Ask the experts:
Crisis, what crisis?

Do treasurers think pension fund trustees and companies are panicking about pension fund deficits?

G J Croydon, Treasurer, IMI plc

I would like to think that most of us are pragmatic enough to be able to differentiate between a real crisis and a number of serious issues. I think there is more 'panic' being voiced in the press than in reality.

The perceived 'crisis' has come about through the softening of equity markets since 2001 and, to some extent, the tough economic conditions in certain sectors and markets. However, perhaps the most concerning factor is the change in demographics and personal expectations. More people than ever hope to stop work before their normal retirement age, whilst life expectancy is increasing all the time. These facts are incompatible without there being a step change in pension contributions.

It is clear that FRS 17 has raised the profile of pension funds considerably. Not just through the mechanics of seeing the effect of any deficit on the company balance sheet, but also through a focus on the relationship between the company as sponsor of the pension fund and the trustees as protectors of the beneficiaries.

Many companies have closed their defined benefit schemes and now offer only defined contribution schemes. Only time will tell whether this was a move made in panic! In the meantime these companies have reduced their risk, but passed it on to the employees.

In theory analysts, investors and ratings agencies shouldn't change their views following FRS 17 as they should already have taken the position of the pension fund into account when undertaking their credit analysis.

The recent trend for pension funds to increase the proportion of their assets invested in bonds has made much sense for the typical mature scheme. Often these schemes are relatively large compared with the sponsor company so the risk of short-term equity volatility is significant. On the other hand, the funds are losing out on the longer term 'expected' higher return from equities.

I am sceptical about the mechanics of the Pension Protection Fund (PPF) although I accept that there is a need for some safety net for pension funds. I wonder whether it will lead to fewer 'white knights' and more corporate failures as people will wait until the PPF bails out a pension fund before picking up the pieces of a business.

John Hawkins, former Head of Finance and Risk, Invensys

The position may well look different to trustees and companies and will, of course, vary between situations.

For a trustee with a large deficit and a better than average chance of it growing in the future through having to use lower discount rates and more 'optimistic' mortality tables, the prospect can look pretty bleak, especially if the credit position of the sponsoring company is poor and/or deteriorating. On the other hand, the PPF is now in existence and will provide basic protection in extreme cases. Also, credit default swap strategies available to funds are becoming increasingly sophisticated and affordable.

For a company, the 2004 Pensions Act restricts its freedom to act even more than has been possible over the last few years – voluntary termination will crystallise a debt on the employer far larger than the accounting or ongoing actuarial deficit. Also, not only does the company have to contemplate increasing deficits for the reasons outlined above, but the likelihood that it will in future have to adopt lower risk investment strategies (for example because of the way the PPF will eventually charge premiums and the Pensions Regulator is likely to look at scheme-specific funding of deficits) and therefore be unable to 'outperform' its way out of the problem by relying on equities. There is some good news – for example hedging duration is becoming cheaper and easier and may increase returns as well as reducing risk. This may not be the time for panic, but complacency is definitely not an alternative.

Peter Blythe, Director of Finance, GUS plc

At GUS neither the trustees nor the company are panicking about the pension fund deficit. On an FRS 17 basis the deficit, after tax, of our DB pension schemes amounts to about £100m or around 1% of our market capitalisation. The trustees are also re-assured by the company's financial strength and proven willingness to provide additional funding if needed.

There are two separate financial issues surrounding defined benefit (DB) pension schemes: cost and risk.

As everyone knows, pension costs have risen significantly because of increased longevity, the growing regulatory burden and falling investment returns. Companies have to look hard at any cost which is increasing. However, we believe DB pensions remain an important part of our remuneration arrangements.

The risks inherent in a DB pension scheme are well known. Every business has a portfolio of opportunities and risks which it must manage, making the appropriate trade-offs, to achieve the optimum return, not the minimum risk. For GUS the major risks include consumer spending, regulation, employment and rental costs and exchange rates, to name but a few. The pension fund risks don't make it into the top ten – but they are carefully monitored and managed.

The ACT 2005 Pensions Conference – Managing Pensions Risks: what are the solutions? is on 29 June in London. See www.treasurers.org/events