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Dealing with deficit

The environment for UK corporate activity where final salary pension plans are involved has changed fundamentally during the past 12 months.

Indeed, the shortfall in UK pension plans for FTSE100 companies alone was recently estimated to be £37 billion, under the FRS17 accounting measure.

If we look at the cost to the FTSE100 companies to 'walk-away' from their UK pension obligations, then this figure would balloon to more than £150 billion. In short, pension deficits are a significant issue and are showing no sign of disappearing.

From a corporate viewpoint, pension issues have been exacerbated over the past 12 months by a raft of revolutionary trustee and member-friendly legislation, including:

- greater powers for many pension plan trustees to extract cash from companies to plug deficits;
- a new pensions regulator with wide-ranging powers to ensure employers meet their pensions obligations;
- the Pension Protection Fund, which provides insurance of pension deficits against the risk of employer insolvency. To pay for this the PPF will charge a levy, predominantly based on the employer's credit rating and the level of under-funding.

Deep impact

The effects of these regulations will certainly be felt by businesses. Indeed, the cash costs of pension plans are set to increase dramatically. The new funding rules and pressure from the regulator are forcing companies to make good their pension deficits over shorter periods. Trustees are also required to be more prudent in their measurements of pension deficits.

The regulator is encouraging pension plan trustees to take the same approach to pension deficits as a lending bank has to corporate loans. Where trustees are not perceived to be negotiating sufficiently robustly, the regulator is prepared to step in.

Examples of the types of corporate activity that can impact the security of pension scheme benefits and where the regulator believes the trustees should be involved include: buying, selling or merging with another company; significant restructuring or refinancing; and large returns of capital or dividends to shareholders.

The powers of the new regulator include the ability to impose financial support directions requiring ongoing support of a pension plan from other companies, and contribution notices requiring lump-sum pension contributions from related companies or individuals.

Long-established principles for limited liability of companies can now be over-ridden. In addition, the PPF levy could be material – particularly where the sponsoring employer has a poor credit rating and the plan is poorly funded. The levy alone may send a number of companies, both large and small, into insolvency over the next few years.

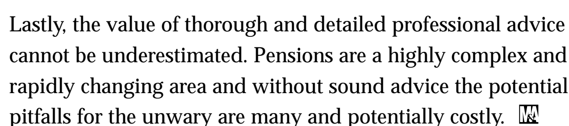
Time for action

Many companies are considering making significant cash bullet payments into their pension plans. Not only does this reduce the PPF levy but the regulator has confirmed that it would not seek to intervene where plans are fully funded – currently by reference to FRS17.

An alternative is clearance statements. The regulator allows companies to submit details of planned corporate actions and in return receive a clearance statement if the action is approved.

It is essential that trustees are involved at an early stage and kept on board. Their powers mean that they can potentially put a spanner in the works for a wide range of corporate actions. Furthermore, applications for clearance statements will not normally be considered unless the trustees are on board.

Lastly, the value of thorough and detailed professional advice cannot be underestimated. Pensions are a highly complex and rapidly changing area and without sound advice the potential pitfalls for the unwary are many and potentially costly.



David Lane is a partner and Charlie Finch a consultant at Lane Clark & Peacock LLP.