
State pension reform may undermine Britain's DB plans

By Editor Test Wed, Mar 30, 2011

Britain's plan to simplify the state pension to a single-tier plan could hurt private DB plans by ending "contracting-out," the practice of substituting contributions to a private plan for contributions to the second state plan.

Last week's announcement by the UK Chancellor of the Exchequer that the UK will simplify its two-tier state pension to a one-tier, £140-per-week (\$227) plan has roiled the providers of employer-sponsored defined benefit plans in Britain, IPE.com reported.

The new reforms will disrupt the practice of "contracting out," whereby employees could contribute to a workplace DB plan instead of making full contributions to the second-tier of the state pension, consultants warn.

Pension experts at Aon Hewitt and PwC expect that the end of contracting-out will increase the costs of DB plans by about 3.4% of employees' salaries and lead to the closure of the few remaining DB schemes.

Marc Hommel, pensions partner at PwC, said: "The end of this incentive will make up the minds of those few remaining employers to accelerate defined benefit closures."

Paul McGlone, principal consultant at Aon Hewitt agreed, saying those employers that had not yet closed their DB schemes had not done so because of the complexity of such a step.

"The danger with the proposal to abolish contracting-out is that, if companies are going to have to go through a painful consultation process anyway, then they may take the opportunity to simply close the scheme at the same time and use other arrangements to fulfill their forthcoming auto-enrolment obligations," he said.