



**TOWERS
PERRIN**
HR SERVICES



EUROPE'S CORPORATE PENSIONS MIX
2007 EUROPEAN PENSION TRENDS SURVEY



OVERVIEW

Across the world, corporate pension plans are under growing pressure. Competitive business environments fuelled by globalisation have placed greater scrutiny on all people programme costs in recent years. Pension is often a significant cost element of reward and is certainly the longest-term, so many companies have been seeking to reduce the cost and risk of pensions.

The drive to lowering the cost and risk of company pensions has been exacerbated (if not driven by) the rising costs and increasing awareness of risks associated with some plans. Just at the time that the focus was squarely on pension costs, shifts in longevity expectations, poor investment performance and falling bond yields compounded to make defined benefit pensions even more unattractive from the company perspective. If this wasn't a hostile enough environment for defined benefit pensions, the EU forced companies to adopt market-based accounting for their current defined benefit pension liabilities. The resulting pension 'holes' threw up massive management challenges and impacted, in some cases terminally, some desired corporate behaviour: M&As became more pensions deficit-focused and underfunded pension plans also started to impact companies' financial strategies more broadly.

The 'perfect storm' was complete when the greater focus on corporate compliance and reporting transparency combined to feed the winds of pensions change. The post-Sarbanes-Oxley environment focused attention on the financial significance of pensions liabilities to companies' overall businesses by multiple stakeholders, including investors, rating agencies, the media, trustees, employees, trade unions/workers groups. Pensions became front page news and analysts' calls became dominated by questions about the viability of define benefit commitments, making deficits good and the impact of pensions funds on the core business. Cynical comments about longstanding companies becoming huge pension funds with attached businesses hit hard with CEOs and CFOs because within the joke was an uncomfortable kernel of truth.

Senior management realised that it needs confidence that pensions risks are understood, quantified financially, and managed. At the same time, CFOs and HR Directors recognise the need for pension benefits to be driven by business needs while being delivered cost-effectively.

It is within this context that Towers Perrin launched its survey into corporate pensions in Europe.

ABOUT THIS SURVEY

This research into the types of corporate pensions provided to employees was carried out among 323 large European companies, typically multinationals, with respondents coming from France, Germany, the Netherlands, Spain and the UK.

Previous pension research by Towers Perrin was local to individual markets because retirement income was thought to be irretrievably country-specific and inextricably tied up with national tax law and social security arrangements. However, this latest research tests the hypothesis that recent developments such as pan-European pensions regulation have fuelled multinationals' move towards centralised oversight/governance and commonality of benefit design – thereby creating greater homogeneity of corporate pension design across Europe.

Figures 1 and 2 provide information about the survey participants.

FIGURE 1
Respondents by country

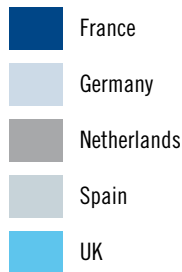
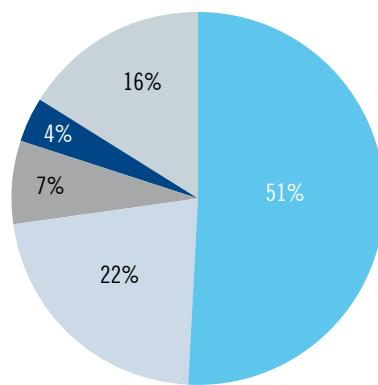
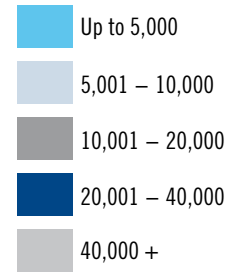
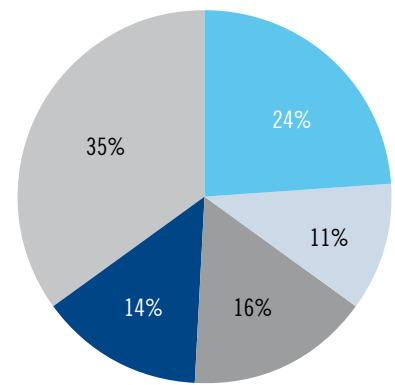


FIGURE 2
Respondents by number of employees (worldwide)



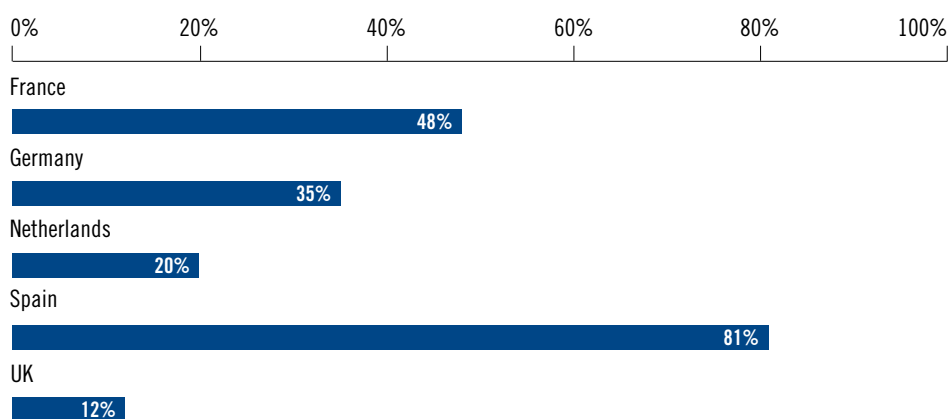
STATE PENSIONS INFLUENCE PRIVATE PENSIONS

Company pension provision has been growing in Europe for many years, but the picture varies enormously by country as illustrated in Figure 3. Despite efforts by national governments to scale back their commitment to state pensions, the state is still usually a generous provider. An accountant retiring today in Spain would expect the government to provide over 80% of retirement income. By contrast, average UK retiring professionals can expect an average of 12% of their retirement income from the government, while the figure in the Netherlands is 20%. Taxpayers in Germany and France provide 35% and 48% respectively.

This uneven market explains the variation in corporate pension provision across Europe: both in terms of types and value. However, the survey data does allow for some generalisations.

FIGURE 3

Percentage of retirement income from the state for a typical accountant



EVOLUTION FROM DB TO DC

The biggest European-wide change has been a general switch from defined benefit (DB) to defined contribution (DC) schemes, but with companies operating a phased withdrawal from DB commitments. For existing employees, the general model throughout Europe – Spain being the exception – is still a DB scheme. The contractual commitment and the need for trustee and member agreement for any change ensure that these more risky schemes from the employer's perspective are more resistant to closure for existing employees than for new members. For example, in the UK 66% of employers still provide current employees with traditional final salary pension plans while only 13% offer the same type of company pension to new

recruits. Generally in Europe, employers now provide new recruits DC plans, which fix the level of cost to the company and transfer the investment-performance risk to the individual employees.

Over 50% of companies have launched a new pension plan in the last five years, nearly always a DC plan.

It is important to note that DC pensions are not identical across Europe. Half of German companies give their current employees a DC plan in which the members' capital is protected – in essence guaranteeing against negative investment performance. In Spain there is no such guarantee, but there are restricted investment choices.

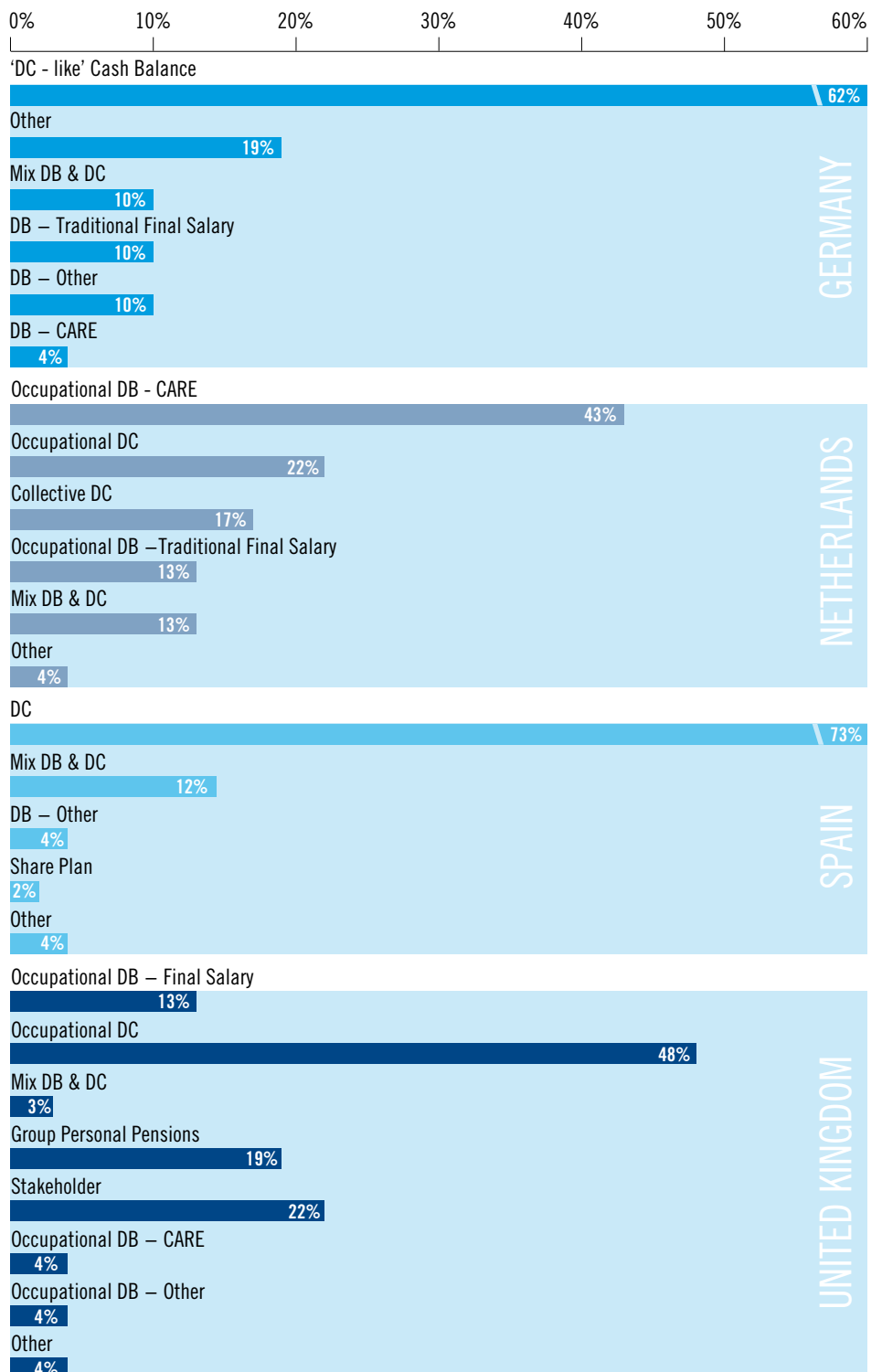
STATE PENSIONS INFLUENCE PRIVATE PENSIONS

VARIATION BETWEEN CURRENT AND NEW EMPLOYEES

Figures 4 and 5 compare the prevalence of different types of pension arrangement for NEW and CURRENT employees in Germany, Netherlands, Spain and the UK. This comparison provides a picture of the evolution of pension arrangements in the different countries.

The Netherlands has resisted this general trend to close DB to new hires. Over 40% of employers provide a Career Average Revalued Earnings (CARE) plan to both existing staff and new recruits. Corporate pensions are evolving more slowly in the Netherlands and, where change does exist, it typically involves the form of benefits rather than costs. Changing the value of pensions requires the agreement of workers councils which, unsurprisingly, are reluctant to accept less beneficial terms for employees.

FIGURE 4
Nature of pension arrangements for NEW employees



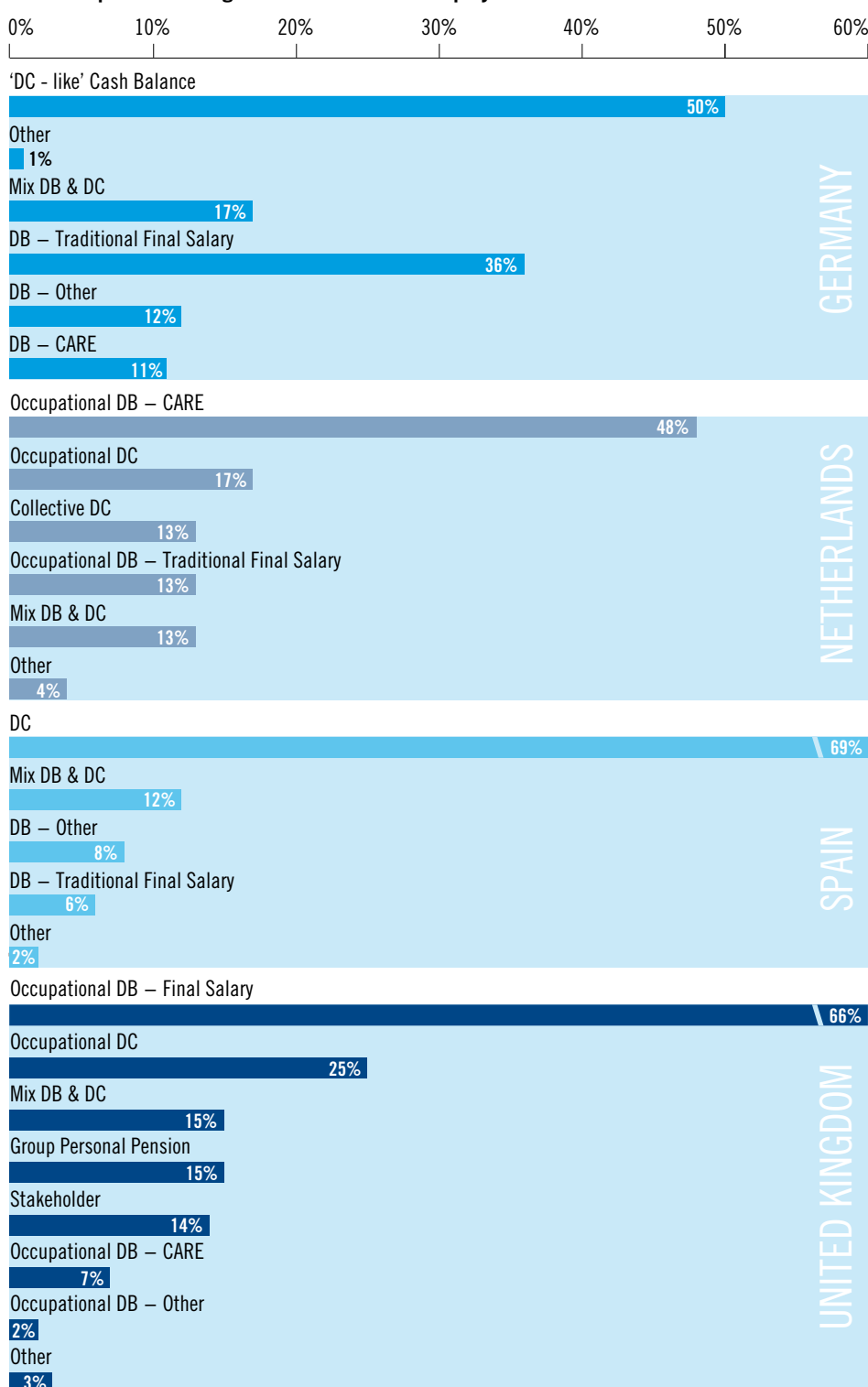
In Germany, 36% of employers still provide existing employees with a traditional final salary plan. But 50% of employers provide 'DC-like' plans to existing employees and the trend continues for new recruits. These 'DC-like' plans are, in effect, cash balance plans. This is a practical interpretation of DC in Germany due to the difficulty of funding and allowing choice in the environment and because employers have to guarantee at least zero per cent investment return.

Spain is unique in that its corporate pension provision has been predominantly DC for years. Spain is by far the most homogenous corporate pensions market with 73% of companies offering new employees DC pensions.

The UK's migration from DB pensions to DC continues. This transition in pension risks from company to employee has also been identified in previous Towers Perrin surveys – as well as other studies and press coverage. DC pension plans (which include Group Personal Pensions and Stakeholder arrangements) are now the norm for new employees to companies in the UK, with few DB plans remaining open. This survey also finds that the shift from DB has been almost exclusively to DC plans with hybrids not gaining any significant application.

FIGURE 5

Nature of pension arrangements for CURRENT employees



NEW DESIGNS HELPING PLAN SPONSORS TO MANAGE RETIREMENT COSTS

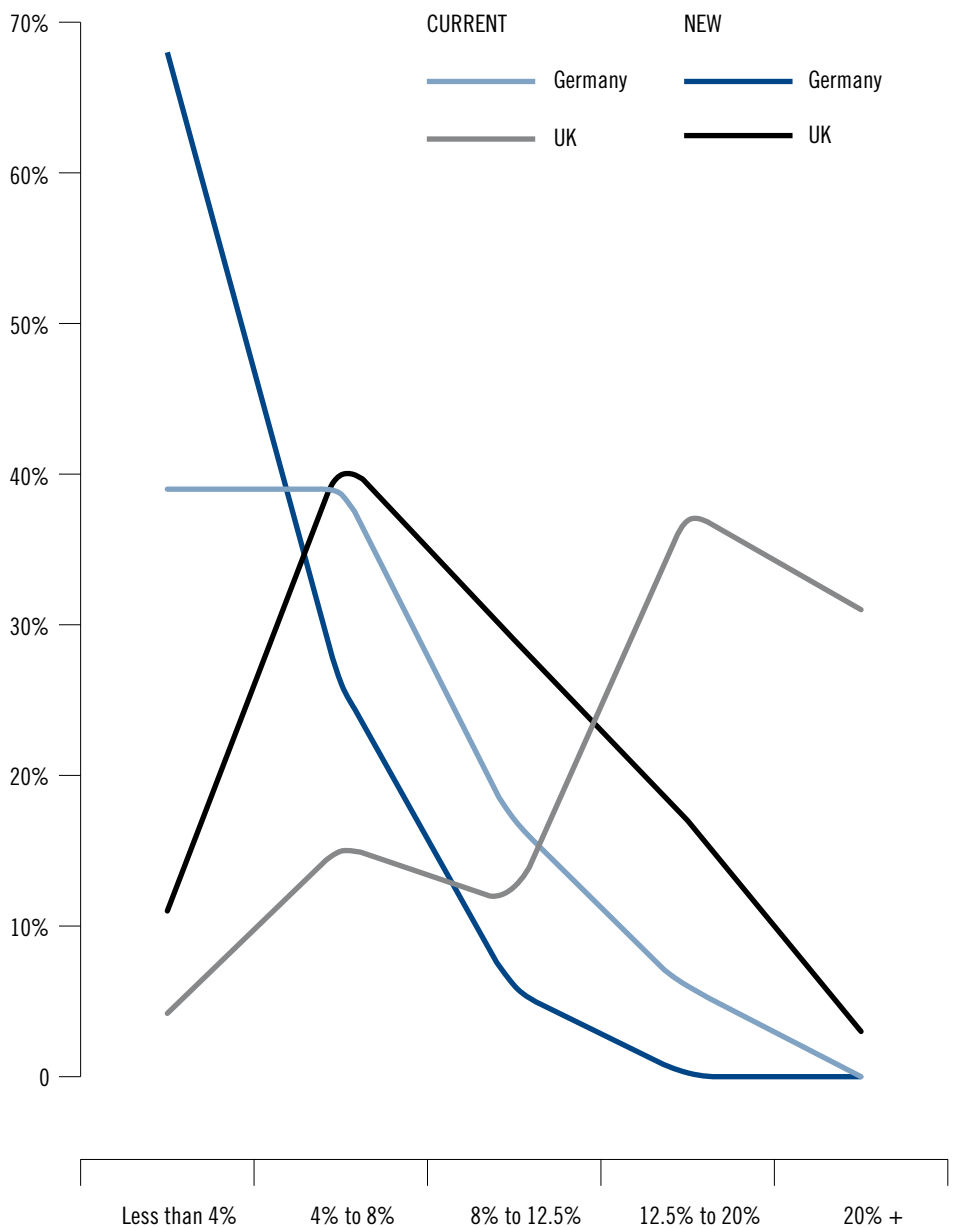
A key reason companies are changing the type of pension provision is simple: Figures 6 and 7 show the difference in the cost of providing pensions to existing and new employees in Germany, the Netherlands, Spain and the UK. The shift of the German and UK lines to the left is dramatic: the Netherlands and Spain show much less of a shift.

DRAMATIC COST SHIFT IN GERMANY AND THE UK

In the UK, companies typically pay between 12.5% and 20% of their payroll costs into pensions for existing employees, compared to between 4% and 8% for new recruits. This shift reflects the increased use of low-cost DC. It is interesting to note the double-hump pattern of current employees for the UK, with the smaller hump reflecting the low-cost DC arrangements for existing employees. This is what has led to the perception in the UK that DC is less costly and provides lower benefits. The low cost and benefits simply reflect the levels at which designs are set and have nothing to do with the type of arrangement.

In Germany, two-thirds of employers contribute less than 4% of payroll costs to pensions for new recruits, as against 40% of companies paying less than 4% for existing employees.

FIGURE 6
Cost of plan for employees as a percentage of payroll



LESS CHANGE IN SPAIN AND THE NETHERLANDS

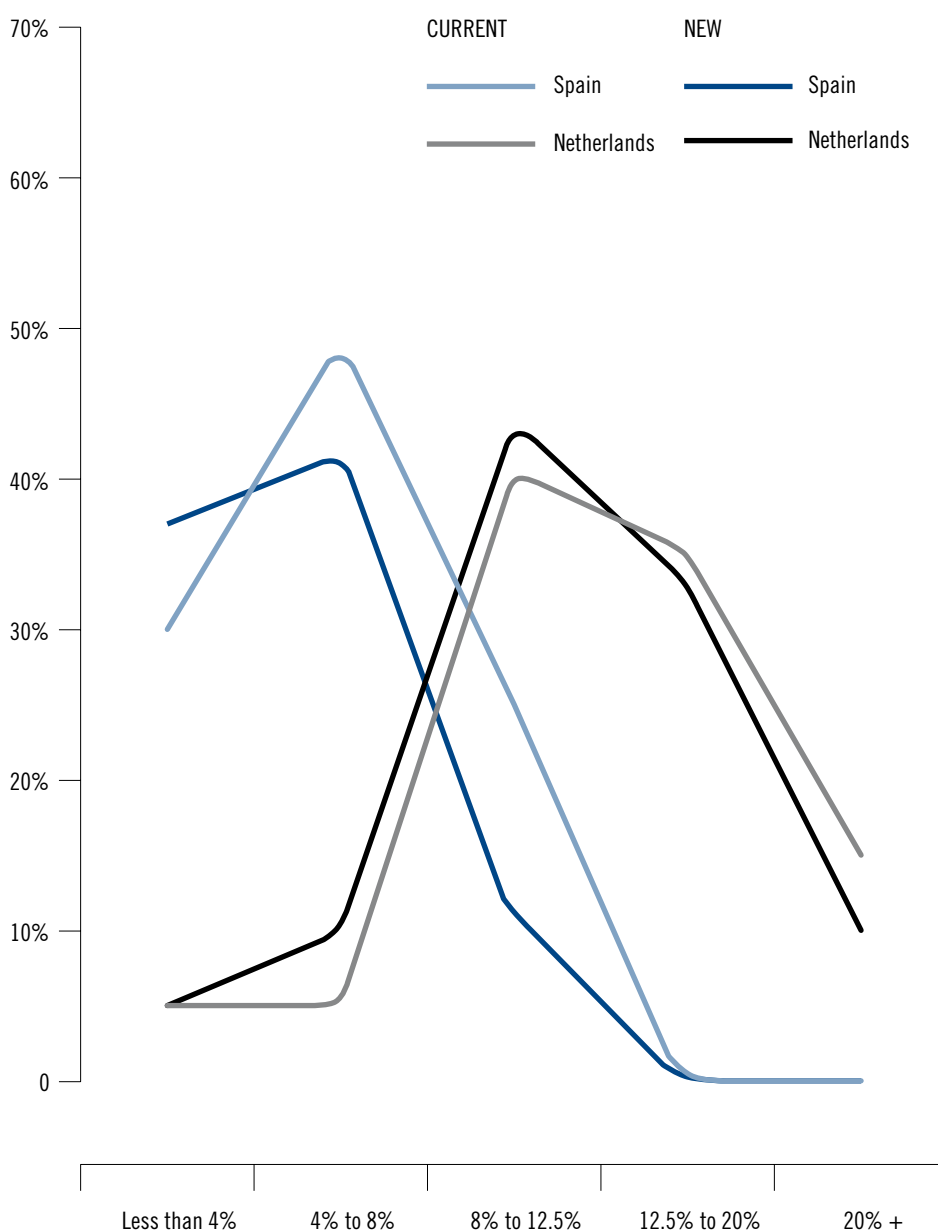
The charts for the Netherlands and Spain are similar in that the cost for current and existing pensions is almost identical. This is unsurprising as there has been little change in Spain's pensions in the last few years.

The relatively small response sample to this question from French companies meant we were unable to chart the changing cost of pension plans in France.

THE NATURE OF RECENT PLAN CHANGES

Across Europe, the main change in pension provision for current employees is a reduction in the value of benefits, manifested in a number of ways. In the UK, 58% of employers operating a DB scheme have increased the level of contribution expected from employees. Nearly two-thirds of German companies (64%) have altered their scheme details for calculating pension payments, dropping the final salary basis in favour of a CARE plan. In the Netherlands, 38% of companies have introduced a life-cycle scheme (tax-efficient benefits plan that also allows for savings of non-pensions benefits such as holidays and study time), which changes the way benefits are formulated, but not their value. The glaring exception in Europe is Spain, which enjoys a markedly different pension climate to the rest of Europe. Eighteen per cent of Spanish employers actually increased their contributions into DC schemes.

FIGURE 7
Cost of plan for employees as a percentage of payroll



KEY CHANGE DRIVER: COST

THE REASONS

Figure 8 shows that the common reasons cited by employers for introducing pension provisions over the last five years are a) cost control, and b) market trends/practice.

In the UK, about half of companies offered some choice, largely along the lines of ‘you can keep what you’ve got but you must pay more’, ‘or you can choose something cheaper but less valuable’. But when changes were made to schemes in Germany and the Netherlands less than 30% of companies gave employees choice.

The line charts (Figures 6 and 7) that show the shifting cost of pension provision are probably more eloquent about the motivation for European pension change than Figure 8, which shows what respondents said were the reasons for pension change in the last five years. Cost control is cited as a more important factor than cost reduction. Actions, it is said, speak louder than words.

FIGURE 8

Three most important issues driving retirement plan changes over last five years

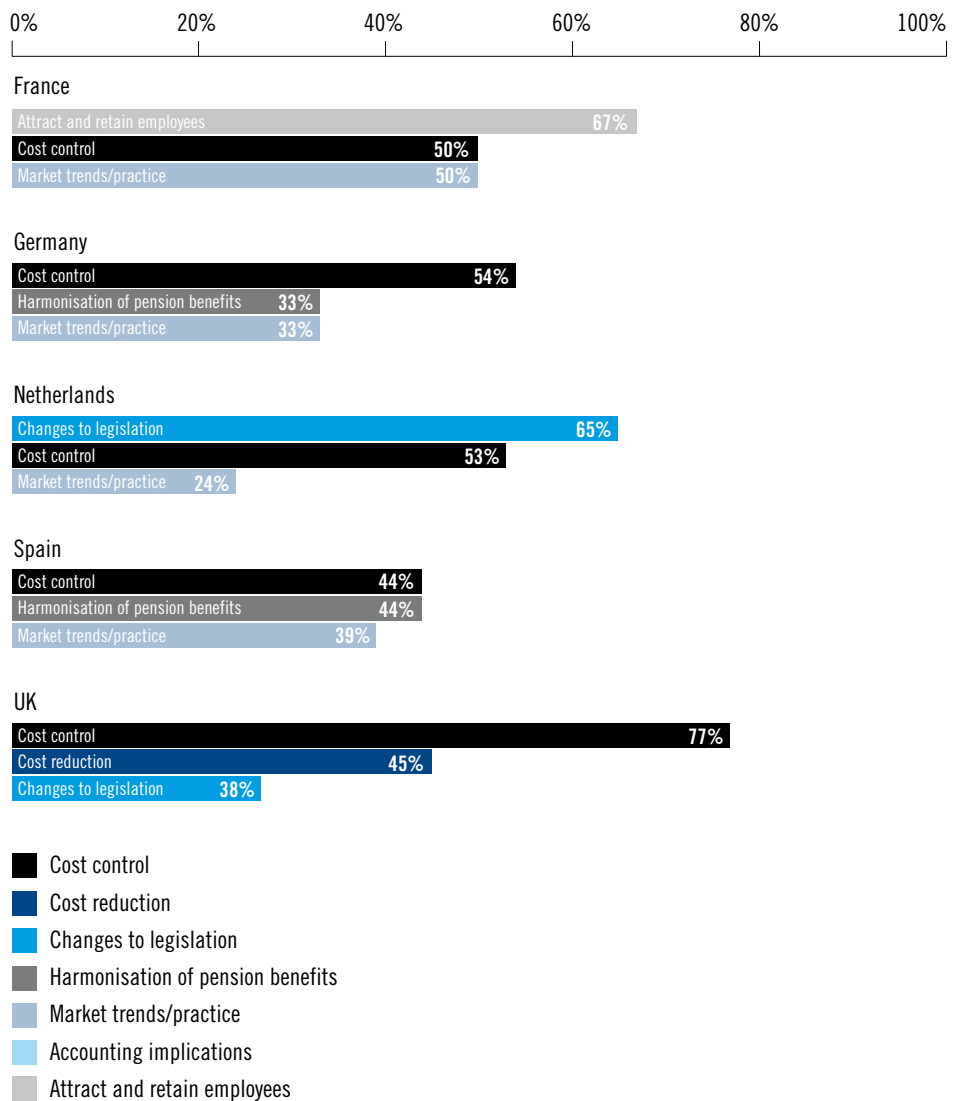
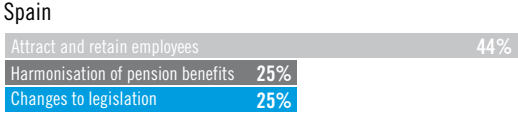
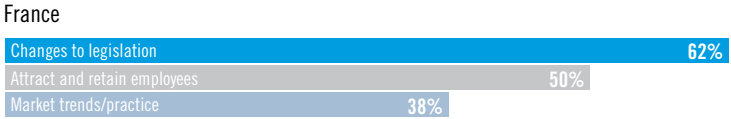
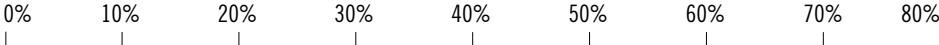


FIGURE 9
Three most important issues driving retirement plan changes in the future



- Cost control
- Cost reduction
- Changes to legislation
- Harmonisation of pension benefits
- Market trends/practice
- Accounting implications
- Attract and retain employees

KEY CHANGE DRIVER: COST

MOTIVATION FOR FUTURE CHANGE

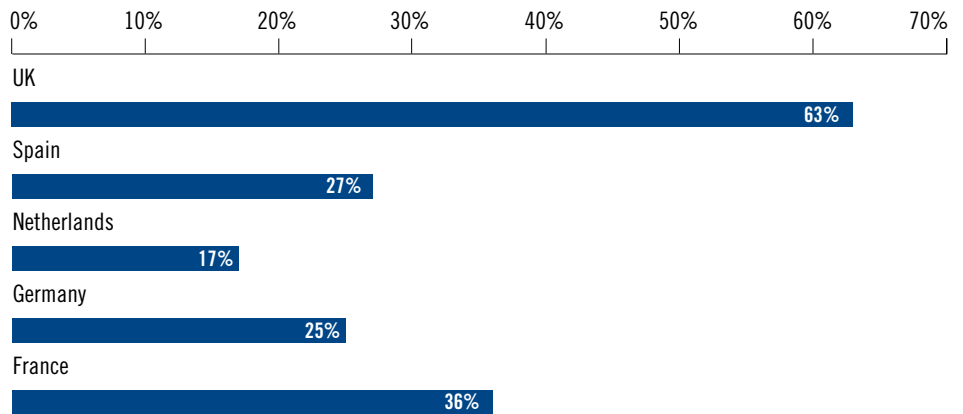
Looking at the motivation for future changes, Figure 9 shows the common themes cited by employers relate to harmonisation of benefits, optimisation of spend and changes to legislation.

A particular example of harmonisation of benefits is in Germany, where accepted wisdom states that employers cannot alter or harmonise legacy pension plans. In fact, with agreement, they can and Towers Perrin has helped a number of major German organisations achieve this. German labour law allows for amendments to plans at a group level, where the changes give benefits to employees as a group that are at least as favourable as the old plan. In exceptional cases, for example where the employer is in financial difficulties, benefits can even be cut.

Legislation – in particular the European age discrimination law – has been a driver of change but is set to become even more important in the next three years. The original EU framework directive introducing this ban has led to the introduction of legislation in each member country. Rather than offering specific protection for older workers, though, the EU directive requires equal treatment of all workers regardless of age. In fact, most cases brought under

FIGURE 10

Companies expecting to make pension changes in the next three years due to age discrimination legislation



age discrimination laws are by younger workers seeking parity with older colleagues. The directive has profound implications for pensions because length of service – a strong proxy for age – drives them. There is no specific exemption for DB plans or for age-related DC plans.

Each country has produced its own version of age discrimination laws, enforcing the directive in line with national interpretation, leaving companies with a patchwork of laws. And with no central or national body to pre-approve pension arrangements as complying with age discrimination law, companies may find that cases decided by tribunals

and courts in subsequent years in other EU countries outlaw aspects of an employer's pension policy. So companies will either have to examine each pension environment in which they operate, or try to take a consistent stance across the board. If they choose the latter, the best option may be to ensure that their pensions policy complies with the most stringent of national regulations in the expectation that more relaxed jurisdictions should not find any problem with it. This turn of events may steer more companies towards the rare but much-discussed cross-border pension fund.

PAN-EUROPEAN PENSIONS

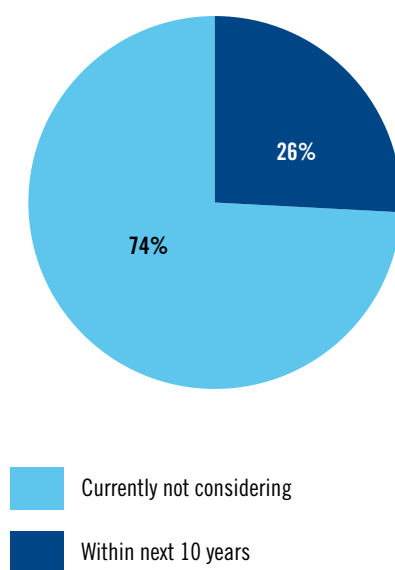
Cross-border – if not pan-European – pension funds are set to become more popular. So far they have been viewed as interesting in theory, but immensely problematic in practice. However, a persistent widely-held belief that cross-border pension funds are prevented by tax barriers has been dispelled by a test case in Denmark. In fact there are about 50 cross-border funds in place in Europe, around ten of them have been introduced since the EU directive.

What companies are beginning to consider is that, instead of implementing a full pan-European pension plan, ie, one plan covering all employees, liabilities and assets for all countries across Europe, they could still gain from combining some aspects (eg, asset pooling), certain types of plans (eg, DC), for some countries, or for certain groups of employees (eg, new hires, internationally mobile employees).

The main potential advantages are reduced costs, improved governance/control and risk management. Other advantages for some companies include resolving how to provide benefits for internationally mobile employees and more consistent employer-employee brand across countries.

This survey finds that a quarter of European participants are considering creating a pan-European pension plan in the next ten years. Momentum for such cross-border plans has increased

FIGURE 11
Creation of pan-European pension plans



noticeably in recent months, with companies in Belgium and the Netherlands (in particular) embracing and initiating serious consideration of the advantages and practicalities of such plans in various forms. This trend has been prompted, at least in part, by Belgium introducing legislation to encourage establishment of cross-border plans there. This is likely also to be fuelled by the continuing shift of operations eastwards: as companies open operations across Europe, especially in new EU accession countries, it makes little sense to offer small-scale pension plans in each of, say, Bulgaria, Latvia, Romania and Slovenia.

CONCLUSION

Most of the retirement markets included in this survey are experiencing great change. With the exception of the Netherlands and Spain, European companies are looking to lower the cost and risk of the company pension plan. DB pensions, while still the most prevalent form of pension for existing employees, are now a scarce form of pension for new joiners. The driving forces of this change – lower costs, risks, cross-border pensions harmonisation – are likely to accelerate this European trend and see the withdrawal of DB pensions for existing employee groups. In the Netherlands, where workers councils are still strong, this trend will be less marked.

Spain, however, shows an interesting counterpoint and potential longer-term insight into the way European pensions may develop. Spain has been a DC market for many years. Eighteen per cent of Spanish companies bucked the cost-cutting trend and increased company contributions to their DC plan in the last few years. And this is likely to continue with Spain's top driver for future change being 'attracting and retaining' employees.

ABOUT TOWERS PERRIN

Towers Perrin is a global professional services firm that helps organisations around the world optimise performance through effective people, risk and financial management. The firm provides innovative solutions to client issues in the areas of human resource strategy, design and management; actuarial and management consulting to the financial services industry; and reinsurance intermediary services.

The firm has served large organisations in both the private and public sectors for 70 years. Our clients include three-quarters of the world's 500 largest companies and three-quarters of the Fortune 1000 US companies.

Our businesses include HR Services, Reinsurance and Tillinghast.

The HR Services business of Towers Perrin provides global human resource consulting and related services that help organisations effectively manage their investment in people. We offer our clients services in areas such as employee benefits, compensation, communication, change management, employee research and the delivery of HR services.

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