

## FEATURE

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# The Occupational Pension Schemes Survey 2006

## SUMMARY

This article presents findings on the number of occupational pension schemes in 2006, their membership and contributions to schemes by employers and employees. It is based on the Occupational Pension Schemes Annual Report (2006 edition). The findings distinguish between public and private sector schemes and include breakdowns by scheme status (open, closed, frozen or winding up), by benefit structure (defined benefit and defined contribution) and by size band. The 2006 results are compared with the findings of earlier occupational pension scheme surveys carried out by the Government Actuary's Department.

This article presents the results of the most recent survey of occupational pension schemes, which was run for the first time by the Office for National Statistics (ONS) in 2006 after it took over the role from the Government Actuary's Department (GAD) in 2005. The aim of the survey is to provide a picture of occupational pension scheme provision in the UK. It does not cover personal (including stakeholder) pensions, whether individual or group personal pensions.

The sample for the Occupational Pension Scheme Survey (OPSS) was selected at random from the list of pension schemes held by the Pensions Regulator as of July 2006. In the private sector, the sample was stratified according to the number of members in a scheme, and higher sampling fractions were used for schemes in larger size bands. In the public sector, the number of schemes was far smaller than in the private sector, so all public sector schemes were included in the survey. The quality of the responses in the completed questionnaires was good, and strong response rates (79 per cent for private sector and 91 per cent for public sector schemes) contributed to the overall reliability of the survey results. Private sector schemes in the

lowest size band (fewer than 12 members) had greater uncertainty due to a relatively small sample and lower response rates. These schemes account for 79 per cent of total scheme numbers but less than 1 per cent of scheme membership.

## The policy context

In recent years, with people living longer, there has been growing concern about the capacity of the pension system to provide adequate pensions in retirement. The UK has relatively modest state pension provision by international standards, but traditionally this has been balanced by strong private pension provision. Since the Second World War, the most important component of private pension provision has been occupational pension schemes, which have been documented by the OPSS since 1953.

Most occupational schemes established in the 1950s and 1960s were 'defined benefit' schemes. The employer uses employer and employee contributions to build up a fund out of which the employee's pension will be paid on retirement. The employee's pension entitlement is unaffected by changes in the value of the fund, except in the case where the fund becomes too small to meet the

### Box 1

#### Occupational pension schemes

An occupational pension scheme is an arrangement (other than accident or permanent health insurance) organised by an employer, or on behalf of a group of employers, to provide benefits for employees on their retirement and for their dependants on their death.

**Box 2****Defined benefit and defined contribution**

The benefit structure of an occupational pension scheme may be 'defined benefit' or 'defined contribution':

- defined benefit schemes are those in which the rules specify the rate of benefits to be paid. The most common defined benefit scheme is a salary-related scheme in which the benefits are based on the number of years of pensionable service, the accrual rate and either final salary, the average of selected years' salaries or the best year's salary within a specified period before retirement
- a defined contribution scheme is one in which the benefits are determined by the contributions paid into the scheme, the investment return on those contributions, and the type of annuity purchased on retirement. Defined contribution schemes are also known as money purchase schemes
- some schemes offer benefits to one group of members on a defined benefit basis and another group of members on a defined contribution basis. In the survey, where a scheme had more than one section, each section was classified separately as either defined benefit or defined contribution, according to the benefits it offered

**Box 3****Scheme status**

The status of an occupational pension scheme may be open, closed, frozen or winding up:

- an open scheme admits new members
- a closed scheme does not admit new members but may continue to receive contributions from, or on behalf of, existing members who continue to accrue pension rights
- in a frozen scheme, benefits continue to be payable to existing members but no new members are admitted, and no further benefits accrue to existing members. Members can make no more contributions but further employer contributions may be made
- a scheme that is winding up is in the process of termination, either by buying annuities for the beneficiaries or by transferring assets and liabilities to another scheme

scheme liabilities. It is the employer who bears the full risk of market volatility.

In recent years, defined benefit schemes have become increasingly unpopular with private sector employers because they tend to be associated with high employer contributions, and they involve considerable investment risk. If the market underperforms against expectations, the scheme develops a deficit which has to be met with additional employer contributions. As life expectancy rises, pensions have to be paid out for longer and financial pressures increase. These concerns have led to many closures of defined benefit schemes and the growing popularity of defined contribution schemes. In defined contribution schemes, the only predictable element for the employee is the contributions made into the scheme: the individual's pension depends on investment performance. Thus, the employee bears the full risk of market volatility.

The OPSS provides evidence of the

decline of defined benefit schemes in the private sector. It also shows that regular contribution rates are lower for defined contribution than for defined benefit schemes. In 2004, the Pensions Commission pointed out that closures of defined benefit schemes and their replacement with defined contribution schemes with lower contribution rates could lead to a significant fall in the pension savings/GDP ratio.

The OPSS shows that total membership of private sector occupational pension schemes has fallen rapidly in recent years. Employees may choose not to join available defined contribution schemes because of the relatively low employer contribution rates (high rates are an important incentive to join) and high levels of individual investment risk. Automatic enrolment is less common for defined contribution schemes than for defined benefit schemes, as the OPSS results show, so most employees have to make a decision to opt in. As noted in the Pension Commission's

First Report, there is a high degree of inertia with regards to financial decision making, especially so for pensions. Therefore, schemes with an opt-in policy are likely to have lower participation rates than schemes with automatic enrolment.

As a result of concerns about pension adequacy and coverage explored by the Pensions Commission in their 2004 and 2005 reports, the Government has introduced a number of reforms. The Pensions Act 2007 and a pensions bill introduced into Parliament in December 2007 aim to introduce a new type of occupational pension scheme known as the 'personal accounts scheme'. Personal accounts will be a defined contribution scheme for those aged over 22 and earning above £5,000 per year. Employers will have to enrol all eligible employees into a personal account scheme or an alternative occupational pension scheme and contribute a minimum of 3 per cent (on a band of earnings) to employees' pensions. Employees will contribute 4 per cent and will receive around 1 per cent from the Government in the form of tax relief. Employees will be enrolled automatically, but will be able to opt out if they actively decide to do so.

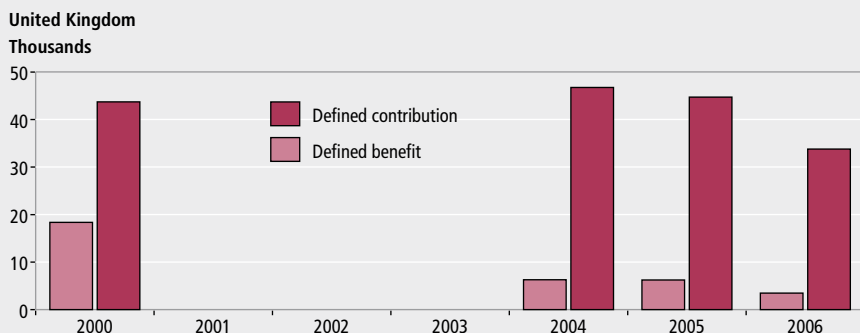
According to the Department for Work and Pensions, personal accounts are designed to address the problem of undersaving for retirement by around 7 million people in the UK. The automatic enrolment and minimum employer contribution features should help to attract new members into occupational pension schemes. For ONS, a key challenge will be to adapt the OPSS methodology, and that of other surveys, to monitor the impact of the new system of personal accounts and of automatic enrolment.

**Scheme numbers**

The total number of occupational pension schemes in the UK fell from 105,320 in 2000 to 66,710 in 2006. The number of occupational pension schemes which were open to new members was 37,540 in 2006, 60 per cent of the number open in 2000. In the top two size bands (membership of 5,000 or more), half of all schemes were closed to new members in 2006.

Most large, closed private sector schemes were either defined benefit or multi-section schemes. Over 90 per cent of open single section private sector schemes were defined contribution; most of these were very small schemes. The number of open single section private sector defined benefit schemes has fallen sharply in recent years, from 18,350

**Figure 1**  
**Number of open single section private sector occupational pension schemes<sup>1</sup>**



**Note:**

1 There were no surveys in 2001 to 2003.

Source: Occupational Pension Schemes Survey 2006, Office for National Statistics

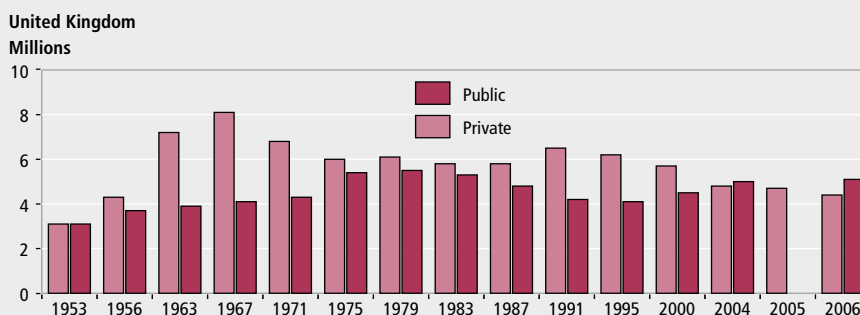
**Box 4**

**Membership types**

Occupational pension schemes can have three types of members:

- active members – current employees who would normally contribute (or have contributions made on their behalf) to the pension scheme
- pensioner members – those currently receiving pension payments from the scheme; this category excludes pensioners who have had annuities bought in their own name
- deferred members – former employees who have preserved their pension entitlements within a scheme but are not yet receiving pension payments. This category includes widows and widowers, dependants, and former spouses who have gained rights following divorce

**Figure 2**  
**Number of active members of occupational pension schemes<sup>1,2,3</sup>**



**Notes:**

1 The 2005 survey did not cover public sector.

2 Excludes frozen schemes.

3 Due to changes in the definition of the private and public sectors, estimates for 2000 onwards differ from earlier years. From 2000, organisations such as the Post Office and the BBC were reclassified from the public to the private sector.

Source: Occupational Pension Schemes Survey 2006, Office for National Statistics

in 2000 to 3,470 in 2006 (Figure 1).

Since 2000, there has been little change in the total number of public sector schemes (310 in 2006), but a big increase in numbers of closed public sector schemes. The number of open public sector schemes fell from 250 in 2000 to 130 in 2006, while closed schemes rose from 36 in 2000 to 110 in 2006.

**Scheme membership**

In 2006, 16.6 million members belonged to private sector and 10.9 million to public sector schemes. After a marked increase in the number of active members (current employees) between 1953 and 1967, there has been a steady decline. In 2006, there were an estimated 9.6 million active

members, of whom 4.4 million were in the private sector, compared with 6.5 million in 1991 and 8.1 million at the peak in 1967 (Figure 2). Over the last 15 years, the decline in private sector active membership reflects a fall in active membership of defined benefit schemes, from 5.6 million in 1991 to 3.3 million in 2006.

In 2006, most active members of public sector defined benefit and private sector defined contribution schemes were in open schemes, but under half of the active members of private sector defined benefit schemes were in open schemes.

Schemes are not permitted to make membership compulsory, but it is possible for any scheme to make all new employees members of their pension scheme (automatic enrolment), provided that the employees are given the right to opt out of the scheme. The proportion of active members belonging to private sector defined benefit schemes which automatically enrol all new employees increased from 47 per cent in 2004 to 61 per cent in 2006, but there has been little change in the proportion of active members belonging to private sector defined contribution schemes which automatically enrol all new employees (28 per cent in 2006).

In contrast with the private sector, active membership of public sector schemes rose from 4.2 million in 1991 to 5.1 million in 2006, despite the reclassification of some large public sector schemes to the private sector from 2000. This is largely due to the increase in public sector employment over this period, which would – all other things being equal – lead to an increase in active membership of pension schemes. Public sector schemes provide relatively strong incentives to join as they are predominantly defined benefit, with relatively high employer contributions; they also have high levels of automatic enrolment.

The number of deferred members rose from 2.8 million in 1983 to 9.4 million in 2006. After increasing in every survey from 1953 to 1995, the number of pensions in payment has stabilised in recent years; the estimated total number in 2006 was 8.5 million.

**Contributions to schemes**

Generally, both members and employers make regular contributions to pension schemes. The OPSS results are for regular contributions; they do not include special contributions, for instance to cover a deficit. The 2006 OPSS found that almost all employers made regular contributions, but

**Box 5****Contracting out**

Contracting out refers to the statutory arrangement under which schemes that meet certain conditions may contract out of the additional component of the state pension, S2P, previously the State Earnings Related Pension Scheme. Members' and employers' National Insurance contributions are reduced or partially rebated for contracted out schemes. Members of a contracted out pension scheme obtain rights in the pension scheme in place of additional earnings related benefits under the state scheme.

**Table 1****Weighted average contribution rates for private sector occupational pension schemes: by benefit type, contributor and status,<sup>1,2</sup>**

United Kingdom	Percentages					
	Member		Employer		Total	
	Open	Closed	Open	Closed	Open	Closed
Defined benefit						
2004	4.6	3.9	12.1	17.1	16.8	21.0
2005	4.9	3.6	13.9	18.8	18.8	22.4
2006	4.9	4.5	14.2	15.0	19.2	19.5
Defined contribution						
2004	2.9	3.1	6.2	4.2	9.1	7.3
2005	2.7	2.6	6.0	8.0	8.7	10.6
2006	3.0	2.5	5.8	5.4	8.9	7.8

**Notes:**

1 Includes schemes with zero contributions.

2 Schemes with 12 or more members.

Source: Occupational Pension Schemes Survey 2006, Office for National Statistics

15 per cent of members of defined benefit schemes and 13 per cent of members of defined contribution schemes did not make regular contributions.

The 2006 OPSS examined contribution rates to schemes with 12 or more members that were either open or closed. One clear difference between private sector defined benefit and defined contribution schemes in 2006 was that contribution rates to defined benefit schemes were considerably higher than to defined contribution schemes (Table 1). However, it should be noted that the majority of defined contribution schemes are not contracted out of the State Second Pension (S2P) and are therefore making higher National Insurance contributions than for defined benefit schemes, which are mainly contracted out of the S2P. In addition, defined benefit schemes tend to offer better benefits, such as ill-health retirement or pensions to dependants, which are usually funded by higher contribution rates.

The OPSS 2006 provides evidence that the gap between contributions to defined benefit and defined contribution schemes has widened. Between 2004 and 2006, member plus employer contribution rates to open private sector defined benefit schemes increased from 16.8 per cent to 19.2 per cent; there was little change for open private

sector defined contribution schemes.

**Conclusion**

The 2006 OPSS found that the number of occupational pension schemes continues to fall, as does membership of private sector schemes. Over the last 15 years, the decline in private sector membership reflects a fall in membership of defined benefit schemes, as closures of such schemes continue. Meanwhile, contribution rates to private sector defined contribution schemes remain low compared with rates for defined benefit schemes and relatively few defined contribution schemes practice automatic enrolment.

The OPSS findings reinforce concerns about pension adequacy and coverage highlighted by the Pensions Commission, which have given added impetus to the Government's drive on pensions reform. For ONS, the pensions legislation establishing the system of 'personal accounts' creates challenges. The OPSS methodology will need to evolve to document this new occupational pension scheme.

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