NAPF
Securing the future of pensions

All Change!

Case studies from the changing world of occupational pensions

May 2007

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Executive Summary

Over the last 10 years, rising longevity, falling inflation and increased regulation have subjected occupational pension provision to immense pressure. Faced with these challenges, scheme sponsors have opted for a wide variety of reform solutions: reducing the cost of their defined benefit schemes, creating new hybrid solutions, or switching to a defined contribution arrangement.

In some cases these changes have only been for new employees, while in others for all employees, both existing and new. Typical changes include: increasing member contributions; raising the Normal Pension Age; reducing accrual rates; reducing pensionable earnings and narrowing the opportunities for early retirement.

However, the task of scheme sponsors has not been made easier by the current constraints of the regulatory environment. This has, in some cases, led to more radical scheme changes than would otherwise have been the case. Unlike other elements of the remuneration package, employers do not have a free hand when it comes to pension provision. This impedes the ability of scheme sponsors to adapt their pension to today's needs. The Government's Deregulatory Review offers an important opportunity to support and nurture the UK's occupational pension provision.

This report provides details of the changes made over the last decade to a range of different schemes: BAE Systems, Marks & Spencer, The Church of England, British Airways, Co-operative Group, Barclays and Renishaw. The analysis highlights some of the trends common to occupational pension provision in recent years. Employers have sought to limit their risks and stabilise costs. Importantly, they have also demonstrated a willingness to go on providing a good pension for their workforce, including for their new recruits. However, very often, the current regulatory environment has pushed them into providing two different schemes – each with different costs and risks – for their new staff as compared to their existing employees. Different employers have come up with different solutions.

The picture that emerges is one of change. Yet there are some constants. Employers have remained committed to good pension provision. But the design of regulation has forced them to adopt solutions that have some shortcomings, such as offering different pensions for existing and new employees and passing more risk on to employees than would otherwise have been the case. A more logical regime would have allowed them to amend their existing provision in the round. Nevertheless, the commitment to good pension provision shown by employers should encourage the Government to take decisive action as it considers how to take forward its Deregulatory Review.

1. The Changing World of Occupational Pensions

The last decade has seen unprecedented changes in the world of occupational pension provision. It is a story of increased costs brought about in large measure by low inflation and improving mortality (a man reaching the age of 65 today can on average expect to live for a further 20 years, compared with 14 years in 1981), combined with increasing sponsors' risk exposure and an increasingly costly regulatory burden. The Pensions Commission concluded that the combined effect of these changes doubled the long-term costs of a typical final salary pension, taking it from 10-14% when many schemes were introduced to 22-26% by 2004.

This pressured backdrop for occupational provision has translated itself into all-too-familiar headlines: the "funding crisis" and scheme closures. And faced with funding pressures, many employers have sought to re-evaluate their pension arrangements. For some, this has resulted in scheme closure. But other employers have sought to maintain their provision and commitment to good workplace schemes, albeit in a somewhat different form.

Using case studies from a range of scheme sponsors, this report explains some of the ways in which occupational pension schemes have evolved over recent years. Whilst it finds that each scheme described faced different challenges, and opted for a mix of solutions reflecting the needs of the scheme sponsor and its employees, this report finds some common approaches emerging:

- **Reducing the cost of defined benefit (DB) provision**: increasing Normal Pension Age, increasing employee contributions, reducing accrual rates, changing early retirement rules, and altering pensionable earnings.

- **Moving to a hybrid design:** usually involving a core level of defined benefit provision with the option for additional defined contribution saving on top but cash balance schemes are also popular.

- **Switching to defined contribution (DC):** providing a defined contribution pension, generally, to new employees, to limit the risks, but not necessarily the generosity of the pension.

This report is not a good practice guide, and the NAPF is not recommending that sponsors emulate the decisions outlined in this report: each option must be considered on its merits and employers will continue to base scheme design – whether DB, DC or hybrid – on their own circumstances. Neither does it argue in favour of one type of provision. It simply describes the actions taken by a number of employers in response to rising costs and liabilities. By publishing this report we hope to encourage a fuller and more informed debate about the future of workplace pension provision in the UK.

2. Modernising provision: cost, risk and regulation

When considering what retirement benefits to offer, scheme sponsors must consider how much cost they are prepared to meet and the degree of risk they are prepared to bear. Although these decisions are closely linked, the concepts are distinct.

Defined benefit pensions, while providing certainty for employees and a good method of recruiting and retaining staff, present a wide range of risks to the sponsor. These include:

- lower than expected investment returns;
- the possibility of higher costs if life expectancy increases;
- unexpected changes to inflation; and
- changes to the legislative or regulatory environment.

These risks manifest themselves as potential extra costs for defined benefit scheme sponsors. But these risks are not easily controlled. For example, employers have no control over the regulatory changes that can fundamentally alter the costs and risk profile of the scheme for the sponsor. The decision on 10 June 2003 to require solvent employers to meet the full buy-out cost of winding-up their scheme is an example of this. This, along with other decisions such as the introduction of scheme specific funding rules, have together altered the original "best endeavours" promise to one that is almost fully guaranteed.

The uncertainty surrounding these risks and costs of pension provision has led many employers to review their pension arrangements.

And employers that choose to offer a scheme do not have a free hand when it comes to its design. Legislation restricts the extent to which benefits formulae can be altered. For example, the Pensions Acts of 1995 and 2004 require pensions in payment to be increased in line with inflation (which can be capped at 5% for accruals between 1997 and 2005 and at 2.5% for accruals being made today). Generally, changes can only be made to future and not past pension rights and under Section 67 of the Pensions Act 1995, employers are prohibited from changing members' accrued rights without the consent of each individual member.

One consequence of the regulatory regime is that there are limits to the extent that scheme sponsors can share any rebalancing of costs. As a result, any cost savings tend to fall on current employees rather than on those who have gone to work for another employer. As the NAPF's 2006 Annual Survey shows, this is important because only around a fifth of scheme members currently work for the scheme sponsor, while as many as half are deferred members, that is to say they have left the employer, probably to work somewhere else, but are not yet drawing a pension.

The employers described in this report have managed to make changes to their schemes working within the current framework. But this is cumbersome, does not allow sponsors to tackle scheme changes in the way that many would wish, and is not applicable to all schemes (for example, those with restrictive trust deeds and rules).

As part of its pensions reform programme, the Government has announced a Deregulatory Review which has the aim of reducing the cost of running occupational pension schemes.

"We are launching a de-regulatory review of pensions regulation…. It may be possible to remove, merge, or simplify the many layers of legal requirements…. [These] reforms could have the scope to make a significant difference to the costs of running occupational pension schemes."
Security in Retirement White Paper, May 2006

The NAPF welcomes and supports this review which is every bit as central to successful pension reform, and a thriving UK workplace pensions sector, as the introduction of Personal Accounts. Whilst not compromising scheme members, the eventual deregulation programme must result in tangible benefits for scheme sponsors that allow greater flexibility for employers to rebalance their risks and costs by removing some of restrictions currently placed on schemes by current legislation.

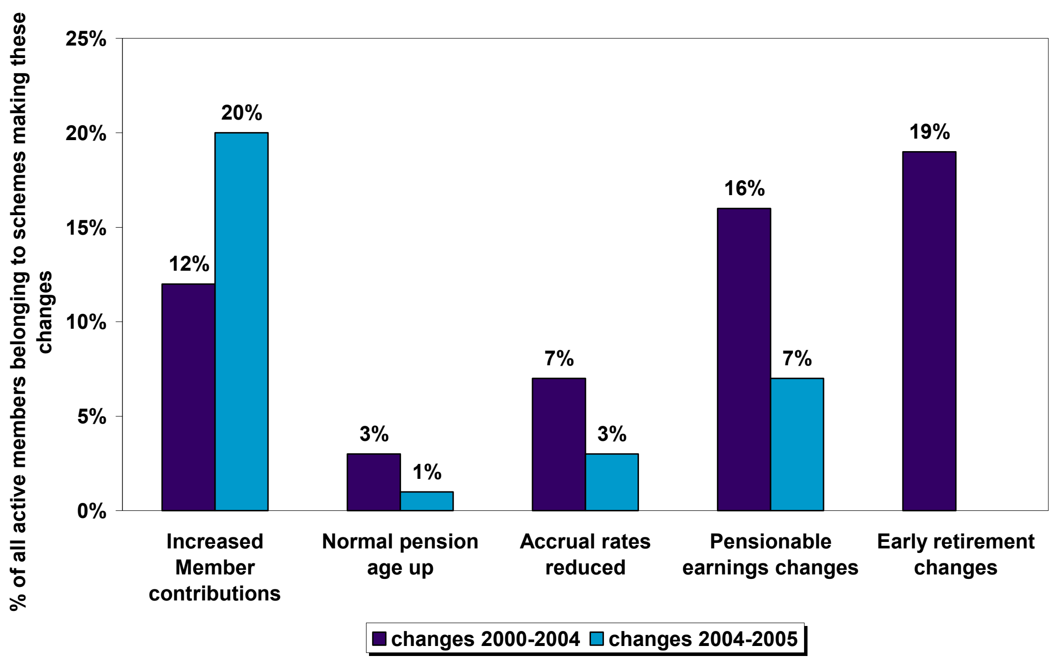
3. Reforming pensions – practice to date

Changing the terms under which employees gain rights to defined benefit pensions is becoming a common "third way" between allowing benefits to be accrued on traditional terms and closing the scheme completely.

Sometimes, these changes have been made by employers wanting to keep their scheme open to both existing and new members. On other occasions, however, the employer has used such changes to maintain a defined benefit scheme for existing members, while offering a different type of pension, usually a defined contribution pension, to new employees.

Before examining the actions of specific employers, it is worth emphasising that these are not isolated examples. Two surveys from the Government Actuary's Department suggest that a significant minority of active members in private sector DB schemes work for employers which have changed the benefit design or increased member contributions in recent years.

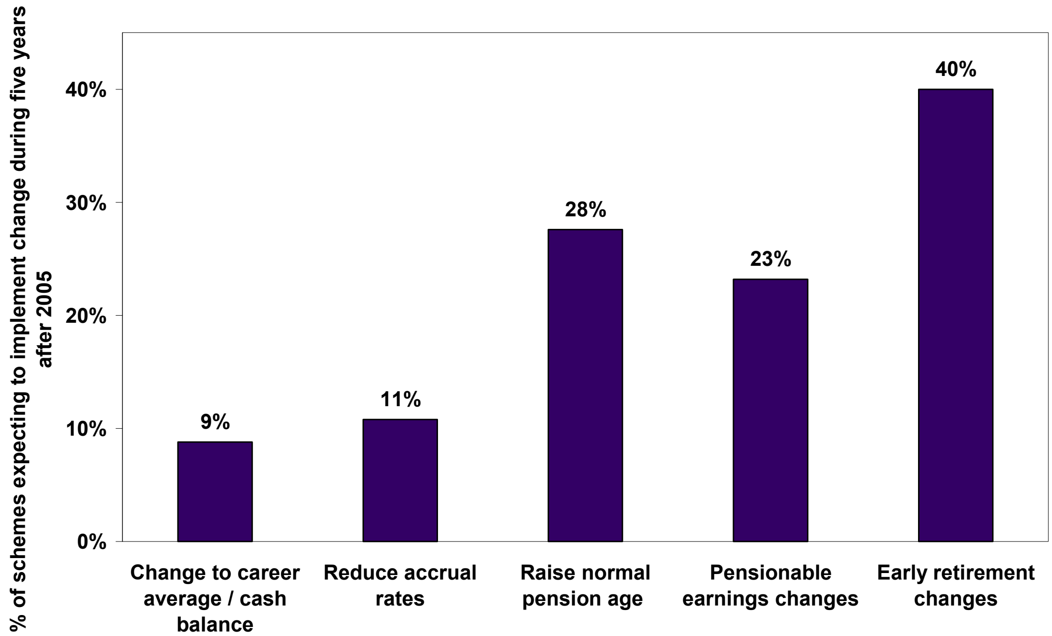
Figure 1: Changes 2000-2005



Source: GAD Surveys 2004 and 2006

The NAPF's 2005 Annual Survey found that further near-term changes were planned, with more than one quarter of private sector respondents expecting to increase Normal Pension Age and one in ten expecting to reduce accrual rates.

Figure 2: Changes anticipated after 2005



4. Case Studies

This section provides an outline of the typical ways in which occupational pension schemes have evolved over the last decade. It covers seven NAPF member schemes:

- BAE Systems
- Marks & Spencer
- The Church of England
- British Airways
- Co-operative Group
- Barclays
- Renishaw

For each scheme, we provide a summary of the main changes to the scheme existing 10 years ago and also details of the new schemes set up to either replace or complement the original provision.[1]

1 Each case study has been based primarily on material in the public domain, including press reports. It has not always been possible to check all of the details with individual pension funds and this document should not be taken as a definitive statement of the employers' positions.

Case Study 1: BAE Systems

BAE Systems is a FTSE100 company which continues to offer an element of defined benefit provision to all employees. A number of steps have been taken to contain the company's costs and to limit the risks to which it is exposed:

- In 2003, BAE Systems closed its defined benefit scheme to new members. New employees (or those who had not yet joined the scheme) were instead offered a hybrid scheme, "100 plus" which provides a contracted-in final salary pension worth 1% of salary for each year of service plus a 2% employer contribution into a defined contribution pension. The total employer contribution to the hybrid scheme is 8% of salary. To qualify for these benefits, employees must contribute 4% of salary. Additional employee contributions may be made to the defined contribution pension.

- Since 2006, members of the old defined benefit pension were allowed to continue accruing benefits provided they agreed to shoulder the risk of unexpected increases in longevity in respect of newly accrued pension rights. Any employee wishing to make up the shortfall in previously expected benefits was given the option to work beyond the Normal Retirement Age of 65, provided work is available. In addition, the basis on which final salary is calculated has been changed from the salary in the final year to the average for the last three years. Other changes included: reducing the indexation attached to newly accrued pension rights (after April 2006 has been capped at 2.5%[2]); increasing employee contributions (gradual rise from 5% to 9.3%); and applying more stringent conditions to the payment of early retirement and ill-health benefits.

Additional information

Relative to its market capitalisation, BAE's pension liabilities are amongst the biggest in the FTSE100. Lane, Clark & Peacock's latest *Accounting for Pensions* study records that BAE's liabilities were 145% of its market capitalisation in 2005, the fifth biggest in the FTSE100. Its FRS17 deficit was 43% of its market capitalisation, the second biggest in the FTSE100 behind British Airways[3].

The decision to reform the defined benefit pension in 2006 followed the 2005 valuation, which changed the assumption about projected life expectancy at 65 (BAE's Normal Retirement Age). The 1999 and 2002 valuations assumed that a member reaching the age of 65 would on average expect to live for a further 16 years. This was increased to 20 years in the 2005 valuation.

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2 The main scheme and the 2000 scheme previously capped indexation at 5% for post-1997 service. The Royal Ordinance Scheme provided full indexation for some benefits and indexation capped at 5% for others.

3 Accounting for Pensions 2006, LCP, August 2006, pages 39-40.

Most strikingly, any *unanticipated* improvements in life expectancy will not increase the company's costs in respect of final salary pension rights accrued after April 2006. Pensions in respect of service during this period will be multiplied by a Longevity Adjustment Factor (LAF). This reduces the pension payable at Normal Pension Age in proportion to any improvements in life expectancy beyond those implied by the mortality tables used by the scheme actuary at the time the LAF was introduced.

If longevity continues to improve faster than forecast, the impact of this change will be felt most heavily by people currently furthest from retirement. The LAF will reduce pensions more sharply and a larger proportion of pensionable service will be subject to the LAF. The LAF will also apply to the defined benefit component of the "100 plus" pension plan offered to new recruits.

The LAF is part of a package of benefit changes which, when capitalised over 20 years, are estimated to reduce the company's UK pension deficit by around £770 million. In addition, a further £466 million reduction in the deficit will be achieved by asking employees to meet a bigger share of the scheme's costs.

Case Study 2: Marks & Spencer

Marks & Spencer is one of the UK's largest retailers. However, faced with rising longevity and stiff competition on the high street, in 2002 it decided to review its pension provision. It made the following changes:

- From 2002, new employees were offered a defined contribution pension in place of a defined benefit pension. Under the new pension, the employer would contribute twice as much as the employee up to a maximum of 12% of salary. If the employee paid in 6%, the employer would pay in 12%. (As staff cannot join the scheme until the end of the first year, the maximum employer contribution in the first year of scheme membership is set at 20% of salary.)

- Members of the final salary scheme (who had all joined before 2002) benefited from the unusually high accrual rate of 1/45th of salary for each year of service until 2007. Going forward, Marks & Spencer have decided to keep their scheme open to existing members. But for future accruals, members must choose from one of three options: to maintain the 1/45th accrual rate but to limit increases in pensionable pay to the rate of inflation (capped at 5%); to maintain the 1/45th accrual rate but begin paying member contributions starting at 2% of salary in the first year gradually rising to 7%; or to reduce the accrual rate to 1/60th but continue paying no contributions and keep all salary increases as pensionable.

Additional information

26,000 employees were still active members of the final salary scheme when the company proposed changes in January 2007[4]. Historically, this scheme replaced a larger proportion of income than most final salary schemes. Members benefited from an accrual rate of 1/45th. In addition, the scheme was non-contributory.

M&S recognise that the three options will work differently for different employees and wish members to have a genuine choice to suit their career and salary profiles.

If members do not return the form specifying which of these options they prefer, the default position is the option which caps pensionable pay increases.

4 The Independent, 24 January 2007

Case Study 3: The Church of England

The Church of England has around 9,500 serving stipendiary clergy. In common with other defined benefit schemes, its costs are rapidly rising as a result of investment returns and increasing longevity. In light of this, it is currently planning to reform its pension arrangements:

- It plans to maintain a defined benefit pension for both current and new clergy. It currently provides a pension of 2/3rds of the "national minimum stipend" after 37 years of service on reaching the Normal Pension Age of 65 years[5]. This typically amounts to a pension of £12,400 per year. It also provides a lump sum payment of three times the annual pension.

- However, from 2008, it is planned to reduce the rate of accrual from 1/37ths to 1/40ths (for future service only) and to reduce the value of indexation of pensions in payment. Until now this has been guaranteed at RPI up to 5%, although discretionary increases in line with stipend increases have historically been paid. Going forward, increases will be at the guaranteed rate and, in respect of benefits arising from service from January 2008, the guarantee will be limited to RPI up to 3.5%.

Additional information

Pensions in respect of service prior to 1998 are financed by the Church Commissioners. Pensions in respect of later service are financed by the Church of England Funded Pensions Scheme. At present, benefit structures are the same in both cases.

Responding to financial pressures on the scheme, the Church established a task force in November 2005 which was charged with producing recommendations for ensuring the scheme was sustainable. Following consideration of the report by the Church's Deployment, Remuneration and Conditions of Service Committee and by the General Synod, the Church has proposed changes to the accrual rate and to the indexation of pensions in payment. Subject to consultation, these changes could apply from January 2008.

5 Senior clergy such as Archbishops, Bishops, Deans and Archdeacons receive a multiple of the full pension for other clergy. As such, the proposed changes will impact on the pensions that senior clergy receive.

Case Study 4: British Airways

British Airways employs around 43,000 people in the UK. Traditionally, the airline had different pension arrangements for ground-based staff and for flying staff.

The company has substantial pension liabilities and sought to limit the risks to which it was exposed by switching to a defined contribution scheme for new entrants in 2003, and by modifying the terms on which existing members of the final salary scheme accrue new benefits from 2007.

- From 2003, new recruits to British Airways have been offered a defined contribution pension, the British Airways Retirement Plan. For most staff, this involves paying a 5% employee contribution and benefiting from a 7% employer contribution, though individuals have the option to forgo part of the employer contribution and to pay a lower employee contribution (e.g., they can pay 4% and receive 6% from the employer). To ensure high participation and contribution rates, British Airways adopted auto-enrolment at a default employee contribution level that attracts the maximum employer matching contribution. This had impressive results. By 2006, the opt-out rate was only 8% and just 2% of members opted to pay in less than the default level.

- British Airways continues to provide a defined benefit scheme for employees who joined the company prior to April 2003. However, in early 2007, it was agreed to reform the pension by: increasing Normal Pension Age, which had traditionally been 60 for some employees and 55 for others, to 65; reducing accrual rates, which had been 1/52nd for some employees and 1/56th for others, to 1/60th; and keeping employee contributions at about the same level as before the reform, while allowing employees to qualify for a lower Normal Pension Age or improved accrual rates by paying higher contributions.

Additional information

Even after the defined benefit scheme had been closed to new employees from 2003, the company's pension liabilities remained a major concern to the board of directors. BA's pension liabilities were more than four times its market capitalisation in 2005 – the biggest ratio in the FTSE 100[6]. By February 2007, BA had reached agreement with trustees and some trade unions on a package of reforms that would apply from April 2007.

The reforms apply to the final salary section of the New Airways Pension Scheme (NAPS), which was created for staff joining from 1984, shortly prior to the airline's privatisation. (At the time, existing members of staff could choose whether to transfer into the NAPS from the old Airways Pension Scheme. Around half chose to do this.) Key elements of the reform package are:

- For pilots and cabin crew, the Normal Pension Age will rise from 55 to 65. For ground staff, the Normal Pension Age will rise from 60 to 65.

6 Lane, Clark and Peacock, Accounting for Pensions 2006

- Accrual rates are being reduced to 1/60th of pensionable pay for each year of service[7]. Previously, they were 1/52nd for flying staff and 1/56th for ground staff.

- Future rises in pensionable pay are being capped at the rate of inflation.

While default employee contributions have been set at 5.25% of pensionable pay, members can elect to pay higher contributions in return for a lower Normal Pension Age. The options are:

- Normal Pension Age of 65 with a 5.25% member contribution (the default position).

- Normal Pension Age of 60 with an 8.5% member contribution.

- Normal Pension Age of 55 with a 17.5% member contribution[8].

In addition, members can elect to pay higher contributions in return for a more favourable accrual rate. Employees who contribute an additional 3% (above the 5.25% default rate) but keep their Normal Pension Age at 65 can accrue 1/56th of their final pensionable earnings for each year of service. Employees who contribute an additional 6% (above the 5.25% default rate) can accrue 1/52nd of final pensionable earnings for each year of service.

These options can be combined, allowing employees who are prepared to pay significant additional contributions to benefit both from an improved accrual rate and from a lower Normal Pension Age.

In common with some of the other employers considered in this report, BA had originally proposed that increases in pensions in payment be capped at 2.5% rather than 5%. Following discussions with members' representatives, the company decided not to proceed with this part of the reform package.

7 Pensionable pay can be either basic pay minus 1.5 times the full Basic State Pension or gross pay minus 15%.

8 AFX News, 7 February 2007

Case Study 5: Co-operative Group

The Co-operative Group recently switched from final salary provision to a career average scheme both for new employees and existing members of its defined benefit schemes.

- From April 2006 all employees, existing and new, have been offered a career average scheme. In return for a 6% employee contribution, members of the new Pension Average Career Earnings (PACE) scheme receive 1/60th of pensionable earnings for each year of service. Each year's salary is revalued in line with inflation, capped at 5%. Employer contributions are expected to be at least 16% of salary until the next scheme valuation. The scheme is contracted out of the State Second Pension and also provides ill-health and dependants' benefits.

- Pension rights accrued before then will continue to be based on the employee's final salary at the time they leave the company, rather than on their salary at the time the scheme career average.

Additional information

On A-Day, the Co-operative Group merged its three principal pension schemes – the Group scheme, the Bank scheme and the CIS scheme. All three provided a pension worth 1/60th of final salary for each year of service.

At the time of the merger, these schemes had more than 19,000 active members between them[9]. Unlike many employers, the Co-op felt it important to provide defined benefit pensions available on the same terms to new and existing staff.

Faced with rising pension costs, the Co-op considered simply closing the final salary scheme to new members but concluded that it did not wish to create a two-tier workforce in respect of pension arrangements. Moreover, owing to the rate of staff turnover amongst members of its final salary schemes, the Co-op estimated that it would take around 15 years before the savings from simply closing the scheme to new entrants would have a full impact on its balance sheet.

There is no change to the Normal Pension Age, which remains at 65. However, the facility to take an unreduced pension at an earlier age has been withdrawn in respect of accruals after April 2006. Rights built up in the three final salary schemes before that date will be subject to no early retirement reduction where the member retires at 60.

9 10,700 were in the Group scheme, 3,600 in the Bank scheme and 4,800 in the CIS scheme (PACE Annual Report, September 2006).

Case Study 6: Barclays

After initially switching from final salary to defined contribution provision for new employees in 1997, Barclays subsequently decided to alter this offering to a cash balance pension plan, with an additional matching defined contribution element.

- Employees that joined Barclays before 1997 are accruing rights in a 1/60th non-contributory final salary pension. This scheme accounts for the bulk of the bank's pension assets and liabilities, but today less than 50% of active staff in the UK are members of the final salary scheme.
- For employees joining after 1997, Barclays first offered a defined contribution scheme. This provided a minimum employer contribution of 5% and employees could potentially gain from matching employer contributions worth a further 6%. However, only 40% of members chose to make any employee contributions so the expected pension was much lower than Barclays had intended.
- To deal with this problem, in 2003, Barclays converted the defined contribution pension into a cash balance scheme - "Afterwork". In return for a mandatory 3% contribution, Barclays promises employees a cash sum at retirement of 20% of salary (revalued annually in line with inflation up to 5% plus a further discretionary investment uplift of up to 2%). This part of the Afterwork plan is the Credit Account. Barclays will also match employees' contributions into a range of investment options pound-for-pound, up to a further 3% of salary. This is the Investment account. By mid-2004, 71% of members were making additional contributions[10]. On retirement, the money in both the Credit Account and the Investment Account is used to buy an annuity.

Additional information

In making its decision to adopt the new Afterwork cash balance scheme, stochastic analysis carried out by Watson Wyatt convinced Barclays that it could commit to smoothing investment returns in this way without exposing itself to imprudent levels of risk[11]. On retirement, the money in the Credit Account is used to buy an annuity. Because the only defined benefit is a capital sum at retirement, unanticipated improvements in life expectancy do not increase costs to the company in respect of the Afterwork plan. The bank provides preferential annuity rates within the fund.

10 Sunday Telegraph, 13 June 2004

11 Watson Wyatt website

Case Study 7: Renishaw

Renishaw is a precision engineering company based at Wotton-Under-Edge in Gloucestershire. It employs around 1,500 people in the UK. In 2006, it decided to reduce the risks to which the company was exposed by its defined benefit scheme.

- Until 2006, Renishaw had a defined benefit scheme that was open to new members of staff. Under this arrangement, employees paying a 4% contribution would accrue $1/80^{th}$ of final salary for each year of service. If they chose to pay a 6% employee contribution, they could instead accrue $1/60^{th}$ of final salary for each year of service.

- The final salary scheme was closed to new entrants from July 2006 and to future accruals by existing members from April 2007. Instead, all employees will in future accrue pension rights in a defined contribution scheme. In order to join the scheme, and receive a company contribution of 11%, employees must contribute at least 2.5% of their pensionable earnings. Employees can contribute more than 2.5% if they wish, but voluntary member contributions do not trigger matching contributions from the employer.

Additional Information

After closing the defined benefit scheme to new entrants in July 2006, Renishaw engaged in extensive discussions with the pension fund trustees about future pension arrangements for new and existing members of staff. Following this review, Renishaw decided to close the defined benefit scheme to all future accruals, rather than make the sort of adjustments to defined benefit design that are illustrated elsewhere in this report. This decision was announced in January 2007, with the changes effective from April 2007. Pensions built up in the defined benefit scheme before then will be based on the member's salary in April 2007, rather than their salary when they leave the company.

The 11% employer contribution in the new defined contribution scheme is almost double the average employer contribution to DC schemes. It illustrates how employers who feel it is not right for them to shoulder investment risk or longevity risk can still choose to pay substantial pension contributions.

Employees who joined Renishaw between July 2006 and April 2007 were initially left without access to any kind of pension scheme while the review was under way. To make up for this, the company is backdating the 11% employer contribution for these employees to the time they joined. (Member contributions need not be backdated.)

5. Overview of Changes

A simple analysis of the six case studies provides a good overview of the changes typically undertaken to occupational pension provision over the last 10 years. A few clear trends stand out:

- **Limiting Employer Risk**: Employers have sought to reduce the risk of unplanned rises in the cost of providing a pension by either modifying their pre-existing defined benefit pension or opening a hybrid or DC pension. The decision at BAE to share the cost of increased longevity beyond current expectations is a good example of the former. The hybrid schemes at BAE and Barclays and the DC schemes at British Airways and Renishaw are also examples of this.

- **Stabilising Employer Costs**: They have also tried to limit the overall cost of pensions by either reducing accrual rates, as at British Airways and the Church of England, or increased Normal Pension Age as at British Airways. A further strategy has been to increase employee contributions. This has been done at BAE and is one of the options available to Marks & Spencer employees.

- **Two Tier Provision**: Many employers have opted to make their most substantial pension changes to new recruits rather than existing employees and pension scheme members. As a result, within the same workplace, two employees may have very different pensions. This is true of Barclays, BAE Systems, Marks & Spencer and British Airways. In some cases, this has resulted in new employees paying more for their pension than existing employers.

- **Equal Provision**: However, some employers have tried to maintain the same provision for both existing and new employees, although only with regard to future accruals. At the Church of England all future accruals will be at the same rate regardless of when the person joins the scheme. The Co-operative Group has achieved equal treatment by placing all employees in a career average scheme while Renishaw has switched to defined contribution arrangements for all employees.

- **Different Solutions – DB, DC, Hybrid and Cash-Balance**: Far from a universal switch from defined benefit to defined contribution provision, our cases studies suggest much more variety. Where new schemes have been opened they include career average DB schemes (Co-operative Group), hybrids (BAE Systems), cash balance (Barclays), as well as DC. Where DC has been chosen, different strategies have been used to encourage participation and extra saving – British Airways have used auto-enrolment with employer contributions more than matching member contributions. Marks & Spencer have opted for a two to one employer match.

- **Future Accruals Only**: Despite the radical changes in the scheme and benefit design for future accruals, there have been no changes to accrued rights.

Table: Summary of main changes to each of the schemes considered.

Scheme	Old Scheme	New Scheme
BAE Systems	Closed to new members in 2003 but open to existing members. Since 2006 longevity risk for new accruals shouldered by employees.	In 2003 a hybrid scheme was opened for new members. DB with a DC overlay.
Marks & Spencer	Closed to new members in 2002 but open to existing members. Since 2007 employees choose either a) reduced accrual rate, b) a limit on increases in pensionable pay, or c) higher employee contributions.	In 2002 a DC scheme was introduced for new members. Employer matches employee contributions on a ratio of 2: 1.
Church of England	Current DB scheme is open to existing and new members. From 2008, accrual rates and indexation will be reduced but the scheme will be kept open to new members.	N / A
British Airways	Closed to new members in 2003 but is open to existing members. In 2007, increased Normal Pension Age and reduced accrual rate.	In 2003 a DC scheme was introduced for new members. This uses auto-enrolment with a default employee contribution rate that attracts the maximum employer contribution.
Co-operative Group	In 2006, three final salary schemes were merged. Changes to the benefits offered in the new scheme meant that newly accrued pension rights would no longer be based on final salary.	In 2006, existing members and new employees were given access to a career average defined benefit scheme.
Barclays	In 1997 the final salary defined benefit scheme was closed to new members but kept open for existing members.	In 1997 a DC scheme was introduced but due to poor take up rates and low employee contributions this was converted to a cash balance scheme in 2003.
Renishaw	Until 2006, new employees had access to a final salary scheme with accrual rates of up to 1/60th, depending on the level of member contributions.	From April 2007, new and existing employees can receive an 11% employer contribution to a defined contribution scheme in return for a 2.5% member contribution.

6. Conclusions

The picture that emerges from this study is one of change, all change! Over the last decade, many scheme sponsors have radically redesigned their pension arrangements. In general, scheme sponsors have sought to protect themselves against further increases in pension costs and reduce the volatility of such costs. They have reformed their pension provision in many different ways. Sometimes they have modified their defined benefit pension by reducing future accrual rates, raising the Normal Pension Age or asking employees to help meet the cost of provision. Other scheme sponsors have replaced their defined benefit provision with hybrid and defined contribution arrangements, often using innovative means, such as auto-enrolment and substantial matching contributions to encourage employees to participate and save extra.

Yet there are some constants. The regulatory regime has constrained the options available to employers wishing to maintain good provision. This has certainly led to some, arguably, undesirable outcomes. An increasing amount of the pension budget is being spent on those who no longer work for the employer. Many employers have opted to manage costs by providing two-tier provision – very different arrangements for new employees compared to existing staff. And more risk is being placed on employees than might otherwise have been the case. We urge the Government to consider these issues with care as it takes forward its Deregulatory Review.

Annex: A Wider View

This annex provides a wider snapshot of the types of changes currently being made by scheme sponsors to their occupational pension provision. Drawing on a simple survey of 20 schemes, this more superficial review bears out the same story as seen in our six case studies.

A major supermarket chain has proposed that employees should choose between increasing their own contributions by an average of 3% and transferring from final salary benefits to career average benefits, or from the career average scheme to a cash balance scheme. The transfer to cash balance would be the default position for employees who do not actively choose higher contributions.

A popular department store is raising its Normal Pension Age from 60 to 65. The changes will be gradually brought in so that staff aged over 50 now will retire at 60 and those between 41 and 49 will retire at between 61 and 64. The group abandoned a plan to allow department managers to retire early, at 62. The final salary scheme remains open to new members of the partnership after a five year qualifying period.

A large financial company closed its non-contributory final salary scheme to new members in April 2003. New employees were offered a career average scheme instead, where employee contributions range from zero to 6%. From April 2006, the existing 3,200 members of its final salary scheme have to pay 6% contributions. Those not wishing to do so can move to the career average scheme.

A large financial services company proposed in December 2005 that staff should either double their contributions to the final salary scheme from 7% to 14% or switch to a cash balance plan. In the cash balance scheme, individuals pay 5% of salary which is topped up to a 20% credit.

A major insurer closed its final salary scheme to new members in 2002, with new members offered a money purchase scheme. In 2005, it was revealed that existing members would switch to career average for future accruals.

A global insurer has raised its Normal Pension Age from 60 to 65.

A major high street chain announced in April 2003 that employees would have to complete a five year waiting period before becoming eligible to join the final salary scheme.

A major UK insurer: From July 2007, existing members of the final salary scheme can either raise their contributions from 3% to 7% (in 1% annual increments) or cut contributions to 2% in 2010 but see their Normal Pension Age increased from 60 to 65. New members were offered a DC scheme which pays a flat employer contribution of 8%, topped up by a matching contribution up to 5%.

A major high-tech engineering company was reported to be planning an increase in its Normal Pension Age from 60 to 65. However, the package of reforms announced in November 2003 does not involve a later retirement age. Benefits will remain linked to final salary but accrual rates will fall from 1/60ths to 1/80ths. The scheme was closed to new members in 1999 and had 18,000 active members when this change was made.

A global insurer closed a final salary scheme for bus drivers at the time of privatisation in 1994. It was announced in April 2006 that it was reopening it for employees over forty who had been with company for five years.

A large bank switched existing members of its closed final salary scheme to career average for future accruals from 2006.

An important high street retail group is increasing the retirement age from 60 to 65 for existing members. Employee contributions have risen from 4% to 6%.

A major international computer company announced in 2006 that only two-thirds of future pay increases would be pensionable.

A building society has raised its Normal Pension Age from 60 to 65.

A well-known charity raised its Normal Pension Age from 60 to 65 for new staff joining from 2003. Existing staff could choose between various combinations of higher contributions, lower accrual rates or later retirement.

A specialist printer and paper operator closed its final salary scheme to new members in July 2004. For existing members, the employee contribution rate was raised from 5% to 7%. A hybrid scheme for new members combined a 1/100th DB pension with a 3% matching employer contribution to a DC scheme.

A major high street building society closed its final salary scheme to new members in January 2002. A career average scheme is available for new employees, with 1/54th each year, revalued at RPI up to 5%. Employees pay 5% contribution to belong to CARE scheme.

An academic institute – Membership of the defined benefit scheme has been restricted to people aged 40+, through the creation of a "sequential hybrid" pension arrangement. A stakeholder nursery scheme has been introduced for people younger than 40.

A long established retailer – When the retailer demerged, it inherited a 1/60th final salary scheme with a 5% employee contribution rate. For new members: employee contributions have been raised to 6%; the Normal Pension Age has been set at 65, the scheme has contracted back in to the State Second Pension; automatic spouses' pensions have been removed; early retirement pensions have been set at an actuarially fair level; and a one year waiting period has been introduced. Existing members could choose between increasing their contribution rate to 7% or reducing accruals to 1/80ths.