Summary
• A series of pension scandals at BHS, Carillion and Toys R Us have made national headlines in recent years, focusing scheme members' attention on the link between the viability of their employer and their pension.
• However, many are less aware of the wider impacts pensions have on their companies, such as the impact on dividend payments, and companies' appeal as a target for potential mergers or acquisitions.
• Increased cost to public-sector pensions has also seen the National Police Chief Counsel chair, Sara Thornton, warn of cuts to the police force, and plans to change USS pensions led to a number of university strikes.
• However, experts still don't believe members are likely to consider the wider impacts their pensions have on their employer.

The butterfly effect

With strikes, protests and corporate insolvencies making frequent headlines, Joe McGrath investigates the impact DB pensions have on companies and the public sector, beyond the financial burden, and asks whether members are aware

A series of extreme pensions scandals in recent years have made global waves. The insolvencies of high street retailers BHS, Toys R Us and the collapse of construction group Carillion are just three examples that have impacted members' pensions.

The sustained coverage of pensions issues relating to the many recent insolvencies has also focused the attention of scheme members on the link between the solvency of their employer and the viability of the pension scheme that it sponsors.

Some consultants believe that employees with DB schemes are increasingly expecting changes to their arrangements, given the number of companies that have already taken steps to reduce liabilities or close schemes to new members. The Pensions Regulator's 2018 DB pensions landscape report identified just 14 per cent of DB schemes in the UK as open and allowing for new members to accrue benefits.

"There is a growing awareness among people in a defined benefit pension scheme, particularly where they are still earning benefits," explains XPS Pension Group head of transactions Wayne Segers. "With other companies making adjustments to their DB scheme, there is an increasing awareness that what they have, is expensive."

Segers adds in instances where employers have taken steps to change the terms of their DB scheme, members often anticipate the move. Most times, people will say: 'I expected some kind of change to come', he says. "Members are also becoming aware of how valuable a DB plan is, and they are trying to hold on to it."

Growth restrictions

TPT Retirement Solutions head of direct distribution, Adrian Cooper, acknowledges that the understanding of the 'value' of a DB pension has certainly increased, but he says that employees still don't understand the fundamental financial issues that companies face in sponsoring a DB scheme.

He says: "The vast majority of employees will not have an understanding of the risks that companies face in managing such arrangements, or the trade-offs they are forced to make as a result."

For growing businesses, their global appeal as a target for merger or acquisition activity could be diminished as a direct result of a pension fund deficit. Similarly, a company's ability to pay dividends to shareholders could be significantly reduced if assets are being used to plug a pension scheme shortfall.

The hunt for income from investments has been rife since the fallout of the global financial crisis and dividends paid by the UK's largest businesses have grown by 74.5 per cent since 2009, according to analysis by the Henderson International Income Trust. Furthermore, 2017 saw a record £94 billion in dividend payments for shareholders of companies listed in the UK.

But while an increasing dividend may be a sign of a company's financial security, this may not be the case. Take Carilion as an example. Prior to its collapse in the summer, the infrastructure firm was yielding an average 7.7 per cent while operating a pension scheme with a £990 million deficit.

This prompted a review into the payment of dividends by companies in a similar position, with Prime Minister Theresa May pledging to tackle "executives who try to line their own pockets by putting their workers' pensions at risk".

Intelligent Pensions technical director Fiona Tait, explains that, while there are no steadfast rules in place, The Pensions Regulator does have a code of practice on the funding of DB schemes, which states that employers are required to take action to fund their pension schemes.

"It is a very difficult position for the employer and the regulator because there has to be a balance between the employer's requirement to appropriately fund the scheme and run their businesses. The guidelines do in fact state that this shouldn't be detrimental to the profitability to the business. One would argue that a business ceasing to exist is not a good outcome for anyone. The difficulty is precisely where that line is drawn and the payment of dividends, I believe, would sit on, or close to, it."

The Share Centre research investment analyst, Helal Miah, highlights: "The Pensions Regulator has indicated it is willing to intervene, should companies with pension deficits prioritise returning capital to shareholders over plugging funding gaps. This may encourage a more conservative approach to payouts. Investors would clearly prefer to see cover improve due to rising profits, rather than falling dividends."

Gauging the wider impact

The issues relating to the maintenance of a DB scheme go beyond public limited companies. In September, the Treasury said that in order to cover a shortfall in public-sector pensions, hospitals, schools, the police and armed forces would have to stump up an additional £4 billion.

The reaction was fierce and in October National Police Chief Counsel chair Sara Thornton warned of 10,000 fewer officers by 2020/21, should the Treasury proceed with plans to make forces responsible for an extra £417 million in pension contributions.

Further compounding the issue, Thornton expressed "concern" about the direct impact and limitations this additional financial burden would have on already stretched areas of "core policing", such as answering emergency calls, investigating crime and neighbourhood policing.

Aon partner Lynda Whitney, explains that issues relating to the provision of defined benefit schemes have been "on the agenda" for private companies for much of the past decade, but observed that public-sector organisations have started to address issues more recently.

"We have seen deficits increase dramatically as life expectancy has increased, and discount rates fall," she explains. "On the public sector side, it has been slower to come through, but the same issues fundamentally still exist. Ultimately, the benefits cost more to provide."

Rising contributions

One of the highest-profile public sector pension stories in recent years has been the ongoing saga of the Universities Superannuation Scheme (USS), which came to a head last year after the scheme published its triennial valuation.

Scheme actuaries had calculated that there had been a considerable rise in the scheme's deficit, unless a change was made to proposed benefits and contribution levels. On 14 November 2017, following a lengthy consultation with Universities UK on the USS's funding proposals, it was announced that in order to fund the £7.5 billion deficit, combined contributions would have to rise to 37.4 per cent of pay, which included an increase in recovery contributions from 2.1 per cent to 6 per cent.

The very suggestion led to widespread national strikes as academics and lecturers protested, not least at the plans for contribution hikes, but also at the implications the funding of the deficit would have on research and teaching budgets, as well as tuition fees.

Reacting at the time, University of York president and vice-chancellor, professor Koen Lamberts, stated: "Scheme reforms driven by funding pressures are challenging, and there has already been some public speculation about how universities might deal with the issue – from the inconceivable prospect of raising tuition fees to address the deficit, to increased pension contributions from employers and scheme members, to further benefit reforms. With everyone involved, we must make some tough decisions if we are to find a long-term solution to the challenges facing our pension scheme."

More than a year later and the issue between the two parties is yet to be resolved. In October 2018, a group of academics published new claims that the USS had miscalculated the size of the deficit – a suggestion the USS denies.

For Tait, while scheme members may be more engaged with their individual circumstances and benefits, they are unlikely to consider the wider burden that sponsoring a DB scheme puts on the employer.

She explains: "I don't think everybody wakes up and worries about the solvency of their pension scheme," she says. "The grapevine may talk about the solvency of their employer, but I would be very surprised if members had much awareness about how the pension scheme could impact that.

"In fact, I would suggest that they would likely think of it, the other way around, thinking 'how would an insolvency impact my pension?'"

Written by Joe McGrath, a freelance journalist