Retirement Income
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England’s Search for a DC/DB Hybrid

By Kerry Pechter *Wed, Dec 19, 2012*

The U.K.’s pension ministry has proposed ‘defined ambition’ as a remedy for the country’s retirement savings ills. ‘DA’ is a hybrid of DC and DB, but remains otherwise undefined. Pictured: A worker at a Morrisons supermarket in Britain.

Morrisons is the U.K.’s fourth-largest grocery chain, with 475 supermarkets and 131,000 employees across England. In 2002, the company closed its final-salary pension plan in favor of a defined contribution plan. But participation in the DC plan has been lackluster.

This past October 1, all British DC plans had to institute auto-enrollment. But Morrisons chose a third way. Dropping its DC plan, it created a cash balance plan that sets aside 16% of employee pay per year (5% from employees) and guarantees that it will grow at the rate of inflation.

“We want our colleagues to be able to retire at a time of their own choosing,” Julian Bradley, a Morrisons spokesman, told *RIJ* this week. “We’re known for friendly service and helpful people. That requires strong morale. So we want them to be here because they *want* to be here, not because they *have* to be here.”

Between DB and DC

In some ways, the U.K.’s retirement financing situation is not at all like America’s. British workers can’t access their DC savings between jobs, for instance. With some exceptions, retirees are required to buy life annuities with their qualified savings.

But in other ways England’s retirement challenges resemble our own. Their Boomers are aging in droves. Their interest rates are low. They’ve seen their private pension system swing from like a pendulum from almost entirely DB toward almost entirely DC.

And now, like some of us, some of them would like to see the pension pendulum swing back to somewhere between DB and DC. One of the buzz-phrases of the moment in U.K. pension circles in the U.K. is “defined ambition.”

The term, borrowed from the Dutch pension industry, refers to pension designs where the risk and responsibility around retirement income provision doesn’t fall entirely on individuals or on their employers.

“Defined ambition is pitched somewhere between DB and DC—less risky for the employee than DC, less onerous for the employer than DB,” said Andrew Sheen, who works on NEST, the government-sponsored, risk-managed, auto-enrolled collective DC plan that started this fall and which represents a kind of default plan, especially for small companies that don’t offer their own.

“Pensions are now very polarized, particularly in the private sector, with older ‘final salary’ pensions at one end, and the newer ‘defined contribution’ system at the other,” said Joanne Segars, chief executive of NAPF, the trade association of British pension funds, in a statement issued in November.

“Either the business bears the risk of paying a final salary deal, or the saver carries the risk of not knowing exactly how much they will get. There could be room for a middle way where that risk is shared. It is certainly worth exploring and the NAPF has been involved in the debate,” she said. NAPF is so far not opposed to defined ambition.

Last spring, the British pension minister Steve Webb began championing defined ambition. His efforts were not uniformly well received by the media, which thought it sounded too much like a failed concept called “with-profits” funds. These were largely unsuccessful pooled retirement savings funds that offered downside protection, “smoothing” of returns during periods of volatility, and some upside potential.

“[Defined ambition] in essence amounts to one thing: the conversion of workplace pensions into giant with-profits funds,” sniffed a columnist in The Independent, a British newspaper. “With-profits as a concept has been a busted flush for a decade—the legendary smoothing of returns so often doesn’t happen—and here we have the pensions minister recommending we port over this concept for workplace plans. The world has also moved on. Having spent the past decade closing final salary [DB] plans, how are employers going to be persuaded to enter an even more complex arrangement?”

Competing agendas

Others questioned the timing of Webb’s defined ambition campaign, which began only months before the October 2012 launch of NEST and auto-enrollment, which represents a national commitment to a modified defined contribution model.

“With automatic enrolment coming into force in less than two weeks, this idea is dead in the water,” NEST’s Sheen told *RIJ* in early October. “Employers don’t have the inclination to put in something that increases their own risk, especially since they can sign up with a DC scheme and essentially wash their hands of the situation.

“Plus, the types of companies this is likely to appeal to will already have put something in place, or have wheels in motion, to meet the requirements for automatic enrolment. It was a good idea in theory but too late to the party to make any difference.

“The right time for this would have been years ago when the decline in defined benefit was possibly reversible. I also think that the announcement was poorly timed – it got a lot of mainstream press and TV coverage at a time when the rest of the industry was trying to get the message about auto-enrollment across.”

But a spokesman for England’s pension fund industry is more sanguine about defined ambition. “Steve Webb has been seeking industry views and getting people talking about how to do things better or differently. He’s talking about finding a middle ground between the two,” said Paul Platt of NAPF.

Platt downplayed accusations that defined ambition represents a digression or distraction from the trend toward DC in the U.K. “Some people are saying that, but they’re selling DC. The situation at the moment is up for discussion. The government has laid out a few broad ideas and they’ll be working on it next year.”

The best sources for information on defined ambition are two reports that were issued this fall, one by NAPF and the other by the U.K. Department of Work and Pensions, Britain's Labor Department.

Ongoing search for solutions

In August, the DWP formed a Defined Ambition Industry Working Group, chairing by the Association of Consulting Actuaries. In November, DWP issued a 64-page report, "Reinvigorating workplace pensions," that lays out a number of possible retirement savings models that might meet the criteria of "defined ambition".

The NAPF report, called "Defining Ambition," includes a collection of essays written by a diverse sampling of government, trade association and private industry pension experts. Rather than advocate any particular course of action, it represents multiple perspectives on the need for retirement saving solutions that are neither extreme DB or extreme DC.

Although British pensions minister Webb borrowed the term "defined ambition" from the Dutch, the DWP's report makes clear that, for cultural and legislative reasons, the U.K. *won't* be adopting the Netherlands' approach to pensions, which requires semi-mandatory participation in collective investment trusts. The trusts pay out an income based on average career pay and on each individual's retirement age, which can range from 55 to 75.

Is there a downside to "defined ambition"? That's difficult to say without more specifics. But there's definitely mistrust of it. Reports in the British media reflect a fear that defined ambition plans can be black boxes, with non-transparent risk management methods and potentially volatile payouts.

Some British observers seem to prefer DC, warts and all. They portray a balanced investment in a DC plan as entailing more acceptable risks—or at least more familiar ones—than a notional interest in a centrally-run, risk-managed fund. But DC solutions, even with the advent of auto-enrollment and NEST, clearly won't satisfy all of Britain's retirement savings cravings. Hence the government's pursuit of other strategies, which it chooses to call "defined ambition."