

FTSE 100 Defined Contribution Pension Scheme Survey 2006

Results

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FTSE 100 defined contribution pension plan survey

2006 Results

This survey has been conducted with the companies that constituted the FTSE 100 index as at 31 March 2006. It has been running for three years now and is beginning to reveal some trends in DC provision and design. Organisations may find the survey results and the trends behind the changes useful in influencing their own DC designs.

The survey contains an executive summary and the following sections.

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Executive summary

This is the third year we have conducted the survey that is concerned with the provision and design of defined contribution (DC) pension arrangements by FTSE 100 companies.

Although we would not expect to see major differences between the results for 2004, 2005 and 2006, we have noticed a few key trends.

The average overall company contribution for all plans increased from 8.5% in 2004 and 9.2% in 2005 to 9.4% in 2006. This assumes members take full advantage of any matching contributions offered by employers.

There have been minimal changes to average core member contributions over the same periods and matching contributions have, if anything, decreased slightly. A few companies we contacted when compiling the survey indicated that they felt their contribution structures were falling behind in competitiveness and had reviewed them (or were about to review them) accordingly.

This year we have allocated a little less space to the detailed analysis of contribution structures and have focused instead on the higher level trends within the three main types:

- Flat rate
- Age-related
- Service-related

In each category, we have considered the overall trends for schemes both with and without matching contributions.

We have also reduced the section allocated to analysis of the different fund options available to DC members, to allow space to cover a broader range of DC plan design areas. However, our analysis does cover the main areas of interest including default options, Lifestyle strategies and the split between with-profits, active and passive funds.

For this year, the survey considers plan design, including waiting periods and retirement options, and provides data on scheme size, in terms of assets under management and cash flow.

We have also introduced a section which analyses the death-in-service and ill-health benefits offered under companies' DC arrangements.

Main findings

- 84 companies within the FTSE 100 participated in this year's survey. Of all pension plans offered to employees, 74% are DC schemes. This ignores executive pension plans and executive contribution tiers. It also ignores those companies which have a designated stakeholder scheme but pay no employer contribution.
- Of those employers which offer DC pension provision, 77% offer a trust-based occupational DC scheme rather than a contract-based GPP or stakeholder scheme. This includes 28% which have established a DC scheme under a stand alone trust and 49% which offer a DC section of a DB scheme.
- The average combined contribution rate (i.e. allowing for employee contributions and full matching contributions) for all plans is 13.7%, compared to the equivalent 2005 contribution rate of 13.8% and the 2004 contribution rate of 13.0%.
 - The core employer contribution rate for plans which do not offer a matching contribution element increased from 6.9% in 2004 and 7.3% in 2005 to 8.1% in 2006.
 - The core employer contribution for plans which do offer a matching contribution element increased from 4.6% in 2004 and 4.7% in 2005 to 6.1% in 2006.
 - The total employer contribution for plans offering matching member contributions was 10.1%, compared to 9.9% in 2004 and 10.6% in 2005. This assumes members take full advantage of the employer match.
- Most employers continue to opt for a flat rate contribution structure (71% of plans) with 66% of all plans offering matching contributions in addition to a core contribution.
- The number of investment funds offered has changed little from last year's survey with occupational schemes tending to offer a small core of funds (6 to 15) and stakeholder and GPP schemes offering a higher number (typically more than 20).
- Based on the 57 responses received, most schemes offering one or more Lifestyle strategies have set a switching period of either 4 to 6 years (49%) or 10 to 12 years (65%).
- Nearly all employers offer some salary multiple on death-in-service (59% of the 63 respondents offer benefits at four times salary). Four employers have taken advantage of post-simplification rules and offer a lump sum death benefit of more than four times salary.
- 67% of employers with defined contribution schemes make some form of incapacity provision, mainly permanent income protection. Of those employers that offer income protection benefits, the most common level of cover (offered by 50% of schemes) is a replacement income of 50% of salary.

1 Introduction

- 1.1 This survey is drawn from the responses of 84 companies in the FTSE 100 index as at 31 March 2006 and covers 88 schemes in total (of which 65 are defined contribution schemes). Not all companies have responded for a variety of reasons, such as insufficient time to devote to completing the survey or a very small number of UK based employees (for example a FTSE listed holding company). Also, not all companies have been able to respond to all the questions asked. However, we believe that this survey is as representative as possible in revealing the DC designs offered to employees by UK blue chip companies.
- 1.2 There are a number of companies which offer multiple DC schemes and, in most cases, they have reported on the main DC scheme. However, a few companies with more than one DC scheme of significant size were felt to be worth including in the survey.

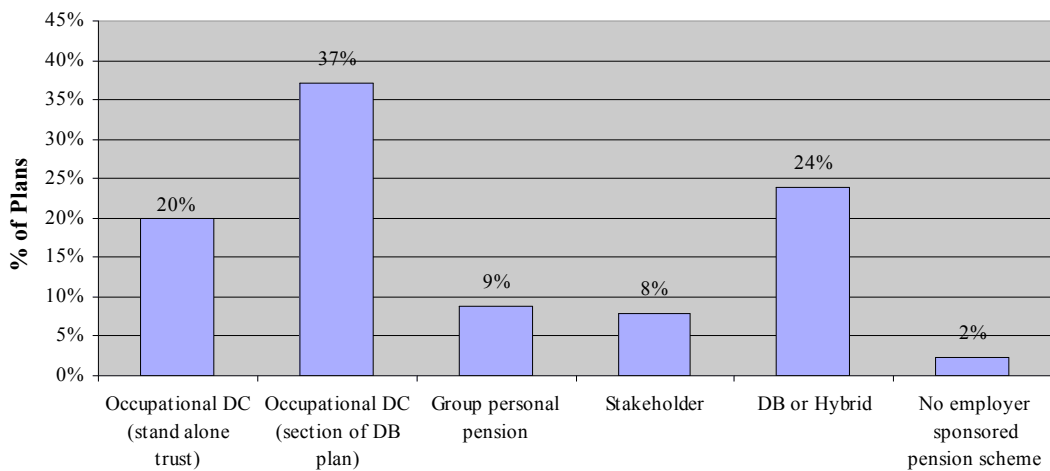
Thank you

We would like to take this opportunity to offer our sincere thanks to the companies who took the time and trouble to help us complete this survey.

2 Plan types and design

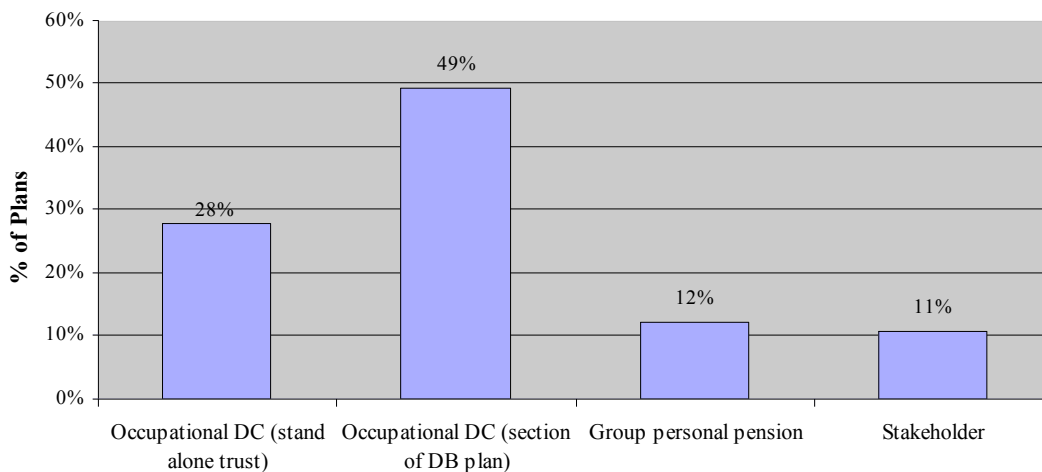
- 2.1 Approximately 74% of plans surveyed are DC schemes into which the employer contributes. We have excluded plans with no employer contribution and any contribution structures targeted specifically at executives.
- 2.2 The chart below shows the percentage split between different types of pension provision detailed within the survey responses received by Watson Wyatt.

Types of pension plan



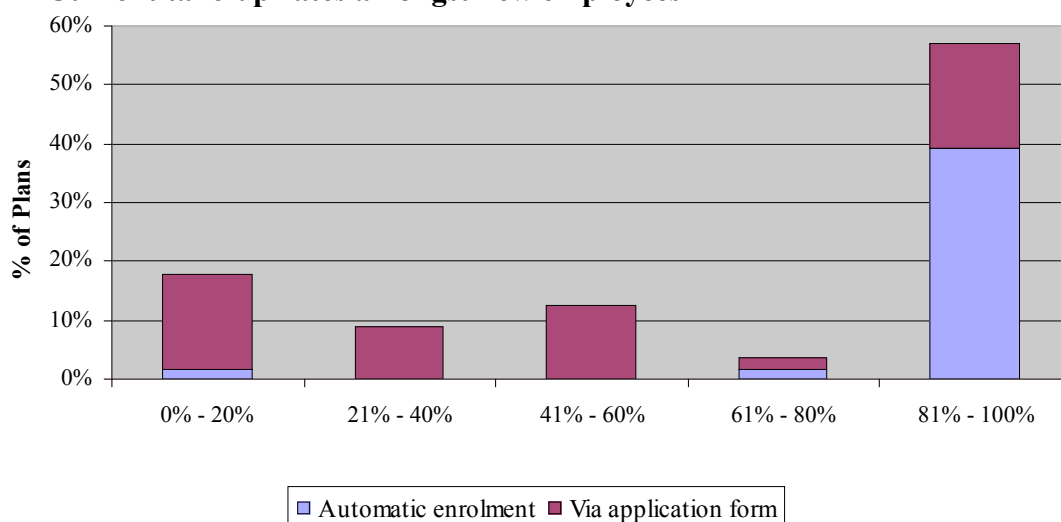
- 2.3 The chart below shows the percentage split between the different types of DC plan offered within the total of 65 plans for which we have data.

Types of DC plan



- 2.4 Over three-quarters of DC plans are occupational, trust-based schemes. This is an increase on last year from two-thirds, as well as an increase on 2004. Some of this may be attributable to the fact that the composition of survey respondents has changed but it is still a fact that occupational DC schemes remain popular within this universe of companies.
- 2.5 We have split occupational schemes between stand alone schemes and DC sections set up within an existing trust (e.g. where a DB scheme has been closed to new entrants and/or to future accrual). The statistics show that more occupational schemes are set up as a section of an existing trust than are established as stand alone schemes.
- 2.6 Membership take up rates, shown below, reveal a similar pattern to the 2004 and 2005 surveys. Based on the 56 responses received for this question, the percentage of plans with take up rates of over 80% is now 57%. This is evidence of Watson Wyatt's experience with new DC schemes that employers are increasingly utilising automatic enrolment. This year, for the first time, we have shown the split between employers offering automatic enrolment and those requiring an application form. As anticipated, the trend shows lower take up rates for companies requesting completion and return of an application form.
- 2.7 Of the 56 responses received, 18% of schemes still have very low take up rates (less than 20%). This may be accounted for by low employer contribution rates but is more likely to be due to low levels of employee awareness and engagement. There is also anecdotal evidence of a correlation between low take up rates and a high proportion of female employees, part-time workers and/or high levels of turnover.

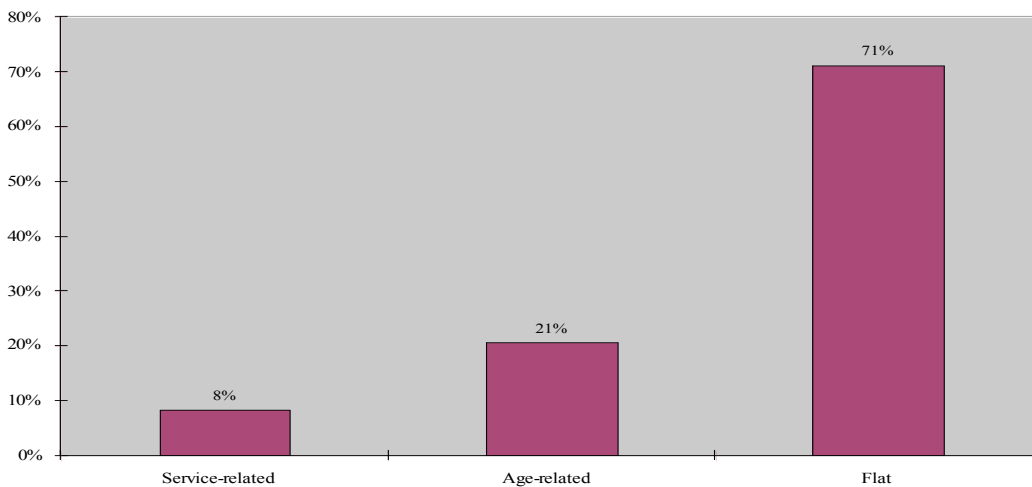
Current take-up rates amongst new employees



3 Contribution rates

- 3.1 Only 4 companies offer an occupational DC scheme which is contracted-out of the State Second Pension (S2P). It is less and less common for companies to offer contracting-out through an occupational scheme, as it has become less financially attractive for members to contract-out of S2P.
- 3.2 There are three common types of contribution structure and the split is shown below.

Comparison of structures



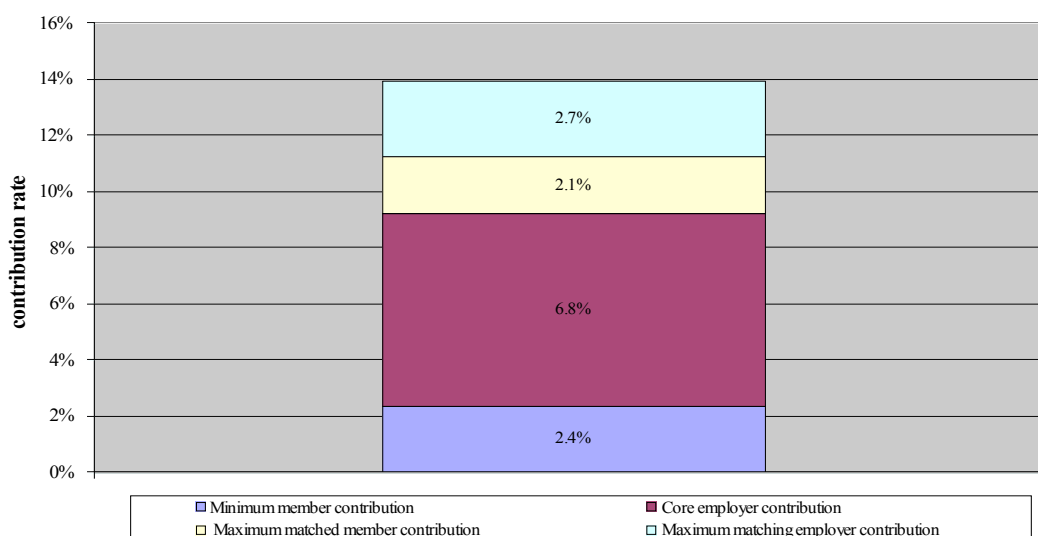
- 3.3 The percentage of schemes with flat structures (by “flat” we mean either one contribution rate for all members, or a core rate with scope for additional matching contributions) is roughly the same as last year (71% in both 2005 and 2006). Service-related schemes account for 8% and, the number of age-related schemes has decreased from 25% in 2005 to 21% in 2006. This is probably due to the Age Discrimination legislation that is effective from December 2006.
- 3.4 In 66% of plans, employers offer some form of additional matching contribution on top of the core contribution to those employees who choose to make additional contributions of their own. The matching bases are typically 1:1 or 1:2 up to a maximum limit. This reveals an increasing trend (42% in 2004 and 57% in 2005) of plans offering matching contributions.
- 3.5 In the following charts we compare the average contribution rates under flat, service-rated and age-related structures.

Average flat contributions

3.6 In the chart below we show the average contribution rates of those DC schemes that offer a flat contribution structure, both with and without employer matching of member contributions. The chart is split as follows:

- Minimum member contributions – the average percentage of pensionable salary that an employee is required to contribute as a condition of membership
- Core employer contributions – the average percentage of pensionable salary that an employer will contribute if the employee pays the minimum
- Maximum matching member contributions – the average maximum matched employee contribution that an employee could pay to gain the maximum employer contribution
- Maximum matching employer contributions – the maximum matched contribution that the employer is prepared to pay if the member pays the maximum matched employee contribution.

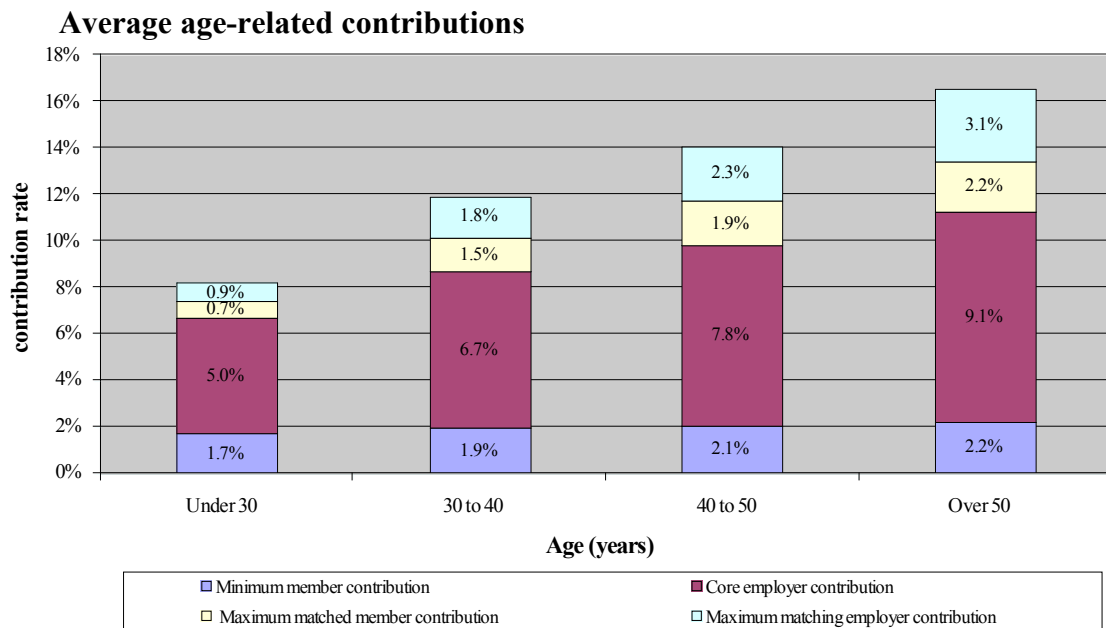
Average flat contributions



3.7 The average structure shows a significant shift from last year. Core employer contributions have increased from 5.7% last year to 6.8% this year. Although some of this may be attributable to movements in the FTSE 100 index and the survey respondents, some is also due to the fact that companies are reviewing their core contribution structures and improving employer rates, without necessarily asking employees to increase their own contributions (average member core contribution rates have only increased marginally since last year from 2.2% to 2.4%). On the other hand, average employer and employee matching rates are lower than last year.

Average age-related contributions

3.8 In the following chart we show the average age-related contribution structures including any additional matching contributions.



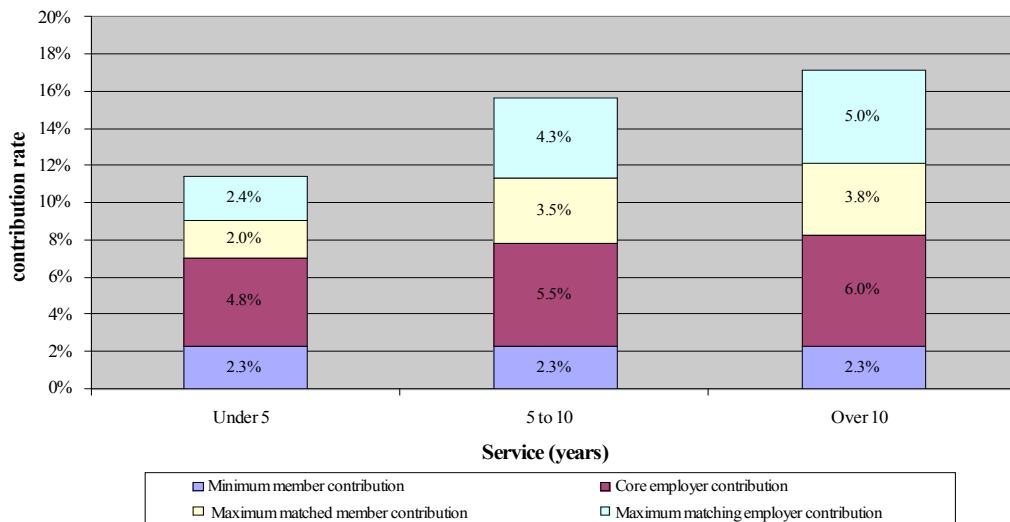
3.9 The contribution structures for age-related rates reveal a similar pattern to flat rates, with employer contributions increasing from last year. For members aged under 30, the core employer contribution has increased from 4.1% in 2005 to 5.0%; for ages 30 to 40, the core employer contribution has increased from 5.7% to 6.7%; for ages 40 to 50 the core employer contribution has increased from 7.0% to 7.8% and, for those over 50, the core employer contribution has increased from 8.0% to 9.0%.

3.10 Average core employee contributions are roughly in line with 2005, with average maximum matching contribution structures decreasing slightly.

Average service-related contributions

3.11 To simplify the chart, we have divided the service periods into under 5 years, 5 to 10 years and over 10 years, although companies will have structures that differ widely from this. The chart also includes any average maximum matching contributions.

Average service-related contributions



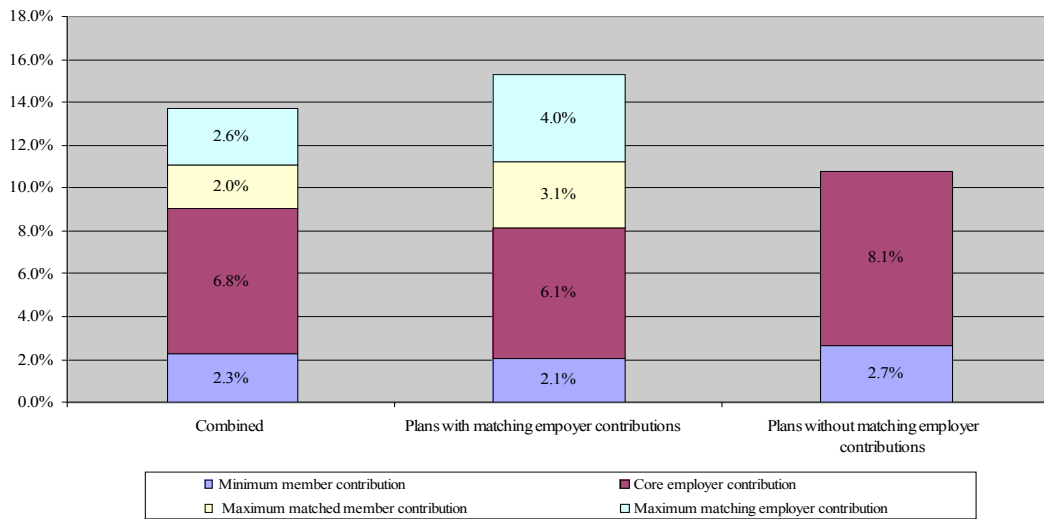
3.12 As would be expected, average core employer contributions increase with years of service. However, employees are not typically asked to commit to higher contributions to take advantage of the additional service-related core contributions.

3.13 Average maximum matched contributions also increase in steps with years of service, for both employees and employers.

Overall average contribution rates

3.14 The chart below compares all types of schemes (i.e. flat, age and service-related contribution structures), with and without matching, against schemes with matching structures only and schemes without matching contributions only. Not surprisingly, matching contribution structures offer the best possible overall level of contribution.

Overall average contribution rates

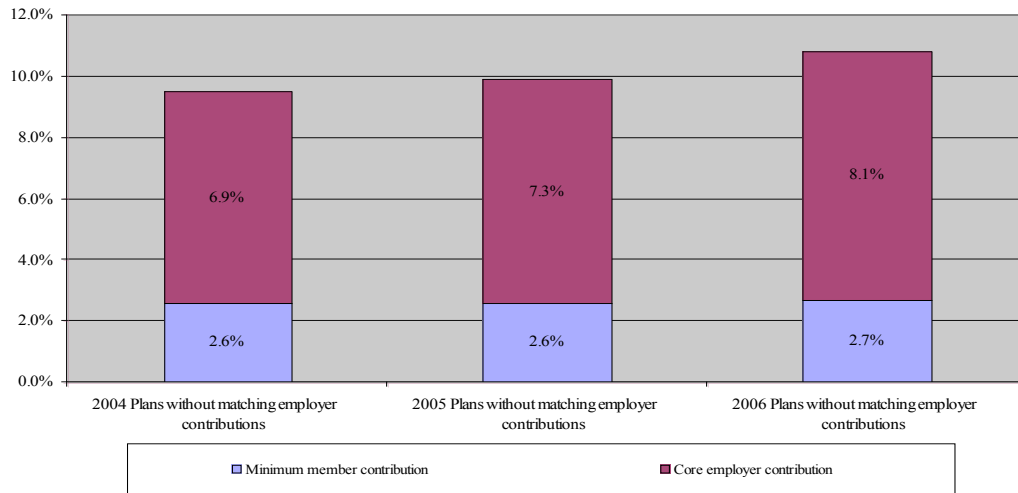


3.15 The charts showing average maximum matching contributions do not show whether members are actually taking advantage of the additional employer contributions. If members are not using this additional facility (where available) the average core employer contributions tend to be lower so that members of these schemes may find themselves worse off than those in schemes not offering any matching contribution.

Overall average contribution rates – trends over 2004, 2005 and 2006

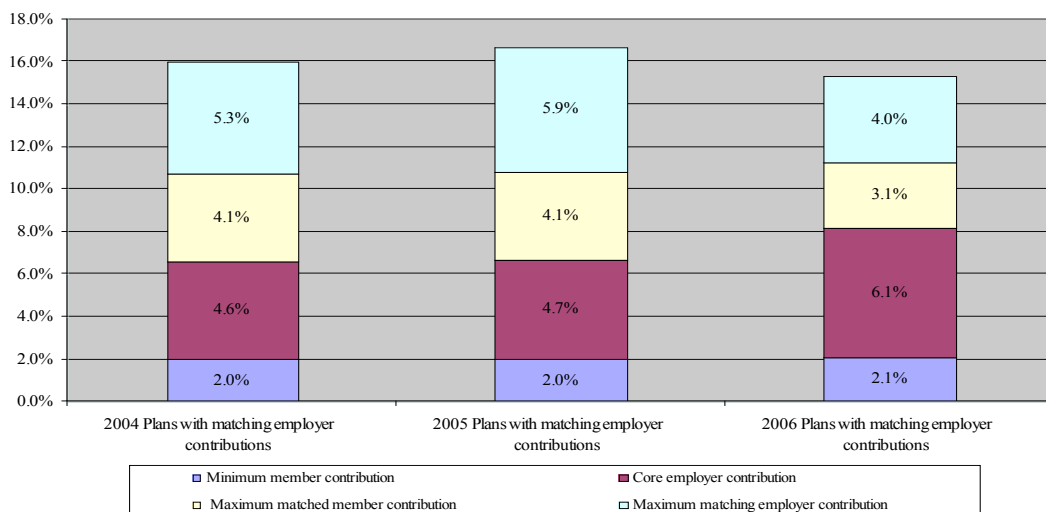
3.16 The chart below compares 2004, 2005 and 2006 average core employer and employee contributions for all schemes where there is no matching contribution structure. It reveals a trend of increasing employer contributions with no corresponding requirement for any significant increase in employee contributions.

Overall average contribution rates – without matching

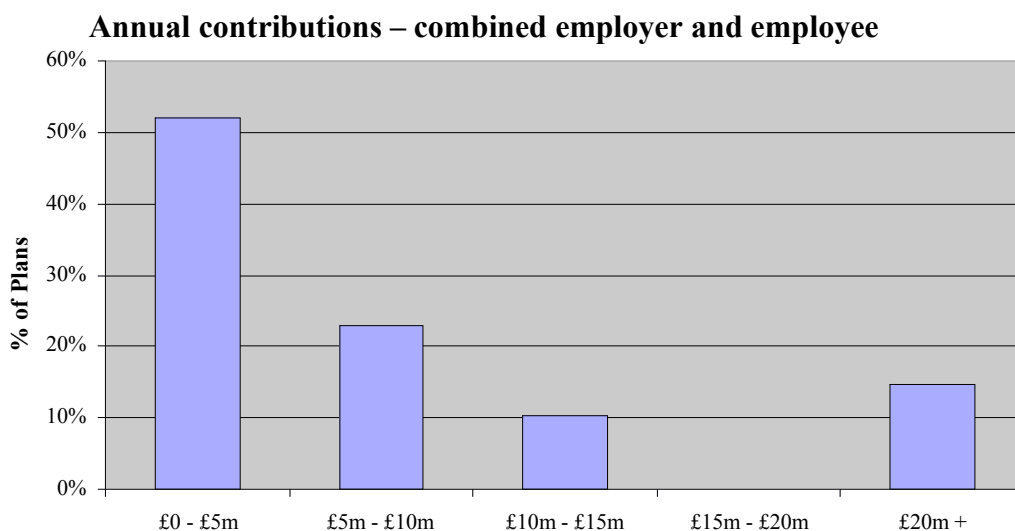


3.17 The chart below also compares the 2004, 2005 and 2006 average core and maximum matching employer and employee contributions for schemes with matching contributions.

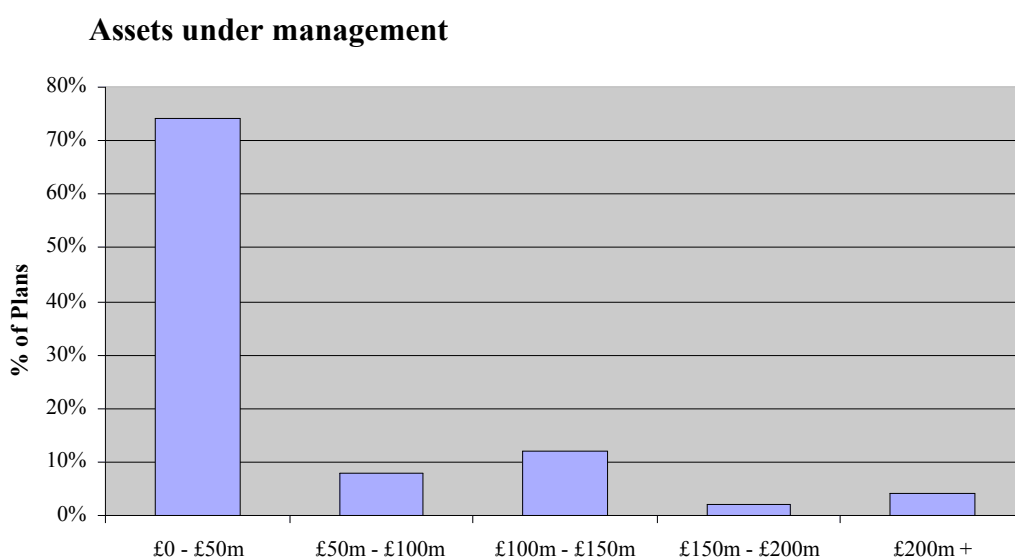
Overall average contribution rates – with matching



3.18 This is the first year that we have decided to analyse contributions in terms of value and the chart below shows the distribution in tranches of £5 million for the 48 respondents. Contributions to DC schemes are still significantly smaller than their DB counterparts.



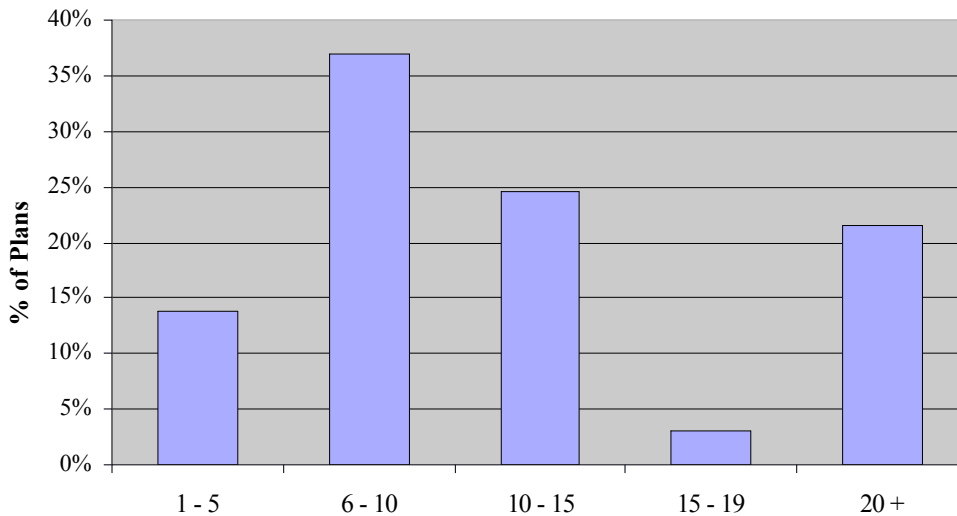
3.19 The chart below reveals that DC schemes are still very immature in comparison to DB schemes, but it is interesting to note that there are a small number of schemes in the higher groups of £100-150 million, £150-200 million and two valued at over £200 million. This is the first year we have requested this data from FTSE 100 companies and the chart below is based on the 50 responses received.



4 Investment options

4.1 There is a significant difference between the number of investment funds offered by occupational schemes and contract-based schemes, with stakeholder schemes and GPPs tending to offer a much wider range than occupational schemes. The data indicates that most occupational schemes continue to offer between 6 and 15 funds. This presents a similar picture to last year, albeit the percentage of schemes offering more than 20 funds appears to have grown.

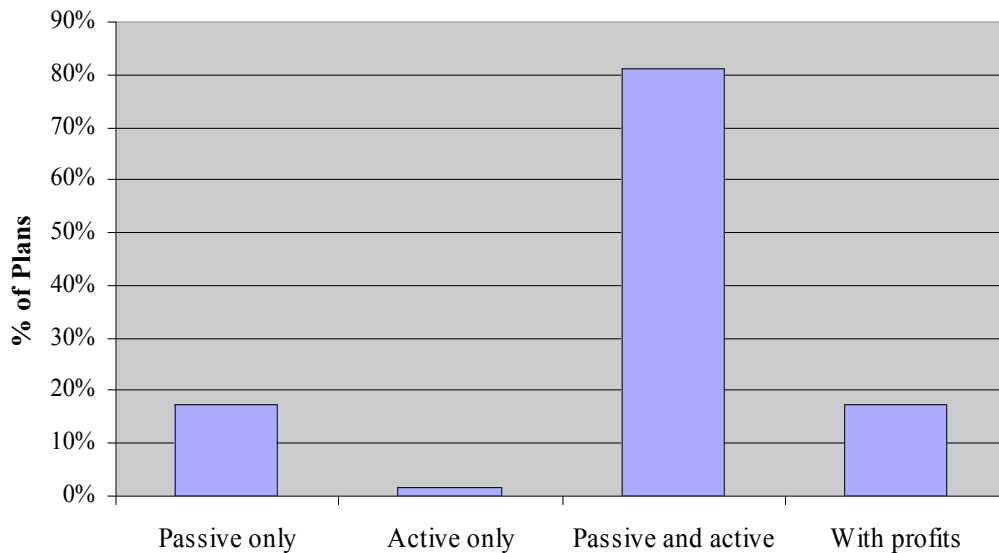
Number of investment funds available



4.2 Most schemes now offer a range of active and passive funds. A relatively low percentage of schemes offer only passive funds, whilst one scheme in the survey offers active investment options only.

4.3 Some schemes continue to offer a with-profits fund, probably due to legacy issues and the presence of market value adjustments.

Types of funds available

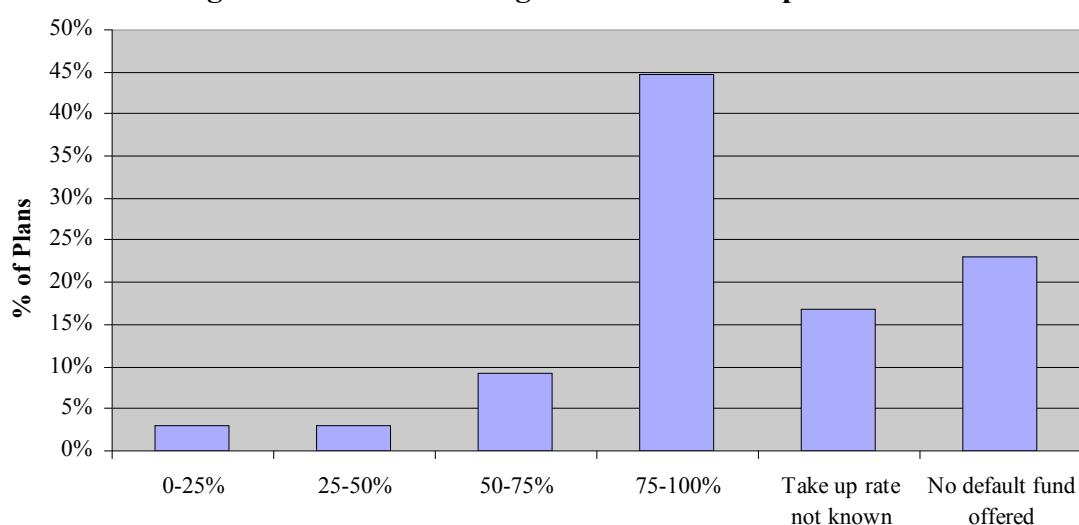


Default options

4.4 77% of schemes offer a default investment option (including stakeholder schemes where providing a default is mandatory). 86% of the respondents offering a default fund use a Lifestyle strategy.

4.5 The percentage of members selecting the default fund option is shown below. Where a default option is available, the majority of members, 75% to 100% will typically be automatically enrolled, defaulted into it or have selected the default.

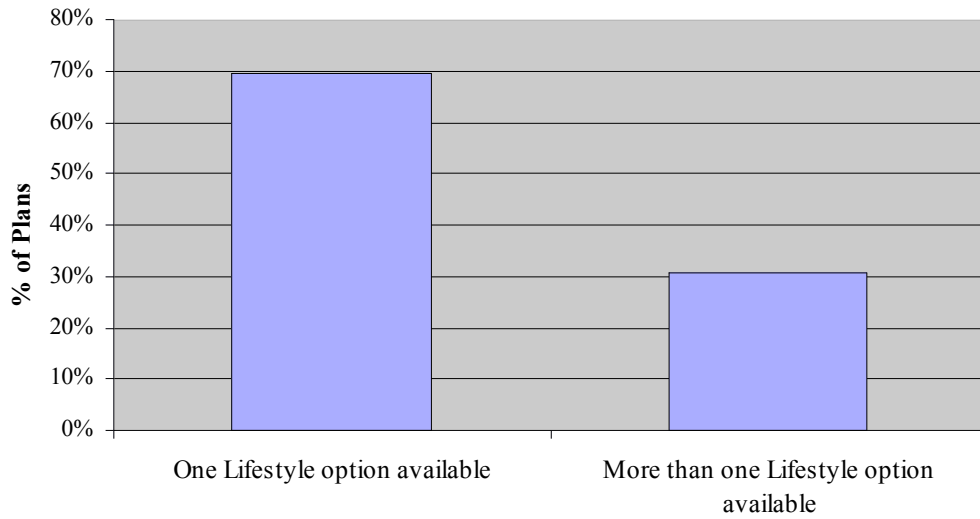
Percentage of members selecting the default fund option



Lifestyle options

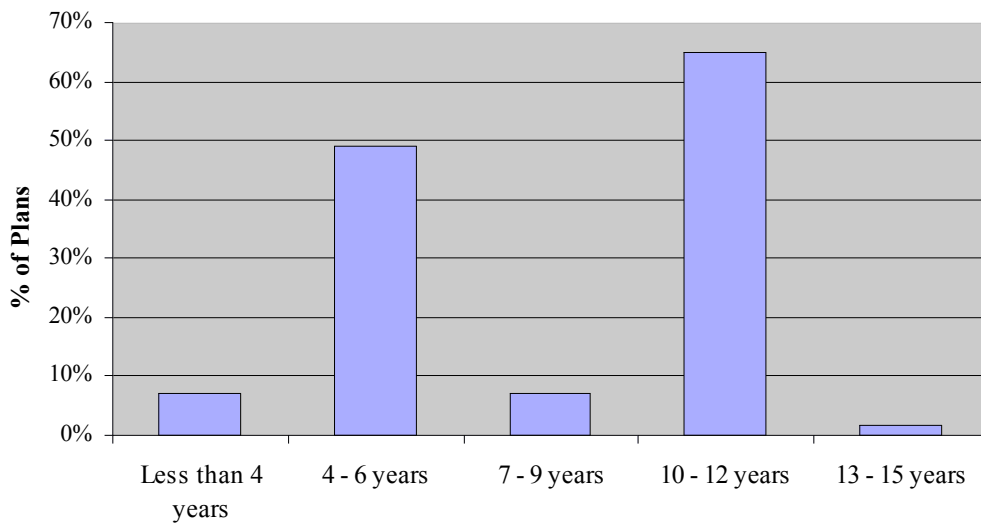
4.6 Of the 95% of schemes offering Lifestyle, 69% only made one strategy available. The percentage last year, at 71%, was very similar. The remaining 31% of these schemes offer more than one Lifestyle option. Only 5% of schemes do not provide a Lifestyle option at all. Trustees and contract-based scheme providers are increasingly moving towards offering multiple Lifestyle options, with different funds and/or different switching periods, thereby giving members more flexibility.

Lifestyle options



- 4.7 The two most popular switching periods are still 5 and 10 years but there has been a shift from 2005, with 10 years now more popular than 5 years.

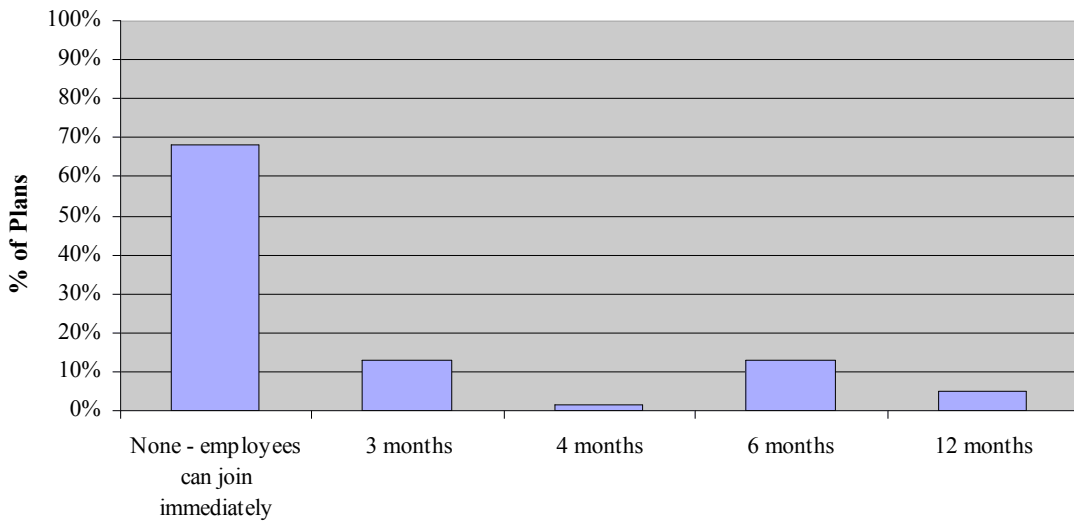
Lifestyle switching period



5 Other aspects of DC design

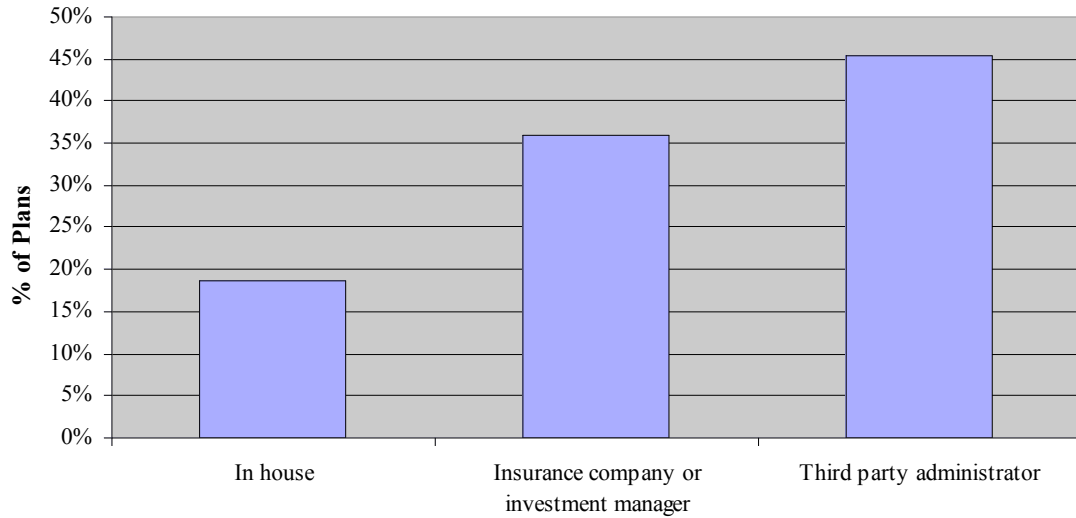
- 5.1 The scope of this year’s survey has been broadened to include other aspects of DC design in which we felt employers would be interested.
- 5.2 The chart below shows that of the 63 respondents, 68% of schemes offer immediate access to new employees. A few stipulate either 3 or 6 months’ waiting (often this is consistent with an employer’s probationary period).

Waiting periods



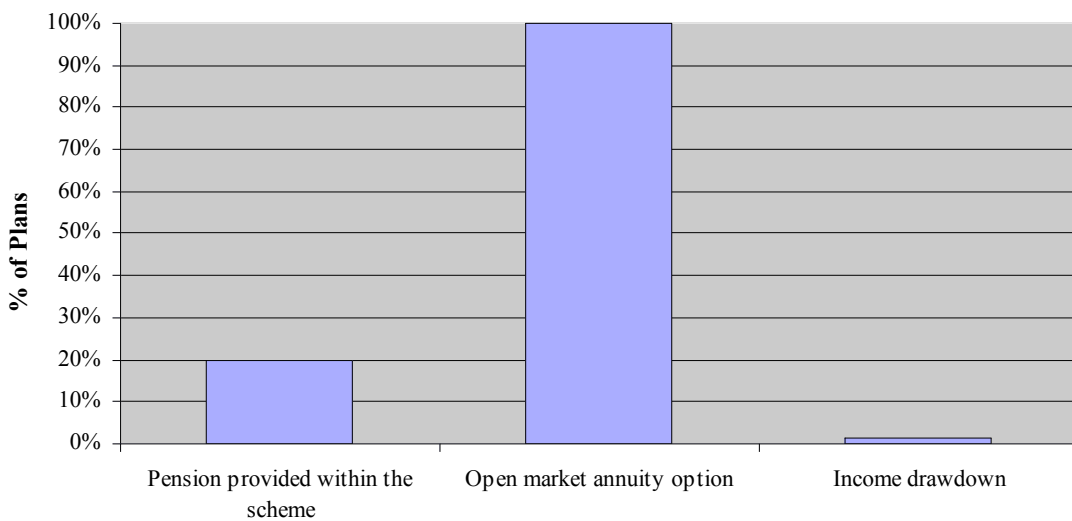
- 5.3 We asked participants in the survey to tell us whether their administration services are provided by a third party administrator, in house or through a “bundled” arrangement through an insurance company or pension provider.
- 5.4 45% of schemes’ administration is carried out by third party providers. This reflects the fact that FTSE 100 companies are offering DC schemes at the top end of the market and have sufficiently high numbers of members, cash flow and assets under management to make this a cost-effective method. More than 35% of schemes use an insurance company or investment manager and this will, of course, represent all GPP and stakeholder schemes as well as some “bundled” occupational money purchase schemes. Those companies providing in-house administration services typically do so as they have historically operated such administration services.

Administration services



5.5 The chart below shows that 20% of schemes offer a pension from within the scheme. This is typically through the main DB fund where the DC arrangement is a section of the same trust. 100% of schemes, regardless of whether they also offer an in-house pension, offer an open-market option, as required by legislation. In our survey only one scheme offers income drawdown. This is despite the fact that companies can now offer this facility from within their scheme (including occupational schemes). Most companies prefer to avoid the complexity.

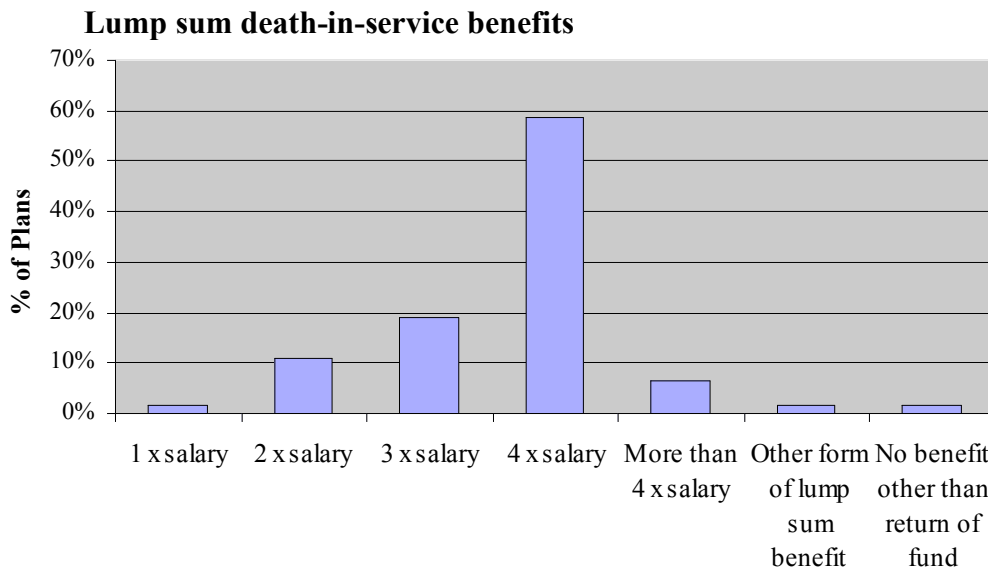
Retirement options



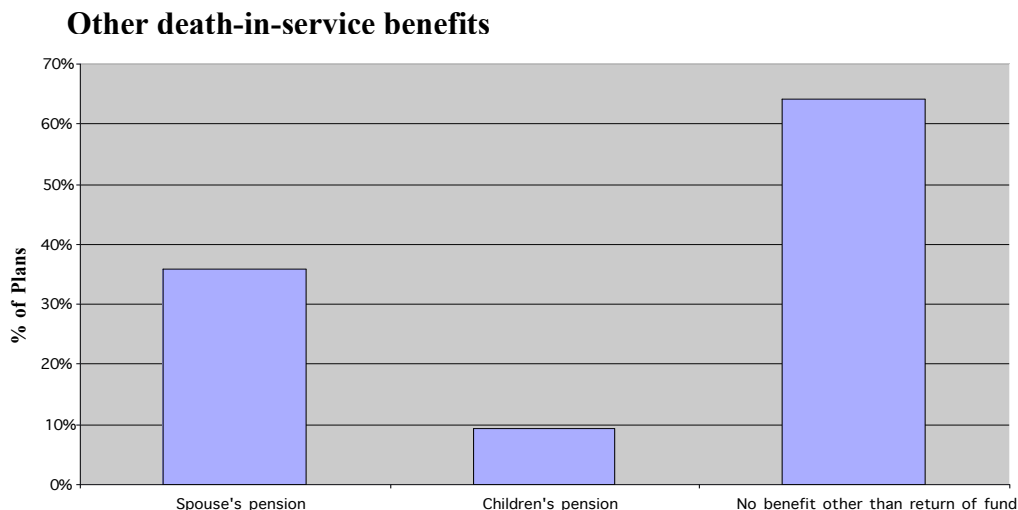
6

Death-in-service and ill-health benefits

- 6.1 The chart below shows the lump sum death-in-service benefits offered to employees. Please note that this is representative of FTSE 100 companies offering DC schemes, not the entire FTSE 100 universe. The most popular option by far is four times pensionable salary. A few companies have taken advantage of the Simplification rules introduced in April 2006 to permit a multiple higher than four times.
- 6.2 The lump sum shown on this chart is in addition to the return of the member's DC fund value.

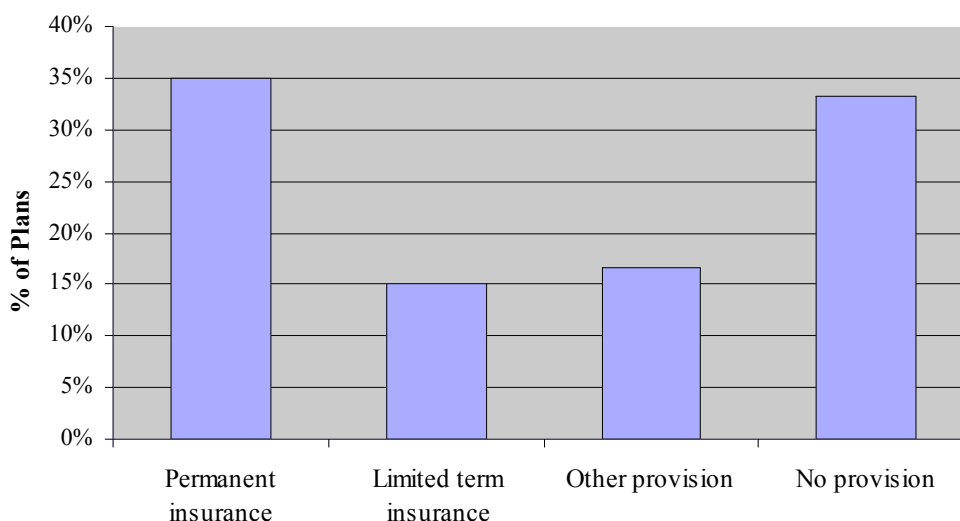


- 6.3 The chart below shows the other types of benefit provided by schemes on death-in-service. The conclusion that we can draw is that most schemes simply purchase an additional pension based on fund value at death (and/or give a lump sum), with only 35% of schemes offering a spouse's pension in addition. "Spouses" now also includes Civil Partners.



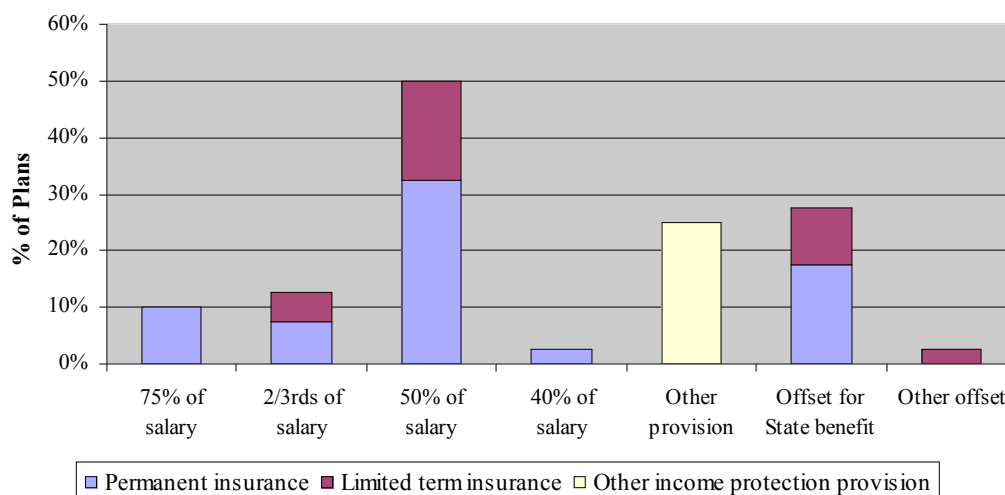
6.4 Of the 60 respondents to this question, incapacity benefits are offered by 67%. 35% of respondents offer a permanent health insurance policy and 15% offer a limited term income replacement policy providing for payments for between 2 and 5 years. 17% of respondents offer provision that takes an alternative form (such as additional lump sums). The remainder of the respondents (33%) make no provision. The provision of Permanent Health Insurance (PHI) amongst employers with DC pension arrangements is likely to be higher than for the FTSE 100 as a whole, as those organisations which still provide DB benefits would typically provide incapacity benefits within the pension scheme rather than through a separate PHI arrangement.

Incapacity benefits



6.5 Of the respondents offering some form of incapacity benefit, 50% offer a replacement of 50% of salary on either a permanent or temporary basis. The 'other benefit' shown refers to those respondents who provide alternative incapacity provision. Our chart does not analyse which schemes' income protection definition includes the offset for State benefit, although the overall figure is over a quarter.

Level of incapacity benefit

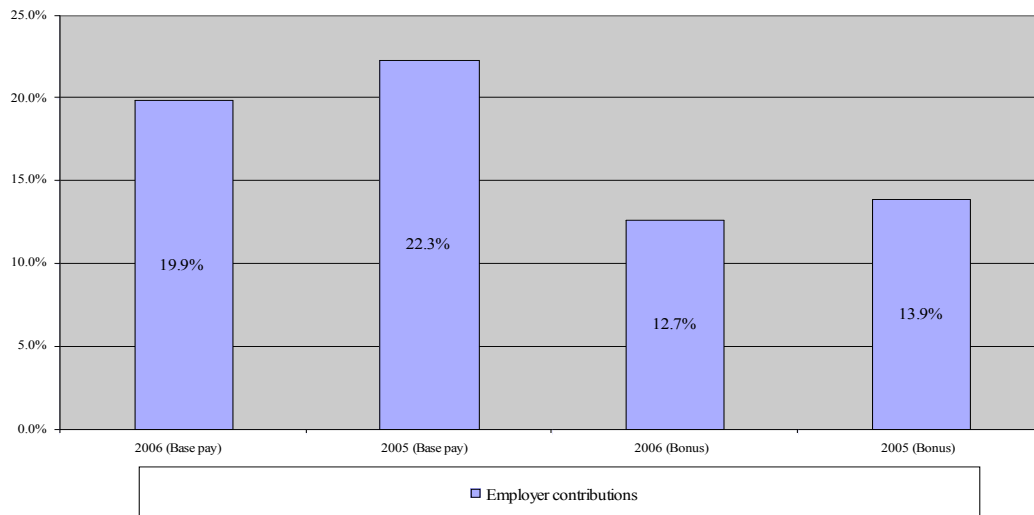


7

DC contributions for executive directors

- 7.1 As a concurrent exercise with our FTSE 100 Survey, we have collated pension data for executive directors. Below we present the data for 2006. All information is collated from the annual report and accounts of FTSE 100 companies.
- 7.2 This Executive Pension Database (EPD) includes information on basic pay, bonuses and the value of DB and DC, approved and unapproved, UK and overseas benefits.
- 7.3 In total we have reviewed data for 490 such directors of all FTSE 100 organisations (in 2006) of which 114 received employer contributions to an approved DC Pension Plan.

Overall average contribution rates



- 7.4 The charts above include pension data for executive directors across the FTSE 100. However, it is particularly difficult to draw conclusions from our analysis given that most employers are understandably reluctant to disclose full details of their senior employees' benefit packages.

8 Further information

- 8.1 In the course of producing this Survey we have collated a significant volume of information that we used for 'cutting' the data and cross-referencing purposes. For the sake of brevity, we have not reproduced all of the data here.
- 8.2 In addition, we publish a range of other surveys including the Pension Plan Design Survey.
- 8.3 If you would like further information then please contact either your normal Watson Wyatt consultant or Gary Smith at the address below.

October 2006

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