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The pensions lifeboat faces a surfeit of distress calls

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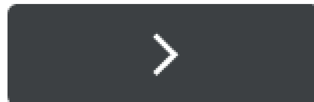

Pensions protection fund lifeboat rides past House of Commons – Jake Hawkins

"We've put these people on furlough, we're making that other lot redundant, and you still want your money. Why is that fair?"

Company directors desperate to channel cash into propping up their businesses during the pandemic are playing the "emotional card" in negotiations with the trustees charged with ensuring payments into employee retirement funds are kept up to date, says Vassos Vassou, a professional trustee at Dalriada.

Trustees and regulators have given leeway to struggling firms during the crisis, allowing monthly contributions to reduce pension scheme deficits to be deferred where necessary.

Close to one in 10 schemes allowed employers to defer contributions during the pandemic but this has now reduced to less than 5pc, according to a client survey by Isio, a pensions consultancy.

The effect of the crisis on defined benefit pension funds, which provide retirees with a guaranteed income linked to their salary but are run independently of the companies they are tied to, has been limited so far.

But an expected wave of company insolvencies as state support is withdrawn and taxpayer-backed loans become repayable, combined with the imminent enactment of new pensions laws, threatens to expose problems that industry figures say are lurking just below the surface.

Some companies are already having difficulty, or are simply resisting, meeting their commitments to pay into their pension schemes. The Pensions Regulator issued 1,026 unpaid contribution notices in the third quarter of 2020, almost triple the 352 handed out in the previous three months. The aggregate deficit of private sector DB schemes hit £168.2bn by the end of October, up from £35.4bn at the end of 2019.

The schemes in the worst shape

Economists have speculated that the Covid crisis will result in a "K-shaped" recovery, where thriving industries such as tech and life sciences enjoy a boom and people working from home save more than before.

Meanwhile, people working in declining industries or who have lost their jobs face bleaker financial prospects than before.

Story continues

Mike Smedley, a partner at Isio, describes a similar divergence between pension schemes. “A lot of schemes have stayed resilient through the crisis because they’re pretty well funded [and] well hedged,” he says.

“The other group were relying on investment returns and hadn’t hedged their risks on interest rates, inflation, life expectancy and so on. They’re the ones that have suffered most.”

Pensions advisers agree that firms in struggling industries such as retail, manufacturing and air travel have the most painful pension headaches.

Debenhams missed payments early in the pandemic and Arcadia, Sir Philip Green’s retail empire, had to seek leniency from the company’s pension scheme. British Airways has long faced jibes that it is an airline attached to a pension scheme.

“The schemes that are in the worst shape belong to the employers that were in the worst shape,” Smedley says. Trustees say that pension funds with a hole to plug – because their current assets plus their investment income are expected to be insufficient to meet the cost of paying retirees’ pensions in future – have been stuck in a Catch-22 situation.

Where a company does not generate enough cash to repair the deficit in its pension scheme, the trustees running the scheme are forced to invest their existing assets in riskier investments with the aim of reducing the deficit through increased investment returns. However, investing in equities rather than stable but low return government bonds, for example, can result in a bigger slump in asset values when a downturn comes.

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Pension reform

The new Pensions Schemes Bill, a draft law working its way through parliament, is expected to discourage trustees from investing in riskier assets in pursuit of returns.

High profile company failures have motivated the Government to avoid other major schemes falling into the Pension Protection Fund, the industry lifeboat which generally pays pensioners of collapsed schemes about 90pc of their previous entitlements.

Retailer BHS collapsed in 2016 with a pension deficit of £571m and records showed that the finance director of insolvent outsourcer Carillion viewed pension payments as a “waste of money”. The Bill has faced fierce opposition and the Government was forced this month to reject several amendments passed in the Lords.

“If you stop the schemes from buying so called higher risk assets you’re forcing companies to put much more money into pensions and making the company’s business weaker than it needs to be,” says Baroness Ros Altmann, a former pensions minister.

The fear is that efforts to protect pension schemes from ending up in the PPF lifeboat by forcing companies to pay more will be counterproductive. It could prevent businesses making the investments needed to drive an economic recovery. Pushing schemes to invest in low risk bonds could also stop billions of pounds of pension fund assets being poured into investment in companies by buying shares.

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Future funding

The regulator says it is too early to predict the outcome of consultations on a new funding code but Baroness Altmann says higher costs for companies are “inevitable” and that she plans to mount further resistance in the House of Lords.

The Government may take a pragmatic view and quietly delay major changes if the economic picture darkens and insolvencies rise as furlough comes to an end, suggests Sir Steve Webb, a former pensions minister and now a consultant at Lane Clark & Peacock.

"The obvious thing for Government to do is just delay, just put the brakes on," says Sir Steve, whose firm predicts that the new rules could force the employers with the UK's 300 largest DB funds to stump up an extra £40bn in the next decade.

New criminal offences included in the Bill are also a concern for some advisers and trustees.

"The provisions are very, very broad and they'll be retrospective," explains Alex Hutton-Mills, managing director of covenant adviser Lincoln Pensions. The Government needs to strike a balance between protecting pension funds and encouraging "an enterprise culture", he says.

"You don't want to find directors in a place where the easy answer for them is to put a business through an insolvency process because it's too difficult for them to kind of navigate the ... implications of the criminal sanctions."

Criminal sanctions could in theory be applied not only to directors but to advisers, insolvency practitioners or even lenders, which has resulted in intense lobbying from business groups, pensions lawyers and the insolvency industry to ensure the parameters are drawn carefully.

Turbulence ahead

There could be further turbulence for pension schemes this week at the Chancellor's spending review. Rishi Sunak is expected to reveal plans to effectively abolish the Retail Prices Index measure of inflation by setting it equal to the CPIH inflation measure, which is about 1pc lower. That would reduce the future liabilities of many schemes to their members but could also hurt the return they receive on index-linked Government bonds.

The more immediate concern for pension scheme trustees may be whether their sponsor companies go bust after a harsh Covid winter.

"Employers are a little bit more stretched than in that initial period [of the pandemic] where perhaps reserves that they had, or contingency plans that they had in place, have now been exhausted," says Vassou. "There's a much bigger group ... of employers that are at the cliff edge. That's my big fear."

Far from receding, the emotional arguments he is hearing from stressed directors may only intensify in the coming months.

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