Time for a holiday?

In a recent article for *Pensions Age*, SPP president Paul McGlone contemplated the return of sponsor contribution holidays for schemes that are in surplus. But should sponsors be able to do this? Those in the industry argue the case for and against

SPP president, Paul McGlone
As DB scheme funding improves, more schemes are finding themselves fully funded or with a modest surplus. With that comes a question that most schemes haven't considered since the 1990s – can the sponsor have a contribution holiday?

The idea is enough to generate crossing of arms and sucking of teeth. Contribution holidays are widely, but often incorrectly, held responsible for the deficits we've lived with for so long. So why should trustees agree to something that previously caused so much harm or controversy?

The position today is quite different. For one thing, schemes are much better funded. A typical 1990s valuation assumed 9 per cent investment return for the lifetime of the scheme, with no reduction in risk or return as the scheme matured. Today almost all schemes are measured on a much lower, and often reducing, discount rate.

The potential impact is also normally lower. Most schemes have limited, if any, future accrual, so a holiday from those contributions may be quite modest. More commonly, a sponsor might ask for a break from just scheme expenses and/or PPF levies.

Contribution holidays may not sit well with trustee boards, but if the scheme has more assets than it prudently needs to pay benefits, why should trustees not agree?

Member communication will be a challenge. The regulator may be interested. And the media certainly will. But if the alternative is to keep putting money into a scheme that doesn't actually need it, surely that doesn't make sense?

The real answer is that full funding on technical provisions isn't the end. It's just a point on the journey. But that's a topic for another day.

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Yes

Yes to sponsor holidays! In my view once a scheme is fully funded on an appropriate technical provision basis then it should be for the sponsor to decide what approach it wants to take to manage the arrangement (subject to usual caveats about schemes with unusual rules etc). Clearly full technical provision funding is not the end but surely it is fair to allow the sponsor to decide what balance of cash, investment return and time period it decides is most appropriate for its circumstances.

Western Pension Solutions director Jon Sharp

Yes, trustees should absolutely be able to agree to a contribution holiday for their scheme's sponsor when the scheme is in surplus on a technical provisions basis! However, this comes with two caveats – are the trustees satisfied that the overall level of risk being run within the scheme can be supported by the employer covenant and is the scheme on track to meet its long-term funding objective? If the employer covenant has been fully leveraged such that contingent guarantees or improvements to the priority position of the scheme have been given and there is a healthy ongoing outlook for the sponsor then trustees should be satisfied that adequate protections are in place should any downside risks materialise. There is no need for trustees to be afraid of entering into such an agreement if the appropriate checks and balances are in place.

There may also be limited occasions when it may be appropriate for trustees to agree to a contribution holiday for a tightly defined period when the scheme is in deficit if it can be demonstrated that the sponsor's cash should be prioritised elsewhere i.e. to facilitate a turnaround of the sponsor in a distressed situation. In this case the trustees will need to carefully assess the upside potential for the business and the additional security this will provide for the scheme in the future versus the benefit of having the cash paid directly to the scheme now.

XPS Pension Group senior consultant Jacqui Woodward

No

I suspect that a large majority of finance directors (and pension scheme trustees) would view the idea of a surplus in their pension scheme as akin to sighting a woolly mammoth. Reports in the press may be but I've never seen one.

In some cases, with the widening gap between gilt yields and corporate bond yields, there has been an increase of the issue of company pension scheme accounting surpluses being revealed, whilst there is still a funding deficit and company deficit contributions must continue – a communications conundrum.

However, there will be some schemes that are fortunate enough (or said to be well managed enough!) or with a sufficiently benevolent employer to be enjoying funding surpluses. But would first thoughts turn to a funding holiday – I think not.

What finance director today, with the benefit of 30 years hindsight, would look back and say I am glad they had a pensions holiday in the 90s, let's do it again. In practice, they long for the day when this scheme is off their books. Furthermore, with focus these days on de-risking, your trustee board is going to want to reduce risk, save money for (another) rainy day and/or plan for the next stage of their exit strategy. As the saying goes, the (90s) past is no guide to the future.

Quantum Advisory partner Rhidian Williams

As with so many pension questions – it depends, is usually the heavily caveated answer one may give. It is quite easy to think of a scenario where a trustee and employer could agree to contribution holiday. The first big question is what will the trustees get in return? Improved security would be high on the list of requests. Employers may be able to create a positive story to have a break from contributions if they can demonstrate a strong covenant and the scheme is well funded on a best estimate basis and so stand a better than evens chance of having enough money to pay the pensions as they fall due. They would may also need a compelling reason why that money would be better used elsewhere.

One area of concern for me though would be the negative connotations that may come with having a contribution holiday. Members may need convincing this is the right decision. A clear rationale would also be needed to head off future criticism in the future.

In the short term, such conversations may be few and far between. However, as schemes mature, recovery plans develop and funding ratios improve, employers may become more mindful of a trapped surplus and broach the subject with the trustees. Of course the simplest way to ease a trapped surplus is to re-open the scheme. We may be a little way from that yet.

Broadstone technical director David Brooks

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