would not need a high level of financial understanding to grasp the fact that, with a long-term financial product like a pension, there would be many opportunities to ride out fluctuations in the markets, and to review strategy if the funds were consistently under-performing.

> *'I am 25 years of age and I am going to retire at 60, and promising me I will get my money that I put in – well, that doesn't really inspire me with confidence in their investment prowess.'*
>
> IFA

Providers were not generally convinced that building a guarantee into a pension was the best way of satisfying the demand, of the small number of people who may approach pensions cautiously enough to be interested in a guarantee. A few providers pointed out that stocks and shares ISAs are very popular even though they carry no assurances. Although, of course, it should be noted that these products are not necessarily designed to provide for an income or to fund retirement, and so are not always directly comparable to pensions. Two providers said that they had done some research with ISA customers, which suggested that their relative simplicity meant that consumers understood that they were a low-risk, low-return product.

> *'They liked the certainty and they liked the modest growth. They weren't so keen on a money-back guarantee because they wanted to get some modest growth, but of course the modest growth guarantees start to become even more expensive, and then it's even less likely that they would be better off. All you are really doing is tending towards a cash return.'*
>
> Provider

Guarantee 2: *'A guarantee that secures a certain amount of savings or guarantees a certain investment return.'*

The second model of risk-sharing that we examined with providers and advisers was one that would secure a certain level of savings or return, over and above a money-back guarantee. Providers and advisers alike could not easily identify a compromise between low guarantees that are cheap but provide a low return, and higher guarantees that are too expensive to be attractive.

One provider argued that the cost of providing the guarantee would lead to a provider needing to use part of the growth from rises in the market to subsidise the loss when the market fell.

> *'We could offer a fund saying that we will guarantee a rate of return … but [the members] don't necessarily get the large returns because in effect the return is smoothed. So we will guarantee, but in the good times it means you are not getting all the good, because we are guaranteeing the bad times.'*
>
> Provider

In a similar vein, one EBC speculated that if there was a guarantee of a particular level of growth, fund managers may not have the incentive to take any risks in aiming for anything higher than the minimum that had been guaranteed.

> *'Providers will just aim for that, so it's not a minimum return. That is what the return is going to be. That is quite an important differentiation. It is not, "The minimum will be this but you could probably expect a lot more than that." It doesn't work like that actually. That minimum is what people will aim for.'*
>
> EBC

Guarantee 3: *'A guarantee on your income in retirement, which builds up gradually as you save.'*

Most providers and advisers agreed that this was the model of guarantee that would appear most tangible and appealing to members, since the provider would be able to translate a certain size of contribution today into a minimum level of annual income in retirement.

> *'The simplest in the eyes of the scheme member is a model in which £100 contribution today will guarantee £1 of income from aged 65 say, either for life or for a period of 10 or 15 years, however the maths work out. That, I think, is a very simple concept and one that members can more readily understand.'*
>
> Provider

Other providers felt that the advantage of this model of guarantee was that it was focused on offering security over an extended period of time after retirement, and therefore was best placed to address the principal objective of a pension: to provide a predictable minimum level of income that the member would receive for a number of years.

> *'Where it would get really interesting is if you were actually offering more than an investment guarantee but you were offering a retirement product … it helps to protect that pot of money, but what is really important is you get as much value out of the annuity as possible.'*
>
> Provider

However, the majority were also in agreement that this would be the most expensive model to deliver and were concerned that the cost would be far too high to be attractive to members. They felt that while this kind of guarantee would provide greater certainty for the member, it would involve too much uncertainty for the guarantor, particularly if the minimum income was guaranteed for as long as the member was alive. Some pointed out that this model would represent a move backwards towards a DB-type model.

One provider did suggest however that the financial liability of the guarantor might be restricted by placing a limit on the time period over which the minimum income would be guaranteed.

> *'What is the core purpose of the pension arrangement? It is about delivering an income in retirement for the member and/ or the beneficiaries. If a guarantee is worth having in my mind, it keeps coming back to being able to express that in income terms. Even if it is too expensive to provide a guaranteed income for life, even being able to say "This buys a guaranteed income of X for five or ten years, post aged 65" I think that would be of value.'*
>
> Provider

7.2 Responses to specific risk-sharing approaches

The research explored five different risk-sharing models with providers and advisers.

> ***Risk-sharing Approach 1:*** *'A form of risk-sharing whereby the employer and employee share the costs of protection.'*

Although the risk of supporting member outcomes on workplace pensions has traditionally been borne by either the employer (DB) or employee (DC), it was by no means clear to providers and advisers that sharing this risk between employers and employees would provide a good 'compromise position'. Nearly all advisers and providers pointed out that the move from DB to DC represented the end of employers' appetites for bearing this kind of risk. Most were therefore highly sceptical that employers would willingly accept any move back in the opposite direction.

Several providers were also concerned that investment risk is already a difficult concept for many members to understand, let alone the idea of sharing that risk with the employer. While it is important to acknowledge providers' concern, it should be read alongside individuals' desire for greater certainty over their finances and their concern about taking risks with money. This view of providers should also be considered alongside the analysis in Chapter 6, which demonstrates employer appetite for offering alternative schemes where the risk is shared between employer and employee, and where there may be more certainty of retirement income for the employee.

> *'What I am worried about on risk-sharing is that the member doesn't really understand what they are getting into … people don't understand risk anyway, I have found, and that just adds another level of complication, so they won't understand where their risk starts and stops and where the employer's is even if you communicate it.'*
>
> Provider

> ***Risk-sharing Approach 2:*** *'A "targeted DC" scheme, whereby employer and employee contributions might need to be varied to keep in line with a desired target.'*

The majority of providers and advisers were concerned that the idea of varying contributions to meet a target would fail to deliver a sense of certainty to either the employer or the employee. Some pointed out that the advantage of DC schemes for employers is that they can quantify their future financial liabilities – in contrast, this model could reintroduce a degree of unpredictability in regard to the future payments that employers would need to make to cover workplace pensions.

Likewise, some respondents felt that the degree of uncertainty that members may face in regard to their future payments could confuse them and possibly contribute to distrust of pensions.

One provider felt that since DC schemes already carry a degree of uncertainty with regard to outcome, it would be better for members to take responsibility for this themselves, without necessarily including it as a requirement of the scheme.

> *'People want certainty on what they have got to spend and what they have got to save. They don't want, say, next month you are going to have to put £50 more in. It might be they have got a spare £50 and to me the savings message should be if you have got a spare £50 then the sooner you put that in the pension, the better.'*
>
> Provider

Some raised doubts as to what, if any, degree of responsibility employers would be willing to bear for people who no longer worked for them. They felt that if employers paid little or nothing into the pensions of their former employees, anybody who left a job would inevitably lose sight of their target on that pension.

> *'It then comes back to the point of actually what happens when the employee has left? Does the employer really want to take on the risk for employees that have already left? I don't think they will. They will want to walk away from those people. It just gets quite complex.'*
>
> Provider

> ***Risk-sharing Approach 3:*** *'A simplified DB scheme, which removes some of the more 'onerous' requirements on employers associated with DB schemes. For example, employers might only be required to guarantee funding a member's defined benefits for as long as they remain an employee, and once they leave, their fund is converted to a DC fund.'*

The majority of providers and advisers interviewed were highly sceptical that employers would be willing to take back responsibility for supporting member outcomes, having relinquished this liability since the move from DB to DC schemes.

'Realistically is any employer, when they can go from DB to DC and not have any liability for any of that, going to be pulled back into a space where suddenly there are providing some liabilities and … they have to manage that bottom line exposure?'

Provider

Some providers felt that employers would be particularly unlikely to accept any liability for new 'Flexible DB' schemes, given that their pension budgets would already be rising to varying degrees due to the arrival of automatic enrolment. However, the analysis of employers thoughts on various risk sharing approaches as discussed earlier in this report, suggests there is some appetite for Flexible DB schemes, such as adjusting scheme retirement ages. While this is a different risk sharing concept to the idea presented here, it should be acknowledged that research has found considerable interest among employers for particular elements of Flexible DB.

A small number of providers also felt that that the example given – a DB scheme that would be converted to DC when the member left their employer – would be too complicated for them as providers to administer.

'At the moment it is very difficult to transfer DB into DC and there are lots of rules about how you can do that. You have got to be an authorised person to be able to do that. We have lots of checks in place to make sure that people are doing the right thing and not be encouraged or incentivised to do things in the wrong way.'

Provider

Many advisers shared this concern that if it became common for DB schemes to convert to DC on leaving an employer, members may feel 'locked into' their current employer. A small number of advisers also suggested that at worst such a scheme could be seen as incentivising employers to dismiss employees who were becoming a financial burden to them.

'You are going to get press saying "This scheme is rewarding everyone that stays and it is discriminatory against people who are leaving." We have just fired somebody and now you are going to make my pension really crap. Is that why you have got rid of me, because actually I am a liability? It is just a mess.'

IFA

Risk-sharing Approach 4: *'A form of risk-sharing whereby the employee and provider share the costs of protection.'*

Most of the providers interviewed felt that they would not be able to take on the additional financial liability of supporting a specified level of member outcome. Some providers argued that their margins are too narrow to allow them to take on this additional cost, while another provider pointed out that they already take on a degree of risk, insofar as they assume that they will run each scheme long enough for it to become profitable, whereas in practice this often is not the case.

Some IFAs also agreed that providers would not be able to afford to take on the risk of providing a guarantee.

> *'The provider can't take the cost. How do they make their money? It comes from the money that they are managing. That is ridiculous.'*
>
> IFA

An EBC suggested that members might not understand that in order to offer a guarantee, providers would need to take a slice of the profit when the market was up in order to lessen the fall when the market was down. In other words, both rises and falls in the market could potentially undermine some members' trust in the provider from whom they had bought the guarantee.

> *'If you are prepared to pay for when things go wrong, you have to benefit when things go up as well. I just can't see immediately how you would structure something where the provider won at some point without someone saying "That is not fair. Why is the provider taking the top slice? So investment returns were 15 per cent last year and why did I only get ten per cent?"'*
>
> EBC

Risk-sharing Approach 5: *'A central body, similar to the Pension Protection Fund, which would take a levy from members to fund any member shortfalls.'*

In the final model of risk-sharing, we asked providers and advisers about their views on a guarantee being funded by a levy raised by a government body.

Again, most questioned how this might work in practice. Some providers felt that it would be difficult to decide upon the appropriate way to charge for the levy. They typically suggested that it would be necessary, but complicated, to calculate a different charge according to the risk level of individual members. If the levy were charged at a flat rate across all members, there would be little incentive for those members invested in low-risk funds to subsidise the more expensive, higher-risk members to stay in the scheme.

> *'To do that fairly, you would have to set the levy based on the investment risk undertaken by the members, which would then mean either invest in exactly the same fund, or you have got a very, very complicated way of actually working out the risk. There would be winners and losers, and the winners and losers would probably be spotted, and then they wouldn't play anymore.'*
>
> Provider

Some believed that it would be unfair to impose a guarantee on all members: the only fair way of offering a guarantee would be on an opt-in basis. These respondents felt that if an overarching goal of the industry was to lower charges, it would be contradictory to impose a levy on members whether or not they wanted the benefit of a guarantee. Yet others pointed out that in order to get the scale required to make the charge affordable, participation would have to be compulsory, effectively making the levy inherently unfair.

> *‘A member wouldn't want that foisted on them if they are happy that the way they are saving for their retirement is going to give them the outcomes they want … suddenly you start charging them more for something they are never going to use, because they planned for their retirement.’*
>
> Provider

A few providers predicted that, even if it was possible to set up a levy in an effective way, there would be a high probability of this body being over-run with claims if the market fell far enough.

> *‘It would have to have some alternate funding because the claims on that kind of fund are all going to happen at the time aren't they? Invariably with this type of arrangement you would have all the people claiming it pretty well at the same time if the market collapsed.’*
>
> Provider

Many of the issues discussed above, such as the trade off between certainty and investment return, the complexity and cost of guarantees are factors that have gone into the development of the Defined Ambition project proposals. Some of the findings discussed above may represent participants’ assumptions about the models.

8. Conclusions

Some of the research discussed in this synthesis was undertaken during the early stages of Defined Ambition. Since then, the Department has continued to develop Defined Ambition and a wider range of evidence has become available. The key findings from this paper demonstrate that there is consumer appetite in having certainty over their finances and employer interest in offering alternative type of pensions. These findings reflect a difference between demand and supply side appetites at a particular point in time – between what consumers and employers want – and the supply side, what employer advisers think employers want and what providers can envisage providing – which has informed policy development.

The material discussed suggests individuals prefer certainty over finance rather than taking risks, even when they stand to gain more. While there is some interest from individuals in taking risks in hypothetical examples with finances when there is an opportunity to gain a higher amount, the majority prefer certainty over the amount they will receive.

When risk-taking with money is calculated and there is a potential for a good return, individuals appear more enthusiastic about taking that risk. However, the term calculated may suggest a feeling of certainty behind the risk-taking behaviour, with individuals feeling more certain that they will secure a higher outcome. The higher levels of enthusiasm among some individuals may also be based on information or knowledge and have made considered decisions about financial products, on the basis of the information received.

The evidence reviewed in this paper also shows employer interest in pension schemes where the risk is shared between parties and schemes which enable them to manage costs but offer a more certain outcome for their employees, such as DC Plus. There also appears to be interest across employers of all sizes in schemes that other employers belong to, such as Collective Defined Contribution (CDC) pension schemes. In part, this may reflect the long-term trend of a decline in employers offering DB schemes. Where employers indicated an interest in a DB risk sharing scheme, such as Flexible DB, this may be due to a long-standing tradition to offer a Defined Benefit pension or where the employer competes with particular industries, such as the public sector, where Defined Benefit schemes are more prevalent. Alongside this interest, there is a desire for greater information on how Defined Ambition may work in practice.

Providers and advisers alike considered that the desire for guarantees is borne out of risk-aversion, and often compounded by a general mistrust of pensions as a savings vehicle. Nevertheless, many felt that most members would not fully understand what benefit a guarantee was offering, and at what cost. They were concerned about the danger of a guarantee simply inflating members' expectations to a level that could not be met. The key issues raised by this group are factors that have gone into the development of the Defined Ambition project proposals, and of course we cannot rule out that in the absence of specific models in what was an exploration of concepts will mean that some of the participants assumptions were not fully discussed.

Most providers and advisers stressed that members needed to understand that pensions are built to deliver a future outcome: even they, as experts, could only at best make an educated guess about what the future holds. Pension intermediaries acknowledge that further education about pensions is required, to enable consumers to understand the risks they may take on with an investment and to make an informed decision. There is an ongoing challenge about the mismatch between behavioural impacts reflected in findings about individual concerns based on common levels of understandings about pensions, and an economic rationale for risk taking reflected in the findings from providers and advisers.

The evidence shows that consumers are supportive of the principles behind Defined Ambition. While pension intermediaries did not feel there was a one single type of guarantee that could function for the whole market, it is important to remember that Defined Ambition offers flexibility and a range of ideas aimed at increasing certainty of pension costs for employers and retirement income for individuals - not just one type of guarantee. The report highlights consumer interest in having certainty over their finances and employer interest in offering alternative types of pensions.

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