Unprecedented times need unprecedented action

Managing your UK pension scheme creditor during the downturn*

A report for organisations with UK pension schemes supported by the 4th annual PwC pensions survey – February 2009
‘As well as treating their pension scheme as a major creditor, an increasing proportion of companies are recognising they need to apply the same disciplines to their UK pension scheme as to any other major subsidiary. That means running the pension scheme as any other business, and ensuring appropriate and quality management of cash, risks, costs and value.’

PwC pensions survey
February 2009
‘The cost of capital is soaring and there is a paucity of available debt refinancing. It’s essential that companies start planning now for how to address pension scheme commitments as part of any overall need to refinance.’

PwC pensions survey
February 2009
Foreword

Unprecedented times need unprecedented action. The current economic downturn, and the subsequent dire straits in which many businesses now find themselves, are also an opportunity to make and implement decisions to tackle ‘sacred cows’ that to date many have found too difficult to address. Among these is companies’ need to regain control of their UK pension provision and associated financial and risk management.

This fourth annual PricewaterhouseCoopers pension survey of 98 organisations, including 29 from the FTSE100, highlights the impact that UK defined benefit (DB) pension schemes are having on businesses during the downturn. However, it also shows there is a renewed determination by those organisations that sponsor UK DB pension schemes to take the actions necessary to regain control and ensure better value for the money being spent and risks being taken.

Commercial approach to managing pension obligations

UK pension schemes represent the largest creditor for many businesses in a world where companies have to manage their creditors with careful attention, the impact of which can affect a business’ robustness and even survival. The cost of capital is soaring and there is a paucity of available debt refinancing. Yet many companies, including blue-chip and strongly rated organisations, are in a position where over the next few months they need to restructure, renew or renegotiate their finance facilities. It’s essential that companies start planning now for how to address pension scheme commitments as part of any overall need to refinance.

As well as treating their pension scheme as a major creditor, an increasing proportion of companies are recognising the need to apply the same disciplines to their UK pension scheme as to any other major subsidiary. That means applying the same commercial focus given to the rest of the business, ensuring appropriate and quality management of cash, risks, costs and value. This requires evaluation of the financial and risk positions for the pension scheme consistent with the rest of the business, establishing more formal and commercial relationships with trustees, more assertive management of information and decision-making, and better use of advisers.

The governance of the pensions subsidiary cannot be left to pensions professionals alone. Today’s pension challenges have wide-ranging commercial implications and a range of stakeholders, including finance, treasury, tax, HR, investor relations and business leaders, increasingly need to be engaged in making informed decisions.

This report sets out our thinking about what companies need to do to manage their UK defined benefit schemes during the downturn, informed and reinforced by our most recent experience working with many UK employers as well our survey, in which finance directors, HR directors and pension managers of 98 organisations participated.

We trust you will find this report helpful and we look forward to hearing about your own views, challenges, experiences and suggestions.

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Key findings of the survey

The top pensions-related concerns for UK companies currently all relate to having control over one or more of three key issues:

**Cash** – how much cash are we having to divert into pension schemes and can we find a way to reduce our cash commitments during the current liquidity strain?

**Risk** – how do we reduce the ongoing risks that our UK pension schemes pose to our business?

**Cost and value** – how do we reduce the cost of our UK pension provision and/or improve the value we get as an organisation for what we spend on UK pensions?

<table>
<thead>
<tr>
<th>Proportion of companies concerned about inability to control pension scheme</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Costs</strong></td>
</tr>
<tr>
<td>Finance directors</td>
</tr>
<tr>
<td>Pension managers</td>
</tr>
<tr>
<td>HR directors</td>
</tr>
<tr>
<td><strong>Cash commitments (funding)</strong></td>
</tr>
<tr>
<td>Finance directors</td>
</tr>
<tr>
<td>Pension managers</td>
</tr>
<tr>
<td>HR directors</td>
</tr>
<tr>
<td><strong>Risks</strong></td>
</tr>
<tr>
<td>Finance directors</td>
</tr>
<tr>
<td>Pension managers</td>
</tr>
<tr>
<td>HR directors</td>
</tr>
</tbody>
</table>
Cash

- 81% are concerned about the size of cash commitments to pension schemes
- 81% of employers are concerned about the Pension Regulator’s stance on scheme funding prudence
- 58% of larger employers intend to be more assertive in presenting the employer covenant to the trustees, especially as:
  - 42% of finance directors think the employer covenant will be weaker at the next scheme funding negotiation relative to the last
  - 39% of large employers believe they need to be more assertive in managing the scheme funding negotiating process
  - 30% intend to use contingent assets to offer trustees security while enabling the company to limit cash commitments

Risk

- 90% are concerned about the risks their pension scheme poses to the business
- 85% are concerned about the pensions impact on their balance sheet
- 81% are concerned about the employer’s lack of control over pension scheme investment strategy
- 46% are considering buying-out liabilities, up from 35% in spring 2008
- 34% intend to hedge longevity risk, on top of the 3% that already have
- 33% intend to offer enhanced transfer values to deferred pensioners to reduce liabilities on the balance sheet, on top of the 4% that already have

Cost and value

- 90% are concerned about the impact of pensions on employee relations
- 85% are concerned about costs of pension provision
- 83% don’t think they’re getting value for the money being spent on pensions
- 45% intend to change their benefit design for existing active members, on top of the 14% that already have
- 23% now say pensions are less important than three years ago in attracting and retaining talent, the first time in our four surveys that ‘less important’ outweighs the number (18%) saying ‘more important’
- 17% intend to freeze future service pension accrual, up from 14% in spring 2008
Background and methodology

PricewaterhouseCoopers LLP has been advising a wide range of organisations on pension challenges and opportunities – from across industries and including government, employers, lenders, private equity, trustees and providers of pensions products and solutions. The thinking in this report is informed by that experience as well as the results of the fourth PricewaterhouseCoopers pensions survey.

The survey tracks the views of finance, HR and pensions leaders across 98 organisations including 29 FTSE100 companies, and was conducted electronically.

Our analysis has been categorised into the key themes of cash, risk, cost and value. However, not all of our detailed analysis is included in this report, so please do get in touch if there are any issues that you would like to discuss or if you would like the survey data in a different format.

Large and small employers

Throughout this survey we refer to large and small employers or organisations. For the purpose of the analysis, the following definitions apply:

- Large employer or organisation – 5,000 or more UK employees
- Small employer or organisation – less than 5,000 UK employees

Survey participants

98 organisations participated, including:

- 29 FTSE100 companies
- 31 other listed UK companies
- 38 owned by overseas parents, based in 14 different countries, private or non-listed companies
Participants

29% of the FTSE100 participated

Role
- HR directors: 17%
- Finance directors: 38%
- Pension managers: 45%

UK employees
- More than 10,000: 20%
- Between 5,000 & 9,999: 13%
- Between 1,000 & 4,999: 29%
- Less than 1,000: 38%

Sector
- Public sector: 1%
- Service sector: 10%
- Retail/wholesale: 6%
- Financial services: 28%
- Manufacturing/production: 28%
- Other: 27%

Pension scheme assets
- £1bn to £5bn: 24%
- £250m to £1bn: 30%
- Less than £250m: 34%
- More than £5bn: 12%

Size of pension scheme as percentage of market capitalisation of company
- Less than 25%: 46%
- 25-49%: 16%
- 50-74%: 8%
- 75-100%: 12%
- More than 100%: 18%
1. Cash

Cash commitments by a business to its UK defined benefits pension scheme are agreed at least every three years following a valuation by the scheme actuary. The scheme funding agreement has to be filed with the Pensions Regulator no later than 15 months from the valuation date, and is the result of a negotiation between the sponsoring employer(s) and the trustees. It includes a schedule of cash contributions (typically covering the next ten years) following the valuation date.

In negotiating scheme funding, trustees are required to act prudently and independently. They are required to take account of the specific circumstances of the scheme, including the employer’s ability and willingness to meet its financial commitments to the scheme – known as the employer’s covenant. All other things being equal, the past three years have seen trustees demanding more cash than ever before, with a powerful UK Pensions Regulator to support and monitor these demands. Many employers have made scheme funding agreements that have resulted in substantial cash commitments to their pensions creditor.

Divergence of cash and accounting

Today’s pension numbers calculated using accounting rules are masking the funding position as evaluated by trustees and the Pensions Regulator. This is because pension liabilities for accounting purposes are calculated using the yields on long-dated AA corporate bonds that, because of the credit crunch, are at historically high levels relative to the yields on government bonds (gilts) used by the trustees to calculate liabilities for funding purposes. The higher the yield, the lower the calculated liabilities.

Accounting calculations are increasingly irrelevant to trustees, who are responsible for negotiating funding commitments to pension schemes. Trustees are more likely to use a gilts-based approach to calculating liabilities for funding targets. We are seeing greater divergence between (relatively high) funding liabilities and (relatively lower) accounting liabilities. Some argue that accounting disclosures are masking the true position of a pension scheme as represented by the present value of future cash commitments.
81% are concerned about the impact of their pension scheme on cashflow

Concerns about cash commitments

The survey results confirm high levels of concern about cash commitments to UK pension schemes, with 81% of respondents concerned about the impact of their pension scheme on cashflow and 86% concerned about their lack of ability to control cash commitments.
Impact on accounts, credit rating and dividends

While cashflows are a pressing issue for many companies at the moment, a significant proportion are also concerned about the impact of their pension scheme on accounts and credit rating, and nearly half (45%) are even worried that their ability to pay dividends could be compromised.

Fig 1.3 Concerned about impact of pension scheme on company's financials

<table>
<thead>
<tr>
<th>Financial Aspect</th>
<th>Very Concerned</th>
<th>Somewhat Concerned</th>
</tr>
</thead>
<tbody>
<tr>
<td>P&amp;L</td>
<td>21%</td>
<td>66%</td>
</tr>
<tr>
<td>Balance sheet</td>
<td>30%</td>
<td>55%</td>
</tr>
<tr>
<td>Cashflow</td>
<td>28%</td>
<td>53%</td>
</tr>
<tr>
<td>Credit rating</td>
<td>6%</td>
<td>48%</td>
</tr>
<tr>
<td>Share price</td>
<td>3%</td>
<td>43%</td>
</tr>
<tr>
<td>Ability to pay dividends</td>
<td>8%</td>
<td>37%</td>
</tr>
</tbody>
</table>

Cash – action checklist for employers:

Current market turmoil, together with liquidity shortages, means some companies regret the richness of the pension scheme cash commitments to which they have agreed. Others are determined to learn from previous scheme funding negotiations and do things differently going forward. Actions that we recommend employers consider to control pension scheme cash commitments during the downturn include:

- Renegotiate prior scheme funding agreements, if necessary, to secure the financial structuring of the sponsoring employer – consider cash commitments to the pension scheme creditor in conjunction with renegotiation of debt to other creditors
- Be assertive in taking the appropriate level of control in scheme funding negotiation processes
- Help the trustees to understand the employer's objectives and constraints, including affordability
- Manage the trustees’ perception of your employer covenant
- Consider offering the trustees contingent assets or security in lieu of cash, as a way of avoiding unnecessarily tying up valuable capital while still meeting the trustees’ needs for security
- Assess whether and how you can reduce your levy to the Pension Protection Fund in the way that you structure participating companies, guarantees and contingent assets
Taking control of scheme funding

In the next round of scheme funding negotiations, 34% of respondents intend to increase the extent to which they control the scheme funding process.

The need to take greater control is even more important for employers that have large pension scheme liabilities relative to the value of the sponsoring company because their exposure to funding changes have a proportionately greater impact.
How are companies intending to achieve greater control?

49% of companies intend to communicate more explicitly the objectives and constraints of the business, so that trustees can take these into account in determining their funding demands. At the previous round of scheme funding negotiations, many companies failed to engage their trustees early and clearly enough.

Employer’s covenant strength and cashflow affordability are two of the most important aspects to help the trustees understand. There are currently many companies that are able to provide the trustees with a strong ongoing covenant (thus justifying a lower level of prudence in calculating liabilities) but who are cash constrained in the short-term (thus justifying longer recovery periods to pay off any deficit). However, sponsoring employers need to take the lead in helping trustees take these factors into account.

### Fig 1.5 How companies intend to change the scheme funding process

<table>
<thead>
<tr>
<th>Change Area</th>
<th>Larger Companies</th>
<th>Smaller Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Being more explicit about employer’s objectives</td>
<td>68%</td>
<td>39%</td>
</tr>
<tr>
<td>Managing the trustees’ perception of covenant</td>
<td>57%</td>
<td>36%</td>
</tr>
<tr>
<td>Use of advisers</td>
<td>52%</td>
<td>36%</td>
</tr>
<tr>
<td>Extent to which company controls the process</td>
<td>45%</td>
<td>39%</td>
</tr>
<tr>
<td>Clarifying roles and responsibilities</td>
<td>36%</td>
<td>36%</td>
</tr>
<tr>
<td>Extent to which contingent assets are used</td>
<td>29%</td>
<td>31%</td>
</tr>
</tbody>
</table>
38% of FTSE100 companies intend to use contingent assets

Growing interest in contingent assets
30% of companies intend to increase the extent to which they make use of contingent assets. This rises to 38% for FTSE100 companies and 50% for companies where the pension scheme is of comparable or larger size relative to the company.

Fig 1.6 Intend to increase use of contingent assets in future

| Pension fund less than 50% of company market cap | 24% |
| Pension fund 50% or more of company market cap | 38% |

Contingent assets and guarantees enable trustees to reduce their cash demands while still being satisfied that they are protecting the security of the pension scheme. For example, a back-end loaded funding plan may be more acceptable if it is implemented in conjunction with a guarantee from a group company.

81% concerned about the Regulator’s stance on scheme funding prudence

Scheme funding prudence
Finance directors are showing the greatest concern about the Pension Regulator’s stance on scheme funding prudence. Our view is that the Regulator’s attitude to prudence remains much misunderstood, especially at the current time of economic turmoil. The Regulator has repeatedly said that the best security for a pension scheme comes from having a strong employer and that trustees should not unilaterally be making demands on employers that could in themselves weaken the ongoing covenant of that employer.

The times when we see trustees drive overly-prudent demands are when the employer is absent or insufficiently assertive in the funding negotiation process.

Fig 1.7 Concerned about the Regulator’s stance on scheme funding prudence

<table>
<thead>
<tr>
<th>Category</th>
<th>Very concerned</th>
<th>Somewhat concerned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance directors</td>
<td>42%</td>
<td>35%</td>
</tr>
<tr>
<td>Pension managers</td>
<td>28%</td>
<td>58%</td>
</tr>
<tr>
<td>HR directors</td>
<td>18%</td>
<td>65%</td>
</tr>
</tbody>
</table>
Managing perceptions of employer covenant

Our survey showed that 22% of companies (30% among the FTSE100) think their trustees’ assessment of the employer covenant at the last valuation was more pessimistic than their own, meaning trustees targeted higher levels of technical provisions (liabilities) than the employer felt necessary.

In addition, 36% of employers expect their trustees at the next valuation to consider the employer covenant to be weaker than the previous assessment. In this case, trustees could aim for even higher funding targets at a time when affordability is severely constrained.

Fig 1.8 Trustees’ perception of employer covenant (as judged by the company)

An accurate assessment of covenant and affordability is essential to facilitate sensible funding outcomes in the interests of all stakeholders. Including the extent to which flexibility can be built in to existing funding plans, the use of back-end loading, and/or extending the period over which any deficit is to be removed. The Regulator has recently taken great care to stress that it will support measures like this in circumstances where, in the short-term, affordability is in doubt or existing funding agreements are a threat to the company’s future.

Companies need to be well prepared and assertive in helping trustees understand the nature of the covenant, and to justify where they believe their trustees are being overly optimistic or pessimistic. They need to be in a position to demonstrate clearly, with evidence, why they think that is the case and to explain the potentially damaging implications of onerous cash demands on employers’ ability to support the pension scheme in the longer term.

A significant number (43%) of companies (rising to 58% of larger companies) intend to change the way they manage perceptions of the employer covenant. Effective information sharing and on-going engagement with trustees is essential in reaching a satisfactory outcome.

Use of advisers

Nearly half (41%) of companies say they intend to change the way they use advisers in the scheme funding negotiation process. There is growing recognition of the need to address conflicts that arise in using the same firm of advisers for both the company and the trustees. Additionally, it is essential to connect funding negotiations with covenant and affordability assessments, as well as risk management and investment strategy.
2. Risk

Funding deficits are very much back on the agenda despite companies having ploughed huge amounts of cash into pension schemes in recent years. This is because, in many cases, cash has been thrown at the problem without the underlying risks necessarily having been removed.

It is essential to understand what risks a pension scheme might pose to the business that sponsors it, and then decide whether these risks are wanted or unwanted, acceptable or unacceptable. To what extent do these risks impact balance sheet, P&L, credit rating, share price, distributable reserves, cashflows, company valuation and so on?

Many companies have concluded that the risks their pension schemes pose to their business are unacceptable and have started taking action to address these. There is often an up-front cost or cash commitment required to reduce ongoing risk and appropriate information and analysis is necessary to make well-informed decisions as to the economic justification and timing for removing risk.

Around two-thirds of respondents (67%) say they are very or somewhat concerned about their company’s lack of ability to influence pension scheme risks and yet:

- Up to 18% of respondents say they do not fully understand the impact their pension scheme could have on their business
- Up to 23% of finance directors say pensions risk is not considered in their organisation’s overall enterprise risk management and, for smaller companies, there is even less focus on this.
The major hurdle to implementing these solutions at present is the availability of and justification for using short-term cash to buy the additional certainty.

Risk – action checklist for employers:

Pension risk should be considered in the context of what matters most to the sponsoring business, in terms of both type of risk and its impact. Boards increasingly demand an understanding of significance and nature of pension risks – and actions to address unwanted risk. It’s necessary to understand and agree the price you are prepared to pay to reduce or remove risk and buy-out is not always the right solution; alternatives may be more effective or cheaper to implement.

There are many options to reduce or remove risk, including:

- Change benefits design for active members
- Offer deals to individual deferred and retired pensioners
- Transfer risk to an insurance company through a buy-out of liabilities or buying-in (investing in annuities or deferred annuities that match the liabilities exactly)
- Align asset strategies with the investment and inflation risks inherent in the liabilities
- Purchase longevity hedging products
- Introduce risk sharing for members of the pension scheme
- Improve governance and decision-making processes

Which risk reduction solutions are being considered?

There is a huge increase relative to our previous surveys in the number of employers that wish to adopt the various risk reduction solutions. The chart below shows the proportion of companies that have already implemented and intend implementing risk reduction measures. The major hurdle to implementing these solutions at present is the availability of and justification for using short-term cash to buy the additional certainty.
Nearly 50% of companies are now considering buy-out or buy-in.

**Buying-out or in**
The increasing desire for buying-out (or buying-in) pension liabilities continues: 27% of companies now say they would consider buying-out within five years and a further 19% over a longer timeframe.

**Fig 2.3 Considering buy-out (or buy-in)**

<table>
<thead>
<tr>
<th>Date</th>
<th>Larger companies</th>
<th>Smaller companies</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2007</td>
<td>26%</td>
<td>27%</td>
<td>28%</td>
</tr>
<tr>
<td>March 2008</td>
<td>27%</td>
<td>35%</td>
<td>43%</td>
</tr>
<tr>
<td>December 2008</td>
<td>44%</td>
<td>45%</td>
<td>52%</td>
</tr>
</tbody>
</table>

**Fig 2.4 Considering buy-out: timeframe**

<table>
<thead>
<tr>
<th>Date</th>
<th>Within 5 years</th>
<th>Beyond 5 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2007</td>
<td>11%</td>
<td>16%</td>
</tr>
<tr>
<td>March 2008</td>
<td>19%</td>
<td>16%</td>
</tr>
<tr>
<td>December 2008</td>
<td>27%</td>
<td>19%</td>
</tr>
</tbody>
</table>

**Considering buy-out: significance of relative size of pension scheme and company**
Buy-out and the timeframe over which it would be considered is clearly more of an issue for companies where the pension scheme liabilities are more significant compared with the size of the company itself.

**Fig 2.5 Considering buy-out: significance of relative size of pension scheme to the company**

<table>
<thead>
<tr>
<th>Employment</th>
<th>Within 5 years</th>
<th>Beyond 5 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension fund 50% or more of company market cap</td>
<td>45%</td>
<td>17%</td>
</tr>
<tr>
<td>All</td>
<td>27%</td>
<td>19%</td>
</tr>
<tr>
<td>Pension fund less than 50% of company market cap</td>
<td>19%</td>
<td>21%</td>
</tr>
</tbody>
</table>
Greatest premium over liability in accounts that companies would be prepared to pay to buy-out pension liabilities

The amount companies are willing to pay relative to accounting liabilities has changed. This is partly because accounting liabilities are currently low relative to buy-out liabilities.

80% now prepared to pay a premium over the accounting provision

When to buy-out or buy-in

The challenges to companies (and trustees) wishing to remove risk through a buy-out or buy-in include:

- Current economic justification to pay the size of premiums being requested by the insurance providers relative to other financing and risk management options
- Volatile pricing due to current economic conditions
- Availability of cash to finance the transaction
- Capacity in the market to meet demand
- Questionable returns-on-capital for investors to provide additional capital for the providers

Those companies (and their trustees) looking towards the end-game beyond current economic turmoil, many should prepare for a potential buy-out or buy-in transaction at some point in the future when market conditions make such a transaction more favourable. Such preparation includes ensuring membership data is as complete as possible, negotiating potential forward-looking deals with certain providers, aligning asset strategies with future intentions and agreeing relevant adjustments in scheme funding frameworks.
3. Cost and value

An incredible 83% of employers are concerned about lack of value for money in the way they currently provide pensions.

An ever-increasing proportion of company boards are questioning how much their pension arrangements are costing and whether the organisation is getting a dividend for this expenditure. Does continuing to offer a pension scheme represent good value for money to your company? Can you spend this money in a way that generates better value and/or generate the same value by spending less money?

Most organisations (83%) don’t believe they are getting value for the money currently being spent on pension provision and there is a sense that most are also concerned that their pension schemes do not fit with the overall reward strategy of the organisation. Yet many employers have avoided tackling pension ‘sacred cows’ for fear of damaging employee relations – almost all employers (90%) are concerned about the impact of pension provision on employee relations.

83% of employers are concerned about lack of value for money

How important are pensions in attracting and retaining talent?

While the majority of respondents feel that the importance of pensions in attracting, retaining and motivating staff remains unchanged, there is growth in the number who feel their importance is declining. For the first time in the history of this survey, more companies have answered ‘less important’ than ‘more important’ to the question of how has the importance of providing pensions changed in the last three years? This could be a reflection that, in the current economic climate, job security and immediate cash earnings are more important to employees than long-term wealth generation.

How important are pensions in attracting and retaining talent?
2012: pensions auto-enrolment will impact every UK employer

From 2012, it will be a requirement that every UK employer automatically enrols all qualifying employees (permanent and temporary) into a pension arrangement with minimum benefit or contribution limits. All employers will need to review workforce pension provision and take a view on how to treat employees not covered in a qualifying employer-sponsored scheme. Employers with a significant number of employees currently not covered in pension arrangements could face considerable cost increases. Many existing company pension schemes will need to be changed to comply with the new requirements. The need to review pension provision for part of the workforce is an opportunity for employers to make decisions about aligning pension provision for all employees with what makes most sense for the business.

Making changes to benefits for existing employees

A growing proportion of employers are looking to change benefits for current employees. This is being driven not only by the current economic climate and need to reduce costs, but also by a desire to ensure value for money being spent on pensions consistent with the employment deal being created for the organisation overall. Drivers for change include:

- Rapidly declining number of executives who still participate in defined benefit arrangements
- Desire to drive a culture of pay-for-performance
- Increasing 'pensions polarisation' between employees enjoying defined benefits accruals and those who are not
- Increasingly diverse and unpredictable career paths
- Increasing diversity in the shape of families and the need to flex how reward is provided to different individuals to reflect different wants and needs
Cost and value – action checklist for employers:

There are a number of actions that employers can take to reduce the underlying costs of pension provision and to improve value to the organisation for that spend. Some of these include:

- Changing the nature of pension provision to the existing workforce as part of the overall employment deal
- Asking employees to share in the cost and risk of pension provision
- Assessing whether and how you can reduce your levy to the Pension Protection Fund in the way that you structure participating companies, guarantees and contingent assets
- Looking at the synergies and efficiencies available by merging two or more existing pension schemes
- Harmonising suppliers and advisers, and revising service-level agreements
- Improving the effectiveness of pension scheme operations and services

Closing existing defined benefits schemes to future accrual

Most employers (around 80%) have closed existing defined benefit schemes to new employees. Many have continued to offer legacy defined benefit arrangements for employees who were in the DB schemes at the time they were closed. However, an increasing proportion are now reducing the future-service benefit levels offered by these legacy arrangements. Changes to future-service benefits include:

- Increasing normal retirement age
- Reducing accrual rates
- Capping pensionable salaries or increases in pensionable salaries
- Increasing the final averaging period for pensionable salaries or introducing career-average pensionable salaries
- Higher employee contributions
It is only in the last year or so that we have seen a discernable trend to freeze defined benefits and cease all future service accruals. In early 2007, only 3% of survey participants had ceased future service accruals; for our latest survey, this figure has risen to 8% of participants. Further, some 17% of employers are now planning to cease future service accruals, up from 11% intending to do this back in March 2008.

Future pension provision taking into account different needs among the workforce

In planning future pension design, 45% of companies say they intend to take into account that different employees at different stages of their lives attach different value to pension provision. Further, 37% of companies intend to address the growing disparity in pension provision between those employees covered by legacy DB pension provision and those who are not.
Pensions for the generation currently entering the workforce

Who knows what the future of pensions in the UK will look like? It is possible that companies will increasingly use a simple Personal Accounts regime for all their employees, to meet the minimum auto-enrolment and qualifying scheme requirements, and then compete by offering more generous employer contribution levels and/or arrangements that top-up Personal Accounts.

People who are currently entering the workforce for the first time have very different expectations for the future compared to previous generations. The 2008 study of 900 UK graduates entering the workforce by PricewaterhouseCoopers, the second survey in the Managing Tomorrow’s People series, revealed that the most valued benefits in the first five years of work are training and development (16%), cash bonuses (15%) and free health care (10%). Pensions are ranked a mere 8th, valued by just 7% of graduates. Further, less than 18% of graduates expected their retirement to be funded by their employer’s retirement scheme.

Fig 3.6 Benefits valued most in the first five years of employment

Source: Managing tomorrow’s people – Millennials at work: Perspectives from a new generation
PricewaterhouseCoopers LLP (December 2008)
Acknowledgements

We would like to thank the companies that participated in our pensions survey. We hope that the insight in this report is of significant value and helps to inform your decision-making. If you would like to discuss any of the findings or commentary, then please contact us.

Award winning insight from PricewaterhouseCoopers

Sponsor covenant assessment provider of the year 2008

Pensions & benefits consultancy of the year 2008
Contact us

To discuss any of the issues raised in this report, please contact one of the following people.

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