



Article

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Final salary pension schemes in times of economic crisis

We operate a 'final salary' pension scheme for our staff. Why are costs rising quite so significantly?

Dramatic improvements in healthcare mean that people are living to be a lot older, which in turn means that their pensions have to last a lot longer. And in the current low-inflation environment, the cost of long-term financial products (like annuities) has also got considerably more expensive in itself.

Does this really amount to a pensions crisis?

Well there's actually a third factor to consider as well. Final salary pension schemes are funded so that they can pay people's pensions when they fall due. They were never designed to have enough money at all times to buy deferred annuities for people who are nowhere near retirement. Which wasn't a problem when the risk of 'corporate failure' was low...

But now?

If a company fails, its pension scheme will go into wind-up. And it will have insufficient assets to meet all of its obligations. Members' benefits will be cut back as a result; although the Pension Protection Fund will then step in, to ensure that they don't fall too far below promised levels.

So that's why our scheme's trustees are asking for increased contributions, just when we can least afford to make them?

Exactly. Trustees' duties to members require them to try and get as much money into the scheme as quickly as possible, especially if that opportunity might soon be lost. On the other hand shareholders want cash invested back into the business, particularly as liquidity problems are a common reason for companies getting into difficulty nowadays.

Isn't this a no-win situation, then?

Potentially, although the Pensions Regulator has made it clear that it expects trustees to be accommodating towards an employer's financial position when setting contribution rates for their scheme. A balance needs to be struck; and the best way of achieving this is for companies to engage with their pension scheme trustees on an ongoing basis, so any problems can be dealt with before they become intractable.

But our senior company people are the trustees. Can they negotiate with themselves?

Well therein lies another potential issue: pension scheme conflicts of interest. Trustees have traditionally been a company's senior management: this was often expected of them. Now it's recognised that this can put people in an awkward situation, especially if they hold confidential information that a company's shareholders might not want the pension trustees to know about.

And the solution is...?

There isn't a one-size-fits-all solution that will work in all cases. It very much depends on the facts. At one end of the spectrum, simply declaring an interest in a matter might be

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sufficient. In other more extreme situations, a trustee might have to step down from the trustee board. And a variety of possibilities exist in between.

How do we know which is the most appropriate in any given situation? Don't worry, help is at hand. Any pension scheme trustee board will have access to a wide variety of professional advisers, whose fees will be met by the scheme whose members they represent. Conflicted trustees should, above all else, take legal advice as to their personal positions. Particularly if discussions involve scheme funding, they are unlikely to be able to 'wear two hats' as they might have done in the past.

Is working with our trustee board, rather than against it, going to be a panacea for all ills?

Not necessarily. But, not only is it the kind of collaborative behaviour that the Pensions Regulator expects, it's also likely to give you the best possible fighting chance of escaping from the current economic climate as unscathed as possible.

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