



Defined contribution case studies

Changes in design – how organisations are reviewing their arrangements



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Defined contribution (DC) case studies

There are some **trends** emerging in **DC scheme design**, and over the last year or so there has been a **shift** in the views of sponsoring **employers** and **trustees**.

Some DC schemes are growing fast and, although the size of DC assets is still often much smaller than those relating to defined benefits (DB), the number of active members in DC in some cases is outstripping those in DB, especially where the sponsor has a high staff turnover. It follows, therefore, that the cash flow both from employers and employees can represent a significant financial commitment. As DC design has evolved markedly in recent years, those organisations which set up DC half a dozen or so years ago have schemes which often look a little old-fashioned and are in need of a revamp.

Unsurprisingly, therefore, some employers and trustees are taking the opportunity to review their DC arrangements, often benchmarking their design against schemes set up more recently and/or against competitor organisations. The main aim is to improve their schemes to reflect either median or upper-quartile results in a bid to attract and/or retain high calibre employees. This, in turn, has the effect of raising standards and the prophecy of 'better' DC schemes becomes self-fulfilling.

This series of short case studies aims to capture the essence of the type of projects that are currently being undertaken by some of our clients.

If you would like further information about any of these case studies or you are thinking about setting up or reviewing a DC arrangement, please call Helen Dowsey direct on +44 (0) 1737 274331, or contact your usual DC consultant.



“ This series of short case studies aims to capture the essence of the type of projects that are currently being undertaken by some of our clients. ”

Case study A

The issue – explaining pension change in the context of the wider reward package

This quoted company was making changes to its final salary and money purchase sections which could reduce the future pension build up for some of its employees. As part of the consultation process, member presentations were promised to help explain the impact.

The approach

We were asked to help the company communicate the impact of the pension changes. However, we noted that the Company offered a number of share plans that allowed employees to build up a stake in the Company in a tax efficient manner. With this potential increase in share ownership the Company also intended to introduce a group self-invested personal pension (Group SIPP) as a means of holding the company shares in a tax efficient manner once the share plans matured.

With all these changes going on we suggested that the emphasis should be on helping employees build up a financial plan for retirement using both pensions and non pension assets. The aim was to help employees realise that the Company offered a number of ways to help them generate wealth. The approach consisted of employee presentations to introduce the topic and a booklet to provide more information on the subject.

The subjects covered included:

- a reminder of the pension changes
- how to go about planning for retirement
- summary information on the share plans, their features and benefits
- wider financial planning options such as AVCs, ISAs and property
- the importance of reviewing plans regularly to take account of changing circumstances
- how to go about transferring Company shares to pensions, including the Group SIPP, in a tax efficient manner.

The result

Feedback forms suggested that many employees intended to review their retirement plans as a result of attending, often by seeking independent financial advice.

When the Group SIPP was launched to coincide with a maturing share plan, 20 per cent of the eligible population elected to make in specie transfers and around £2.1 million worth of company shares were transferred into the Group SIPP.



Case study B

The issue – restructuring DC to maximise operational efficiencies

This client in the logistics industry had set up a bundled trust-based scheme with a provider a few years earlier, on the advice of a previous adviser. Active membership had quickly swelled to over 1,500 and contributions exceeding £5 million a year were being paid.

The client was frustrated by the need to fit in with the provider's administration model, rather than for the provider to fit in with the client. Members were able to invest in almost 100 funds, many of which offered access to the same asset classes.

The approach

We recommended a root and branch review of the scheme, from contribution rates to investment choices. As part of the review, we recommended the client unbundle the scheme and appoint separate third-party administrators, investment managers and communication consultants. We also recommended the employer adopt salary sacrifice, which we

estimated should save around £250,000 a year. The review also concluded the investment range should be consolidated, to ensure members were not bewildered by the amount of choice, and to permit proper monitoring and review of the funds.

The result

All parties have benefited from the change. The employer deals with an administrator that meets its needs and systems, and benefits from the savings through salary sacrifice, even after it meets the administration costs. The members benefit from reduced charges resulting from unbundling and higher take-home pay that follows from salary sacrifice. Members also have a more manageable investment range to select from and early indications are they are exercising more choice. The trustees have a scheme that is fit for purpose and commensurate with its scale, and an investment range that can be properly governed.

Overall savings of over £100,000 a year were delivered in year one, and over the longer term, the annual savings compared against the bundled scheme will grow further.



Case study C

The issue – redesigning DC in response to legislative changes and member behaviour.

This retail sector client had established a DC arrangement some years earlier and had not revisited it since.

The contribution design was age related, and there were concerns from both the employer and trustees that the design might not satisfy anti-age discrimination legislation. There was growing evidence that the workforce, predominantly aged under age 40, were investing in an increasingly cautious fashion. In addition, there was evidence some members were simply splitting their investments between the available fund options, seemingly because they did not understand the different choices.

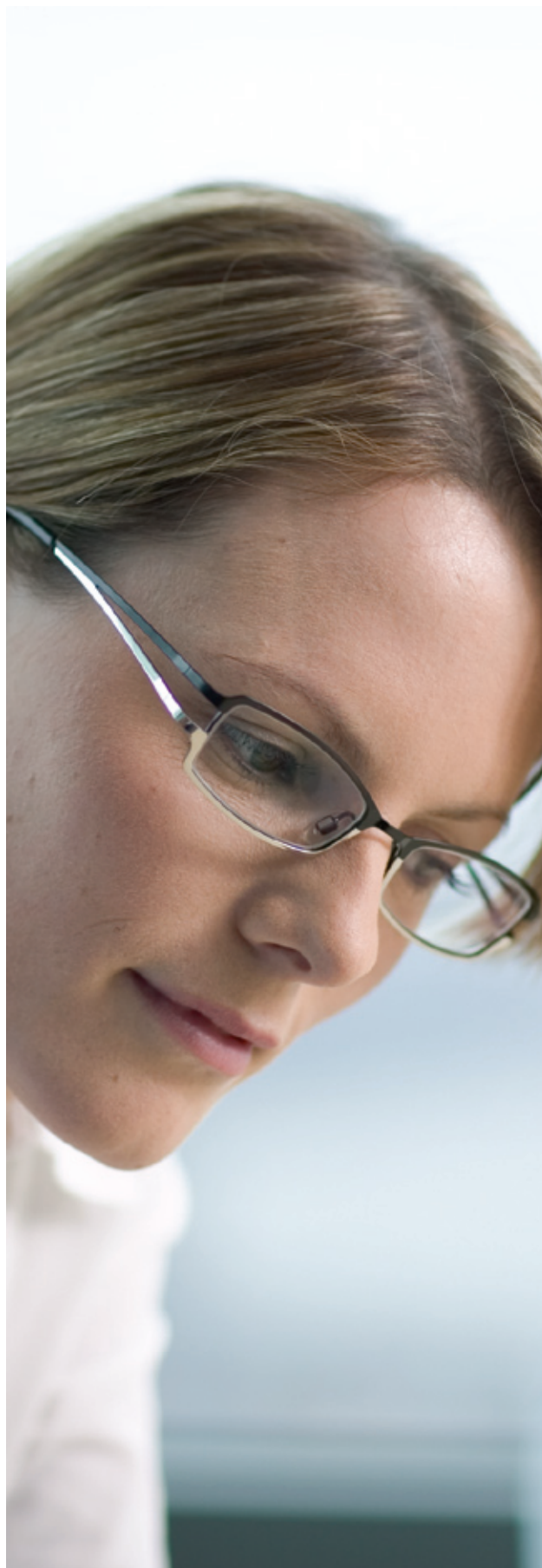
The approach

The contribution design was revised to a matching scale, following legal advice. All employees were advised of the change and non-joiners were again invited to join. There is growing evidence that where people are provided with a number of investment options to select from, but no default option, many will select all options, particularly where they do not fully understand their choices. In this instance, some members invested relatively heavily in cash and bonds.

We recommended the existing fund range be slightly expanded to increase the proportion of equity funds within the range. In addition, we recommended the trustees adopt a default lifecycle investment option. This sends a signal to members about a sensible long term approach to investment, and removes a potentially difficult decision from those members who feel unable to make it.

The result

The revised fund range, new default option and reasons behind the changes have been communicated to members. As hoped for, a sizeable proportion of new joiners have invested in the new default lifecycle option, and a healthy number of existing members have chosen to switch their funds into investments more appropriate to their age.



Case study D

The issue – dealing with outdated AVC arrangements

The trustees and pensions management team of a DB scheme had experienced years of poor service from a variety of AVC providers.

AVCs were occupying a wholly disproportionate amount of trustee and administration time and expense. The trustees wanted to replace their existing AVC providers, but were concerned about continuing problems from legacy providers, particularly as a large proportion of assets were invested in with profits assets with guarantees.

The approach

Before advising on a new AVC provider, we suggested that the trustees establish whether they wanted to continue to offer AVCs at all. Simplification legislation means that it is no longer a requirement for occupational schemes to offer members access to AVCs.

As part of an overall review to decide whether AVCs were still appropriate, we concluded that the trustees had two credible alternatives if they wanted to cease AVCs altogether. One option was to close AVCs to new contributions and then transfer the existing AVC liabilities to individual member policies outside the scheme. The guarantees underlying some with profits assets formed a potential obstacle to this approach.

An alternative was to close AVCs to new contributions and for the scheme to offer DB benefits in exchange for the accrued AVC funds. The amount of DB benefit offered to members could reflect the underlying guarantees within with profits funds, removing a potential problem. Members could also be given the options of transferring their AVCs to an arrangement of their choice, or a policy containing their AVC benefits to be assigned to them.

It is anticipated that an alternative 'AVC' vehicle will be offered by the employer.

The result

This exercise has not yet been completed, but the trustees have asked us to look further at the option of converting AVCs into deferred DB benefits, on either a fixed benefit or added years basis.

The new 'AVC' vehicle has yet to be decided upon, but is likely to be a contract based arrangement. It is possible that an appropriate vehicle might be a Group SIPP. A Group SIPP would permit much wider investment options to those members who required them, far beyond what is currently possible within conventional AVC arrangements.



Case study E

The issue – consultation and communication of closure to DB and launch of new DC.

This multi-national FTSE 100 client had a big DB pension deficit and paid a one-off cash injection, with plans to pay increased contributions over the next six years.

The company presented a longer-term solution to its trustees: ceasing future accruals for all existing active members and offering them a DC scheme as an alternative pension vehicle. The company had union representation and a handful of DB members were vociferous in their views, opposing this proposal. The 60 day consultation process was a new legal requirement at the time.

The approach

Before proposals were put before members, we worked with the employer to find an appropriate design and to model potential DC benefits. Potential new DC designs were benchmarked against both the employer's peer group and the former DB benefits. Once the design phase was complete, we advised on the selection of a third party administrator and investment managers for the new unbundled occupational arrangement.

We recommended that the DB to DC change be communicated in two stages; first consultation on the closure of DB and the proposals for a new DC scheme design, and secondly the new DC arrangement with some changes incorporated following the closure of the consultation period. We worked in partnership with the company to deliver a comprehensive bespoke communications strategy for the 60 day consultation process. Some key aspects of the strategy included:

- manager briefings in group face-to-face presentations at all sites
- feedback channels (email and telephone helpline) opened
- a newsletter confirming the way forward and inviting comment via email and helpline
- 'Your questions answered' – series of three publications issued

- personal illustrations showing projected DC benefits sent to every employee/member
- pensions roadshows – 85 per cent of members attended
- closing consultation leaflet – highlighting areas where the employer had listened to feedback.

The result

The new arrangement combines 'best of breed' administration and investment solutions to offer the company's employees a market leading, future proofed DC scheme.

The consultation process allowed the company to present a very competitive DC proposition to employees and provided feedback which shaped certain key aspects of the new scheme. A potentially controversial change to benefits was delivered without major disruption to the business.



Case study F

The issue – replacing legacy occupational arrangements with contract based solutions

This FTSE 250 financial service industry client had a trust-based DC arrangement which they found to be costly and time consuming to operate in relation to the relatively small numbers in the workforce.

The contribution design had been carried over from a previous final salary scheme that had been wound up some time ago and was very generous compared to the client's competitors. The client felt the contribution design was unaffordable in the long term, particularly with plans to expand the company and increase headcount.

The approach

We worked with the client to introduce the new pension scheme, in particular:

- The client advised that they wanted to introduce a contract-based arrangement to reduce the cost per member of operating a trust-based arrangement. We undertook a provider selection exercise for the new stakeholder pension.
- We also undertook a provider selection exercise for section 32 bulk buy-out policies in respect of the funds under the existing occupational pension scheme.
- We drafted the member communication material with the client to address the changes to the

pension plan and the options available to members. Members had only one investment fund under the old occupational scheme and a core range of funds were introduced under the new stakeholder.

- Presentations to staff were held by the chosen provider of the stakeholder plan to explain the new pension plan and give attendees the opportunity to ask questions.
- We provided benchmarking information to the client who decided to keep the generous contribution design for existing members and introduce a new scale of contribution rates for new employees.
- Our role was to project manage the changes from a trust to contract-based arrangement and ensure that all the parties worked together in order to meet the tight timescale set for introducing the new pension plan.

The result

The project allowed the client to clearly present the changes to both the existing members of the occupational scheme and to new employees.

The client has introduced a governance committee which meets once a year to review and monitor the plan.

Members view the move to a contract-based arrangement in a positive light.



Case study G

The issue – Putting in place a DC pension solution for executives

This client in the property services industry had an executive pension plan in place for its directors.

The client recently went through a restructure and wanted to provide the directors with more control and flexibility for their pension plan. The client, however, was also keen to continue with a group arrangement that could be monitored through a governance process and benefit from group terms.

The approach

We met with the directors to:

- Review the directors' existing pension plans and understand how these fitted in with other benefits such as share options and bonuses.
- Understand their business and the directors' plans for the future.

- Understand the amount of involvement the directors wanted to take in monitoring and reviewing their pension plans.
- Discuss how the directors' pension plan fitted in with the staff scheme and whether there would be members promoted from the staff scheme to the directors' plan.

The result

We recommended a deferred Group SIPP arrangement which would allow the directors (at an individual level) to switch on the SIPP facility at a later date without the need to transfer to a SIPP product. This recognises the varying needs of the directors, some of whom value SIPP functionality, some of whom are happy with insured arrangements.

The Group SIPP will operate under the same governance plan as the staff scheme.



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