



Twilight or a new dawn for Defined Benefit Schemes?

**Report 1
2009 Pension Trends Survey**

**Produced by
Association of Consulting Actuaries**

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Close to nine out of ten defined benefit schemes now closed to new entrants, but unease with the present alternative...

"87 per cent of defined benefit schemes are now closed to new members and of these 18 per cent are also closed to future accrual. In addition to the closures to date, a third of employers say their defined benefit scheme is under review at present"

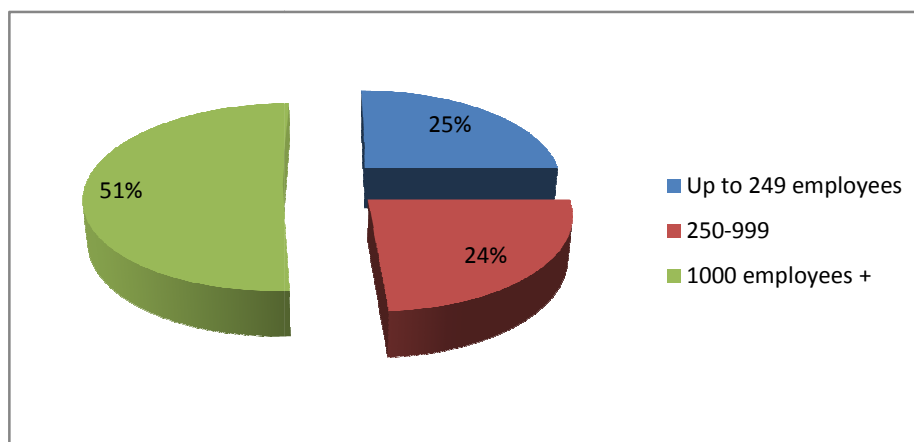
The Association of Consulting Actuaries' (ACA) latest 2009 Pension trends survey was conducted in June and July of this year. Over 300 employers of all sizes responded to a wide range of topical questions, including changes in pension design since our last survey two years ago. A second report, to be published later this month, will examine their emerging views on personal accounts and pension reform in the run up to 2012.

A final report, including all the statistical tables, will feature in the Association's Biennial Review, to be published later this year.

The survey this year again paints a picture of continued change in pensions across companies of all sizes. The report's evidence of a further move away from defined benefit provision comes as no surprise given the regular announcements of closures over the last year. The increased cost of funding accrued and future defined benefits, reported in the survey, is also no surprise. However, what is concerning in terms of pensions being accrued, is the stalling of contributions being made into defined contribution schemes and the danger this represents in terms of pension outcomes. Allied to this is the perception of employers that most employees remain uncomfortable with the risks associated with defined contribution.

Figure 1: The Survey respondents

309 employers responded to the survey, made up as follows:



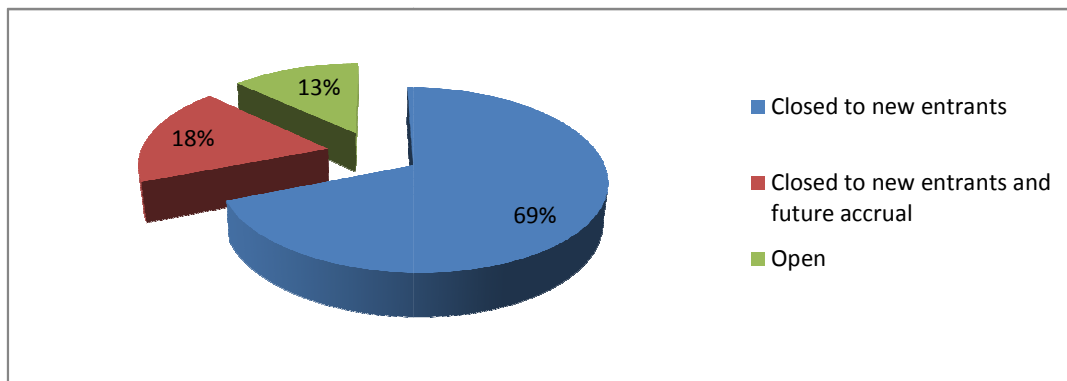
Defined benefit closures and reviews escalate

The number of defined benefit schemes closed to new entrants now stands at **87 per cent**, up 6 points on the position we reported two-years ago. **Of these, some 18 per cent of schemes are now also closed to future accrual for existing employees**, again an increased number, up 4 points on two-years ago (see *Figure 2*).

Separately, ACA members also report that there is certainly no slowing of the trend, certainly in the private sector, with many employers continuing to keep what remains of their defined benefit provision under regular reappraisal. Indeed, this year's survey found **34 per cent of defined benefit schemes are presently under active review**, with **39 per cent of companies considering changes to future accrual**, alongside a mix of other changes that are likely to reduce benefits in the future for members, whilst reducing the ongoing costs of providing these arrangements to employers (see *Figure 3*).

"The principal options being considered in ongoing reviews of defined benefit schemes are reduced accrual rates, a move to career average and a move to defined contribution"

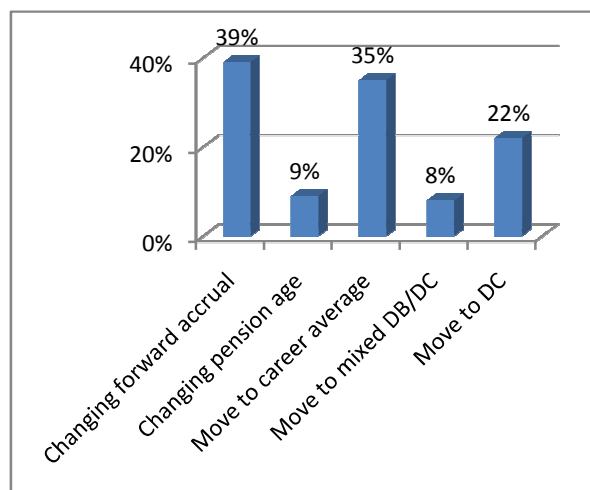
Figure 2: Status of defined benefit schemes



What is perhaps surprising is that rather than an en masse move to defined contribution, many employers are looking, certainly in the near-term, for ways to reduce the forward cost of providing ongoing defined benefit provision, largely for existing employees, under present legislation.

This is building on the pattern of increased defined benefit contributions evident from employers and, in many cases, scheme members over the last few years. It also comes on top of actions already in hand to change both accrual rates and pension age, where **some 14 per cent of schemes have reduced forward accrual rates and/or increased their scheme's pension age**, notably those where the age hitherto has been below age-65.

Figure 3: Options being considered for defined benefit schemes presently under review



Support for 'middle way' options

The survey found, however, that many of these same employers are unhappy with the pension design limitations placed upon them by existing legislation. They are supportive of 'middle way' reforms that would allow them to offer a range of designs not presently available, with **half saying that they would themselves consider introducing such an arrangement if public policy allowed.**

"77 per cent of employers said that present legislation did not allow them to easily share investment, inflation and longevity risks.

76 per cent said public policy should be more supportive of 'middle way' pension design"

Pension contributions

The steady rise in pension contributions into defined benefit schemes from employers, evident from our surveys since 2002, has continued. **Employer contributions now average 23 per cent of earnings into such schemes.** With member contributions also trending upwards, **combined employer and employee defined benefit contributions are now close to 30 per cent of earnings.**

Six out of ten employers say they have increased their contributions to meet future service benefits and half of the employers sampled have either made significant lump sum

contributions into their scheme and/or have made additional fixed annual or monthly contributions over and above normal contributions. **Four out of ten members of defined benefit schemes have also seen their contributions increase in recent years.**

In stark contrast, despite lower investment returns, improvements in longevity and reduced annuity rates – all of which are depressing the pension outcome of defined contribution schemes – contributions by both employers and members into defined contribution arrangements have pretty well stalled since 2005 (see *Figures 4 and 5*).

Figure 4: Average of contributions paid into pension schemes (as a percentage of total earnings).

Average employer contributions into:									
	2002	2003	2004	2005	2006	2007	2008	2009	Longer term
Defined benefit scheme	11.5%	13.1%	15.1%	16.5%	21.0%	22.6%	23.0%	23.2%	18.8%
Defined contribution	5.1%	5.2%	5.8%	5.9%	6.0%	6.2%	6.5%	6.7%	7.0%
Group Personal Pension	5.6%	5.6%	5.8%	6.1%	5.8%	6.0%	5.9%	6.0%	6.0%
Stakeholder (see note)	5.0%	5.2%	4.3%	4.5%	4.0%	4.1%	4.5%	4.5%	5.0%

Average employee contributions into:									
	2002	2003	2004	2005	2006	2007	2008	2009	Longer term
Defined benefit scheme	4.3%	4.5%	4.9%	5.5%	5.8%	6.1%	6.1%	6.3%	6.5%
Defined contribution	3.4%	3.5%	4.0%	4.1%	4.1%	4.1%	4.2%	4.3%	4.5%
Group Personal Pension	3.6%	3.8%	3.6%	3.8%	4.0%	3.9%	3.7%	3.9%	4.0%
Stakeholder	3.3%	3.5%	3.7%	3.8%	4.1%	4.1%	4.0%	4.0%	4.5%

Average combined employer and employee contributions into:									
	2002	2003	2004	2005	2006	2007	2008	2009	Longer term
Defined benefit scheme	15.8%	17.6%	20.0%	22.0%	26.8%	28.7%	29.1%	29.5%	25.3%
Defined contribution	8.5%	8.7%	9.8%	10.0%	10.1%	10.3%	10.7%	11.0%	11.5%
Group Personal Pension	9.2%	9.4%	9.4%	9.9%	9.8%	9.9%	9.6%	9.9%	10.0%
Stakeholder (see note)	8.3%	8.7%	8.0%	8.3%	8.1%	8.2%	8.5%	8.5%	9.5%

(Source: ACA 2003, 2005, 2007 and 2009 Pension trend surveys. Note: Stakeholder figures exclude nil employer contributions made into 22 per cent of Stakeholder schemes)

Nine out of ten schemes in deficit

Despite the increasing levels of contributions into defined benefit schemes, the survey still found **nine out of ten schemes are in deficit, with an average ongoing funding level at their last actuarial assessment of 79 per cent**, 8 points down on the position reported two-years ago (see *Figure 6*), which may to some degree reflect the adoption of more prudent valuation bases over the period.

Four out of ten schemes reported an ongoing funding level of 85 per cent or below, again an increase, this time of 10 points, in the position of two-years ago.

However, the **deficit recovery periods reported this year did not reveal the same deterioration. Indeed, only 22 per cent of schemes said their anticipated recovery period was in excess of 10-years**,

compared to 29 per cent two-years ago. This suggests the work of the Pensions Regulator has been effective in persuading an increasing number of schemes and their sponsors towards a recovery period of ten-years or less. Whether this position can be maintained over the period ahead will to a large degree depend on the shape of the economic recovery over the next few years and ongoing movements in longevity, investment returns, inflation and interest rates.

Figure 5: Trends in combined employer and member contribution rates

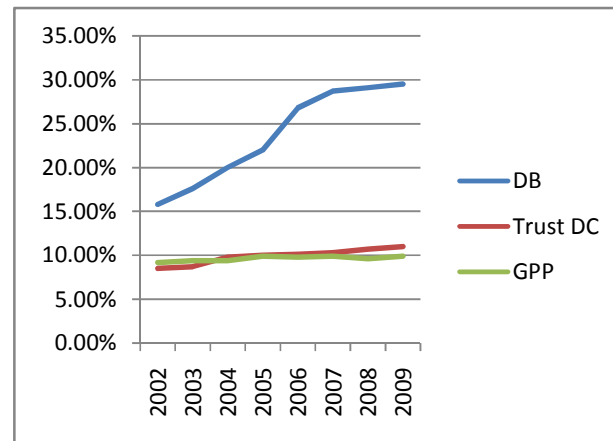


Figure 6: Bands of ongoing funding level as a percentage of liabilities at the last actuarial assessment

Funding Level	Percentage of schemes
+ 100%	8% (14%)
+95 – 100%	10% (9%)
+85 – 95%	39% (44%)
+75% - 85%	29% (23%)
Below 75%	14% (10%)
Average ongoing funding level	79% (87%)

Period over which firms say scheme deficits are expected to be removed?

0 – 5 years	25% (15%)
6 – 10 years	53% (56%)
11 – 15 years	15% (20%)
+15 years	7% (9%)

(Note: Figures in (brackets) are from the ACA's 2007 Pension trends survey)

Employees are uncomfortable with defined contribution risks

"The survey found that employers felt eight out of ten of their employees were not capable of determining how they should manage their defined contribution pension saving"

Despite the move of an increasing percentage of employees into defined contribution arrangements, the survey found widespread concern amongst employers about the outcome of this change.

Some 76 per cent of employers felt their employees were uncomfortable in taking on investment, inflation and longevity risks. An even higher percentage – 81 per cent – feel employees are not capable of determining how they should manage their defined contribution pension saving.

These views echo the results of other commissioned studies into attitudes to risk and undoubtedly help to explain the high use of default funds by defined contribution scheme members; funds that are often quite inappropriate for the members concerned in terms of the risks being taken on by investing in such funds. The results highlight the challenge presented to millions of new pension savers that it is envisaged will join personal accounts from 2012 – all of whom will have to address the risks involved with defined contribution pension saving. We will be addressing in our second report later this month how employers feel personal accounts will sit alongside existing pension arrangements.

Conclusion: design flexibility can preserve defined benefit provision, but action is needed ahead of 2012

At first sight, this year's survey results look to endorse a trend against defined benefit pensions that seems to be running in one direction only. Whilst surely no one can now argue, as the then Pensions Minister did during the passage of the *2008 Pensions Act*, that the defined benefit scheme position 'had stabilised' (and hence glorious inaction was to be defended), it is clear from the survey that there are considerable concerns about the practicalities associated with more and more employees saving in the most obvious alternative - defined contribution arrangements. If, as seems the case, employees simply cannot cope with the risks involved, should we, as a society, be content with allowing a 'disaster in the making' to unfold before us? Whilst the move towards defined contribution is undisputed, this survey shows many employers, who have hitherto offered defined benefit provision as part of their pension strategy, are endeavouring to adapt what remains of that provision to the challenging economic climate of today. But, of course, they are not finding this easy.

Despite the Government's assertions that there is no consensus on new 'middle way' pensions, designed to lower the burdens on employers whilst providing greater stability to the pension platform than is possible through pure defined contribution, this survey has found widespread support for greater freedom in pension designs to achieve that end. It is sad that the present Government has shown so little adventure or commitment to finding ways to help preserve quality provision. The latest tactic seems to be "we will consider help, so long as employers keep defined benefit schemes open". That simply is not good enough. The Government needs to act to free up designs without duress and allow employers to then make the choices best suited to their human resource strategies so they can recruit and retain high quality employees. There seems no reason to believe, if the costs of providing quality pensions can be controlled by practical and sensible policies, they will not make the same forward-thinking decisions they did in the past, when UK workplace provision was widely admired as the best in the world. However, with the vast majority of employers set to review their pension arrangements ahead of the 2012 introduction of auto-enrolment and personal accounts, it is absolutely essential that the new freedoms of design are available ahead of that date, otherwise choices based on existing available options will be made. Inevitably, this will mean more employees exposed to the risks inherent with defined contribution.

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