

BBS briefing note

Regulator's Statements – Funding in the Current Economic Climate

Over recent months, the Pensions Regulator has issued separate Statements to trustees and sponsoring employers of pension schemes clarifying its stance with regard to the impact that the current extraordinary economic climate might have on agreed funding plans.

These Statements can be found on the Regulator's website (www.thepensionsregulator.gov.uk). This *BBS briefing note* summarises the Statements.

STATEMENT TO TRUSTEES

The Regulator's Statement, "Statement to trustees about current financial pressures", was issued in October 2008 and set out the Regulator's general position with regard to the problems caused by the significant deterioration in financial markets. The Statement separately covered the issues facing defined benefit and defined contribution schemes.

In relation to defined benefit schemes, the main points made by the Regulator were as follows:

- Whilst the exposure to so called "toxic" assets within pensions schemes was relatively limited, the significant decline in asset values, coupled with the impact of weakened employer covenants, was likely to have a significant impact on funding plans going forwards.
- The Code of Practice on funding, and the Regulator's general approach to monitoring funding plans submitted, incorporated flexibility for the Regulator to take into account the particular circumstances of the scheme and the employer. As such, the Regulator considered its approach to funding remains "fit for purpose" and no changes were envisaged.
- The Regulator emphasized that the Code of Practice states that trustees should consider reviewing and, if necessary, revising recovery plans where there is a significant change in the employer's covenant. If the employer believes an existing recovery plan is no longer affordable, the trustees should consider any counter proposal carefully, and take into account plans for payments to other creditors and dividends to shareholders. Any revision to a recovery plan must be notified to the Regulator.

- In relation to the Regulator's triggers, the Regulator noted that recovery plans in 2009 were likely to be based on larger scheme deficits and weaker employer covenants. This is likely to imply higher Technical Provisions resulting in longer recovery periods. The Regulator will review these plans in the light of current financial conditions.

In relation to defined contribution schemes the main points made by the Regulator were as follows:

- As the investment risk is borne by the members, it is essential for members to review their pension arrangements and consider any changes needed to the funds in which they are invested.
- Trustees of trust-based schemes should carefully consider how to communicate with members to enable members to make informed decisions on the investment choices. Trustees should consider the Regulator's separate guidance relating to defined contribution schemes and the arrangements in place for lifestyle and the purchase of annuities in the open market.
- In contract-based schemes, employers may want to encourage employees to engage with their providers to address these issues.

STATEMENT TO SPONSORING EMPLOYERS

The Regulator's Statement, "Statement to employers sponsoring DB pension schemes", was issued in February 2009 and recognises the real concern of employers caused by the further significant deterioration in economic conditions.

The main points made by the Regulator were as follows:

- The Regulator wished to reassure employers that the current funding regime is flexible enough to cope with the current economic conditions. The funding regime includes the flexibility for recovery plans to be renegotiated where this is considered necessary. The Regulator confirmed that it would apply the flexibilities within the system pragmatically, looking for outcomes in the best interests of the scheme and the sponsor.
- The Regulator reiterated that trustees and sponsors have a shared interest in maintaining the health of the sponsoring employer and that there is no reason why a pension scheme should push an otherwise viable employer into insolvency.



BBS briefing note (continued)

- However, it was essential that all parties appreciate that the pension scheme should not be disadvantaged, and that all unsecured creditors are treated fairly. In particular, trustees should ensure they understand what was affordable by the employer.
- Where the trustees agree that there are short-term concerns over the employer's affordability, a back-end loaded recovery plan may be more appropriate than extending the plan length.
- Where there is a more fundamental concern over the employer's covenant, this could give rise to a review of the funding assumptions. This could then give rise to a much larger deficit where a longer recovery plan might be appropriate. In such circumstances, trustees might look for alternative security, e.g. contingent assets.

Where a recovery plan is revised, the trustees are responsible for submitting the revised schedule of contributions and recovery plan to the Regulator, together with a justification for the change. Trustees will need to take independent advice on the issues involved.

BBS VIEW

The Regulator's Statements are to be welcomed, if only for the reassurance that the Regulator will be pragmatic and sympathetic to the impact of current financial conditionals on the employer's covenant and its ability to meet its contribution commitments.

Trustees will also be sympathetic to the difficulties faced by employers and will be well aware of the need to ensure that there is a healthy employer backing their scheme.

However, trustees will also need to ensure that any changes to agreed recovery plans are justified, and are likely to need specialist independent advice on the employer's covenant. A full and open dialogue between the employer and the trustees will be essential in this regard.

