

Evolution of Pensioners' Income from Defined Benefit schemes

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Background and data considerations

This note looks at the evolution of the average payment to pensioners from Defined Benefit schemes between years 2007-2060.

The analysis was conducted using a DWP modelling tool called Pensim2. Pensim2 is a dynamic microsimulation model based on a sample of synthetic individuals, representative of the characteristics of the British population, and as such results will be subject to sampling error and stochastic variation. As with all modelled results outcomes are also sensitive to the assumptions made. Pensim2 is aligned to common modelling assumptions made across Government e.g. on inflation, earnings growth and fund returns on investments etc. Economic assumptions originate from the Office for Budget Responsibility. If any of these assumptions changed, results would be affected to a greater or lesser degree.

Using Pensim2, we modelled payments to pensioners from Defined Benefit schemes¹. Defined Benefit payments depend on the number of years that an individual contributed to a Defined Benefit scheme and their earnings during those years. Trends in employment rates are aligned to the Office for Budget Responsibility's cohort model; earnings are estimated from the British Household Panel Survey and are updated using average earnings assumptions provided by the Office for Budget Responsibility; enrolment rates to Defined Benefit schemes are derived from assumptions estimated using the Occupational Pension Scheme Survey (OPSS) and internal DWP modelling.

The payments from Defined Benefit schemes have been deflated to 2012 using the Average Earnings Index. Based on extrapolated trends of private sector Defined Benefit membership of open schemes, it is assumed within Pensim2 that there are no new entrants to private sector Defined Benefit schemes after 2018. This is largely consistent with GAD's assumption for DWP modelling that there will be only a very small stock of private sector workers contracted out of Defined Benefit schemes by 2018 with virtually no contracted-out DB provision remaining in the private sector by the 2030s.

The version of Pensim2 used was version 13.01, and for individuals aged at least State Pension Age in Great Britain. The model does not include changes to account for recently announced public sector pension reforms. The volumes and amounts reported in this note were obtained from the modelling tool even for past years (2007-2011); they do not refer to *actual* volumes or amounts.

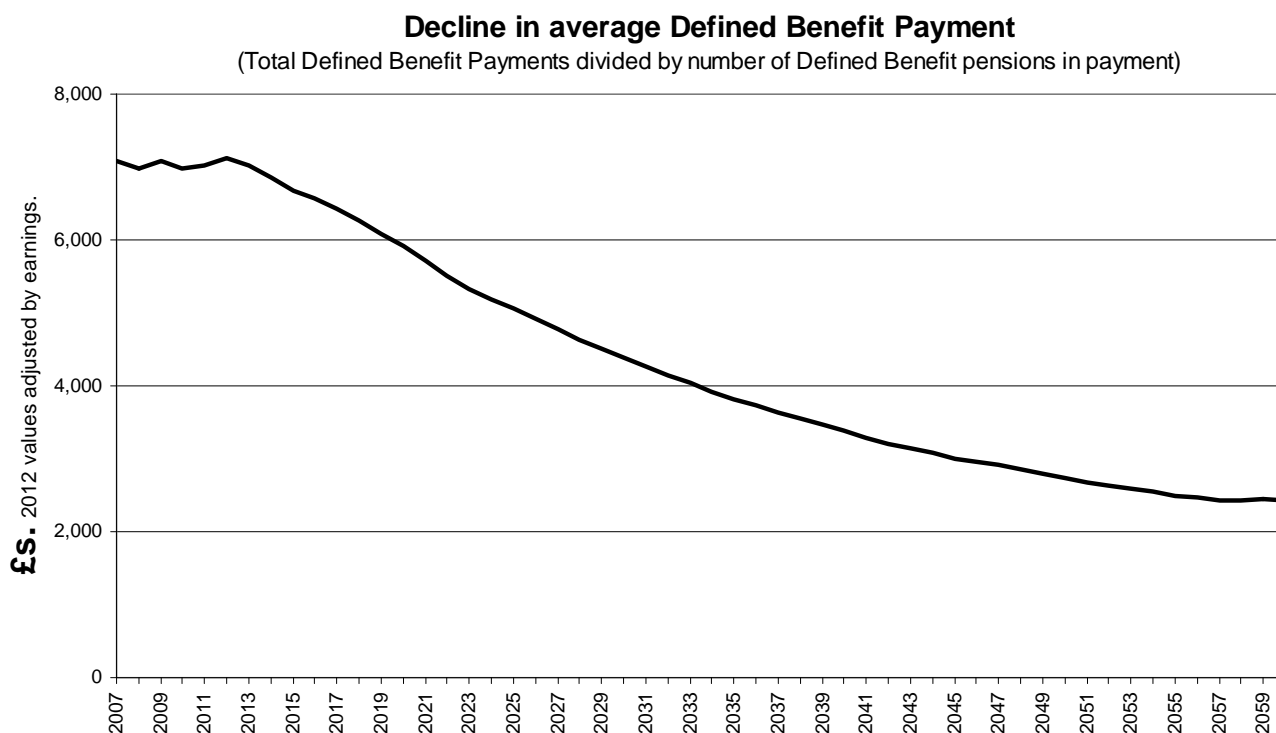
¹ An introduction to and more details about Defined Benefit schemes can be found on the Directgov website. In particular:
http://www.direct.gov.uk/en/Pensionsandretirementplanning/Companyandpersonalpensions/WorkplacePensions/DG_200768

Results

The outcomes shown are heavily based on accruals of Defined Benefit pension rights to date and show how the closure of schemes will reduce reliance on Defined Benefit pensions. Nevertheless it is worth reiterating the degree of uncertainty that surround projections based on modelling tools like the one used here. The amounts presented in the graph below should not be taken as a precise or certain forecast; they only constitute projection based on a series of assumptions and stochastic factors.

Chart 1 shows the average payment from Defined Benefit pension schemes peaks in 2012 and is expected to fall substantially from then onwards.

Chart 1: Decline in average income from Defined Benefit schemes across Defined Benefit recipients²



Source: DWP modelling using Pensim2

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² Includes 'own' and 'inherited' Defined Benefit pensions.