22\textsuperscript{nd} October 2003

Pensions - What to tell The Board
What to tell Your Employees

Let’s start with the facts

John O’Connell
A typical landscape
- Conflicting employee and shareholder requirements

The key to squaring the circle is
- Information
- Analysis, and
- Communication

What’s different about today?
- Pension scheme deficits
- Risk is not just a theoretical concept
A typical landscape
Caught in the middle?

Executives:
- Our benefits cost too much!
- DC is the future!
- We shouldn’t be running a pension scheme

Workers:
- Pension benefits aren’t great here
- Why am I paying for the pension scheme?
- What is DC?
The best decisions are made with the best information.

So what makes a benefit right or wrong?

What would we expect in a good fit?

Some questions ...

- What is typical for the chosen peer group?
- Is the peer group 100% comparable?
- What is the HR strategy? And the pay/benefit policy?
- What is the business strategy?

External considerations

Internal considerations
Information about the peer group

- Be careful with generic surveys
  - Is the information comparable to your situation?

- You can commission a survey ... accurate, slow and expensive

- Or if you participate in an industry grouping, you may get some good information there
Comparability of the peer group

- Same industry doesn’t mean comparability

- You need to compare yourself to companies with
  - Similar business strategies
  - Similar HR strategies
  - Similar remuneration/benefit strategies
Company-specific features

Business strategy

- Pile ‘em high or high margin/low volume  
- Craft work or process driven  
- Premium or functional?

What does this mean for culture?

What does this mean for the employee relationship?

What behaviour are you hoping to cultivate?
Company-specific features

HR & pay/benefit strategy

Benefits can be used as ‘glue’

Is glue good or bad for your business?

Too much glue can be as bad as too little!

What do typical recruits think about – pay or benefits?

What do typical established employees think about – pay or benefits?
Benefits may include

- Pension
- Bonus
- Share schemes
- Car (or allowance)
- Health insurance
- Health checks
- Sports facilities
- Club subscription
- Sickness policy

- Flexible benefits
- Dental/optical/GP expenses
- Company events
- Newspapers
- Holidays
Inspired questions?

Executives:
- Our benefits cost too much!
- DC is the future!
- We shouldn’t be running a pension scheme
Focusing on pension provision:

- Size
- Nationalities
- Skill levels
- Labour cost to overall cost
- Benefit philosophy
- Work design – fixed/variable
- Level of incentive pay
- Importance of cost stability
- Age of workforce
- Pension fund surplus/deficit
- Turnover – important or not
- Desired relationship with employees

Lots of variables:
- Size
- Nationalities
- Skill levels
- Labour cost to overall cost
- Benefit philosophy
- Work design – fixed/variable
- Level of incentive pay
- Importance of cost stability
- Age of workforce
- Pension fund surplus/deficit
- Turnover – important or not
- Desired relationship with employees
Some Pension Strategy Options

Hybrid DB/DC

- Vertical DC/DB
- Horizontal DC/DB

- DC (Top up)
- DB (Core)

- All DB
- DB
- DC

- All DC

Working Lifetime
You could analyse your situation in detail

<table>
<thead>
<tr>
<th>Questions</th>
<th>Suitability of Different Pensions</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>DB</td>
</tr>
<tr>
<td>Number of employees</td>
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</tr>
<tr>
<td>Nationalities</td>
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</tr>
<tr>
<td>Company Skill level</td>
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</tr>
<tr>
<td>Company labour cost</td>
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<tr>
<td>Benefit philosophy vs peers</td>
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<td>Single status</td>
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<td>Work design</td>
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<td>Non-pensioned incentives</td>
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<td>Union influence</td>
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<td>Employee appreciation</td>
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<tr>
<td>Employee Understanding</td>
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</table>

Suitability of Different Pensions:
- DB: Defined Benefit
- DC: Defined Contribution
- Top-up: Top-up contribution
- Pure Stock: Pure stock scheme

This does not equip you to make benefit strategy decisions

But do not make benefit strategy decisions without asking these questions.

Available from our website
- www.MercerHR.ie
Time to review benefits

- Misalignment of benefits to business goals
- Cost, cost, cost
- Investment/annuity risk (DB)
- Onerous accounting standard
- Move to individualisation/empowerment
- Changing work patterns (home, part)
- Compensation redesign (more variable pay)
- Staff turnover/attraction & retention
- Competitiveness
- M&A
- Poor employee perception
- Co-ordinating global benefit strategy
- Review overdue
A moving target

- If you know how your organisation compares ...
- If you feel that the existing benefit structure suits ...
- Then ask
  - What are the trends affecting comparable companies (no use aligning yourself to something that is about to change)
Trends

- All new schemes defined contribution (DC) - more or less same costs
- FLEX gaining momentum
- Volatile recruitment environment
- No major complete DB to DC switches - employee resistance
- Indications of trend towards DC for new employees
- More fluctuating pay (less basic salary)
Future Developments

Demographic
- Mortality
- Employment patterns
- Take-up rates

Financial
- Investment strategy
- Investment markets
- Price & earnings inflation

Legislative
- Taxation
- Regulation
- State pensions
Demographics: Mortality
- Mortality: male life expectancy

1940s: 73
1980s: 78
2020s: 88
Demographics
- Employment patterns – scenario 1

<table>
<thead>
<tr>
<th>Decade</th>
<th>Education</th>
<th>Work</th>
<th>Retirement</th>
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<tbody>
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<td>1940s</td>
<td>15</td>
<td>65</td>
<td>73</td>
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<td>1980s</td>
<td>18</td>
<td>60</td>
<td>78</td>
</tr>
<tr>
<td>2020s</td>
<td>21</td>
<td>60</td>
<td>88</td>
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</table>

Key:
- Education
- Work
- Retirement
Demographics
- Employment patterns – scenario 2

<table>
<thead>
<tr>
<th>Decade</th>
<th>Education (%)</th>
<th>Work (%)</th>
<th>Retirement (%)</th>
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</thead>
<tbody>
<tr>
<td>1940s</td>
<td>68%</td>
<td></td>
<td></td>
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<tr>
<td>1980s</td>
<td>54%</td>
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<tr>
<td>2020s</td>
<td>51%</td>
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Key:
- **Education**
- **Work**
- **Retirement**
Who’s got it right?

- Future unknown
- BUT
- Can identify:
  - Expectations
  - Trends
### Design – long term strategy?

<table>
<thead>
<tr>
<th>Questions</th>
<th>Options</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension Scheme or not</td>
<td>Paternal Employer</td>
</tr>
<tr>
<td>DB, DC or something else</td>
<td>Company commitment</td>
</tr>
<tr>
<td>Guaranteed or discretionary</td>
<td>Integration with State benefits</td>
</tr>
<tr>
<td>How are benefits built up</td>
<td>Standard of living in retirement</td>
</tr>
<tr>
<td>Flexibility</td>
<td>Degree of security</td>
</tr>
<tr>
<td>How do members pay for benefits</td>
<td>Commitment of employee</td>
</tr>
<tr>
<td>Other options</td>
<td>Cover eventualities</td>
</tr>
<tr>
<td></td>
<td>Suit differing lifestyles</td>
</tr>
</tbody>
</table>
Design - short term pressures?

- Cost
- Risk
Who’s Got it Right?  
- Survey evidence from the UK

- Staff turnover is 38% higher in companies offering low levels of pension contributions (2% or less)
- Staff turnover is lower in companies offering a DB pension scheme
- Lowest level of staff turnover is found among companies that provide an AVERAGE level of pension contribution **BUT COMMUNICATE** the value of benefits through a number of different channels.
- UK Businesses could save over £2 billion each year in staff turnover costs by communicating their employee benefits better.
- While only 13% of companies currently operate a flexible benefits scheme, over 60% are considering introducing one in the future.

*Source: Momentum Financial Services’ 2003 Employee Benefits Survey*
A summary ..
What to tell the Board

- Benefits don’t just cost money
  - They confer a benefit
  - The employer hopes to gain financially by offering the benefit
    - Through reduced turnover
    - Through influencing behaviour

- Stop talking about costs

- Start talking about cost/benefit analysis

- Perhaps what’s different today is that you will have to justify the investment in people more
PRSAs – possible uses

- PRSAs could form part of your pension strategy in one of the following ways
  - Your main pension offering
  - Excluded employees
  - Instead of AVCs, you could allow contributions to PRSAs

- Key differences vs. DC
  - No trustees
  - Charges capped
  - No vesting period
  - BIK
  - Company has no right to information e.g. PRSA values
PRSAs – will they work?

- Hopefully overall coverage will increase
- There is little momentum at present
  - SSIAs
  - Awareness
- What message is conveyed if PRSAs are the main offering?
  - Employee benefit?
  - Deduction facility for personal savings plan?
- The overall complexity of pensions is an inhibitor
Next steps & summary

- The poor investment returns of recent years together with improved longevity are placing enormous pressure on the pensions system
- Review the objectives of your benefit programme
- Know where you stand relative to your competitors
- Be aware of the trends which are shaping future pension scheme design
October, 2003

Managing Employee expectations by communicating effectively about pensions

Maurice Johnston
Today's pension world

Shock in store for pension members

Scale of disaster about to hit home in new statements

Clouds over new pension forecasting

Pensions cause panic

Providers face a 'PR disaster'

Shock in post over pensions

Pension returns halve in six years

Mercer claims many companies were not preparing themselves for people's reactions to the statements when they are issued.

The scale of disaster about to hit home in new statements has many pension schemes considering the likely income the fund will provide in retirement.

The employees of defined benefit schemes are members of defined benefit schemes. They are entitled to a pension on retirement based on their pay and service. These pensions are paid for by the employer and the employee and are not subject to income tax.

However, the new statements will also include a projection of the likely income the fund will provide in retirement.

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Why are we communicating?

Uncertainty

Imposed change

Require action

Everyone else seems to be doing it!
Basic Understandings

- Communication requires:
  - originator
  - medium
  - recipient

- It also requires feedback to ensure intended message was:
  - received
  - understood

- Managing needs and choices requires two-way communication.
What employees are really asking

How much should I be paying?

What income do I need when I retire?

Do I need a pension?

What’s this got to do with me?

Is it worth it?

What is the company going to do to help?

What notice?
The members’ perspective

- Retirement planning
  - individual circumstances and
  - complex legislation
  - Pre-retirement courses
    - Total income requirement / potential outgo

- Understanding member’s needs and their level of knowledge will help Companies (and trustees) to
  - Make available appropriate investment options and defaults
  - Focus communication.
  - Anticipate surprises and eliminate in advance
Studies show that employees pay most attention to information that’s personalised.

**Employees want to know:**
- How much will I need in retirement and what should I be saving now?
- What can I do to manage healthcare costs in retirement?
- What is the value of my total compensation package?

**Personalised media include:**
- Access to online Web sites where personalised information is stored and employees can model alternatives
- Print statements with information specific to an individual
- One-on-one or small-group meetings

**What fits best with the employee group in question?**
What’s Effective
Rule No 2 - Tailor the Message

- Messages may need to be tailored to different groups of employees

- Examples of how groups can be segmented… by:
  - Type of plan – DC or DB if you have both
  - Age – pre-retirement group / under 30s
  - Managers, general employees
  - Bonus earners
  - Income level
  - Marital status
What’s Effective
Rule No 3 - Create a “burning platform”

Employees will not act unless

- they understand the urgency of doing so
- they may have to pay more for the benefits they receive
- fear of not being able to retire
- fear of retiring in poverty/lower standard of living
- free money

Employee can be motivated to act

Employee can be motivated to act
What’s Effective
Rule No 4 - Make it easy / inexpensive

- We live in an era of “information overload”
- People want information that is:
  - Compact, in bite-size pieces
  - Easy to understand (written in a layperson’s language)
  - Inexpensive to obtain (prefer their employer pay any fees)
  - Up to date
  - Available when they need it
The Company’s perspective

Assumption: an employer that provides a Pension Plan will want it to be successful.....otherwise they will not provide a plan

A plan will be viewed as successful if

• It is highly valued by employees and meets their expectations
• It also meets the company’s objectives
• Problems are avoided or managed

The keys to success are

• Robust management
• Flexibility and choice tailored to employee needs
• An educative communications approach targeted towards different employee groups – their needs and current levels of understanding
Too Young?

“Another excuse” – Matt and Mairead have a new arrival
Too Busy?

“Think about it?” For Cliona and Daragh, life’s just one big whirl
“Ever heard of AVCs?” Bill wished he had.
**Stay on course**

**Leaves Fund**
- Continuation options

**Approaches retirement**
- Pre-retirement seminars

**Annual contact**
- Benefit statement
- Annual report

**Written confirmation of all changes**

**Work life**

**On employment**
- New member kit

**Employee joins**
- Welcome pack
- On-site seminars and/or video

**Regular contact**
- ‘Your Wealth & Health’ newsletter

**Ongoing support**
- Internet
- Service Centre
- Education seminars
- Financial Planning
The price of Communication

- What is the price of not communicating?
  - Poor and uninformed investment decisions
  - No knowledge of cost of early retirement
  - Didn’t make AVCs

- RESULT: Disgruntled employee, bad press for benefits plan in general
Key issues you need to address

- State benefits are a safety net for those who have low or no pension provision
- The impact of investment returns and interest rates on your DC Plan options
- The impact of the solvency level in your DB Plan on future early retirements.
- Ensure employees are confident in making decisions about their retirement income and benefits
- Ensure employees are educated investors
- Prevent surprises for both the employee and the company
Communicating with employees

- Communications tools should be a bit like a Lawnmower:
  - Easy to use
  - Easy to access
  - Does a good job
  - Low cost
Communicating with employees
Best practice

- Test member understanding and behaviour before deciding on the most appropriate communication approach – what do they want to receive?
- Design a communication strategy with a purpose of changing member behaviour
- Utilise a range of communication media to appeal to your membership – have you got different interest groups?
- Make use of the providers’ communication material but always within the context of your aims
- Be aware of the way in which the use of words will influence decision making – do not give advice
Communicating with employees
Best practice

- Provide Internet and intranet access unless they are all radio babies
- Build your material for the user’s priorities – not yours
- Focus on the “service” in self-service
- Make it simple
- Measure, measure, measure
Communicating with employees

Best practice

- Concentrate on life/career events
- Get their attention
- Personalise the message
- Make it easy
- Don’t be scared to repeat yourself
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Thank you