The UK Enhanced Financial Accounts: changes to defined contribution pension fund estimates in the national accounts; part 1 – the methods

Change in the method for estimating household entitlements in DC pension funds recently approved by the ONS National Accounts Methods Advisory Committee.

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1 . Introduction

In November 2015, the Office for National Statistics (ONS) and the Bank of England published a comprehensive review of UK financial statistics. The review highlighted strengths in the current estimates, but also areas where the quality of the statistics could be improved. As part of the " Flow of Funds" project, which aims to transform financial statistics and enhance estimates in the UK National Accounts, teams have been established within ONS in 2016 to take forward this work.

This article is about work undertaken by the new "Pensions in the National Accounts" team within the ONS "Enhanced Financial Accounts Development" branch to improve estimates of Defined Contribution (DC) pensions in the UK National Accounts. It discusses a change in the methodology for estimating household entitlements in DC pension funds that was recently approved by the ONS National Accounts Methods Advisory Committee. The article does not present the data changes; these will be presented in a follow-up article to be published on 30 January 2017.

2 . Scope of the work

In the UK, pensions are provided by pension funds (the funds associated with occupational pension schemes) and by insurers. As the Pensions in the National Accounts team aims to develop a full picture of the value of pensions in the UK – transactions and balances, government and private sector, funded and unfunded and by type of pension and provider – it is working closely with insurance colleagues within Enhanced Financial Accounts Development. However, in the national accounts, insurance corporations and pension funds are separate institutional sub-sectors (S.128 and S.129 respectively) within the financial corporations sector (S.12). Therefore we are taking forward the work on pension estimates in S.128 separately from the work on pension estimates in S.129.

DC pensions appear in both insurance corporations (S.128) and pension funds (S.129), but this article focuses exclusively on the work we have carried out in 2016 to improve the estimates of DC pensions in S.129. We also discuss our plans to improve the estimates of Defined Benefit (DB) pensions in S.129. Articles planned for later in 2017 will discuss the work on pensions in S.128, which is a separate workstream.

When this work is complete, we aim to be able to produce improved estimates for both DC and DB pension entitlements in the UK National Accounts. We also hope to be able to show these series (DC and DB) separately and to break them down further, as we have been asked to do by users. For example, we would like to be able to break down DC entitlements into the "accumulation" (building up) and "decumulation" (paying out) stages and, in the latter, into annuities versus drawdown products.

3 . Pensions methods

The work of the new Pensions in the National Accounts team builds on 2 earlier strands of work on this topic: (1) to produce a UK National Accounts Supplementary Table on Pensions in line with the requirements of the European System of Accounts 2010 (ESA 2010), in 2011 to 2012[1]; and (2) to incorporate these ESA 2010 standards and methods into the core national accounts from 2014[2].

Some important definitional points are worth noting in relation to the treatment of pensions in the national accounts:

1. Under ESA 2010, pensions are defined as “pensions in social insurance”, a concept covering social security schemes and pension schemes for employees such as occupational and group personal pensions; individual personal pensions are treated as savings, not pensions.

2. All pension entitlements are, by definition, “owned” by the household sector (S.14) and are shown in line AF.63[3] in the UK National Accounts (Blue Book).

3. The pension entitlements of households in S.14 (household sector) are equal to the liabilities of pension providers in S.12 (financial corporations sector).

4. For DC pensions, liabilities are equal to assets at market value.

5. For DB pensions, liabilities are calculated on an actuarial basis and may be more than or less than the value of assets; the difference between liabilities and assets is shown as AF.64 [4] “claims of pension funds on pension managers”.

Notes for: Pensions methods

1. Pensions in the National Accounts series (3 articles), Sarah Levy, ONS, 2011-12.

2. ‘ESA10: Developments to the Treatment of Pensions in the National Accounts’, Robbie Jones, ONS, April 2014 and ‘Detailed explanation of the impact of the changes to the treatment of Pensions in the National Accounts’ Robbie Jones and David Matthews, ONS, September 2014.

3. AF.63 is not separately identifiable but it is the largest component of AF.6M (entitlements of households in pension schemes) in Blue Book Table 6.1.9.

4. AF.64 (claims of pension funds on pension managers) is another component of AF.6M in Blue Book Table 6.1.9.

4 . Method changes for DC pension entitlements in S.129

4.1. The current method

In 2011, when the current method for calculating DC pension entitlements in S.129 was developed, there were 2 main sources for estimating S.129: (i) data from The Pensions Regulator (TPR) and the Pension Protection Fund (PPF) and (ii) data from ONS’s Pension Funds Survey. At that time, TPR and PPF were publishing estimates of DB pension liabilities, which we decided to use; but estimates of DC pension liabilities had only just begun to be released by TPR on an experimental basis. ONS’s Pension Funds Survey did not contain a DB versus DC split of pension assets or liabilities; but it did contain such a split for regular contributions by employers and employees. We decided to use this to estimate the DC part of pension entitlements in S.129. The DC proportion based on this “contributions proxy” was applied to the private sector part of the variable RYIR (gross pension assets) from the Pension Funds Survey to estimate levels of DC pension entitlements in S.129.

Contributions are an imperfect proxy because DC schemes have built up much smaller assets to date than DB schemes, due to DC schemes being in existence for less time and tending to accumulate lower entitlements than DB schemes. Therefore the amounts currently being contributed to DC schemes in S.129 as a proportion of total contributions (DB plus DC) will inevitably be higher than the assets that DC schemes have built up as a proportion of total assets (DB plus DC). This has become more so since 2012 with the introduction of the policy of “auto-enrolment”, where large numbers of people have started contributing to DC “master trusts” [1], which are classified in S.129. As a result, regular contributions to DC schemes have risen sharply but their assets are still quite small.

In 2016, when we reviewed the figures for pension entitlements in S.129, DC entitlements were found to be significantly overestimated. We compared the current series for DC pension entitlements in S.129 with new survey data on asset breakdowns and with regulatory data on DC assets now available from TPR. Both of these sources showed that the proportion of DC assets in relation to RYIR (gross pension assets) should be between 1% and 4%, rather than over 20% as currently estimated in the accounts.

4.2. The new method

Given that TPR can now provide ONS with annual estimates for DC pension fund assets, the National Accounts Methods Advisory Committee has taken the decision to use this data. The data provided to ONS by TPR will consist of published estimates for the market value of assets of DC pension schemes [2] with 12 or more members[3] and also an adjustment for the market value of assets of schemes with fewer than 12 members that are not relevant small schemes[4]. Relevant small schemes are generally set up to provide retirement benefits for company directors rather than for employees, so they do not meet the criteria for treatment as pensions in the national accounts (see Section 3).

The main advantages of using regulatory data for DC pension fund assets for estimating DC entitlements in S. 129 are:

- consistency: it would bring the method for estimating DC entitlements into line with that already used for DB entitlements
- quality: the data comes from scheme returns submitted to the regulator by DC occupational pension schemes, which is reviewed by TPR analysts; in general the data is considered to be of reasonable quality
- efficiency: use of regulatory data reduces our reliance on survey data, potentially leading to savings in data collection costs and reduction in respondent burden in the medium-term
- time series: the TPR data series starts in December 2010; it also shows a clear trend over time, which allows us to model the results prior to 2010

4.3. The new estimates

The new estimates are expected to reduce considerably the value of DC entitlements in S.129. DC pension entitlements are part of AF.63 in the Blue Book and this line will change in Blue Book 2017 as a result of the changes described in this article. There will also be an indirect impact on the DC part of line D.6141 in S.129, known as “social contribution supplements” or “investment income”, because this is calculated as the ratio of DC entitlements to total entitlements. We are working on experimental estimates for these lines from 2010 to 2015 and will be publishing them on 30 January 2017.

In the case of funded pensions, any change to D.6141 affects the D.8 “adjustment for the change in pension entitlements”, which in turn leads to a change in household saving and therefore the household saving ratio [5]. However, as the article to be published on 30 January 2017 is an experimental article, it will not show the impact of the changes on the full sequence of accounts, including the D.8 adjustment and the household saving ratio. This will be shown as part of the series of articles accompanying Blue Book 2017 later in the year.

Notes for: Method changes for DC pension entitlements in S.129

1. A master trust is a multi-employer occupational, trust-based scheme with one legal trust and board of trustees covering the staff of many unconnected employers.

2. Readers should note that TPR's DC assets figures do not include assets held by hybrid schemes in respect of DC members as the regulator does not require hybrid schemes to provide this information.

3. See TPR's '[DC Trust]' publication.

4. TPR's DC Trust publication notes that relevant small schemes "are subject to fewer regulatory requirements than other DC schemes. Schemes which were previously known as small self-administered schemes, or SSAS, will commonly be relevant small schemes".

5. D.8 is an adjustment made to Gross Disposable Household Income (GDHI) as part of the process of transforming GDHI to produce an estimate of Gross Saving ([Jones April 2014]). The D.8 adjustment adds pension contributions to households' resources and subtracts the pension benefits paid. The reason is that although only benefits should count towards disposable income, only contributions should count towards Gross Saving.

5 . Other changes for S.129

The other main change to S.129 estimates that will be included in Blue Book 2017 relates to figures for DB pension entitlements. These will be revised to reflect updated estimates for the Local Government Pension Scheme (LGPS), which is the largest funded pension scheme for public sector employees. ONS is reviewing the LGPS estimates with support from the Government Actuary's Department (GAD). GAD helped design our "roll forward" method for reporting LGPS entitlements in the UK National Accounts as part of work on the Supplementary Table on Pensions in 2011 to 2012 (see Section 3).

6 . Conclusion

This article reports on work to improve the estimation of household DC pension entitlements. The ONS National Accounts Methods Advisory Committee has recommended replacement of the current method for estimating these entitlements, which is based on a proxy, with an estimate based on regulatory data on DC pension fund assets provided by The Pensions Regulator (TPR). These changes will be made in Blue Book 2017, which is due to be published in October 2017. In addition, Blue Book 2017 will contain updated estimates for the Local Government Pension Scheme (LGPS), which will have an impact on estimates of household DB pension entitlements.