

# corporate briefing



## Tackling pensions in turbulent times – seminar highlights

### Summary

Watson Wyatt's Corporate Consulting Group held its latest seminar on 5 December 2008, exploring some of the actions companies can take and other key issues facing sponsors of defined benefit pension plans. The key points coming out of the seminar were:

- A new trend is emerging - ceasing future accrual for existing final salary scheme members - with economic pressure as justification. But successful implementation still requires planning and commitment.
- Trustees are likely to be requesting additional contributions at a time when they are least affordable - preparation is key to negotiating a good result.
- In a time of even higher investment risk and cost, sponsors need to take action on to ensure that their objectives are met.

Many companies are tightening their belts in the face of unprecedented turmoil in financial markets and an uncertain economic outlook. In business conditions that appear to be getting tougher by the week, tackling pension costs may pay dividends for some and prove to be a necessity for others.

Watson Wyatt's Corporate Consulting Group held its latest seminar on 5 December 2008, exploring some of the actions companies can take and other key issues facing sponsors of defined benefit pension plans, in particular, plan design, funding and investment. The briefing was attended by delegates comprising senior finance, treasury and pensions executives and their advisers. This corporate briefing summarises the headlines from the seminar.

### Plan design – successful change

Statistics, including the Watson Wyatt 2008 pension plan design survey, show that the trend of closing final salary pension schemes to new hires is increasingly complete. However, to date, companies have been reluctant to take the next step in risk containment - ceasing future accrual for existing members. This may now be about to change, as recession and cash flow limitations force employers to look at every avenue to reduce costs.

An internal survey of Watson Wyatt clients showed that 14 had already taken this step, with existing scheme members being switched to defined contribution arrangements for the future, while many others are planning to do so in 2009. A further eight companies had converted their final salary schemes to career average or cash balance (where the benefit accruing is a lump sum rather than a pension and the member bears the longevity risk and post-retirement investment risk). The driver for these closures is nearly always cost and, in the face of a difficult financial environment, the business case for such change is compelling; employers will be less concerned about employee reaction and potentially adverse PR.

As with any pension scheme design change, however, planning is essential. The lessons we have learned from our involvement in these projects include:

- developing a coherent and open business case
- involving senior management in delivering and supporting the message
- allowing adequate time – and resource – for the consultation process, with project management a key element
- running a genuine consultation process with no pre-planned concessions, but flexibility to respond to employee reactions.



“...the diverging pressures on trustees and companies may lead to more difficult funding negotiations than previously experienced”

“Gaining influence will need a pro-active strategy from the company, demonstrating to the trustees that members’ interests will not be weakened”



### **Scheme-specific funding - negotiating the best deal**

The financial crisis and onset of recession have put pressure on corporate cash flows while at the same time making it difficult for companies to access external finance. These same factors mean that many trustees will be looking for increased contributions as a result of falls in scheme asset values and potential concerns about the sponsor covenant. The outcome of this is a potential ‘double whammy’ of trustee requests for additional cash contributions at a time when they are least affordable.

Whilst the Pensions Regulator has issued a statement advising trustees not to seek contributions that jeopardise a company’s future prospects, the diverging pressures on trustees and companies may lead to more difficult funding negotiations than previously experienced. Our tips for corporates engaging in pension scheme funding negotiations include:

- understand the range of the possible results – what is the best result from the corporate perspective and what is the absolute maximum affordable
- effectively present the corporate covenant – make sure the trustees focus on the right metrics
- decide on a negotiating strategy – is there an advantage in driving the agenda or letting the trustees lead?
- investigate the assumptions and be able to support the corporate view – even the more ‘minor’ assumptions can have a significant impact in the context of any deficit
- a deficit doesn’t need to be met in full by cash, for example, higher investment returns could be allowed for in the recovery plan
- consider alternatives to cash: guarantees, contingent assets, escrows etc
- if you give something away, get something in return, for example, control of the investment strategy
- understand the options if differences are irreconcilable, such as, closure to new accrual.

Most importantly, be prepared!

### **Corporate influence on investment strategy – more necessary than ever**

Even though companies have seen the headlines, they are only now starting to appreciate the extent of the financial turmoil’s damage to their pension schemes – especially because the accounting numbers have appeared so benign.

It therefore seems surprising that most companies have little or no influence on the investment strategy their schemes follow? As an analogy: would a company be financing and underwriting a major subsidiary without control or influence on how it goes about its business?

Given the legislative restrictions, obtaining influence is problematic. As mentioned above, one possible strategy is for companies to look at it as part of negotiations when agreeing scheme contributions. This said, a large number of trustee bodies will appreciate the extra expertise and insight the company can bring to the investment strategy question. Gaining influence will need a pro-active strategy from the company, demonstrating to the trustees that members’ interests will not be weakened. This strategy must be integrated with the steps identified in the section above.

“There are significant opportunities at the moment to reduce investment risk and improve outcomes”



A company's 'normal' perspective on their balance sheet, profit and loss account and their cash flows has probably changed in recent months. Pension scheme investments pose distinct threats to each of these and a key step (in focussing on changed circumstances) is for the company to be fully aware of what these threats are.

There are significant opportunities at the moment to reduce investment risk and improve outcomes. Companies must help to drive the process to take advantage of these. Indeed, given a company's specific objectives and priorities, opportunities will probably exist that only the company can effectively identify and act upon.

#### **Further information**

At Watson Wyatt we have significant expertise advising sponsors on these issues. If you would like to explore these topics further please contact your Watson Wyatt consultant or:

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