PENSIONS POLICY INSTITUTE

PPI

The changing landscape for private sector Defined Benefit pension schemes

Executive summary

Summary of conclusions

The private sector Defined Benefit (DB) landscape is not a homogenous one. Schemes of varying size, with contrasting histories, and in separate industries, have very different characteristics.

In general though, occupational Defined Benefit pension provision in the private sector in the UK has been declining:

- The majority of DB schemes in the private sector (60%) are now closed to new members or are in the process of closing down completely.
- Although the number of open DB schemes in the private sector has fallen, fewer DB schemes have closed in recent years.
- Smaller DB schemes are more likely to be closed to new members than larger schemes.
- A significant proportion of all members (43%) are in DB schemes that are still fully open to new members. Not all of these members, however, are active members and some are existing pensioners.
- Only one quarter (26%) of scheme members are active members (i.e. are accruing a pensionable service) and many of them (42%) are now in closed DB schemes.
- The majority of active members are in a small number of large schemes, which tend to be better funded than small schemes.
- Total contributions into DB schemes, and employers' special contributions in particular, have been increasing to help reduce the deficit between assets and liabilities.
- Contribution rates to DB schemes are increasing, and tend to be higher than contributions in Defined Contribution (DC) schemes.
- Scheme sponsors are moving away from providing DB schemes and are instead offering DC.

A number of factors have influenced this decline. Better than expected improvements in longevity, low investment returns, increased legislation and regulation, and broader economic factors have all added to the costs and risks to sponsoring employers of providing a DB pension scheme.

In response to these factors, scheme sponsors have been changing DB provision in a number of different ways:

- ***Reducing deficits.*** Scheme sponsors have taken measures to increase scheme assets and / or to reduce liabilities.
- ***Changing investment strategy.*** Pension schemes have been attempting to reduce the size of the deficit or to help stop deficits growing by changing their investment strategy.
- ***Reducing the risk and / or level of pension provision.*** Many DB schemes have been closed to new members and the replacement schemes are predominantly DC schemes, which can be less generous, place greater risk on the employee and have lower take-up rates.

However, some employers have adopted hybrid or risk-sharing schemes, which spread the costs and risks of the pension scheme between employers and employees.

- ***Winding up or selling on pension provision.*** Although still relatively uncommon, buy-outs are becoming a viable option for some employers. A buy-out is when a company sells a closed but fully funded pension scheme to a third party, usually an insurance company.

The future for Defined Benefit schemes in the private sector remains uncertain. The cost pressures on DB schemes from rising longevity and uncertain investment returns are likely to remain, and pressures could be increased or reduced by planned government interventions.

An important factor is likely to be the new national system of Personal Accounts with auto-enrolment from 2012. Auto-enrolment is likely to lead to higher participation in existing DB and DC schemes and it is uncertain how employers will respond to the extra cost pressures they will face from increased participation. They will have a choice about whether to retain an existing pension scheme or, alternatively, to close their provision and instead offer Personal Accounts.

Cost pressures may or may not be offset to a certain extent by government initiatives, such as, the Deregulatory Review. The Review aims to provide further flexibility for scheme sponsors to share the costs and risks associated with DB pensions.

The PPI asked a panel of pension experts for their views on the future of DB pension schemes. Although there is not a consensus about the future for DB schemes, there was a general agreement that how the sector evolves will largely depend on how employers and government respond to the underlying cost pressures, the introduction of Personal Accounts, and the possibility for deregulation. And it is clear that DB provision, if it survives in the private sector, is likely to look very different in the future to the DB provision of the recent past, with potentially fewer schemes and more use of risk-sharing arrangements.