February 2009

The Pensions Regulator

Statement to employers sponsoring DB pension schemes

The Pensions Regulator (the regulator) understands that the current economic conditions facing employers will be of real concern. Those who sponsor final salary pension schemes may feel that falling asset prices and increasing deficits are compounding difficulties.

Employers need to be reassured that the current scheme funding regime is flexible enough to cope with the impact of an economic downturn and that the regulator's operational processes on scheme funding aim to reflect the prevailing conditions.

This statement sets out our general position.

Pension scheme trustees

The position of trustees of a pension scheme in deficit is akin to unsecured creditors of the sponsor organisation. They normally have a shared interest in maintaining the health of the company, as sponsors are in a position to make up shortfalls and in the event of insolvency pension funds generally fall behind payments to secured creditors.

When the sponsor company is under pressure there is potential to renegotiate previously agreed plans to repair pension deficits (recovery plans). There is no reason why a pension scheme deficit should push an otherwise viable employer into insolvency. But the pension recovery plan should not suffer, for example, in order to enable companies to continue paying dividends to shareholders. There may be exceptional circumstances if, for example, fresh equity is injected. Pension scheme trustees should be in a position to understand what is reasonably affordable for their sponsor, but all unsecured creditors must be treated equitably and the pension scheme not disadvantaged.

The regulator has already issued a statement to pension scheme trustees drawing their attention to our existing guidance and the circumstances under which they should consider reviewing and, if necessary, re-opening recovery plans.

If any employer believes that an existing recovery plan is at serious risk of jeopardising the company's future health or solvency then they should discuss this with their pension scheme trustees.

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Our triggers

Deficit recovery plans that have a duration of longer than 10 years trigger greater scrutiny. This is a trigger for recovery plans, not a target. It merely means that we are likely to take a closer look at the arrangement. All recovery plans that come to us are looked at on a case-by-case basis.

To date we have seen, and considered appropriate, recovery plans ranging in length from less than 1 year to over 20 years. In each of these instances the particular plan length appeared sensible for the circumstances of the scheme and sponsor concerned. Pension schemes are long-term undertakings and the challenges presented by current economic circumstances should be seen within this longer-term context.

Pension scheme trustees and employers should be assured that the regulator will continue to apply the flexibilities in the system pragmatically, looking for outcomes in the best interests of the scheme and sponsor.

Reasonable affordability

In determining what is reasonably affordable it is important for the employer and pension scheme trustees to understand the difference between any temporary impacts of the economic cycle on sponsor cashflow and longer term structural changes to the strength of their scheme sponsor. We understand that this is a difficult judgement.

Where there are short-term concerns over affordability – and where pension scheme trustees and the employer agree to reschedule the deficit recovery plan to maintain the long term health of the employer – a back-end loaded plan may be more appropriate than extending the plan length.

Where an employer is facing more severe difficulties, it is in the interest of pension scheme trustees and the employer for information to be shared openly on the circumstances facing the sponsor. In such circumstances, pension scheme trustees may need to review investment assumptions in their funding plans on, for example, the amount of investment risk the employer can underwrite.

Should a new valuation show a much larger deficit, a longer recovery plan length might be appropriate – remembering that the best outcome for scheme and employer is a viable sponsor that will continue to support the scheme.

In such circumstances, pension scheme trustees are likely to look for alternative security, perhaps using contingent assets or other mechanisms. We would encourage schemes and sponsors to talk to us if they have concerns.

Where any changes to a recovery plan are agreed between an employer and the pension scheme trustees then the regulator must be informed.

We will continue to monitor the situation closely, and would encourage employers to contact the regulator with any concerns.

How to contact us

The Pensions Regulator
Napier House
Trafalgar Place
Brighton
BN1 4DW

Customer support
Phone: 0870 606 3636
9am to 5.30pm, Monday to Friday
Textphone: 0870 2433123
Fax: 0870 2411144
Email: customersupport@thepensionsregulator.gov.uk

www.thepensionsregulator.gov.uk
www.trusteetoolkit.com

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