

Managing pension scheme risk

Changing benefit design to reduce risk

September 2006

The cost and risk associated with defined benefit pension schemes remain high on the corporate agenda. As a result, many companies are re-examining the benefit design – this bulletin highlights the emerging trends.

The changing landscape

Watson Wyatt's 2006 Pension Plan Design Survey demonstrated that companies are making wide-ranging changes to pension scheme benefits; these findings were applicable irrespective of whether companies have closed defined benefit schemes to new hires, or not.

Such changes could have a material impact on companies' financial statements: on both service cost and balance sheet.

The wide variety of pension changes

The most common changes to date have been to increase member contribution rates and/or reduce accrual rates. Our survey showed that companies expect to increase member rates still further over the next two years.

What other changes are being made? Here are just a few examples:

- **Increase the normal retirement age:** typically to age 65
- **Limit the amount of each annual pay rise that is pensionable:** for example, only 50% of each annual pay rise might be pensionable, or impose a limit of RPI. This could result in a design similar to a career average scheme.
- **Reduce the cap on pension increases from 5% to 2.5% a year:** almost 40% of companies have adopted this change.
- **Give employees a choice:** target the pension spend at those employees that really appreciate it. Members can elect to pay higher contributions to maintain defined benefits whilst other employees can pay lower contributions in return for, say, a defined contribution scheme.

Some companies are being still more innovative and introducing 'risk sharing' elements into the design, so that members share the burden of any future increases in pension costs.

The information in this document is based on UK legislation and practice. The Watson Wyatt commentary in this document is not intended to be comprehensive, nor to provide professional advice. It should not be treated as a substitute for professional advice on individual circumstances.

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The broader context

With unions and employees increasingly aware of the value of defined benefit pensions, the communication of any benefits changes needs to be managed carefully. Companies are increasingly seeing pensions as a part of the overall remuneration to employees, and using the 'bigger picture' to introduce change. For example:

- Use improvements in other elements of pay (eg bonus, share save schemes) to balance out any reductions in pension benefits.
- Introduce a flex package, so that the total value of benefits is clear.
- Focus overall spend on specific groups of employees; for example, reward loyalty by giving access to improved benefits.

How can we help?

We would be delighted to explore these matters in greater depth with you, helping you to develop a clear understanding of your options, in light of your objectives and current scheme design.

Further information

To find out more, please contact your Watson Wyatt consultant or call Steven Dicker on 0161 839 1600 or Andrew Reid on 020 7222 8033.