Summary
• Sceptics do not see how hybrid schemes can fit into a rapidly-evolving work market where many employers are loathe to find themselves shackled by a pension benefit guarantee of any type and are still scarred by their experience of DB.
• Pension freedoms have made defined ambition in the accumulation phase less of an attraction. However, the freedoms may have created the right environment for an at-retirement risk-sharing product.
• With the legislation in place from the 2015 Pensions Act, the DWP could draft the necessary regulations to kick-start a hybrid scheme regime.

A break in the clouds

The idea of risk sharing in pension savings reached its nadir shortly after the 2015 General Election. But there is still a glimmer of hope that some form of defined ambition product could eventually take hold in the UK

When Steve Webb cleared his desk in Westminster after the Liberal Democrats' disastrous showing in the 2015 General Election, so too was cleared away his vision of a pensions system that more equitably shared risk between employer and employee.

Within weeks his successor, Ros Altmann, shelved Webb's plans to address the growing risk imbalance in retirement provision through the introduction of defined ambition schemes.

In the same year, it also became clear that George Osborne's pension freedoms were also going to put a severe dent in the former Pensions Minister's blueprint.

As TPT Retirement Solutions' product and technical manager, Billy Wheeler, explains, the avenues available to members when they draw their benefits have moved on with pension freedoms. And options such as flexible drawdown reduce the attractiveness of a rigid collective DC scheme – the most talked-about form of defined ambition.

Then there is the experience from abroad. The Dutch, held up as a shining example of how to run hybrid pensions, have been mired in an intergenerational conflict that has complicated their own plans to reform pension savings.

Willis Towers Watson's senior consultant David Robbins says that tension between different cohorts is almost inevitable in a collective DC scheme.

"If investments underperform, someone's got to make a decision," he says.

"Do they say, 'don't worry things will turn to normal, we'll carry on and pay your pension in full'? And if things don't return to normal, then the younger guys are in a bigger mess as the scheme is even more underfunded than before. And there's no recourse to an employer to plug a shortfall."

Conversely, if a fund performs well, then pressure for benefits to be increased can come from pensioners and those close to retirement. But younger members may well push for prudence and to reserve money for leaner times.

"And what happens if people bail out and say 'we're not subsidising these older guys'?" asks Robbins.

Ensign Retirement Plan pensions director Ivan Laws says that there is also a wider economic picture to consider when weighing up the merits of defined ambition.

"Is it right that an employer carries the significant covenant risk that goes with any DB provision, even on a hybrid basis? How much damage has been done to the economy and job prospects through the requirements of having to pay very significant deficit contributions?" he says.

Laws argues that the demographic

shape of the UK, with its ageing population and shrinking tax base, mean that personal responsibility for long-term income provision has to be a reality. What's more, the traditional shape of lifetime work patterns will have to shift as artificial intelligence gathers momentum.

He believes that employers will need to be agile and flexible. The imposition of a new type of DB-related financial risk would therefore be counter-intuitive.

So would things have been any different if Webb had held onto his seat and stayed in some sort of coalition government?

Squire Patton Boggs' pensions partner Matthew Giles is doubtful.

"It feels as if the timing was wrong for risk sharing," he says.

"By the time *[the 2015 Pensions Act]* was done, the pendulum had already swung from DB to DC. And employers had embraced this idea of a lower risk model.

"And the idea of introducing a bit more risk onto the table, well, there just wasn't the appetite there. I remember in 2015 when this was being debating heavily, no client said 'brilliant, we look forward to this being available'. There was just general disinterest."

Hope springs eternal

Nevertheless, not everyone has abandoned all hope of some sort of risk reversal, not least because Webb's foundations are still in place. With the primary legislation sitting on the parliamentary books, the DWP could draft the necessary regulations if so directed.

"I try to be half glass full about risk sharing pension provision," says JLT Employee Benefits' head of technical John Wilson.

He believes that there are a couple of glimmers of hope for it in the near future.

The first is the government's forthcoming white paper on DB reform, due later this year or early next. Wilson says that this may be taken as an opportunity to mention risk sharing.

Whether or not the current administration picks up Webb's baton, Aon Hewitt senior partner Kevin Wesbroom is also optimistic that hybrid schemes may come into fashion. One reason for his optimism is the fact that the Labour party now supports the idea, after having rejected it when in government in 2009.

"A couple of unions have been advocating it and briefing Labour, saying that it would be a way of allowing the last few bastions of defined benefit schemes to maintain some sort of certainty."

Wesbroom points out that defined ambition satisfies one of the unions' objectives, which is to view retirement savings as deferred income, rather than a disconnected and mismanaged DC pension pot.

"That is a differentiator that the unions have latched onto," he says.

Along with political support, there is also, says Giles, the possibility of a new generation of business leaders looking to stand out in the job market.

"If everyone is offering low-level DC provision then at some point the time will come when employers think, 'well it's going to help us reward and recruit if we offer something slightly better'. I suspect one of these risk-sharing hybrid models could work in that context.

"Memories fade quickly and those who have been battered and bruised by DB might start to feel a bit more relaxed about taking some more risk on."

But if employers remain reluctant, there is always the power of master trusts, adds Giles.

"This may link in with another trend, consolidation. Schemes then cease to be employer-established arrangements and they're more insurance/benefit consultant run arrangements that are mass market. When you've got those, then things like collective DC becomes more viable thanks to critical mass.

"The complexity of the models, with the introduction of some partial guarantees or partial benefits, might be more tolerable in an industry-wide or mass-market arrangement, rather than a smaller, employer one."

Decumulation

The second glimmer of hope that Wilson talks of is the auto-enrolment review. This could take a position on the decumulation phase, where annuity sales have fallen off a cliff since 2015.

Wilson argues that some sort of hybrid product, muscling in on the current line up of annuity, drawdown and lump sum, could be phased in much like auto-enrolment has been, by using nudge theory.

In this scenario, pensioners would manage their own savings at the start of their retirement, and then gradually move into an annuity in their seventies and eighties.

This type of risk sharing makes a lot of sense in the context of pension freedoms, as State Street Global Advisors' head of European DC investment strategy Alistair Byrne explains.

"Removing the requirement to annuitise has created a situation where individuals are taking on more market risk in the decumulation phase. This is where we see most scope for a collective, risk-sharing approach, delivered via insurance. This will be most important in future where fewer retirees have DB incomes and more people are solely reliant on DC."

Wesbroom believes that any such arrangement could also work in a trust-based model and identifies NEST as a potential home for a new hybrid retirement product.

"You need a fairly large group of people to make it work, so an organisation like NEST might be able to do that with the number of people that they're going to have coming through, to make the actual mechanics of sharing risk work.

"In a few years' time when people stop taking their money out to buy Lamborghinis, they will need to make their DC pot last as it's all they have, so it's something that's on the horizon, even if it's not a today thing."

Written by Marek Handzel, a freelance journalist