PENSION SCHEME WIND-UPS SINCE 1997

ESTIMATE OF LIKELY NUMBERS OF PEOPLE AFFECTED AND POTENTIAL COSTS OF GOVERNMENT COMPENSATION

Conclusion:

This paper concludes that up to around <u>42,000</u> people have lost some of their pension rights, when their employer has wound up its defined benefit pension scheme since 1997. It also assumes that the average maximum annual cost to compensate these people and restore their expected pensions should be under £100 million a year on average for up to 60 years.

PLEASE NOTE: These assumptions are deliberately conservative, to show Government that the cost of compensation may not be as frightening as they fear. This paper assumes that three quarters of schemes still winding up since 1997 are being wound up by an insolvent employer. Also, the figures assume full compensation, but if the amount was capped, the cost would be less, so this may be an upper limit estimate.

Methodology:

Part 1 – Estimate of numbers of people affected:

Using figures obtained from the Pension Schemes Registry, I have estimated firstly the number of defined benefit schemes which started winding up since 1997, but have not yet finished and then estimated the number of people not yet retired in these schemes. The Pension Scheme Registry does not give breakdowns between solvent and insolvent employers, so we must make an assumption as to how many have wound up with insolvent employers. From anecdotal evidence of conversations with leading firms of independent trustees, I believe that approximately one quarter of schemes would have a solvent employer who has chosen to voluntarily wind up the scheme. The figure for number of defined benefit schemes winding up is therefore adjusted to assume that three quarters of these had an insolvent employer.

Data:

Figures have been obtained from the Pension Schemes Registry[1] (part of OPRA) and relate to the period from 1997 to end March 2003. The data show the following:

Total approx. number of schemes which finished winding up since 1997   24,000

(approximately 4,500 of these are defined benefit schemes – around 18%)

Total number of schemes which started winding up but not yet
finished, since 1997 – approximately   6,300

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[1] Courtesy of PPI, with grateful thanks.

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Of these 6,300 schemes:

Membership breakdown for all 6,300 schemes still being wound up:

Number of members	Approx. Number of schemes
2-11 4,000	2-12
12-99 1,800	12-100
100-999 500	100-1000
> 1000	40

Total number of members of these 6,300 schemes is approx. 290,000 people.

Of these 6,300 schemes, the data from the Pension Schemes Registry show that around 1,400 are defined benefit schemes (around 22%). If 75% of these have an insolvent employer, this will leave 1050 schemes in line for compensation.

Estimation and assumptions:

Unfortunately, we do not have age breakdown or membership numbers for these 1,050. We have therefore had to make an assumption about numbers. Ultimately, it would be optimal if we can obtain more data from the Pension Schemes Registry.

We assume that the membership distribution is typically higher for defined benefit than for defined contribution schemes, and the assumption is that defined benefit schemes which wind up have approximately 46% more members than defined contribution schemes. This suggests that approximately 30% of the total number of people were in defined benefit arrangements, which would equate to 64,000 people in total – including pensioners, actives and deferred members in the 1050 schemes with insolvent employers.

This gives an estimate of the numbers of people who would potentially be involved in the compensation scheme.

Final estimate of number of members affected:

Conclusion regarding number of people affected:

Estimated figure for numbers of people whose pension
rights may have been affected by wind-up of schemes since 1997   64,000

Part 2: Estimated breakdown of membership of schemes in wind-up between pensioners, actives and deferreds:

Using the suggested total figure of 64,000 members of schemes winding up since 1997 we need to identify how many of these are non-retireds, since it is this group which will have lost most of their pension entitlement.

Anecdotal evidence:

From the few schemes which I have seen detailed data for, the breakdown of members tends to be one third pensioners, one third actives and one third deferreds. However this is not an objective estimate and I wanted to try to verify this in some way.

Data for research estimates:

Figures for membership breakdown are not readily available, without going to each individual scheme. However, I analysed data using a random sample of scheme data from the publication 'Pension Funds and their Advisers'. This analysis is shown in the Appendix. The data from the random sample suggest that 34% pensioners is correct, yet the proportion of deferreds is higher at 36% and actives lower at 30%. In order to ensure the assumptions used in this research are conservative, we have taken a lower percentage for deferreds and higher percentage for actives, which will mean a higher potential cost of compensation. We are comfortable with this, since we are aiming to err on the side of conservatism.

Conclusion for breakdown of scheme membership:

This implies that estimated scheme membership distribution for the schemes which have started winding up since 1997 is as follows:

Breakdown between pensioners, deferred pensioners and actives:

Of these 64,000 people:

22,000 are estimated to be pensioners

20,000 are estimated to be active members

22,000 are estimated to be deferred members

This assumes that schemes in wind-up have, on average, 34% pensioners, 34% deferreds and almost 32% actives.

Part 3. Estimate of average pension entitlements for scheme members

Using figures from the Pension Schemes Registry and National Statistics Pensioners' Income Series, we estimate that the average pension in payment can be assumed as £6,000 per annum. (From 2000/1 Pensioner Income Series, the mean occupational pension income for all pensioners was £6,000 pa and the median figure was £3,380pa)

For recently retired pensioners (i.e. men aged 65-69 and women aged 60-64, the mean occupational pension income was higher at £7,800 pa (and the median was also higher at £5,000 pa).

I have, therefore, assumed that pensioners receive an <u>average</u> income of £6,000 pa from these schemes.

I have then assumed that active members will be entitled to a pension higher than the £7,800 for recently retired people, to cater for the possibility that average pension incomes are on a rising trend. Again, this may well be an overestimate. It is assumed that average pension entitlement will increase to a figure of £8,500. (This may also be an overestimate, if the schemes which have failed are dominated by less well paying industries).

Finally, I have assumed that the average deferred pension entitlement is £3,000 pa (in line with figures from the ASW scheme.) Deferred entitlements are often quite small and this, again, may well be an overestimate.

Conclusion regarding average pension entitlement for members of winding-up schemes:

	Pensioners	Actives	Deferred
Number of members	22,000	20,000	22,000
Average pension entitlement	£6,000	£8,500	£3,000

Part 4: Estimate of potential annual costs of compensation:

Using the figures obtained for numbers of pensioner members, active members and deferreds, together with the estimates of annual pension entitlements for each group, it is then possible to estimate the potential annual cost of compensation for all the schemes.

Assumptions:

It is assumed that there will be sufficient assets in all the schemes to pay pensions as they fall due for the first 10 years. If the annuities are not purchased for the pensioners, then all assets could be pooled in a central fund and pensions paid out on an ongoing basis over time. The savings on costs of buying annuities and costs of administration, should free up significant amounts of money which would be better used to pay the pensions.

It is then assumed that by Year 10, 40% of previous actives and deferreds will have retired, then a further 30% would be retired by year 20 and the final 30% by year 30.

It is also assumed that during Years 10 – 20, some 30% of the current pensioners will have died and by Year 40 that all the current pensioners will have passed away. There will thus be rolling adjustments to the amounts payabale as some people come up for retirement and some of the existing pensioners die. These assumptions are made and the resulting distribution of average costs is shown below:

Estimated annual cost of compensation:

	Pensioners	Former actives	Former deferred
Year 1-10	0	0	0
Year 10 (assume 40% of active/def retire)	£100m	£68m	£27m
Year 20 (assume next 30% retire)	£ 40m	£119m	£46.5m
Year 30 (assume final 30% retire, some died)	£ 10m	£130m	£55m
Year 40 (original pensioners gone)	0	£70m	£25m
Year 50	0	£30m	£10m

Total cost in successive decades, per annum – **before adjustment**:

Year 10 - £195m
Year 20 - £205.5m
Year 30 - £195m
Year 40 - £95m
Year 50 - £40m

Adjustment factors:

 a. Some schemes will still have assets left after Year 10.

These figures then need to be adjusted for funds still remaining in the schemes in Year 10. Many schemes (such as ASW Sheerness) will have sufficient assets to last for 12 or 15 years, rather than only 10.

If we assume that, say 20% of schemes will still have funds in Year 10, the cost in Year 10 will be reduced by around £40m, so the total cost would be £155m.

 b. If compensation is not paid, those who have lost their pensions will need to claim means tested benefits.

The figures need to be adjusted for the offsetting saving to the Exchequer of not supporting these people on means tested benefits.

We assume that, without compensation, these people would have no pension and would, therefore receive means tested benefits. The average annual entitlement to means tested benefit, above the basic state pension is perhaps £2,500 per person (this will cover top-up to the MIG and a little of other means tested benefits, such as housing benefit). This cost must be deducted only from former active and deferred members, since pensioners will receive full pension, even without compensation.

Year 10 – assume total 8,000 former actives, 9,000 former deferreds –
 50% of these on MTB – total amount £10m + £11m = £21m

Year 20 – assume total 14,000 former actives, 15,500 former deferreds –
 50% of these on MTB – total amount £17.5m + £19.5m = £37m

Year 30 – assume total 15,000 former actives, 18,000 former deferreds –
 60% of these on MTB – total amount £22.5m + £27m = £49.5m

Year 40 – assume total 8,000 former actives, 8,000 former deferreds –
 60% of these on MTB – total amount £12m + £12m = £24m

Year 50- assume total 3,500 former actives, 3,300 former deferreds –
 60% of these on MTB = £5.25m + £4.95m = £10.2m

CONCLUSION:
The bottom line!
Final cost estimates suggesting possible cost to Government per annum
Year 0-9 -   zero
Year 10-19: - £155m – £21m = **£144m**
Year 20-29: - £205.5m - £37m = **£168.5m**
Year 30-39: - £195m - £49.5m = **£145.5m**
Year 40-49: - £95m - £24m = **£71m**
Year 50-59: £40m – 38.5m = **£29.8m**
Over a total period of 60 years, this would equate to an average annual cost of £93million.

Appendix: RANDOM SAMPLE OF SCHEMES TO VERIFY ASSUMPTIONS OF MEMBERSHIP BREAKDOWN:

In order to verify the estimates of average pension in payment used for the calculations in this paper and assumed breakdown of membership between pensioners, actives and deferreds, a random sample of scheme date was analysed.

Random Sample of Pension Schemes – 25 Schemes selected at random from 'Pension Funds and their Advisers' 2003. The information relates to the latest available reported information.

Name of scheme	Average pension approx payment (£'000 pa)	Total Members	pensioners %	actives %	deferd %
AAH	5	1225	49	5	46
Avon Rubber	3	5835	51	18	31
Bradford and Sons	4.5	634	21	54	25
Chubb	10	30346	47	7	46
Cmnwlth Graves	5	842	53	32	15
Deloitte	6	2258	19	25	56
EMI	4	26107	41	6	53
EEF	10	1070	36	44	20
George Fisher	0.8	624	34	35	31
Gillette	5	5474	36	27	37
Halcrow	12	3393	17	48	35
Harland/Wolff	3	5130	47	10	43
Kalamazoo	4.5	2139	41	9	52
Kellogg	5.5	19102	19	33	48
Mars	10	23500	26	21	53
Medway Ports	4	570	38	34	28
Pochin	7.5	256	25	40	35
Safeway	7	89126	15	52	33
Smith & Neph	3	9493	40	21	39
Sulzer	5	2041	30	41	29
Totalfinaelf	6.5	2955	47	20	33
VT Group	2.5	2505	37	30	33
Wella	7	903	23	43	34
Wilkinson Sword	3	3077	56	10	34
Wyman Gordon	11	417	10	79	11
AVERAGE	6	9500	34	30	36

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