

Exploring Pensions

Special 'Final Salary Schemes' Edition

By Mattioli Woods

Exploring Pensions is designed and written for practicing chartered accountants, and the owner-managers of privately owned businesses

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Big Brother is watching you!

The Pensions Regulator has been with us since April 2006 and already has established a new clearance process for corporate transactions, introduced statutory codes of practice for providing practical guidelines and developed a new regulatory framework for the funding of defined benefit schemes. At the end of April 2006 the Regulator issued its first strategy report, setting out its strategic priorities for the next three years.

The Regulator has made it clear that it will continue to take a risk-based approach to the regulation of pension schemes and will continue to inform all parties of its activities. The Regulator's medium term strategy defines its key strategic challenges for the next three years as:

- 1 Strengthening the funding of defined benefit schemes
- 2 Improving the governance of work-based pension schemes
- 3 Reducing the risk to members of defined contribution schemes

Over the long term the Regulator expects the current trends in pension provision to affect the direction of their work. The most documented development within the UK has been the closure of final salary schemes. The report confirms that an estimated 54% of final salary scheme were closed to new members between 2001 and 2004 and that by October 2005 only 24% of FTSE 100 companies offered

final salary schemes to all new employees and 67% offered final salary benefits to any employees. The number of active members of defined benefit schemes is in decline and if trends continue at the current rates, it is anticipated there will be an equal number of active members of final salary schemes and money purchase schemes by 2012.

Indications are that UK occupational defined benefit schemes have a collective deficit of between £300 billion and £400 billion and that between 150 and 300 large occupational pension schemes are at risk and as such are being actively investigated. Their problems include large deficits, threats to company solvency, or poor performing trustees. The regulators report gives three examples of badly-run small schemes where the trustees were either dominated by the employer or had failed to do their job to ensure that deficits had been made good.

According to a recent survey, 43% of companies perceive closed final salary schemes as an unwanted legacy.

However the Regulators report argues that only a substantial increase in funding will erode pension scheme deficits and that whilst future improvements in the returns on shares and bonds may turn out to be beneficial for pension schemes, the effects will probably be offset by the increased longevity of pension scheme members.



Article by Karen Woodall

Final Salary Schemes – What's your Strategy?

Case Study #1

Our client has a Final Salary Scheme which became a paid up arrangement in September 1999. There were insufficient assets to buy out members' benefits on the insurance market, but a significant surplus on the 'ongoing' funding measure. This followed the winding-down/selling off of the majority of participating employers. The scheme's assets are worth in excess of £30 million and there are around 3,000 members in total.

Mattioli Woods was introduced to the trustees by an existing client in early 2002. Even though the scheme had been simplified by securing of a large portion of the scheme's assets via insurance policies, the trustees had become concerned over a number of issues, including poor administration, the standard of advice being received and costs.

The administration was being provided by an 'all-in-one' service provider which was also responsible for actuarial work, consultancy and investment advice. While convenient it is often the case that such a provider is weak in one or more areas. This can lead to questions over impartiality, particularly where the scheme actuary is giving the same scheme investment advice, and also regarding the apportionment of costs.

The 'final straw' came when it was revealed that the scheme's largest member liability had been accounted for twice. This followed a period during which the trustees had been led to believe that the scheme's funding position was considerably weaker than in reality (and after they had taken appropriate action to protect solvency).

Following a detailed assessment, Mattioli Woods was appointed as consultant/advisor and was asked to oversee the appointment of a separate administrator and scheme actuary.

Subsequent to our appointment and following the correcting of the error outlined above, we assisted the trustees with an exercise to reduce the number of trustees from five to three. We also arranged for the role of the scheme's legal advisor to be reduced (previously the legal advisor had been attending all trustees' meetings and undertaking secretarial duties). These changes immediately served to reduce costs and streamline the scheme's operation/management.

Following the above, a review of the scheme's investments was undertaken and the Statement of Investment Principles was revised to reflect the improved (corrected) funding position and changes in market conditions. This resulted in Mattioli Woods recommending a number of investment changes as follows:

- Investing the portion allocated to fixed interest on a direct basis (taking into account a 'model' of the scheme's liabilities provided by the new scheme actuary)
- Taking a more aggressive stance in respect of a portion of the fund allocated to equities
- Investing a significant portion of the fund into commercial property via a combination of institutional funds and directly held or syndicated investment

Based on the latest actuarial results, the funding position remains strong and the scheme is well positioned for the future. With regards to Mattioli Woods' efforts to streamline the scheme's running costs, overall costs are now around one third lower per annum.

Case Study



Case Study by
Bob Woods



Case Study by
Martin Scarrott

Two case studies introducing a selection of problems and how we solved them.



dy #2

Our client is a major distributor in the retail sector employing some five thousand people, but of which only circa 1300 are members of the company's final salary scheme.

Background

Mattioli Woods had been invited to advise the company about the growing deficit concern. The Company has always taken a strongly paternalistic view and decided to attempt to save the scheme. A package of measures was put in place including a substantial seven-figure contribution; a change to the accrual of future service entitlements and higher contributions for both the company and members. Furthermore, the investment strategy was changed to create greater stability and improved performance.

Over a period of some three years, notwithstanding a near doubling of the scheme's assets, the effect of the above was that the deficit had actually got worse.

The reason why the improvements that should have been achieved did not materialise was simply that over that period the Government had 'moved the goalposts' on more than one occasion, exacerbating the actuarial position.

Forward strategy

The company has regrettably decided that it is no longer appropriate for a final salary scheme to underpin the company's pension strategies. The measures that are now in progress for a progressive winding down of the scheme include the following:

Administration and actuarial functions outsourced to both reduce costs and improve service levels; the scheme is now closed to new members, nor is there any future service accrual for existing members; rather than establish a new money purchase scheme a money purchase section has been added to the scheme, and which had avoided the cost of running two separate schemes; and finally a number of strategies are in place to reduce the remaining final salary liabilities over a five-year programme. These include offering trivial commutation where applicable; offering 100% transfer values to 'left service' members, and enhanced transfer values in respect of current employees. Collectively these strategies are targeted to generate seven-figure savings for the company over the period.

Mattioli Woods is one of the UK's leading and fastest growing consultancies in its area of expertise, the provision of pension and wealth management services for controlling directors, professional persons, owner-managed businesses and small to medium-sized PLCs. In particular, the practice has specialised in the application and provision of small self-administered pension schemes (SSAS) and self-invested personal pensions (SIPP).



Mattioli Woods plc Life After the Float

It has now been over six months since the company floated on AIM and the business is continuing to grow from strength to strength.

We were pleased to be A-Day ready, processing new regime transactions immediately after 6 April. This was after completing a vast number of property purchases at the end of the old regime. In addition to this, we have taken on a record number of new schemes in the last month. With the increased client base and the higher level of activity within the schemes we look after, we have recruited seven new account managers since the float. This enables us to continue to provide a proactive and genuinely personal service.

This growth is in line with our expectations and we hope to continue to develop the business over the following years. We would like to thank all those contributing to this development.



Article
by Ian
Mattioli

The cosy world where the FD told the trustees what the company was going to contribute to the final salary pension scheme is well and truly a thing of the past. Trustees are a new breed, emboldened by their new powers and fully aware that not to exert them could expose them to claims of negligence or worse. Advisers, in particular the scheme actuary, are clear where their responsibilities and allegiance lie, which leaves them little scope to advise the company. What's more The Pension Regulator's (TPR) teeth are much sharper than those of its predecessor, OPRA, and is out to protect its own baby, the Pension Protection Fund (PPF), by ensuring that schemes are 'fully' funded as quickly as possible.

The sponsoring company, without realising it, is being left out in the cold with no one to champion its cause and challenge the trustees. Often the company is unaware of the options it has to reduce and control costs.

What advice can the scheme provide the company? Playing with a straight bat, the scheme actuary can provide a calculation service to the trustees but must copy to the trustees; he cannot provide confidential information to the company and can certainly not represent the company's point of view. The company risks: losing all control over the decision on its own contribution; not having its interests taken into account; and being characterised as the 'bad guy' to the employees and members.

By appointing a separate adviser/actuary the company will get advice on the options available (e.g. scheme redesign, scheme closure...) that suit the corporate strategy and finances. The company will be helped to understand its own negotiating position in advance of the discussions with the trustees about the contribution. The adviser can also help the company to have some influence over the investment strategy of the scheme – this can be a crucial element in managing the risk.

Companies have learnt that the final salary pension scheme legacy is a financial risk to the balance sheet that should be managed like any other business risk. With expert help the challenge need not be as scary as it seems.



Article by guest writer David Pettitt

Who will buy?

It used to be that pension implications were an afterthought for those buying a business or a company.

The Pensions Act 2004 made changes to the existing TUPE regulations and the Transfer of Employment (Pension Protection Regulations 2005 now provides added protection) for occupational pension scheme members, where there is a transfer of undertaking to which TUPE applies. It can mean that the new employer must either provide an equivalent pension scheme or a pension scheme by which the company has to pay 6% of pensionable salary.

It does not end there. The Pensions Regulator has the power to impose contribution notices and/or financial support directives on a range of parties if it suspects that there are motives behind actions (or in actions) to avoid pension liabilities. In September 2005, new debt on employer regulations requires participating employers exiting a group pension scheme to pay their share of any buy-out shortfall in the scheme.

We have already seen some business sales collapse because of pension issues and many venture capitalists will not even consider an acquisition involving a defined benefit scheme.

However, if you are aware of the issues and how it can affect your potential sale or purchase and are happy to negotiate with the Pensions Regulator and the pension trustees, many of these issues can be resolved.

One thing for sure in the sale of any business: ignore pension implications at your own risk!



Article by Karena Woodall