PENSIONS POLICY INSTITUTE

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PRESS RELEASE

For Immediate Release

"The future for private sector Defined Benefit Pension schemes is uncertain" says Pensions Policy Institute

There is considerable uncertainty concerning the future for Defined Benefit (DB) schemes in the private sector according to ***The changing landscape for private sector Defined Benefit pension schemes,*** a research report published today by the Pensions Policy Institute.

The research shows that DB pensions have been in decline for a number of reasons, including better than expected increases in life expectancy, low investment returns and increased regulation and legislation.

Scheme sponsors are reacting in a number of different ways to the challenges they face: reducing deficits or scheme benefits; changing investment strategies; shifting all, or some, of the risks associated with DB to the scheme members; or, taking the final step and winding-up or selling-on DB pensions.

Around two thirds of private sector DB schemes have already been wound up or are closed (or are in the process of closing) to new members. Where there are replacement schemes they are predominantly Defined Contribution (DC) schemes, which can be less generous, place greater risk on the employee and have lower take-up rates.

But it is not yet clear if the one third of private sector DB schemes that are still fully open to new members remain so because the sponsors are committed to continuing DB provision in the future, or because there are other barriers, such as poor funding positions, that are preventing them from closing the schemes.

Chris Curry, PPI Research Director, said "The cost pressures on DB schemes from rising longevity and uncertain investment returns are likely to remain. On an optimistic view, not all schemes are closing, and the rate of scheme closure has slowed in recent years. Some of the pressure could be eased by deregulation, and by greater encouragement for risk sharing between schemes and employees.

On a pessimistic view, the requirement for employers to auto-enrol their employees into existing pension schemes or into Personal Accounts from 2012 could increase cost pressures further, and hasten the switch to DC provision.

The future for DB pensions in the private sector remains uncertain. But it is likely that any future DB pension provision in the private sector will look very different to the provision of the recent past, with fewer schemes and risks shared differently between employers and employees." ENDS

A summary of conclusions from the report follows on the next page.
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Notes for editors
The PPI is an independent research organisation, focused on pension provision. Its aim is to improve information and understanding about pensions and retirement provision through research and analysis, discussion and publication. It does not lobby for any particular issue, but works to make the pension policy debate better informed.

The research report contains contributions from expert commentators, giving their views on the likely future for DB pension. The commentators are Dr Deborah Cooper (Mercers and The Actuarial Profession), Joanne Segars (NAPF) and Eddie Thomas (Law Debenture).

The research considers the extent of defined benefit pension provision in the private sector. The majority of public sector employees continue to have defined benefit pension schemes. The PPI published a report on occupational pension provision in the public sector in March 2005 which can be downloaded from the PPI's website at:www.pensionspolicyinstitute.org.uk/news.asp?p=114&s=2&a=0. Forthcoming research will examine the impact of recent reforms in public sector occupational pension schemes, and draw comparisons with pension provision in the private sector.

The research is being launched at a special PPI members' event on 8 October 2007. The launch and publication costs have been sponsored by Threadneedle, who have issued a separate press notice - please contact Monina Villaroman (monina.villaroman@threadneedle.com 020 7464 5932) and Andy Fleming (Andrewf@penrose.co.uk 020 7786 4823) for details.

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The changing landscape for private sector Defined Benefit pension schemes

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.

The report can be downloaded from www.pensionspolicyinstitute.org.uk