

# All at DC

Pensions are not plain sailing but done properly defined contribution (DC) schemes can keep members afloat, says [Helen Dowsey Watson Wyatt](#)

There is a common misconception that defined contribution (DC) is not a good deal for members. The perception is that DC itself is in some way deficient. There is nothing intrinsically wrong with DC; it is poor scheme design that creates issues further down the line. Many employers need to take stock and review their scheme design to prove to employers that DC forms an important part of their reward package.

## Keeping your head above water

In the last few years, defined benefit (DB) schemes have given companies almost continuous headaches with increasing legislation, regulation and funding costs to make up massive deficits, sometimes running into hundreds of millions of pounds. Employers have been loath (or simply cannot afford) to finance further DB accrual. DC has been a common replacement but historically for new employees only. The argument for this move has often been cost containment, not necessarily cost reduction. However, for DC schemes established a few years ago, cost reduction has been the result, with employers committing as little as 3% of salary.

There has been a trend for new DC schemes to offer a more generous employer contribution. Watson Wyatt's *FTSE 100 DC Survey 2006* shows the average maximum employer contribution is 11.2%. Even so, without considerable additional contributions from members themselves, this is still unlikely to provide most people with sufficient income for a

comfortable retirement.

More enlightened employers are reviewing existing DC contribution structures and new scheme designs tend to use matching arrangements that, in partnership between employer and employee, aim to produce a fund size that is more likely to provide a reasonable standard of living in retirement.

## Preventing mutiny

One of the reasons DC has such a poor reputation is that take up rates can be low. There has been considerable interest lately in automatic enrolment. This can play a key role in addressing this problem, although, it can create scheme design issues of its own.

Lack of member engagement is a major risk for employers and trustees running DC schemes. There is growing interest in auto-contribution strategies as a way of encouraging members to contribute sufficiently towards retirement savings. These are programmes, which members can select, where their contribution rate increases automatically over time, combating inertia.

## Plain sailing?

The overall investment trend (as shown in our surveys) has been to offer more choices; this is particularly true of contract based DC schemes, such as stakeholder.

Members are often completely bewildered by the range offered by their schemes. This is not only a complaint from contract based scheme members; trustees can also make the choices difficult.

However hard we try to educate members on investment matters, we have to face the reality that some (or many of them, depending on the profile of the workforce) will never grasp the concepts. Some trustees are simplifying their scheme's investment choice, using the latest thinking to create more advanced solutions, albeit packaged and presented to members in very simple ways. It is possible for employers and trustees to provide DC that is a good deal for members and we are beginning to see the emergence of a new enhanced breed of scheme. It does, however, require focus and effort. Employers should also accept that they, as well as their employees, will have to pay for it and take joint responsibility to ensure success.



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## In a nutshell

- poor scheme design gives DC a negative reputation and historically DC schemes were set up with low employer contributions; as little as 3%
- trends for new DC schemes reveal more generous contribution structures, automatic enrolment and automatic contribution designs and ways of improving member engagement
- increasing investment options is not necessarily a good thing for members; it may be better to simplify the choice using the latest investment thinking to create advanced solutions
- employers and employees should take joint responsibility to ensure a scheme's success.