Willis Towers Watson

2018 UK Pension Strategy Survey

What are organisations planning for their benefit strategy in 2019 and beyond?

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Introduction

Over the last five years we have seen major changes in the pensions and retirement savings landscape. This started with the introduction of the auto enrolment legislation in 2012 which has dramatically raised the number of employees saving in a retirement plan across Britain. For many employers this is now fully embedded in the fabric of the organisation's internal processes and has become 'business as usual'. Yet, the backdrop for many organisations is raised benefit costs with possible additional cost pressures on the immediate horizon when the statutory minimum contributions increase to their highest tier in April 2019.

Secondly, the introduction of Pension Freedoms in April 2015 has fundamentally altered the pension landscape. This changed the way in which defined contribution (DC) pension scheme members could take their benefits, removing requirements around annuitisation. However, the introduction of greater choice has also created additional complexity and uncertainty for employers and trustees of pension schemes, with investment strategy, member engagement and communication, governance and delivery models being reshaped in response. Three years on since its introduction, we see a large number of organisations and pension schemes grappling with how to deal with the challenges and opportunities introduced by the Pension Freedoms.

As part of Pension Freedoms, new opportunities also opened up to members of defined benefit (DB) pension schemes and increasing numbers are transferring their DB entitlements into DC arrangements to gain better control and choice over the shape of their income in retirement. A combination of record high levels of transfer activity and annuity purchase lows in 2017 prompted concern about whether members are making informed choices and whether they are equipped to manage their retirement savings in a world where drawdown of DC pots over a period of time is becoming ever more prevalent.

Thirdly, tax allowances associated with pension saving have continued to be eroded by consecutive governments. Today, many organisations see an increasing cohort caught by the reduced and tapered Annual Allowance or the reduced Lifetime Allowance. As a result, organisations are being forced to reconsider their remuneration policies and seek alternative ways of rewarding their talent.

Alongside these changes, we see heightened economic uncertainty for UK employers. Brexit, and its possible impact on the UK economy, as well as concerns on the future path of the global economy, are leading many companies to be cautious about their investments and budgets. For employees, many of whom have experienced a long and sustained period where price inflation has outpaced salary growth, the squeeze on living standards shows little sign of abating in the near future.

Against this backdrop, we surveyed nearly 200 organisations in the UK in the summer of 2018 to examine how they have tackled these challenges and, more importantly, how they plan to evolve their pension and benefits policies/programmes in the future. The survey examines three key areas:

1. Emerging developments in benefits strategy and how employers are supporting broader financial well-being.
2. Their strategy for DC provision.
3. Changes to plan design in DB schemes still open to future accrual.

Ben Knight
T +44 20 7170 2185
ben.knight@willistowerswatson.com

Minh Tran
T +44 20 7170 2750
minh.tran@willistowerswatson.com

Executive summary

Benefits strategy: Key themes

1 **Cost control:** For 4-in-10 employers cost control is a key priority: organisations are typically looking to reshape their benefits within their existing spend.

2 **Financial well-being:** A third of organisations report adding financial well-being programmes is a top priority.

3 **Choice and flexibility:** 3-in-10 organisations are looking to increase employee choice and flexibility regarding their benefits.

Defined contribution (DC) pensions: Future direction

4 **Growing appeal of master trusts:** The number of companies opting to use a master trust as their main DC vehicle could more than double in the next three years.

5 **Choice and flexibility:** Less than 10% of organisations give employees the flexibility to use the employer's pension contributions for other financial priorities. But this could treble in the next two years.

6 **Focus shifting to at-retirement support:** Almost 60% of organisations are looking to review their at-retirement support, such as guidance, regulated financial advice and retirement seminars.

Defined benefit (DB) plan design

7 **Continued plan closures:** Around one third of schemes currently open to accrual expect to close to accrual over the next three years.

8 **Drivers of change:** Reducing scheme risks, volatility and costs are all key objectives for DB schemes. Union influence and legal restrictions are the foremost barriers to change.

9 **Concessions:** A large proportion of employers looking to make plan design changes are willing to make concessions, primarily by improving the DC offering for members impacted by these changes, either through higher contribution rates or through one-off lump-sums.

Well-being and choice

10 **Financial well-being:** Access to financial well-being programmes in the workplace could rise sharply in next two years. Employers want to educate employees via seminars and tools.

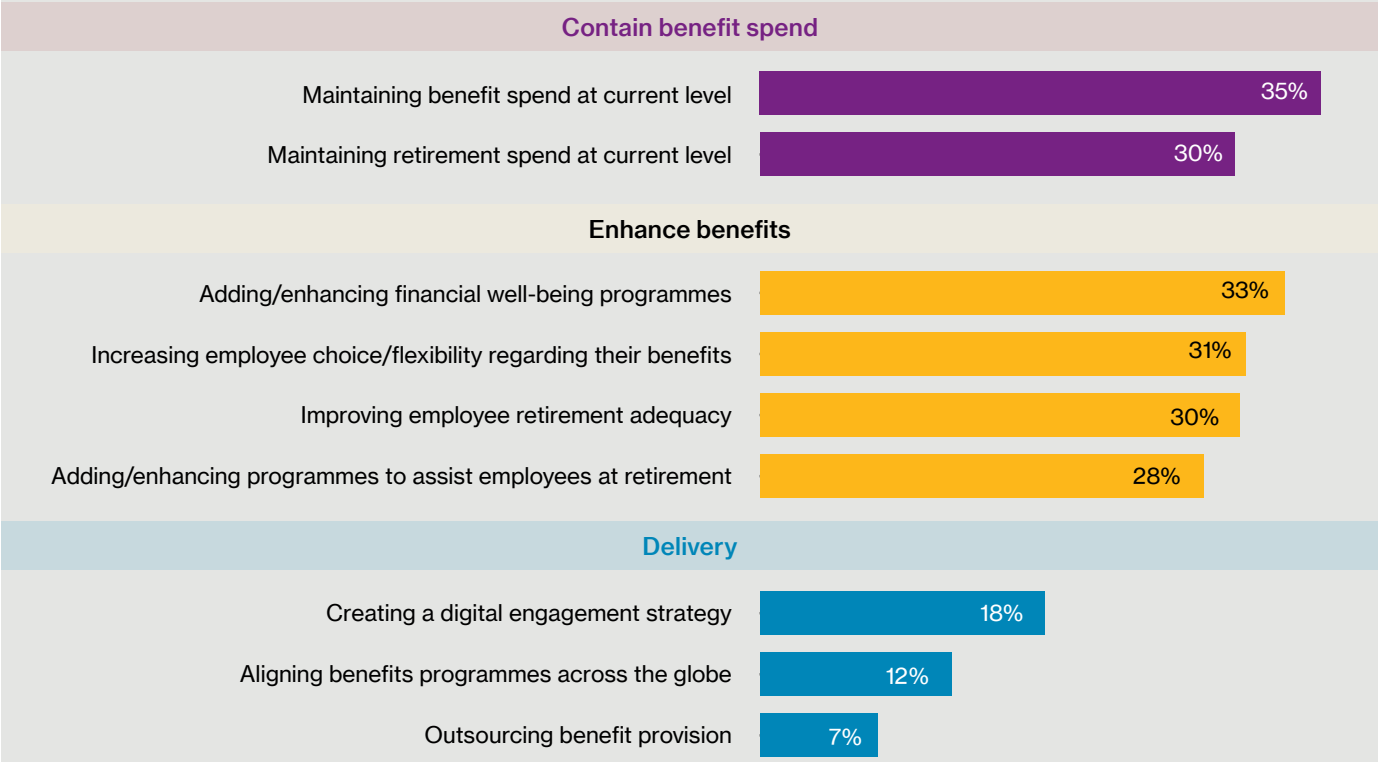
11 **Flexibility and choice:** A focus on financial well-being goes hand in hand with flexibility and choice. Employers are much more likely to consider alternative savings products in the benefits package if they already have flexibility in pension contributions.

Benefits strategy

When asked about their priorities for their organisation's benefit strategy (Figure 1), employers' top priorities in the next three years are to maintain cost control and reshape benefits to address a broader range of needs.

Some 35% of respondents reported that containing benefit spend was a very or extremely important priority, whilst 30% reported that controlling retirement spend was a top priority. In combination, 40% reported maintaining control of benefit costs or retirement costs as a top priority. Moreover we see little desire from employers to improve the generosity of their retirement provision (Figure 2). For the large majority of organisations, maintaining the status quo, and reacting to any legislative requirement, is the target.

Figure 1: **Employers' top benefit strategy priorities**

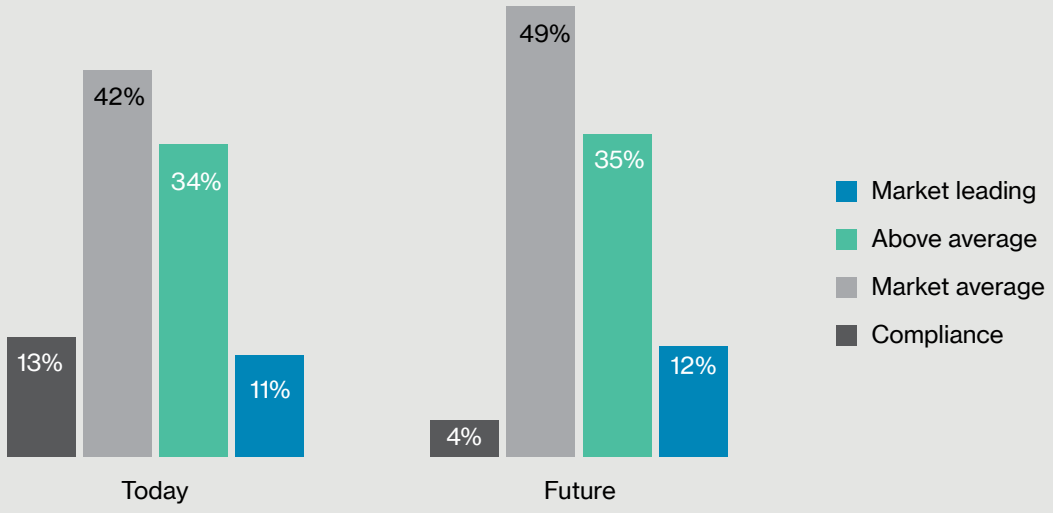


Priorities for organisation's benefit strategies in the next three years: Percentage 'Very or Extremely important'

The current economic environment is also very challenging for employees, many of whom are struggling to meet their financial needs.[1] Companies increasingly understand this and are looking to reshape their benefits packages to address a broader array of needs: targeting the improvement of employee financial well-being (a top priority for 33%) and providing employees with more choice and flexibility in their benefit packages (31%). This focus on financial well-being, flexibility and choice is particularly strong amongst larger firms with more generous retirement provisions.

Finally, nearly a third of organisations are prioritising their retirement provision: looking to improve retirement adequacy (30%) or decumulation options (28%) (Figure 1). Our results suggest that there is a roughly equal split between those for whom retirement benefits are not a differentiator in the reward package and those who are ahead of the game (Figure 2). However, the preference for superior retirement benefits appears to be relatively static, with only minor changes expected in the future. In addition, as highlighted later, market leading does not necessarily only mean greater retirement contributions, but can also mean offering a greater array of benefits, greater engagement and communications or providing more tools to assist in retirement decision-making.

Figure 2: **Employer objectives for retirement provision**

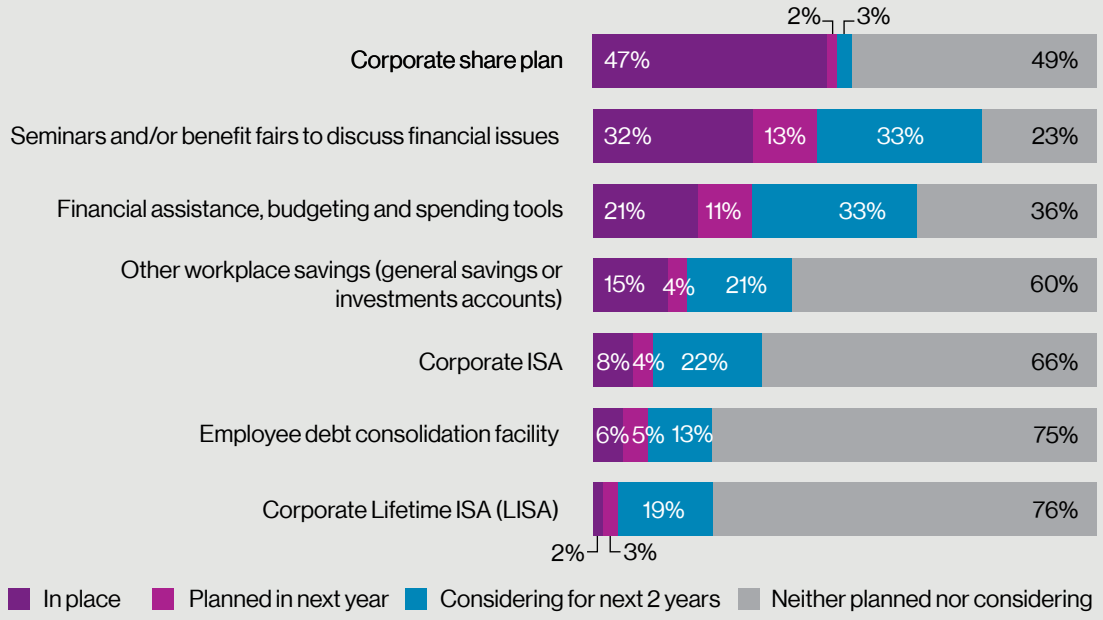


[1] According to the 2018 Willis Towers Watson Global Benefits Attitudes Survey, only 43% of UK employees are satisfied with their financial situation.

Growing interest in financial well-being

The increased interest in employee financial well-being is reflected in the strategies employers have deployed to tackle it (Figure 3). Our results show that employers are focused on those strategies that provide support to employees in their financial management. Almost 80% of employers expect to provide seminars (and/or benefit fairs) over the next two years and nearly two thirds expect to provide financial assistance, budgeting and spending tools over the same period. By contrast, although still a significant proportion, fewer employers are looking to implement workplace savings vehicles and other products.

Figure 3: **How employers are approaching financial well-being programmes**



Numbers may not sum to 100% due to rounding

Our employee research suggests that workers are looking to their employers for help in addressing their financial well-being and here we can see organisations are looking to respond. However, the focus on seminars is not aligned with employee preferences. While the use of spending tools is highly valued by UK employees, seminars to discuss financial issues are at the bottom of their preferences when it comes to employer financial management support (2018 Willis Towers Watson Global Benefits Attitudes Survey).

This focus on more traditional forms of support by employers could reflect a perception that more advanced solutions are not yet fully developed and seminars/benefits fairs are easier to deploy. On the one hand, this could mark a careful first step for employers in assuming a more active role in their employees' personal financial well-being, where some employees may be skeptical of their employer's involvement. But on the other hand, the challenge is to build engagement in traditional programmes, when employees are increasingly focused on the types of technology, tools and apps they see in their everyday life. Employers may need to find new ways to engage employees with financial well-being initiatives, providing support in line with employees' needs and strongest motivations.

Flexibility to use pension contributions for other financial priorities could triple

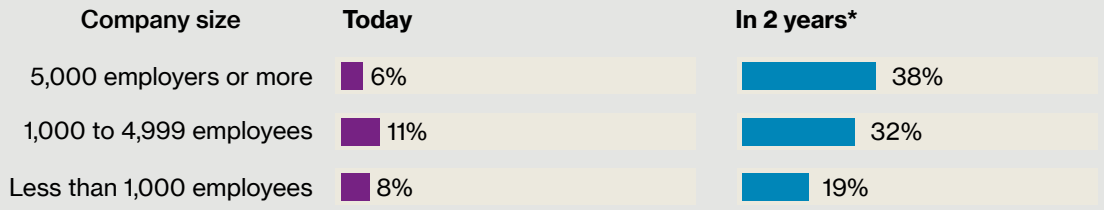
The notion of giving employees more choice over their benefit spend, so as to direct it to the benefits they value the most, seems to be taking hold within UK companies. In the past, concerns about money leaking from retirement saving, overwhelming employees with too much choice, and the administrative complexity of facilitating wider choice have acted as barriers to providing employees with greater flexibility over their benefit spend. Yet today, we increasingly see such concerns being outweighed by a desire to meet a broader range of financial priorities.

Initially this movement towards greater flexibility has concentrated on high earners (those employees affected by the lifetime or annual allowance). Today, 65% of employers offer flexibility to those employees affected by lifetime or annual allowance issues. This is expected to increase to 80% in two years' time.

Increasingly companies are looking to offer this flexibility to all employees. Today, less than 1-in-10 companies provide employees with the flexibility to use the employer's pension contributions for other financial priorities, but this could potentially treble to almost 30% in two years' time. Is this the start of a new era in flexibility?

Figure 4 shows that the current provision of flexibility in the use of contributions doesn't vary considerably by company size. However, large companies seem to be leading the way in the move towards offering more flexible contributions over the next two years.

Figure 4: **Flexibility to use the employer's pension contributions for other financial priorities**



(*) Percentage in place, planned or considering

This trend is associated with the movement to offering broader financial well-being programmes. Employers are much more likely to consider alternative savings products in the benefits package (such as corporate ISAs or other workplace savings) if they have (or are planning on offering) flexibility in pension contributions:

- Amongst employers considering flexibility within the next two years: 64% of companies could have a corporate ISA in place in two years, 67% other workplace savings.
- Amongst employees not considering offering flexibility: 20% are considering a corporate ISA, 29% other workplace savings.

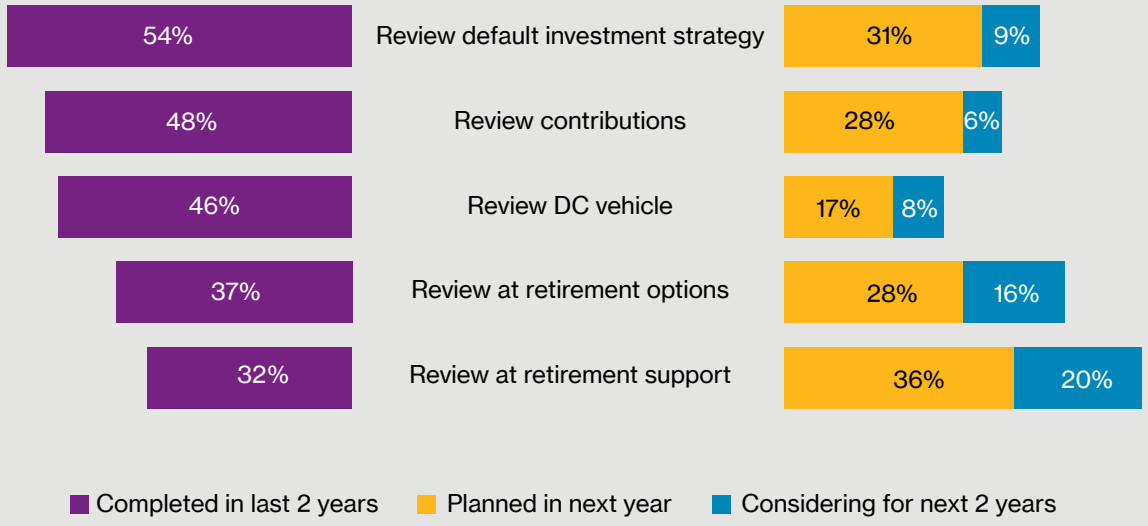
However, these differences do not extend to other well-being strategies. Notably all types of employers say they plan to do more to support employees through financial management education and tools.

Consequently, for larger employers, we see a twin focus on flexibility and providing an extended range of benefits from which employees can choose. By contrast, smaller employers are more concerned with cost control – although even here we see some interest in more flexibility and choice.

DC pensions: Future direction

In the last five years the pension landscape has been transformed. Auto-enrolment has succeeded in bringing many millions of employees into pension schemes. In addition, Pension Freedoms have opened up new choices for pension members, allowing them to access their retirement savings more flexibly. Given these factors, we asked employers about the changes organisations are making to their DC provision, and what they plan in the near future (Figure 5).

Figure 5: **Has your organisation reviewed its DC provision recently, or does it have plans to do so?**



In the recent past, the key areas of focus have been reviewing investment strategy, contribution rates and the DC vehicle, but we now see organisations turning their attention to how they support employees reaching retirement in the future.

- Over half of organisations have reviewed their default investment strategy in the last two years and a further 4-in-10 are planning or considering it in the next two years.
- Nearly half of employers have reviewed the contribution rates they offer and just over a third are planning or considering doing so in the next two years.
- Around 6-in-10 organisations are looking to review either their at-retirement support or the options they provide to members in the near future.

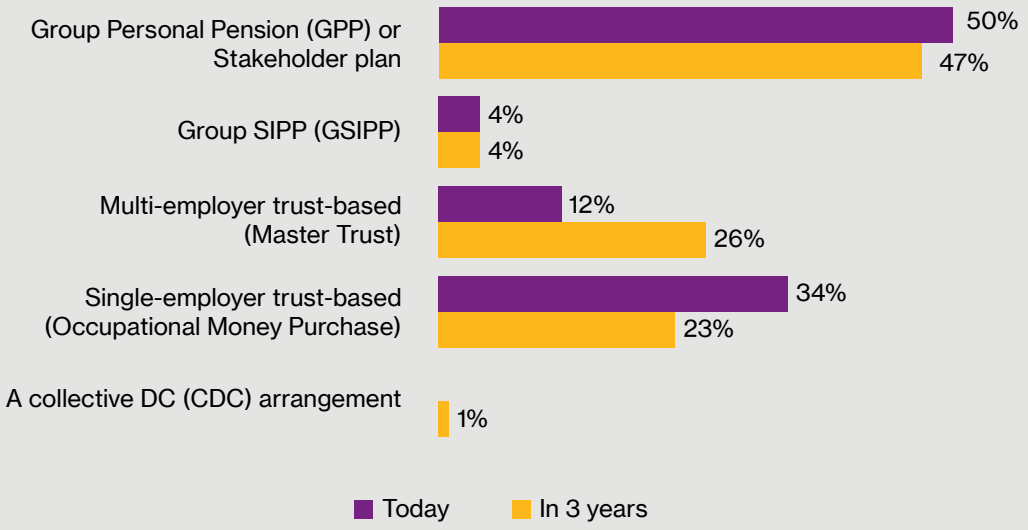
Whilst half of employers have reviewed their contribution rates, the last five years have seen remarkable stability in average contribution rates in DC plans (source: 2018 Willis Towers Watson FTSE 350 DC survey) and, as seen in Figure 1, many companies are still looking to control their benefit spend. So whilst companies have reviewed their contribution structures, outside of complying with requirements to change auto-enrolment minimum contribution rates in 2019, there seems little appetite to make major changes to contribution rates. In our survey, we see a very large majority of companies targeting a similar level of retirement plan generosity in the future, albeit allowing flexibility for employees to divert some of this employer funding to other savings options and benefits.

Growing appetite for master trust schemes

The other major trend emerging within DC is the shift in how DC pension plans are delivered. Figure 5 shows that nearly three quarters of respondents have reviewed, or are planning or considering a review of, their pension vehicle. Alongside this, we see the continuing emergence of master trust schemes (Figure 6). While contract-based plans (Group Personal Pension, Stakeholder plans and Group SIPPs) are likely to remain the structure of choice for around half of employers, the survey suggests that many companies expect to switch to master trusts, chiefly from single-employer trusts. While currently 12% of employers in our survey deliver their pension arrangements via a master trust, this figure is expected to climb to over 1-in-4 schemes in the next three years.

Figure 6: **DC pension scheme delivery: Today and in the future**

Current and expected form of the organisation's main DC pension scheme

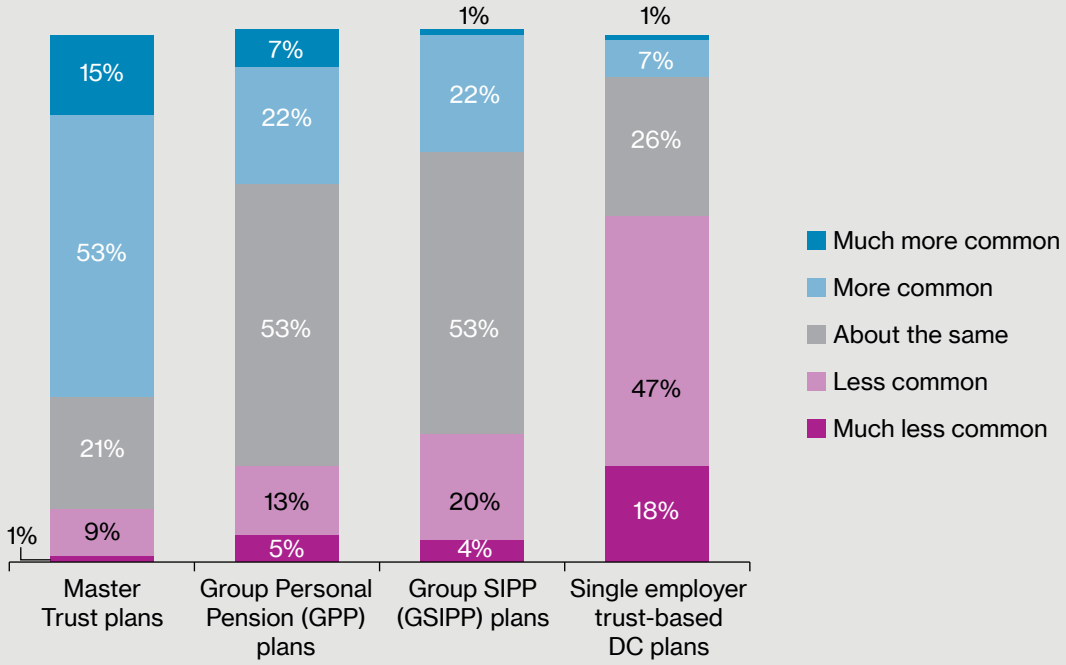


Numbers may not sum to 100% due to rounding

Master trusts are therefore seen as an increasingly viable option. This is especially true for larger employers. Amongst companies employing between 1,000 and less than 5,000 employees, 29% are expecting to be using a master trust within three years. For the largest companies, with 5,000 or more employees, this number increases to 41%.

In line with this, when thinking about how retirement provision will change across companies as a whole (as opposed to their own organisation's provision), over two thirds of respondents expect master trusts to be more common or much more common in the next three years. Around the same proportion expect single employer trusts to become less common or much less common (Figure 7).

Figure 7: **How will retirement provision evolve in the UK over the next three years?**



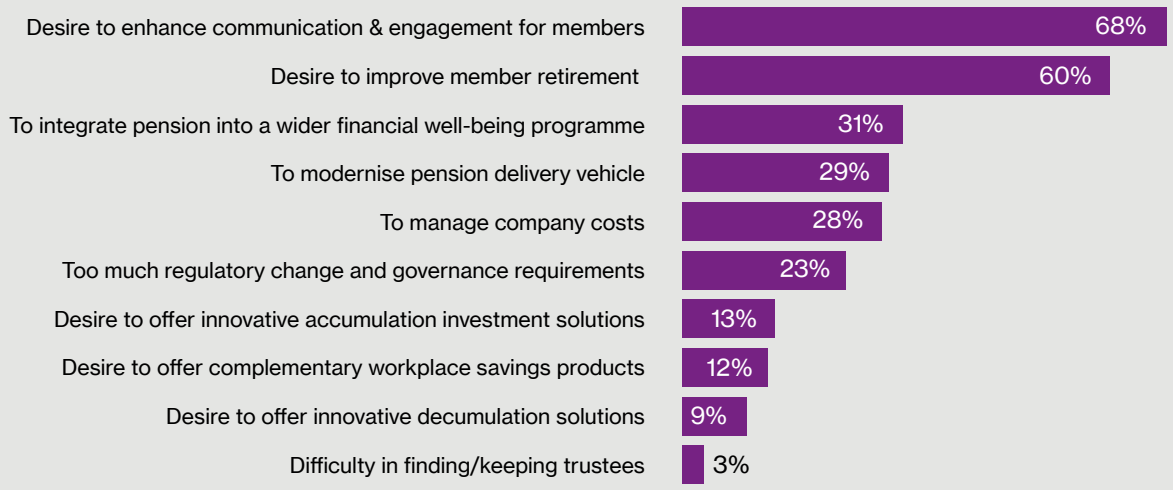
Numbers may not sum to 100% due to rounding

Focus of organisations on improving member retirement outcomes and member engagement

What is leading employers to review their DC vehicle? Figure 8 shows the overwhelming drivers for review are that companies are looking to improve communications, engagement and member's retirement outcomes, which are reasons cited by around 70% of employers in the study. And around 1-in-3 cite looking to integrate their retirement provision into a broader financial well-being offering as a driver to review their DC vehicle. This is in line with what we saw in Figure 1, which showed that improving flexibility and financial well-being is a key focus for organisations.

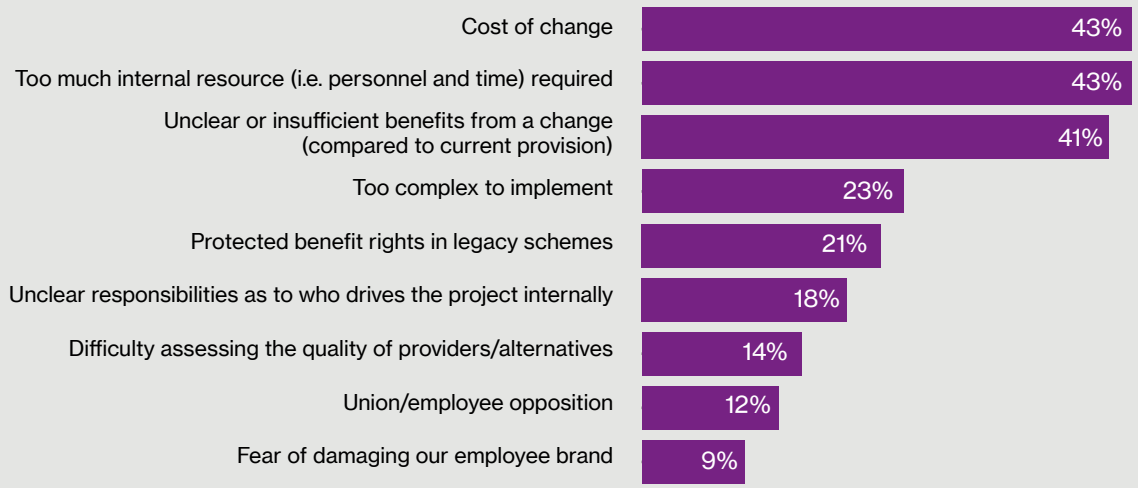
The most typically stated advantages of outsourcing DC pensions (removing the operational and governance challenges of maintaining plans and reducing costs) then follow. Costs are reported as important for nearly 3-in-10, whilst concerns on governance are a priority for around a quarter.

Figure 8: **What is leading organisations to review their DC pension vehicle?**



What are the key considerations organisations have when thinking about changing their pension vehicle? The scale of the project, either in terms of direct costs or the internal resource required (staff time, etc.) is a hurdle for more than 2-in-5 employers (Figure 9). Other organisations struggle to see the benefits of change (41%). For a quarter, complexity (either in terms of the process of change or legacy protected benefits) is a barrier to change.

Figure 9: **Barriers to changing a DC pension vehicle?**



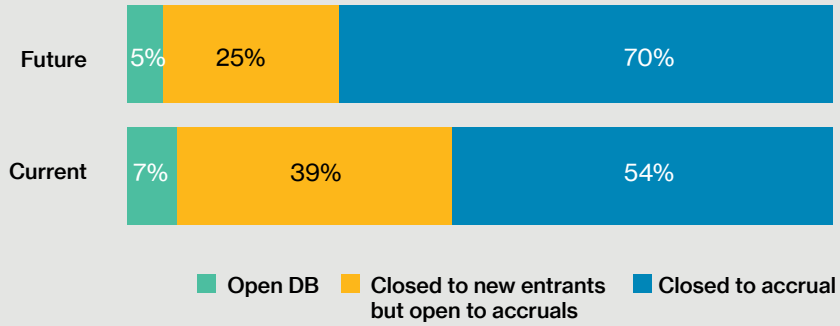
Finally, for those companies who have already switched to master trust, we asked them about areas on which they wish they had spent more time. The lessons learned stated are: to pay more attention to communicating with members and employees, and to focus more on project management and administrative transition.

DB plan design

In March 2018, the Department for Work and Pensions (DWP) issued a White Paper entitled '*Protecting Defined Benefit Pension Schemes*'. Together with the 2018 funding statement from The Pensions Regulator, this has sharpened the focus on the "end game" for DB schemes, either through run off to a low risk investment target with the existing sponsor, or via the settlement of those liabilities with an insurance company. Amongst all of this, it is easy to forget that many sponsors either continue to allow new joiners to the company to join their DB scheme or, where the DB scheme is closed to new entrants, to leave it open to future accrual for existing employees.

Our survey indicates that closure of schemes to DB accrual continues apace: nearly a fifth of DB schemes closed to future accrual closed in the last two years. Figure 10 illustrates that we can expect these changes to continue over the next three years. In particular, one third of schemes still open to accrual are expected to hard close over this period.

Figure 10: **Status of DB schemes now and in the future**



What are the drivers for these changes?

Risk and volatility are crucial here. In fact, Figure 11 shows that more than 85% of survey participants who have carried out plan closure in the last two years cited reducing scheme risks/volatility as either very or extremely important.

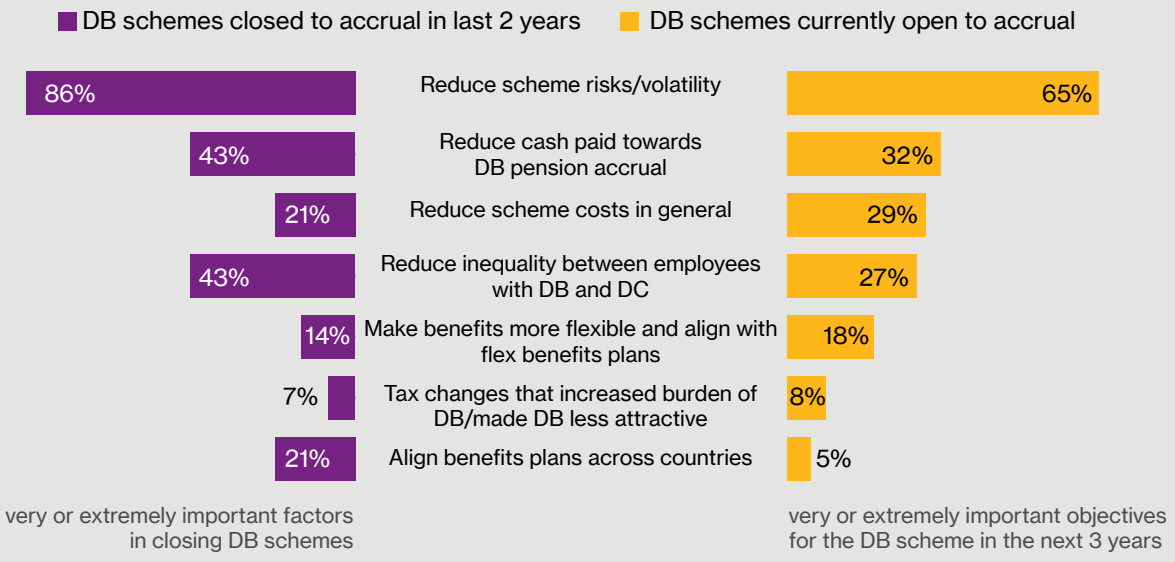
As schemes continue to mature quickly, many schemes will have put in place a long-term journey plan. This is a funding and investment strategy to reach a prescribed low-risk end point within a specified time period. As part of this, many schemes have already taken specific actions to manage and mitigate their risks. Examples of this are increasing their interest rate and inflation hedging, moving from return-seeking to matching assets, diversifying their assets, liability management options (such as pension increase exchange and transfer value exercises) and investigating insurance options. In this context, it makes sense to manage further risk build-up.

Figure 11 further shows that in over 40% of recent plan closures, the size of employer cash contributions in relation to accrual has played an important role. Falls in gilt yields over the last few years, coupled with ageing DB employee populations, mean that schemes carrying out their triennial funding valuation now may well be looking at employer future service costs of upwards of 40% of salary. This is clearly unpalatable from a cost perspective for most sponsors.

These levels of costs compare with average employer DC contributions of around 9% of salary. Clearly this is a concern for sponsors – over two fifths cite inequity between DB and DC employees as a very or extremely important reason for closure, with over a quarter believing that this will continue to be an issue in the future, when the relative size of the DB population as a proportion of the overall workforce is likely to shrink further.

In addition, employers are considering the integration of their benefit structure within their overall benefits strategy, with nearly one-fifth citing this as a reason for potential future change. This is consistent with the messages that we are seeing elsewhere in the survey.

Figure 11: **Key drivers of change in DB schemes**



Why have more organisations not made changes to their DB schemes?

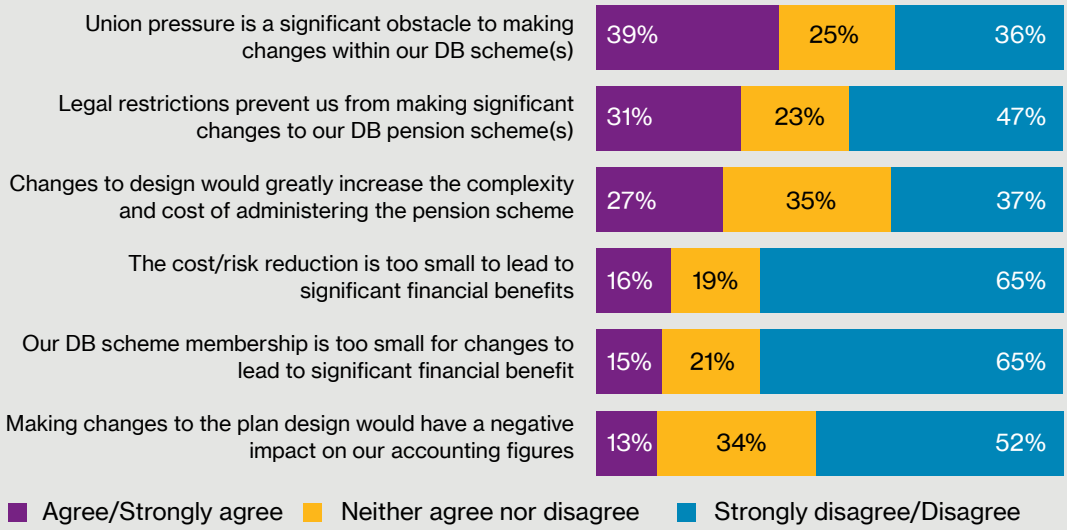
As Figure 12 shows, there are a variety of reasons why sponsors of DB schemes have not yet rung the changes.

A key reason (cited by around 40% of respondents) has been the prevalence of unions in plan design discussions. A number of high profile plan changes announced in the last few years have featured a significant amount of union involvement. In the case of the Royal Mail, following a difficult start to DB pensions closure negotiations which nearly led to strike action, the final agreement for Collective DC pensions arose from a collaborative approach between the company and unions. This demonstrates that identifying potential sticking points at the outset and having a robust and co-ordinated project plan, with buy-in from all of the key stakeholders, is imperative for a successful plan design project.

As well as the reasons cited in Figure 12, less tangible reasons, such as the fear of negative media coverage, may be putting some companies off making changes to their DB schemes. Pensions have rarely been in the media as much as in the last 12 months. Unfortunately the attention has not always been favourable, with the collapse of Carillion featuring prominently. However, in practice we find that a well-run and communicated exercise should reduce the risk of reputational damage for companies.

The other implication of pension managers and finance directors having many pensions balls to juggle is a lack of internal resource within organisations to drive these projects forward and manage the various stakeholders. One solution to this problem we have seen adopted is to use a specialist project manager to provide a dedicated resource. Such resources can add not only the necessary rigour to the process, but also bring valuable insights from other similar projects.

Figure 12: **Key barriers cited by organisations for making changes to DB schemes**



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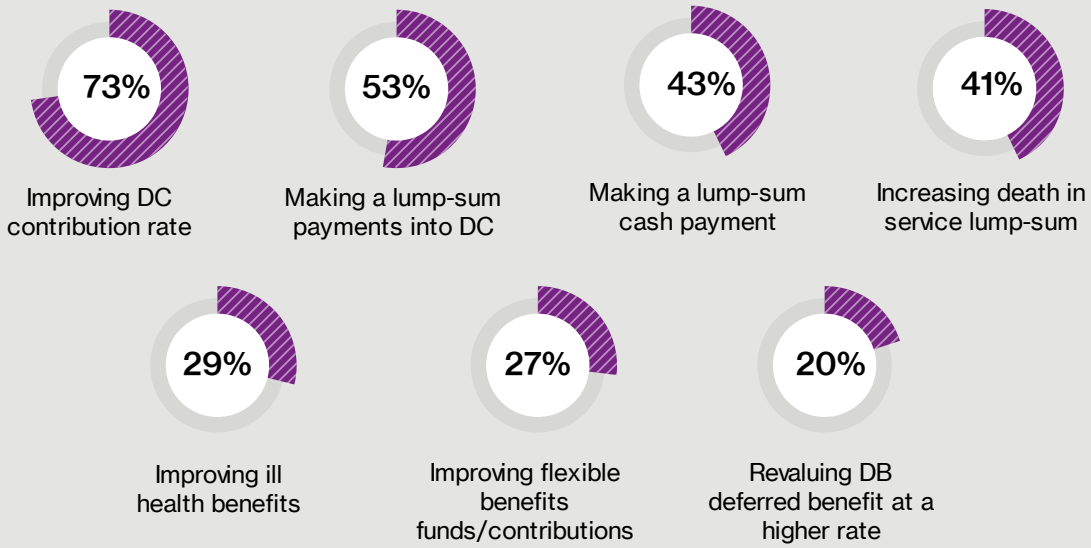
What concessions would sponsors consider as part of plan design changes?

Although sponsors will have a clear picture of a preferred post-implementation outcome for their plan design changes, ultimately they appreciate that the process will involve some give and take between the various parties. This is where concessions come in (Figure 13). Typically, these tend to take the following three forms:

- Additional DC benefits: these have the advantage of being consistent with the likely benefits being provided going forwards and being easy to cost from an employee perspective, with the bonus of clarity for members. Around three quarters of respondents would consider providing an improvement to the DC contribution rate.
- Enhancement to risk benefits: typically these are popular with members as they tend to be emotive in nature and hence highly valued. Around 30% to 40% of respondents would consider providing these concessions.
- Improving flexible benefits: these have the advantage of fitting seamlessly with the existing overall employee benefits programme, which should allow employees to better understand the value of the benefits that they are receiving. Around a quarter of respondents would consider providing these concessions.

Figure 13: **Concessions which respondents would consider making as part of plan design change projects**



Summary

Against the backdrop of political and economic uncertainty, and after five years of unprecedented changes to employer benefits, many companies are looking to control their benefit spend. In addition, given concerns about the financial hardships many workers face and that, for some, retirement saving is no longer the attractive option it once was, there is growing interest in looking at financial well-being, rather than purely retirement.

Consequently, many employers are looking to offer their employees a broader range of benefits, whilst maintaining control of their benefit spend. For employers, this means making their benefits budget stretch further and companies are increasingly leaning towards greater flexibility and choice as the answer. Employers, especially larger ones, are increasingly looking to allow employees the flexibility to use their pension contributions to meet other financial needs.

Alongside the potential broadening of benefit provision, we also see a changing focus from employers on their pension provision. The survey suggests a growing appeal of master trusts: the number of companies opting to use a master trust as their main DC vehicle could more than double in the next three years. This appears to reflect a desire to improve engagement and communication, and member outcomes.

Possibly in response to growing concerns on whether members are making appropriate choices in the aftermath of Pension Freedoms and choice, almost 60% of organisations are looking to review their at-retirement support. This looks to be the major area of focus for companies' DC plans over the next three years.

Amongst open DB schemes, we expect scheme closure to continue over the next three years. Reducing scheme risks, volatility and costs are all key objectives for DB schemes, with union influence and legal restrictions being the foremost barriers to change. However, these barriers can be overcome by careful consideration of different concessions, particularly around enhanced DC offerings.

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