Reinvigorating Workplace Pensions

Overview

- The DWP has set out its strategy for reinvigorating workplace pensions
- It seeks to achieve a fundamental shift in culture towards savings and pensions
- Options for Defined Ambition schemes are outlined

The DWP has published its strategy for reinvigorating workplace pensions. This aims to address the issues of an ageing population and the need to boost pension savings. DWP is seeking to achieve a fundamental shift in the culture and attitude of working age people towards savings and pensions. It is in the early stages of developing solutions in many places and the proposals set out below are described as exploratory. The strategy runs to 56 pages but a brief summary is set out below.

Reinvigoration objectives

The 'reinvigoration objectives' are defined as:

- Increase the amount people are saving in pensions;
- Increase the amount people receive for their savings;
- Enable industry innovation and development of new products including those which will give people more certainty about their pensions and encourage more risk-sharing;
- Increase transparency and build trust, confidence and engagement in pension saving as the norm; and
- Ensure the sustainability and stability of the UK pension system.

Refining the current position

Most of the areas in which the DWP suggest possible refinements to the current position relate to Defined Contribution arrangements.

The DWP acknowledge that for many people, saving at the minimum level under automatic enrolment will not achieve the level of income they expect in retirement. It is keen to encourage additional saving.

There are no plans to increase the automatic enrolment minimum but the DWP intend to consider mechanisms to increase savings – such as automatic escalation, where members commit to future increases in contribution levels.

As small differences in charges can have a big impact on a member’s pension pot, charges are to be closely monitored. Prompt action will be taken if there is evidence that charging structures are being used inappropriately. The DWP notes that it has powers (through additional regulations) to stop a scheme being used for auto-enrolment if charges are too high.

Further examination of the retirement process will look at alternatives to lifetime annuities, such as wider use of income drawdown and fixed term annuities, in addition to the ongoing work to improve the Open Market Option.

At the macro-level, the DWP intends to explore with the pensions industry whether a smaller number of large-scale, multi-employer pension schemes might provide greater value for money and better investment options.

The DWP believes that current pensions legislation (for both DB and DC schemes) is largely fit for purpose and that the introduction of automatic enrolment requires stability in legislation. However, one refinement identified is the significant scope for simplification of the disclosure regulations and, as expected, draft regulations are to be issued for consultation early next year.
Defined Ambition
The Government is exploring the scope for a new category of 'Defined Ambition' (DA) pension, to complement the Defined Contribution and Defined Benefit structures that currently dominate the market. The aim is to create greater certainty for members and lower cost volatility for employers (in comparison with DC and DB respectively).

The principles for the development of DA are that it should be:

- **Consumer focused** – address member and employer needs
- **Sustainable** – affordable over the long term
- **Intergenerationally fair** – no bias to pensioners or non-pensioners
- **Risk-sharing** – genuine stakeholder risk sharing
- **Regulated proportionately** – a permissive regulatory structure that protects members
- **Transparency** – high governance standards

Several new models have been identified for further exploration.

**Simplified/core DB schemes** could provide a core level of benefit together with a discretionary element. The requirement for DB schemes to provide spouses pensions and inflation protection could be removed. Increases might be dependent on the scheme's funding level or optional.

**Fluctuating pension arrangements** could include a discretionary element of pension subject to a lighter funding regime, which might fluctuate in payment according to the scheme's financial status.

**Conversion of benefit** could provide a defined level of benefit which is converted to a DC fund at exit.

**Linking scheme retirement age to state pension age** for past and future service could be made possible (provided the relevant service was accrued after the introduction of the necessary legislation).

**Mutualised guarantees** could share risk between the member and the mutual fund. The cost might be met by the employer or by a levy on member funds. The guarantees might include a "money-back" guarantee or a guarantee of retirement income. The mutual fund might be private or Government sponsored but industry funded.

**Insurance based guarantees** could guarantee a minimum level of return and allow the member to share in any actual returns above this level. For those members closer to retirement, the guarantee could extend to a minimum level of pension.

**Employer funded "smoothing funds"** could receive core employer contributions and manage a targeted outcome, possibly using annual or final bonuses. The design could include specific parameters for contribution increases.

**Collective DC schemes** are discussed in particular detail, including a suggested model scheme. Employers pay a fixed contribution and risk is shared between members. Benefit levels are targeted but not promised. A small fall in investment returns might lead to a reduction in revaluation and indexation. A significant fall in investments might lead to a reduction in basic benefits. As the fund is collective, it can stay invested in return seeking assets for longer than an individual member of a DC scheme.

**Next steps**
The document is not a consultation. The issues raised within it will be the focus of future work by Government and discussions with stakeholders.

On Defined Ambition, an early outcome is likely to be a published framework for DA pensions, possibly jointly with industry.