Taking the sting out of final salary closure

What Unilever and the public sector pension dispute show clearly is that the extent of the push-back from members does not just depend upon the scale of pension change. There are always company-specific issues which come into play. The financial strength of Unilever and the British Government seems to have been a hindrance to them, with their members not understanding why they need to make changes. However, the legal backdrop is that employers do, in general, have power to amend pensions for future service, as long as they properly consult with employees. There are plenty of examples of large, profitable, household names who have closed their final salary schemes to future accrual without apparently any significant employee relations issues. How have they achieved that? I believe it largely comes down to the way in which they developed their proposals and then communicated them to employees.

In this Pensions Perspective, I look at the design and consultation stages of pension change projects. I explain how to set about delivering what could be a tough message on final salary closure, in such a way as to minimise the risk of seriously upsetting your employees. Of course, existing DC members may also be affected by a pension change project, in particular if the company is establishing a new DC design for all employees going forward. However, my focus here is on how to take the sting out of final salary closure.

Develop a compelling business case

There are many reasons why companies are closing their final salary schemes to future accrual and I examine these in my Pensions Perspective entitled “Pension change – time to grasp the nettle”. However, the foundation for any successful pension change exercise is a compelling business case.

The starting point is to be clear on the company’s objectives - what does it need to achieve from the re-design and can it demonstrate this need with hard figures? Having defined these objectives, the company should review the pros and cons of all possible new pension designs, relative to the status quo. The proposed new design should be the one which best delivers the objectives, which is how it provides the compelling business case.
It is surprising how often pension change proposals are undermined from within the company itself.

This review does not need to be time-consuming or expensive, but some companies miss it out and move straight to the design they favour. Aside from the risk that, in this situation, the chosen design may not actually be the best fit with their objectives, it also weakens the company’s hand in the consultation with members, who are sure to ask why the proposed design was chosen, what others were considered and why they were rejected.

Prepare the ground – within the company

It is surprising how often pension change proposals are undermined from within the company itself. Usually it is because one or more of the following areas has been neglected:

- a consistent message – it seems obvious but the business case for pension change needs to be consistent with recent comments made by the company on the pensions it provides and with any other corporate initiatives happening at around the same time. If it is not, then this should trigger a review of whether now is the right time to push ahead. I know of one company that, following a funding valuation, recommitted itself in the strongest terms to the future of its pension scheme – only to announce a proposal to close it to future accrual on the grounds it could not afford it just 6 months later.

- the right resource – a project team needs to be established, with sufficient power to take day-to-day decisions. Crucially, the project needs a senior business sponsor, ideally the Finance or HR Director, or perhaps even the Chief Executive. The sponsor is not just a figure-head – at critical stages, they are going to need to invest time and their own authority for this project to be successful. Given what is at stake, the project deserves this level of senior input.

- everyone pulling in the same direction – whilst the company’s senior management will have taken the decisions on pension change, what is often over-looked is the need to ensure that a much wider group of line managers, as well as the HR team, are also on board. Some will be personally affected by the end of final salary accrual and negative comments by these individuals can seriously undermine the consultation process. For that reason, it’s vital to ensure that, before consultation with employees starts, the management and HR teams understand the business case for change and will endorse it – this is an area where the sponsor needs to be directly involved.

- clarity on any contractual commitments – the company needs to be crystal clear what, if anything, employees’ contracts say about pensions. There can be practical issues in identifying the wording of all the relevant contracts, especially for a company which has grown by acquisition. Usually contracts do not specify that the company must provide a final salary pension. Even if they do, it is still possible to stop final salary accrual but the consultation will take place under employment, not pensions, law and will be more complex than I am considering here.

All of the above areas are directly within the company’s control – but there are others which are not.

Prepare the ground – with trustees and unions

The proposals can be knocked off course by the trustees of the pension scheme, who will usually need to sign a deed of amendment to implement the changes. As a starting point, the company needs to take legal advice on:

- any relevant trustee powers under the scheme’s trust deed and rules
- any difficulties it could face in breaking the link between active members’ accrued benefits and their future salary increases and
- whether ceasing final salary accrual could trigger a buy-out debt on the employer.

The company should be able to argue that closure strengthens its covenant to the scheme, rather than weakening it.

Assuming this gives a green light, the company will want to present its proposals to the trustees on a confidential basis before the consultation with employees starts. The company should be able to argue that closure strengthens its covenant to the scheme, rather than weakening it.

The strength of the existing relationship between the company and the trustee board will be important here. In some situations, trustees use impending closure to justify demands for higher contributions, extra security or de-risking of the scheme’s investment strategy.

However, faced with a compelling business case, the trustees should hopefully confirm that they anticipate signing the deed of amendment. It is not possible for them to sign the deed at this stage as, until the consultation has taken place, there is no certainty about what changes will be made. However, like management and HR teams, it is important that the individual trustees understand the reasons why the company needs to push ahead with its proposals, as they are sure to be asked questions by members.

If there are unions representing some of the workforce, then they are another
stakeholder to whom the company will want to present its business case and proposals before consultation starts. Indeed, unless there are real concerns about keeping the proposals confidential, it is preferable to give both trustees and unions sufficient time for them to take their own advice and respond with any questions or concerns prior to the start of the formal consultation with employees.

Decide how best to consult

The DWP’s guidance describes consultation as “an exchange of views and the establishment of a dialogue between the relevant employer and the person he consults”. The Regulations impose a duty to “work in a spirit of co-operation, taking into account the interests of both sides”. This is why the company is only able to put forward proposals initially and why, at the end of the consultation, it must consider all of the responses it has received before making a decision on how to proceed. However, crucially, the consent of the employees and those representing them is not required.

The company can choose to consult directly with the affected members or through their representatives, which means unions, staff associations or employee representatives elected specifically for the pension consultation. Either way, members still need to receive all of the communication outlined in the next section.

The best approach will depend on the specific company and workforce. For large multi-site employers, consulting through unions and/or employee representatives generally helps the process run more smoothly. This is because regular meetings of the representatives throughout the consultation provide an effective forum for two-way feedback, greater accountability for answering the questions raised by members and, ideally, a partnership approach between management and representatives. Even if consultation is direct with the members, it pays to keep the unions fully involved and make sure they understand the rationale for change.

Communicate openly, honestly and often

Although the legal requirement is for consultation and not negotiation, no company can afford to approach a pension consultation in a half-hearted fashion.

The better the employees understand the need for change, the more likely they are to accept it.

The communication with members is a significant project in its own right, involving:
- announcements explaining the proposals
- member presentations
- personal illustrations
- establishing feedback channels
- answering frequently asked questions (FAQs)
- confirmation of the final decision.

If a final salary scheme is to close to future accrual, there will be a large number of questions. For example, a resource of over 150 FAQs in four regular member updates was needed for a recent closure project. The communication programme needs to be planned like a military campaign but be flexible enough that, if an unforeseen but potentially significant issue is raised by members, it receives a prompt and direct response.

Companies need to be honest in their communication and not pretend the changes are good news for everyone if that is clearly not true for some. The business case needs to be explained openly and clearly, as do the reasons why the company’s review of pension design led it to its proposals. The better the employees understand the need for change, the more likely they are to accept it. It is good practice to communicate frequently, as over-communication is rarely a problem and silence, even when there may be little to say, is often interpreted negatively.

Help employees on their journey

The reason for all this communication is that, when faced with pension change, members’ initial reaction is usually a mixture of shock and anger. However, that is only the start of their emotional journey, which can quickly lead on to blame and resistance. The key is not to allow members to remain in these stages but, by proactive and varied forms of communication, help them move on to understanding and, eventually, acceptance, as illustrated in figure 1. The two-way flow of feedback and information, which regular meetings of the employee representatives facilitate, can be very helpful in ensuring that employees reach the stage of acceptance. In fact, that is not quite the end of the journey because, for a successful implementation involving a switch to DC, the company’s goal will
be for members not just to accept the change but to have become engaged enough in pensions to make their DC investment choices.

The last word
In this Pensions Perspective I have shown how to tackle the design and consultation stages of a pension change project, in such a way as to minimise the risk of damaging employee relations. However, this approach is not just good at minimising the negatives. If a company is whole-heartedly committed to the process, it can help turn pension change into a positive experience for employees, by enhancing their engagement in and their appreciation of the pension benefits which the company provides.