# Increasing pressure on pension contributions

**Chris Tavener, a partner at Lane Clark & Peacock, argues that although companies have been making record pension contributions and investment conditions have been generally favourable, pension scheme deficits remain stubbornly high. Pressure is growing on companies to increase their contributions and the introduction of new scheme funding legislation will increase this pressure.**

For some years, companies have been required to disclose their FRS 17 deficit in a note to the accounts. However, from 2005 companies will be required to include the deficit on their balance sheets. Not only will a deficit reduce the company's net assets, but in some cases, it could restrict the company's ability to raise capital or pay dividends to shareholders. Companies with FRS 17 deficits which wish to restructure or return funds to shareholders may decide to seek clearance from the Pensions Regulator before going ahead. The Regulator has confirmed that it will not seek to intervene where the scheme is 'adequately funded'. For this purpose, it is currently placing significant emphasis on the FRS 17 position, giving companies a strong incentive to make one-off payments to fund these deficits.

Three quarters of FTSE 100 companies paid higher contributions into their schemes in 2004 than in 2003. Some companies have made sizeable, one-off cash injections. In addition, many companies have trimmed back benefits and have asked employees to share some of the burden by increasing the amount they contribute. Despite this and double digit investment returns, deficits have remained stubbornly high over the last year. The average FRS 17 funding level for the UK pension schemes of the FTSE 100 companies was 88 per cent as of July 2005, up just three per cent over the year.

This is because increases in assets values have been largely offset by falling 'real' bond yields and by companies recognising longer life expectancies – combining to increase the value placed on the liabilities. Looking forward, new research due out in the next six months on the projection of future mortality rates may prompt further adjustments.

The past 12 months have seen a vast number of new regulations that affect companies. Measures introduced by the *Pensions Act 2004* to improve the security of members' benefits will almost certainly continue to accelerate the pace at which companies fund their schemes.

The introduction of the 'risk-based' element of the PPF levy from April 2006 gives companies further incentive to improve the funding of their schemes as, under current proposals, the amount of the levy will be directly related to the size of the deficit.

Under the new scheme funding regulations, companies will no longer have the final say in how much they pay to their schemes. Instead, companies will need to agree the funding strategy with the trustees of the scheme. The Regulator's code of practice, issued for consultation over the summer, stated that trustees should set 'prudent' funding targets, with any shortfall in the assets funded as soon as practicable. The impact on the amount a company pays in the short term could be significant. It will depend crucially on the final interpretation of 'prudence', and on what the company and trustees agree is realistic.

Final guidance from the Regulator was originally due by 23 September, but is now not expected until the end of October. The draft guidance required trustees to negotiate 'robustly' with the employer. It will be interesting to see whether the final guidance goes quite so far or whether some of the requirements are watered down. Nevertheless, even a diluted version will bring greater pressure to bear on companies to increase their contributions.

Increased security for some? Undoubtedly, but at the expense of much-reduced pension provision in the future as companies continue to close their defined benefit schemes to new members and, increasingly, to future accrual for existing members.

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