Britain’s pension provision threatened with collapse

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The final salary “gold-plated” pension schemes of Britain’s top 200 companies are in deficit by more than £100 billion. The schemes include the pensions of some the country’s best known companies, such as British Airways, Shell and British Telecom.

Final salary schemes, also known as salary-related schemes or defined benefit schemes, offer a pension on retirement that is generally commensurate with final salary level and length of service. They must be increased by at least 2.5 percent every year as a hedge against inflation.

The biggest black hole in the top company defined-benefit pension schemes of £103 billion ($165 billion), was reported this month by pension experts Aon Consulting. Financial advice site *This Is Money* pointed out, “That's roughly equivalent to the total size of the economy of Hungary.”

The speed with which the deficit is growing is equally staggering. At the start of the year, the schemes were in surplus by £6 billion. Only last month, the deficit stood at £88 billion, and now it is £103 billion, meaning a rise of £15 billion was recorded in a single month.

Even this shocking figure tells only part of the story. Britain’s entire pension system faces collapse.

The 200 defined benefits schemes cited above have between 10 and 15 million members, including current employees. But all final salary schemes are in danger, including the defined contributions schemes that pay out much less generous pensions based upon the level of contribution.

According to an analysis of 7,783 private sector schemes covered by the government-run Pension Protection Fund (PPF), the funding shortfall of pension schemes throughout the private sector had doubled in the past year, to over £242 billion ($380 billion). A year ago, the shortfall was £110 billion. This is the largest shortfall in the history of its four year calculations. Around 91 percent of schemes including final salary pensions now have insufficient funds to meet their liabilities, according to the PPF.

David Cule, principal at Punter Southall, pointed out, “This is significantly greater than the quantitative easing package put together, and is on a par with the level of support being put together for the UK banking system.” But since the PPF's liabilities represent only some 80 percent to 90 percent of the actual liabilities of the 7,783 private pension schemes in the UK, the shortfall could, in reality, be much higher, at between £350 billion and £400 billion.

Just 11 percent of workers in the private sector are covered by final salary schemes. The number of active members in or contributors to private sector pension schemes has fallen by 100,000 since 2008 and now stands at 2.6 million.

The list of companies that are closing their defined benefit schemes is lengthening by the day. Companies that have closed their scheme this year include Whitbread Breweries and Trinity Mirror, the UK newspaper conglomerate.

In August, financial actuaries Watson Wyatt estimated that more than one million workers would see their final salary schemes closed in the next three years. Their survey revealed that 50 percent of private sector final salary pension schemes would close, and an additional 28 percent would have their benefits substantially curtailed. Fully 80 percent of company directors in the UK believe that final salary pension schemes will be closed to new members in the short term.

Most companies intend to offer instead only the less generous defined contribution pensions schemes. This is one of the major factors—along with wages—provoking strike action, as it threatens workers’ long-term future. For example, the pension deficit contributed to the strike this year against Royal Mail, which the government plans to partially privatise.

The Royal Mail's 2009 annual report showed a £7 billion pension deficit affecting 450,000 members, the largest scheme by members in the UK. But some estimates of the deficit range as high as £12 billion. Business Secretary Lord Mandelson warned that if part-privatisation did not go ahead, staff may have to see the value of their pension slashed in half. But pensions consultant John Ralfe said such a large deficit meant a private buyer would be unlikely to

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buy part of the Royal Mail unless the government took on the pensions' liability, as recommended in an independent study published by Richard Hooper, a former deputy chairman of Ofcom.

At British Airways, the package of cuts that precipitated the vote to strike that was nullified by the High Court centre on efforts to reduce a combined deficit for the company's two pension schemes of £3.7 billion—£1.5 billion more than the airline is worth. Both schemes are now closed to new members. This deficit reduction is vital if the planned merger with Iberia is to go ahead, a key element in the loss-making airline's survival plan.

Royal Mail's official deficit is surpassed by that of British Telecom, which has an estimated hole of £9.4 billion.

There is a further problem. As the recession continues, more businesses are failing. But the only protection for workers should companies go bust or their pension scheme fail is the PPF, which oversees most of the UK's private pension schemes. It currently collects just £0.7 billion a year in levies and it was reported in November that the PPF is now running an annual deficit of £1.23 billion.

Worse still, a rapidly growing number of workers have no personal pension to fall back on. For example, less than 30 percent of private sector workers have any form of pension scheme. This situation is worsening daily due to the collapse or ending of schemes, or workers not taking them up due to growing hardship and debt.

The deepening of the pension crisis is primarily the result of the economic catastrophe that began in 2008, but it has been exacerbated by the measures taken by the Brown government to rescue the banks and pump-prime the economy. Long term it is the product of a toxic mixture of capitalist economics and corporate greed.

In the 1990s boom, many companies took grotesquely-named "pension holidays," stopping payment into occupational schemes while their employees continued to pay. During the three-year bear market that began in early 2000, according to the *Guardian*, a £200 billion deficit developed that reduced the average individual pension pot from £50,000 to £37,500. This recovered somewhat during the dot-com boom. But 2008 swung everything sharply back into reverse.

To revive the economy, the Bank of England undertook a policy of "quantitative easing"—i.e., printing money and facilitating cheap credit. This had a massively negative impact on the price of government bonds, in which most pension funds invest, at the same time as share prices generally were in decline.

Analysing the fate of Royal Mail's pension fund in the *Telegraph*, pensions consultant John Ralfe said it had "gambled on equities and lost." Royal Mail has traditionally held up to 80 percent of its assets in equities, leaving it highly vulnerable to market fluctuations. Although it had diluted its equity holding to about 30 percent in 2007, this was "too little too late," said Ralfe.

Another factor contributing to the pension deficit is the ever increasing salaries and fat pensions paid to top management and professionals, whose own contributions do not fully fund their pensions.

The response by many workers to the decline in their pension has been to plan to extend their working life into their late sixties and seventies, or consider selling their homes and other assets. A report by annuity provider MGM Advantage states that 1.85 million people in the UK will be delaying their retirement.

AXA has said that more than three in five people are looking to rely upon the state pension as their main source of retirement income. Fully 10.5 million already rely on the state pension, and this will rise to 12.5 million by 2025.

The state pension is both minimal and declining in value. The basic state pension is currently paid to women at 60 and men at 65, who fulfil National Insurance (NI) contribution requirements. The full weekly rate for a single person is £95.25 and £152 for a couple. This rate is set lower than the income support threshold, and pensioners can claim income support or possibly Disability Living Allowance and other benefits, but these are discretionary.

Many workers may not even get the state pension as it depends on length of service and the number of "qualifying years" built up—with at least 30 qualifying years required to receive a full pension. Those who have not made sufficient contributions may only get a partial pension or, if they retire with less than 25 percent of the qualifying years, no pension at all. This particularly affects women and those with caring responsibilities.

The state pension has declined in value over the years. The link between pensions and earnings was first introduced in 1974 and scrapped by the Conservative government of Margaret Thatcher just six years later. An indication of the decline in the value of pensions can be seen by the fact that restoring the link would cost £10 billion per year.

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