

# DECISIONS





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**What a year** it has been in the world of pensions: a fitting metaphor for the market might be a sinking ship, and the myriad of companies that have been jumping from its decks by way of closing their final salary schemes those clever rats.

But escaping isn't that easy. Not only are companies that have undertaken layoffs in 2008-09 now thinking about how to retain the staff they have left by incentivising them with various benefits or salary sacrifice schemes; incoming regulation will require companies to automatically enroll all eligible staff into a qualifying pension scheme from 2012 – and if companies fail in this or are seen to in any way be coercing staff into joining, there could be large fines coming their way.

There is renewed downward pressure on UK employers and on FDs in particular to be aware of their increased duties, to perform them, to report them and to spend money doing so. All this as we plough our way through a crippling recession!

In this, our latest *Decisions* supplement, our pensions correspondent Anthony Harrington sets out what those duties are for FDs and some ideas on how to comply without breaking the bank – and if you need to get some cash through the door for this, check out our piece on securities lending.

Melanie Stern

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# PAID AND PAMPERED

Employee benefits are not just about retaining staff. They are a risk management tool that could impact the bottom line

**When a particular human resources**

practice that has proven its worth in the US makes its way to these shores, one common response if the practice proves itself to be valuable is for organisations to say: "We were kind of doing that anyway". The concept of 'wellbeing' still sounds odd to many in the UK – but its potential to help reduce absenteeism, boost staff morale and enhance employers' standing with employees is more than a soft issue. Anything that purports to do all that, and rather more cheaply than most other mainstream, well-recognised employee benefits such as company cars, pensions and various insurance-related perks, should interest the corporate world.

Many still believe the term is little more than a faddish invention of the benefits industry, but a number of major companies have sophisticated wellbeing offerings. The main driver for the creation of the wellbeing movement in the benefits industry is the enormous expense associated with the provision of healthcare in the US. This forced major employers to start investing in the health and wellbeing of their employees before they got sick, in order to bring down the costs of healthcare provision for staff after the fact.

"There is no doubt that wellbeing came across the water from the US and it had a very good reason there for coming into ▶



existence,” says Wayne Pontin, business development director at healthcare and wellbeing consultancy the Jelf Group, who adds that the concept has gathered steam in the past five years. “Clearly, if you can improve the overall health of your employees, you reduce your medical expense spend,” says Pontin.

This is assuming the employer provides medical health insurance as a benefit; in the US, healthcare insurance tends to be a highly valued and widely used benefit. The testing of various wellbeing schemes by US companies has benefited the UK corporate world to the effect that the stronger, more useful and more efficient ones are now common among companies

wellbeing provision as those employees who were not culled – the valuable ones – are being treated more carefully now. “A number of companies have had to downsize and are under even more pressure than before to improve the health and wellbeing of their remaining staff. Since they need all hands to the pump, it is critical for them to cut down on sickness and absenteeism,” says Pontin. Everything about wellbeing programmes works to boost staff morale and get people feeling better about themselves and their overall health – that, at least, is the theory and surveys of staff with wellbeing programmes in place tend to bear this out, says Pontin.

employee, which is much less than you would pay for monthly membership in most big city gyms,” he says.

In fact, he says there has been a noticeable upsurge over the past 18 months in UK schemes providing a package of gym membership, health and stress screenings and personal trainers as part of a designated wellbeing benefits package. And more new products in this area are appearing all the time.

### Health check

Something that has recently been launched in the UK is a benefit known as protection plan. One of the main providers is US Preventive

## Early identification and clear health risk assessment programmes increase employee health and lead to a decrease in sickness and absenteeism



Another key point in favour of wellbeing programmes in a recession is that they are considerably cheaper to introduce than other sorts of benefits. “If you take a death-in-service insurance package, that works out at about 0.7% of payroll, while a

Medicine, operating as iHealth in the UK.

The basic theory is that since five main diseases – heart disease, cancer, strokes, chronic obstructive pulmonary disease (better known as bronchitis or emphysema) and diabetes – are responsible for more than two-thirds of all deaths in the UK each year, providing employees with comprehensive screening for these conditions on a regular basis is good for the employees and good for the risk and expenses management of the company. Early identification and clear health risk assessment programmes both increase employee health and, from the company’s perspective, lead to a decrease in sickness and absenteeism.

iHealth recommends companies

take an integrated approach to healthcare: those not so comfortable with touchy-feely subjects may wince, but the company has set this out in its ‘four quadrant’ framework – with its four interacting categories being ‘inside’ (how you feel about things, your subjective stress levels); ‘outside’ (your physical assessment, the state of your body and behaviours); the ‘individual level’; and the ‘collective level’ (the culture, beliefs and practices around you, the environmental, workplace and home aspects).

Employers select from a range of packages for staff, including various imaging and testing ▶

in the UK, including everything from gym membership, regular health screening, stress monitoring and counselling to nutritional advice and cafeteria menus that reflect good nutritional practices, diet advice and even personal trainer expenses.

Perhaps counter-intuitively, Pontin says the recession has bolstered corporate

full-blown private medical insurance will cost about 1% of payroll. However, to introduce a wellbeing package costs less than 0.4% on average,” says Pontin. Rolling up all three means that for just over 2% of payroll, the employer gets a well-rounded package of health and wellbeing measures to provide across the board to employees.

“What we find is that gym membership is particularly valued and employers using bulk-buying can get monthly gym membership discounted to about £25 per month for each



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programmes, to identify the sources of pressure on the individual and map out strategies to keep them well balanced, bodily and mentally. Anyone in doubt as to the importance of employee wellbeing need only look at the recent spate of suicides at France Telecom – many of which were blamed on workplace stress.

Another recent trend is employee assistance programmes specifically designed to reduce absenteeism from stress-related causes.

flagged up,” explains Health Assured’s Taylor. “We also provide the employer with anonymous information on the general state of health of the workforce, which can help to formulate further preventative strategies.” Health Assured is an example of a company that offers an online stress coaching tool for employees to define the degree of stress they are experiencing in their work, while a further level of functionality it offers ensures employees who are off work for stress-related

causes are visited by an occupational health nurse, who will explore with the employee what needs to be done to overcome the difficulty and get them back to healthy working.

“This is a very good line of defence for the employer, but it does need to be part of a joined-up approach to stress reduction,” says Taylor. The service provides a telephone helpdesk for staff to ring for support, and if the support staff feel that it would be necessary or

## These benefits packages are more than just a ‘nice-to-have’ for employees – they also serve the employer as a primary defence against workplace stress claims

Companies can buy an employee assistance programme as a package that includes a sliding scale range of features and benefits for employees, says Phil Taylor, managing director of employee benefits provider Health Assured. From the employer’s standpoint, this kind of benefits package is more than just a ‘nice-to-have’ for employees – it also serves the employer as a primary defence against claims by employees suffering, or claiming to suffer, from workplace stress-related illness.

### Employee screening

Taylor points out that for the employer, the service can begin at pre-employment stage through pre-employment screening of candidates. This is emphatically not a discriminatory practice, Taylor argues, because even where the employee suffers from some recognised disability, pre-employment screening is vital: it is about helping the employer to understand that particular individual’s needs and the kinds of reasonable adjustments to the workplace that might need to be made to accommodate the individual if they are employed. Taylor points out that this can also help guard the employer from legal action at some later stage for having negligently disregarded the individual’s special requirements (for example, you don’t put someone with chronic back trouble in an area that involves constant lifting of moderately heavy objects, such as stacking high shelves).

Online management of employee benefits is gaining popularity. “All employees in the programme are encouraged to go to our website and fill in a health assessment. This is confidential, but it allows our staff to respond if problems are

beneficial for that staff member to move from telephone support to a face-to-face meeting they will be referred to qualified stress counsellors. The cost of this for the employer works out at around £10 per employee – a pointless expense or a trivial sum compared with some of the extremely large, headline-grabbing awards made by employment tribunals and courts in stress-related litigation.

### Chill out

One of the key points for both management and employees to grasp about wellbeing benefits is that apart from those elements of the package whose function is obvious, such as gym membership, employees will need some help and guidance understanding how a wellbeing programme will benefit them.

From the employer’s side, they can also help to identify hidden problem areas in the company’s processes and practices that might be generating unfair and unnecessary stress. If an employer is genuinely interested in cultivating a reputation as the employer of choice in their sector and takes staff motivation and workplace morale and satisfaction seriously, then wellbeing benefits will rank alongside work-life balance and flexibility as a valued part of its offering to attract and retain good staff. What you do not want is a wellbeing programme that ends up looking to the staff as if Big Brother is watching their waist line, or looking to pick weak links for redundancy fodder. ■

**Anthony Harrington**

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# DEBT BOMB

Complex draft rules governing employer debt could prove to be a timebomb for unsuspecting business

**Everyone in the pensions world** knows the full annuity-based buyout price for a final salary scheme fund is usually exorbitantly expensive. So Section 75 of the Pensions Act, which triggers the full buyout debt if the employer, even inadvertently, crosses one of a fairly large number of lines in the sand while carrying out a common or 'garden' group restructuring as a tidying exercise, is a very scary piece of legislation.

The only thing that makes Section 75 a touch less scary is the fact that the legislation makes the trustees responsible for deciding whether to push for a buyout or not, following a 'termination event' – Section 75's polite name for the employer making a major error. Trustees, most employers would feel, are a lot easier to negotiate with than the cold and complex logic of Section 75 itself.

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from industry and from professional advisors, HM Treasury and the Department of Work and Pensions have completed a consultation exercise looking to push through some 'easements' to the Section's draconian logic, mindful of the fact that we may see more corporate restructuring in 2010. Both the pensions industry and its professional advisers – the lawyers, accountants, actuaries and pensions administrators – argue that where a restructuring exercise leaves the employer's covenant in respect of the final salary scheme no worse, and possibly better than before, it is wildly illogical to talk about triggering a Section 75 debt.

#### **Loophole phobia**

The DWP seems sympathetic to this point, but as the consultation paper it has issued shows, it is hamstrung by its fear of creating loopholes in the

legislation that will allow employers to walk away from their pension debts unscathed. This fear makes the Section 75 consultation document read like a trainee lawyer's nightmare exam paper. As a result, most advisers are less than thrilled with it.

Clive Fortes, a partner and head of corporate consulting at Hymans Robertson puts his view bluntly. "Is this a useful consultation exercise? No. It will be of extremely little value," he says.

There are two easements suggested in the consultation, both designed to make life easier for companies carrying out restructuring exercises. First, company A entirely consumes company B, in which case it can take over company B's pension liabilities if a number of commitments are satisfied. This means company B is then released from its liabilities – which tends to be because it no longer has any active members in its final salary scheme and all the deferred members and pensioners are

now under the wing of company A, which has to be able to offer at least as strong a covenant as company B in the eyes of the scheme trustees.

The second easement is a *de minimus* easement, a kind of parallel to the easement HM Revenue & Customs provides that allows trivial sums of money in pension schemes to be commuted rather than turned into annuity-driven pension payments of some silly sum such as 0.02p per month. For this proposed easement to work, a scheme must be fully funded to the level set by the Pensions Protection Fund; the withdrawing employer cannot employ more than 2% of the membership in the remaining fund, company A's fund, in our example.

### Out of proportion

Hymans Robertson's Fortes says these two provisions are just about acceptable, but believes the killer clause is the one that says the proportion of employees moving from company B to company A's scheme cannot represent more than £100,000 of the fund's PPF liabilities. If one takes

changes so tightly that it makes these changes impractical and unworkable," he says. The upshot is that the easements proposed are not going to make any sort of major impact.

What perplexes Fortes more than anything else about the consultation the DWP is currently going through is simply the scale of the complexity it has woven around its proposed easements. It is far simpler for any group that wants to do a restructuring to ignore all this, instead going directly with its proposals to the regulator and its pension fund trustees to request they sign off on the plan.

"Most restructurings involve multiple companies and multiple restructurings, not the one-to-one model proposed by the legislation. You are better off doing multiple restructurings in a single pass and getting clearance, rather than trying to use the legislation as a multi-pass approach," he says.

John Herbert, chief actuary with pensions administration specialist Premier Pensions Management, points out that, as things stand, before any changes to the legislation that might

once Section 75 was introduced in April 2005, employers were effectively nailed to their final salary schemes, since any attempt to walk away would trigger the full buyout debt. In an ideal world, he says, the consultation paper would have addressed the fact that it is senseless for the legislation to trigger the debt if a restructuring leaves the final salary scheme being supported by an employer with just as strong a covenant as the exiting employer. This is not what the consultation is about. Instead, it has introduced a thick net of conditions around a couple of simple easements. "This is great for advisers, but it adds dramatically to the cost of restructuring," he says.

One of the complexities being introduced is that even in the simple instance envisaged in the consultation paper, where employer A exits and employer B takes on responsibility for the scheme, you have to ensure that the exit and the entry happen on exactly the same date, with all the transfer of pensions going through on that date. "Section 75 is one of the most detailed and complicated pieces of legislation ever devised, and

## The government's anxiety to avoid any possibility of a loophole has caused it to draft the proposed changes so tightly that it makes them impractical and unworkable

the fact that the typical scheme liability per employee with not much service with the company is about £20,000, this suggests an upper limit of schemes with no more than four members. "What kind of easement is it that only works for restructurings that involve schemes with virtually no members?" he asks.

But there are at least two more killer clauses. First, they cannot come into play if there is an expectation that the exiting employer would go into liquidation within 12 months should the deal not go ahead. This means the consultative paper does not apply if a forced restructuring is involved. It has to be a voluntary restructuring, leaving company B in good health as it goes off into the sunset. Second, the trustees have to be entirely comfortable in their minds that Company B will not be subject to an insolvency event within the next 12 months. This means they need to go through a fairly stringent financial due diligence process to sign off on the deal.

Where does this leave the consultation paper? Fortes believes it is a good thing that the government is looking to find ways of easing restructurings within the same group. "However, its anxiety to avoid any possibility of a loophole has caused it to draft the proposed

result from the consultation paper, a company that had just one active member left in its final salary scheme could find a Section 75 debt triggered for all its current pensioners and deferred members if that lone employee left.

"You have to remember that for most schemes, the majority of the pension liability is not for the active members who are contributing, but for former members who have moved on to other companies," he says. "It is a real legacy weight on the company. What companies want to do is to manage down this debt over, say, 30 years, while ensuring they do not drift into a position where a Section 75 debt is triggered."

What stops trustees from insisting that the full Section 75 debt is served on the employer on any trigger event is generally not love for the employer, but a lively sense that the employer would not have enough money to meet the debt, so members would not do well out of it. "This creates the basis for a sensible conversation between the employer and the company scheme trustees," Fortes adds.

### Looking for clarification

Premier Pensions Management's Herbert takes a more hopeful view of the consultation exercise than Fortes. "I suspect the new consultation is simply looking to clarify a few minor points in the way easements will work in specific circumstances," he says.

Andrew Holehouse, pensions partner at law firm Shepherd & Wedderburn, points out that

I say this against a background of a great deal of complex pensions legislation," Holehouse muses.

As it stands, the consultation paper makes the scheme trustees responsible for deciding whether the covenant of the restructured employer is as good after the event, as it was before the restructuring. "Pension fund trustees have a serious responsibility here and they will need to get the right reports and the right advice and they will have to spend money to get themselves properly informed," Holehouse says. Saying that one covenant is as good as another is actually a tough call to make. Many people doubtless thought Lehman Brothers was in good shape the day before it went down, for example.

Similarly, the requirement to look ahead 12 months and to confirm that neither the exiting employer nor the incoming employer are likely to go insolvent in the next 12 months is another tough call, for the same reasons. "The DWP has decided that trying to draft easement proposals for complex restructurings is just too difficult to do. Could it have done more with this consultation document? Probably, but what we can say is that this is a start, and making a start on difficult subjects is what consultation documents are all about," says Holehouse. ■

**Anthony Harrington**

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# SWEATYO

Securities lending is controversial, but in lean financial times

**In early October**, Labour MP Frank Field wrote to *Pensions Week* warning that pension funds were running “alarming risks” by allowing their securities to be lent to third parties. Field’s letter drew a blistering response from International Securities Lending Association (ISLA) chief executive David Rule, who itemised all the points he thought Field had got wrong. However, politicians shrug off that sort of thing readily enough and Field’s subsequent responses showed him determined to uphold the position on this sometimes controversial practice.

But a lack of knowledge about securities lending is by no means unusual. It is an arcane topic well off to one side of the usual final salary – versus – defined contributions debates, and there probably *are* trustees in large schemes who have very active securities lending programmes that would find a briefing from their pensions advisors on this theme useful.

A basic tutorial would very briefly explain what securities lending is all about. A pension fund has a

portfolio of assets, including government bonds and equities which it trades to achieve the fund’s objectives as laid down by the trustees. If it is a buy-and-hold fund, which pension funds tend to be, since they are trying to achieve a match of assets to very long-dated liabilities, once it buys the assets they sit on its books and gain (or lose) value under their own momentum. What securities lending does is to enable the fund to earn a handful of basis points from a borrower by assigning them a security for a defined period, in exchange for sufficient collateral.

One of the very good things to come out of the fuss Field kicked up was a collaboration between *Pensions Week* and Data Explorers, an organisation that gathers data about securities lending around the world. This collaboration resulted in a survey of the top 50 UK pension funds, conducted in the summer, which found that 68% were participating in a securities lending programme. All respondents said they were participating by choice – putting paid to one of Field’s major concerns that trustees of pension funds did not know their agent lenders (the banks who provide

# URASSETS

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custodial services to the fund investment management team) were lending out their securities. Around 88% of the sample said they lent through their custodian, while 11% engaged a specialist third-party agent to manage their securities lending programme.

## On whose authority

ISLA's Rule made the point that there is no way a reputable custodian would indulge in a lending programme without the explicit authorisation of the beneficial owner of the securities. Who would it pay the proceeds to? Imagine the conversation:

*Bank: "Excuse me, Mr/Ms Trustee, here's £1m.*

*Trustee: "Eh? What's this for?"*

*Bank: Well, we've been lending your securities on your behalf, we thought it would be a good thing to do."*

A second major fear Field expressed was that, while securities lending is done on a fully collateralised basis – I lend you £1m of my portfolio of securities, you put up £1.05m worth of government gilts to cover the trade – there is still some risk. The risk he focused on is trading volatility, suggesting that markets sometimes

lose 10% in a day and so the industry standard practice of accepting 105% collateral is, to his mind, risky. But this point missed the fact that it is standard practice, when taking equities as collateral, to mark-to-market on a daily basis, which means whoever is managing the lending programme would be automatically pulling more security from the borrower to bring the collateral up to the level specified by the lender.

Of course, if the borrower could not afford to meet the additional security call, then there is an insolvency situation where the agent acting for the lender would begin liquidating the borrower's collateral to replenish the lender's securities. Does this not still involve the risk of loss to the lender? No, not unless the custodian bank also fails: as the Data Explorers survey discovered, more than 82% of lending agents indemnify the lender against counterparty default.

It only takes a moment's thought to see that if there is a market event of such cataclysmic proportions as to wipe out both a borrower and the custodian bank itself, sending both into default, then a glitch in its securities ►



lending programme is likely to be the least of any pension fund's worries. The global financial network would be in meltdown.

The point of all this is that there is some counterparty risk to securities lending, but nothing to get anyone excited. Two rather more significant and related obstacles standing in the way of pension fund trustees getting involved in securities lending is short-selling and the reputational risk to the fund, which boils down to thinking short-selling is simply a bad thing, or the concern that your pension fund is in any way associated with that bad thing. It is a case of education.

That said, once securities lending has been explained, there is a good chance many trustees would opt not to pursue it given the relatively paltry rewards on offer. Is an average return of say, five, six or seven additional basis points worth any kind of effort, or worth running even the most modest of risks for? After all, trustees are supposed to be prudent.

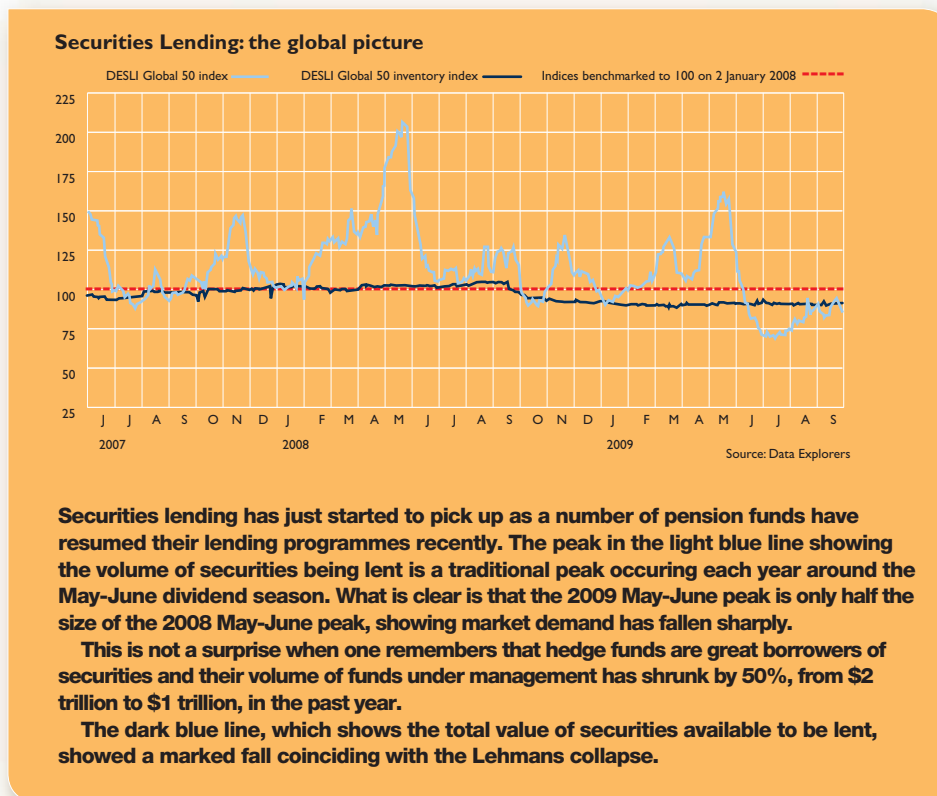
Ed Oliver, a director at Data Explorers, points out that the average return to beneficial lenders amounts to around £1m. Take a pension fund grappling with a shortage and ask the trustee board if it would like an extra one million pounds for doing nothing, and the board should leap at the chance if the risk profile is right.

### No compromises

Sonja Spinner, senior associate with pensions administrator Mercer, points out the National Association of Pension Funds view on securities lending. It says there is no evidence making assets available for securities lending in any way compromises a pension fund's goals. That is worth emphasising since one of the arguments against trustees giving the go-ahead to securities lending for their scheme is that securities lending is a major assistance to short-selling – and short-selling drives down the value of assets in the fund's portfolio.

Data Explorer's Oliver argues his survey shows that supporting directional short-selling – whatever the merits of short-selling might be – amounts to only a very small percentage of securities lending demand. "Some 50% of securities lending is about lending fixed-income securities and not about equities at all, which means that short-selling doesn't come into it in any shape or form. Of the remaining 50% of equities lending, Oliver adds that the vast bulk of this is directed at activities such as covering arbitrage opportunities or market failure, leaving only around 4% of the total volume being used to support directional short-selling. The Credit Suisse Tremont Index, a comprehensive index of hedge fund strategies, shows just 0.7% of hedge fund strategies are about pure directional short-selling.

Nevertheless, Data Explorers' charts show a marked decline in securities lending volumes since the fall of Lehman Brothers, undoubtedly due to some major funds stepping back from securities lending (see graph). Mercer's Spinner points out that



in the UK, Hermes, looking after the BT pension fund, was the most high-profile fund to withdraw totally from securities lending.

"Our view is, provided a pension fund's securities lending programme is properly collateralised, with the kind of securities that are taken as collateral being clearly in line with the fund's risk profile, then securities lending can be a useful additional source of revenue for a fund," says Spinner.

What she means by the collateral "being in line with the fund's risk profile" takes us into another terrain, namely what constitutes sufficient collateral. A conservative approach, which Spinner suggests should logically be the approach adopted by trustees new to securities lending, would be to accept only G7 nation government securities as collateral. "We tell funds that accepting 102% government bonds as collateral (102% by reference to total value of the bundle of securities being lent) is sufficient if there is no currency risk involved, and 105% is sufficient where there is a currency risk. This is the industry standard," she says.

One form of collateral that pension funds accept is cash, though it is something less common among European or UK funds. It might be thought that cash would be the safest form of collateral for pension fund trustees to accept. However, as it turns out, it is one of the riskiest. When the borrower gives the lender a large sum of money, standard industry practice is for the lender to agree to pay the borrower a set amount of interest at the end of the lend. This puts an investment

risk on the lender, since the lender has to invest the money, make a set return to pay the borrower and then an additional return to make the whole deal worthwhile.

Moreover, while custodian banks will indemnify lenders, the beneficial owners of assets, against counterparty loss on trades collateralised with fixed income or equity securities, they won't indemnify the lender for losses resulting from investment failures around cash. So if you take cash, you'd better be able to make it work for you. This is why the vast majority of UK securities lending programmes use securities as collateral and not cash.

Mark Tidy, head of international business development for global securities lending at Bank of New York Mellon, points out that Lehman's was a major borrower of securities in Europe as well as in the US and when it crashed, that default stress-tested the securities lending system. "What the failure of Lehman's showed was that securities lending worked, the collateral system worked and lenders were protected," he says.

Tidy adds that it is well worth funds having a debate about whether to lend or not to lend, because, ultimately, that helps trustees to be clearer about the whole concept. Essentially, he points out, it is about making idle assets work that bit harder. ■

**Anthony Harrington**

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# PREPARED FOR THE WORST

Grouping risk products provides a cost-effective way for companies to manage the cost of employee benefits packages, while ensuring staff are covered for all eventualities

## Apart from pension provision,

the next big-ticket item on many organisations' employee benefits package is the group of insurance products collectively termed 'group risk' by employee benefits consultants. The key components of group risk are death-in-service benefits and various life assurance options, group accident insurance, income protection and critical illness insurance, the latter of which pays a lump sum to an employee if they are affected by any of the critical illnesses defined in the insurer's policy document.

Private medical insurance is another large part of this, though PMI is now increasingly lumped together with wellbeing and health benefits.

Legal & General has been providing



environment, where many employees have a portfolio career and really only stay with the company for five to six years," says Baker.

As a result, providers have been changing the product to offer, say, a maximum of six years of cover, with a lump sum payment if the employee is unable to return to work after that period.

The cost to the employer of providing this benefit is considerably less than a whole working life benefit, being usually around 60% of the cost.

## Fine tuning

There are opportunities here for savvy providers to fine tune the package to make their

for six weeks, the statistics point to it being very difficult to get them back to work. So it helps everyone if the provider can get the employee the treatment they need before they have missed six weeks of work," she says.

## Dual benefits

Paul Davies, marketing and business development director at Unum, agrees with L&G's Barker that with products where added value can be achieved, providers are looking to ensure their product offers more than the competition. Unum, for example, throws in free employee assistance programmes with its income protection benefit. This gives employees telephone access to a range of counselling options.

Another angle is to look to provide benefit to both the employee and the employer. Unum provides a benefit to the employer as part of its income protection product. "The employer is going to be out of pocket through having to advertise or recruit for temporary staff while the employee is off. So we give the employer a six-month benefit which covers the advertising and recruitment costs."

Davies says the UK market is about 8% down over last year in group risk premiums. "The major change in the market through recession has been the way the upsell business has vanished. In normal

## Businesses are questioning whether cover to age 65 is realistic in the current environment, where employees only stay with the company for five to six years

group risk products to corporates for many years. Linda Baker, the company's marketing and product development director, says that while recession has caused companies to take a close look at all aspects of their employee reward programmes, they are not so much cutting back on group risk products as looking to purchase benefits more efficiently. Not surprisingly, companies are looking at cost and one of the products changing to reflect this is group income protection – where employees have most of their salary, typically 75%, guaranteed until retirement should they fall ill and be unable to work again.

"Businesses are questioning whether cover to age 65 is realistic in the current commercial



offerings more attractive than the competition. Legal & General, for example, will continue to pay the employee until retirement if their illness falls into certain prescribed categories, which makes the package more attractive than a straightforward six years and a lump sum approach.

There are other ways providers can add value in a way that they can't with, say, death-in-service benefits, which are now pretty much a commodity purchase where the competition is virtually on price alone, though supplier reputation and solidity might come into it for some companies. Baker points to the fact that employers are very concerned about the cost of absence, so if the provider has a programme that can get help and support to the employee quickly, that is very attractive to employers.

"There is a six-week tipping point with long-term absences. Once people have been off

times we get a tremendous amount of business from selling more benefit products or upgraded benefit products to existing clients and this year that business has completely vanished," he says.

There is some obvious shrinkage in the premiums derived from risk products because of the number of UK employees who have been made redundant. But on the whole, companies are not cutting back on benefits – they are just not buying any new benefits. On commodity products such as death-in-service insurance, provider rates have come under tremendous pressure and corporates are now able to force through some very good deals. ■

Anthony Harrington

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# HANDSOFF

Employee benefits provision is constantly evolving, but making changes can cost employers more than they bargained for

**When cash is in short supply** and companies are looking to cut costs, it is inevitable that reward and benefits packages will come under scrutiny. However, all the evidence so far is that most companies have resisted the temptation to take an axe to staff benefits. What they are doing instead, reports Jonathan Fice, a director in PricewaterhouseCoopers' employment solutions business, is looking very closely at the makeup of the whole combination of pay and benefits.

But this is an area where there are elephant traps all around for employers, even where it looks like a benefit is simply there as a historical accident. "We had an interesting example where two employers each got rid of the staff canteen. One found that they were removing a benefit that was hardly used and not particularly valued by the staff, the other found that they had removed a cherished benefit and had to deal with a storm of protest from staff," says Fice.

What follows from this is that if employers are thinking about cost savings and not looking at the degree of employee disconnect and disassociation they might generate by removing the benefit, they can find out that they have bought some slight savings at an enormous cost.

"There is no substitute for talking to employees and finding out what really matters to them," he says – which is where salary sacrifice plays extremely well. Since individuals are reluctant to give up pay, if they want a benefit so much that they are prepared to sacrifice headline salary to achieve it, then that is a good indication of the value staff place on a benefit.

## Value for money

Another area employers are looking at is benefit procurement and ensuring they get as much bang for their buck as possible. "There are normally a number of suppliers who will sharpen their pencils in a downturn, so employers are looking around and re-pricing the component parts of their

benefits package," says Fice.

One benefit that employees almost universally treasure only fractionally less than pension provision is private



who can buy with economies of scale.

By comparison, Lusted points out, for a husband and wife buying PMI privately, the total cost including tax would be around £5,000 for the same benefit – in other words, getting PMI through the company is ten times more cost-effective.

The other PMI benefit is targeted at getting immediate treatment for employees who are off sick for any reason. The treatment is about speeding up the process of getting the employee back to work by paying for access to say, an MRI scan, or physiotherapy, without having to wait for the NHS. "Employers could buy this on their own, but then either the employee has to pay tax on what could be quite a big bill – as a benefit-in-kind – or the employer has to pay the tax for them. That makes the self-paying approach very expensive," says Lusted.

## Salary sacrifice

Kim Honess, head of flexible benefits consulting at Watson Wyatt, says that while it is hard to get reliable statistics, most companies are now running salary sacrifice options for a range of benefits, with the big supermarkets, the oil majors and financial services companies leading the way. In addition to childcare vouchers, cycle to work schemes are almost exclusively salary sacrifice arrangements. "The take-up is probably no higher than for childcare, which works out at between 2% to 5% of the workforce, but for those who take it, it is extremely highly valued," she says.

William Laing, director at Laing and Buisson, which provides statistics on the PMI market in the UK, says the evidence points to PMI being an absolutely stable part of the employee benefits mix for a long time to come. "PMI is definitely regarded by employees as a valued part of their benefits and as such it is very much worth an employer's while

By removing benefits, employers can find they have bought some slight savings at an enormous cost

medical insurance. Second behind PMI is childcare vouchers, with the latter almost always being provided through salary sacrifice. However, Fice points out that Gordon Brown dropped a bombshell on this benefit at the 2009 Labour party conference when he announced that, with effect from April 2011, tax and National Insurance relief on childcare vouchers in salary sacrifice schemes would be withdrawn for most people. At present, people can have a maximum of £243 per month free of tax and NI in childcare vouchers.

Dudley Lusted, head of corporate healthcare at Axa Health, points out that there are two approaches to PMI. The one with all the bells and whistles is targeted at senior managers and used as a major retention tool. It costs around £500 per employee per annum for corporates

to keep it on the table. Including the two main providers, Axa and Bupa, there are about 25 providers in the market so prices are very competitive," he says.

Mike Izzard, chairman of the Association of Medical Insurance Intermediaries, says that the combination of group risk and PMI with flexible benefit packages (where employees choose the benefits they want from a menu of options) is developing extremely well. "Given the chance, employees are choosing PMI above a host of other benefits," he concludes. ■

**Anthony Harrington**

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