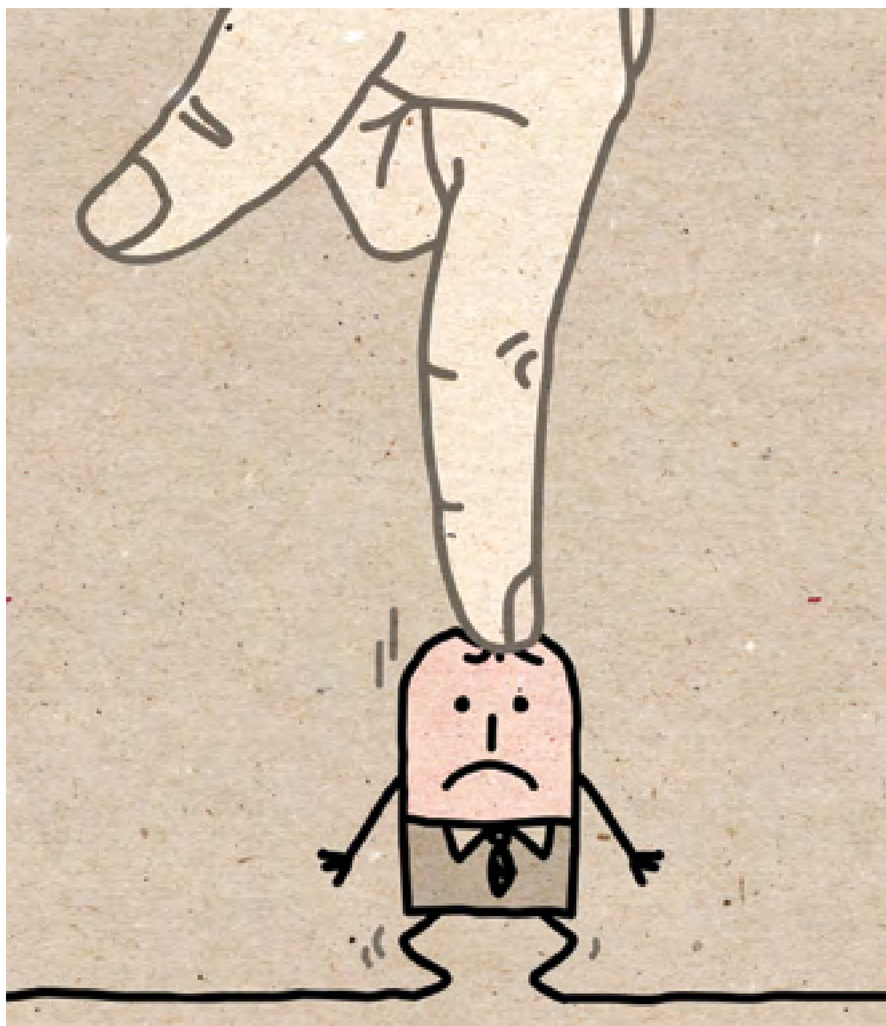
**Summary**
- The UK can expect to see further company collapses involving highly indebted DB schemes.
- The pressure this could put on the PPF may have been underestimated by the lifeboat.
- Getting back to basics and recalibrating DB risk management is the only way to fix the current malaise.

# Easing the pressure

**Recent high-profile company collapses have been accompanied by embattled DB schemes. Action needs to be taken to ensure that future business failures do not overburden the UK's safety net**



Tata Steel, BHS, Monarch, Carillion: a sorry list of high-profile companies falling victim, in varying degrees, to global economic forces, poor management and simple old fashioned competition.

What linked their collapses was their sponsorship of struggling defined benefit (DB) schemes that hit the headlines and elicited inconsistent responses from the UK's pension regulatory system.

History affirms the inevitability of further company failures in the near future. And, as Redington's managing director of integrated actuarial, Marian Elliott, says, many of those will have chronically underfunded DB schemes.

"While many DB schemes are closed and therefore we might expect the problem to reduce over time, this is unlikely to happen any time soon," she explains. "The aggregate funding position of DB schemes is largely unchanged since 2008, despite the contributions that have been paid by companies to fund deficits over the past 10 years."

These contributions, amounting to some £20 billion a year according to the Pension Protection Fund (PPF), would appear – to an outsider looking in – to have simply disappeared into a vast black hole. As a result, if and when companies with DB schemes fold, they will be dumping yet more underfunded liabilities onto the PPF, leaving a number of questions that the pensions industry must face. Has regulation been up to scratch? Is there enough flexibility in the system? Have trustees used their powers to their full capacity? And have sponsors truly honoured their pension promises?

Another question is what the steady procession of abandoned DB schemes will have on the PPF.

The lifeboat fund has been resolute when questioned about its financial position. In its 2017 annual funding strategy update, it reported a 93 per cent probability of achieving its self-

sufficiency funding target by 2030. The report also included modelling some worst-case scenarios, including a post-Brexit recession, global economic contraction, and collapse of large-scale employers with significant pension scheme deficits. Even under these circumstances, the PPF says that the probability of achieving self sufficiency is 74 per cent.

"The PPF does have some flexibility over the time within which they need to achieve this funding target," says Elliot. "While a corporate failure with significant pension deficit would undoubtedly impact the funding position of the PPF, and therefore levy payers, the PPF's funding strategy is reasonably resilient to these shocks."

However, Cardano's UK CEO, Kerrin Rosenberg, disagrees.

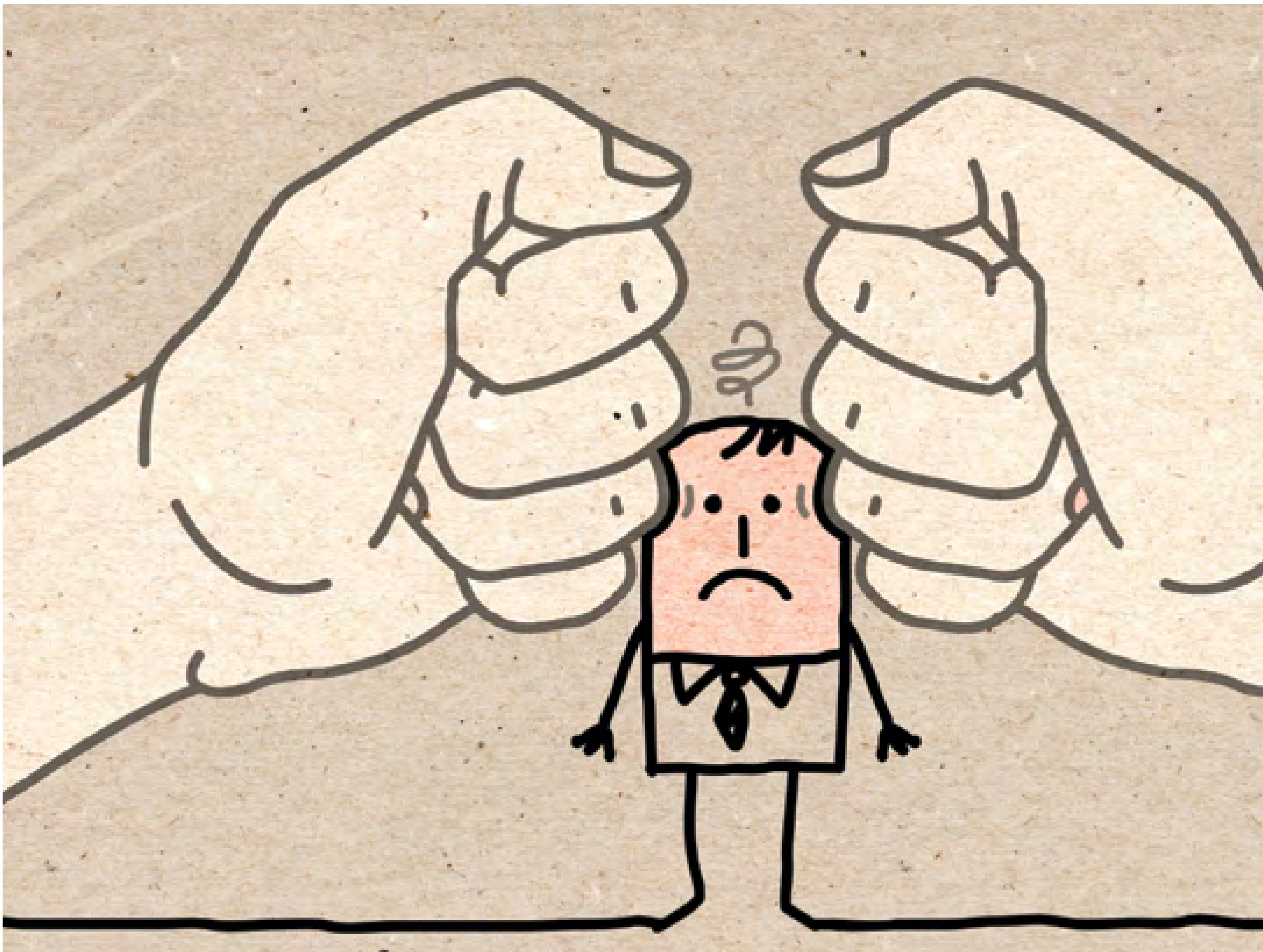
"If you listen to the PPF's story they'll tell you that they are in surplus and it's all hunky dory," he says.

"Our view is different. There have been quite a few people in the industry who feel a lot more worried about the overall health of the DB sector and the impact it would have on the PPF."

Rosenberg evidences separate reports by Cardano and Lincoln Pensions, the PLSA, as well as the Cass Business School and the Pensions Institute, which all lay out projected figures that lead to concern for the PPF's long-term health. These studies have predicted somewhere between 20 and 35 per cent of all current DB schemes ending up under the PPF's control.

"If you look at the PPF's projections, they're only projecting 5 per cent of DB pensions landing up with them. But if they're wrong, by, call it a factor of 6, meaning it's 30 per cent, then suddenly they're not looking so healthy and there will have to be dramatic increases in the PPF levy," warns Rosenberg.

"The Cass Business School has come



up with a one in six *[company]* failure rate, or even slightly higher. That's not a dramatic change from the historic run rate. If you look at the number of funds that have entered the PPF and assume it carries on at the same rate, then you do get that ratio.

"Our view is that the PPF have been perhaps a little too sanguine in their risk assessment and projections."

**Restructuring**

Pressure could be lifted off the PPF if companies had the freedom to restructure their pension benefits, argues Sackers partner Faith Dickson.

She has been a vocal advocate in recent years for changing legislation to enable schemes to have more scope to reshape pension benefits. If a sponsor is getting to the point of insolvency unless a level of restructuring can be carried out, then she believes that the ability to lower benefits, but still keep ones that are higher than PPF compensation, is in the members' best interests.

"Companies can restructure a lot of elements of their finances and liabilities but the scope for them to restructure their pension liabilities is incredibly limited. This is the final nail in the coffin, essentially for many of them," says Dickson.

This, could also, in turn, take some pressure off The Pensions Regulator. The watchdog came under fire in February from Work and Pensions Committee chair Frank Field for "sniffling" around Carillion, "clearly to no effect" as it collapsed.

But could the regulator have done more? The Merchant Navy officers' Pension fund chair of trustees, Rory Murphy, is unconvinced.

"The regulator may appear to have been found wanting. But they have a very difficult job," he says.

Murphy also doubts whether Frank Field and the committee truly understand the complexity and nuances of fiduciary responsibility. In response to Field's comments, Murphy is adamant that it is not the pension schemes that need regulating, but the companies.

"How can any company pay out dividends when it's in debt to its pension scheme? It's illogical. But we've got into that situation in the past 30 years; it's almost like bullying in the workplace.

"Companies say 'oh it's the pension, we can't afford it'. It becomes a very aggressive them-and-us scenario. And it isn't at all. The money should be put aside by the employer to pay the pension of their employees. And all trustees are doing is being guardians of that money. And I do sometimes think that we have to recalibrate how we view it."

**Going back to basics**

Recalibration is something that Elliot would also like to see. She believes that the whole system of pension scheme risk management is fundamentally flawed.

Elliot argues that the regulator, trustees, advisers and sponsors make decisions that get struggling schemes "over the line" when it comes to their valuations and result in set-in-stone contribution schedules for the next three years.

Although it is impossible to make all the right decisions and ensure that pension benefits are fully secure in advance of any corporate insolvencies, she says that the current system does allow for "a great deal of can kicking".

"As an industry, we should be brave enough to look in the mirror and recognise that we haven't gone far enough towards effective pension risk management," she says.

"Moving away from a three–year regulatory valuation cycle, and implementing a more joined–up and regular approach to risk monitoring and management would make it far easier for all stakeholders, including the regulator, to identify where action should be taken, and to be clear on the rationale behind any action."

The relationship between trustees and sponsoring companies also needs examination, says Murphy. His view is that trustees should take some responsibility for the poor state of some DB schemes, which in some cases, is due to employers treating them as a nuisance.

"Trustees have got power, but do they understand that power and how to deploy it?" he asks. "Do the employers understand it? They have to get the balance right of getting enough money and helping support the employer.

"Getting more transparency from companies is critical."

**Reputational risk**

Fixing some of DB's internal and regulatory maladies could prove fruitful across the retirement savings spectrum as well.

"If things continue as they are then there is a reputational risk," says Dickson.

"People lose trust in the system and don't understand the difference between DC and DB schemes. Bad news stories are just another disincentive for people to save."

Rosenberg agrees: "If there's more willingness to acknowledge that there's a material problem here, then there's stronger credibility in the regulatory environment. And that can only help."

**Written by Marek Handzel, a freelance journalist**