



CRITICLEYE



# A Whale of a Problem

*Total pension liabilities in the UK now exceed £1.3 trillion.  
Criticleye investigates how companies are addressing  
monstrous deficits and why some boards need to be more  
imaginative in devising solutions*

As investments and strategic deals get blocked because of pension deficits, directors, trustee boards and regulators need to work together to find ways to see through some of the madness created by actuarial assumptions. With an ageing population, volatile equity markets, low gilt yields and eye-watering levels of debt, compromises do have to be made in order to arrive at real-world solutions.

First and foremost, if a corporate does have a problem, there's no excuse for senior leaders burying their heads in the sand. Those executives at the top have to own the issues – not delegate them.

**Lady Barbara Judge** CBE, Chairman of the Pension Protection Fund, says: "It's absolutely fundamental that executives understand the risks surrounding their pension fund; directors need to understand that the pension fund liability is essentially a debt of the company.

"Companies have a responsibility to their employees and the pension fund, as well as other stakeholders. Accordingly, any pension fund liability is clearly an issue on which company directors should be educated and company finance directors need to manage their pension fund exposure as part of their broader balance sheet management."

**Alastair Lyons**, Chairman of outsourcing company Serco and car insurance provider Admiral, comments: "I would expect the CFO to have an in-depth understanding of the... accounting deficits [and] to changes in market and non-economic assumptions. I would also expect the CFO to have examined different mitigation strategies – for example, investment de-risking – in order to reduce the potential impact of pension scheme volatility."

That said, it's unrealistic to suddenly expect directors to become pension experts.

**Richard Farr**, Partner in BDO's pension advisory team, says: "How many of those in the C-suite actually understand pension risk? They're struggling with corporate risk, let alone pension risk and it is a completely different universe of understanding."

**David Harding**, Deputy Chairman at private-equity backed Malaysian lottery operator Magnum Berhad and former CEO of bookmakers William Hill, comments:

"It is reasonable to expect senior execs and non-execos to focus resources on major risks. However, this is a specialist area and not one many execs or non-execos will have dealt with, so it is not reasonable to expect them to come up with solutions without specialist help; and it is unlikely to climb the risk ladder and grab their attention unless it is flagged by specialists."

The danger is for executives to fail to see how a pension deficit is intrinsically linked to the sustainable performance of a business. **Jeremy Stone**, Chairman of Trustees of the WH Smith Pension Fund, says: "It's almost a fiduciary requirement but often plc boards lack patience with the subject. They don't have much appetite for understanding why the numbers have moved against them."

## A QUESTION OF TRUST

Undoubtedly, the pension crisis is a man-made disaster of epic proportions. Recent figures released by The Pension Protection Fund in the UK show that the aggregate deficit of 6,316 defined benefit (DB) schemes – representing about 12 million members – increased from £201.5 billion in February to £236.6 billion in March. Total liabilities in the UK now exceed £1.3 trillion.

This dire state of affairs makes the interaction between the trustee board and the executive team increasingly important. **Anthony Arter**, London Senior Partner and Head of Pensions at law firm Eversheds, says: "Given the liabilities at stake it is vital that pension schemes are run by an effective and properly constituted trustee board with clear leadership. The Pensions Regulator has made clear that ensuring good pension scheme governance is one of its top priorities.

“Companies should treat deficits as one of the largest risks that the company faces”

"This means that trustee boards need to be well run; be on top of the issues affecting their scheme, and be able to make good decisions that are not tainted by conflicts of interest in a timely manner."

**Alastair** says: "Particularly important is the quality of the Chairman of trustees as those on the board will typically follow his or her lead. The Chairman needs to be highly knowledgeable of the intricacies of pension scheme funding and preferably have confronted difficult situations before – if they have they will, therefore, have confidence in their own judgement as to what shape and structure of solution is appropriate for the scheme concerned."

Inevitably, there will be some that need to raise their game. “All schemes will have properly constituted boards but whether they actually have the right distribution of competencies on that board is another question,” says Jeremy Stone. “The way it’s set up, some are nominated by the company, often people from the finance or HR function, so they know something about the subject, then you might also have some independent representatives.”

“*You have to change the framework, the guidelines and encourage partnerships*”

According to **Richard**, a real problem in arriving at perfectly achievable solutions is the lack of knowledge among some trustee and corporate boards about what is possible. “The trustee boards are not aware of the potential solutions because they’re not being told,” he says. “There are very competent and committed trustee boards out there, but the lawyers, accountants and actuaries need to give them more options – however, that also involves the advisors understanding the economics of the employer as well.”

The future lies in finding ways to share risk. “You have to change the framework, the guidelines and encourage partnerships – if there isn’t an answer through that, then there is no answer at all,” says Richard, who predicts greater activity among investors, especially hedge funds, in taking on pension risk as schemes are

restructured and sold on at a discount. While there may need to be more regulatory flexibility around how corporate and trustee boards can de-risk their schemes, the less involvement from Government on the issue is uniformly seen as a good thing. **Ian Harley**, Criticaleye Board Mentor and Senior Independent Director at media distribution company John Menzies, argues that “regulation and politicians have been a large part of the reason for why we are where we are”.

**Alastair** says: “It is important to determine early-on the position of the Pension Regulator so that where there are material deficits that require imaginative funding solutions, a lot of time is not spent seeking a detailed solution with a pension fund that the regulator itself will not support. Ultimately the pension fund trustees will be constrained by the need to satisfy the regulator that any solution to which they are a part is, in the regulator’s view, in the best interests of their pensioner body.”

Communication and education is what is needed. **Jeremy Small**, Group Company Secretary at insurance company AXA UK, says: “Companies should treat deficits as one of the largest risks that the company faces and deploy resources accordingly. All the senior executives on the board need to understand what the issues are and to have a shared commitment to resolving them in an effective way.

“They have to recognise that there are clearly trust arrangements in place designed to protect the assets and to ensure the assets are used to pay the beneficiaries, the so-called ‘pension promise’, but it’s important not to underestimate the magnitude of the

severity of risk being faced... It is a big challenge to decide how best to fund the scheme in a way that allows them to fulfil the promise made to members but links back to the company in a way that doesn’t ultimately destroy it.”

What’s painfully clear is that solutions do need to be found as it’s difficult to see how the current situation can carry on for much longer. ■

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Featuring Commentary From:



**Anthony Arter**  
Senior Partner and  
Head of Pensions  
Eversheds



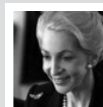
**Richard Farr**  
Partner  
BDO



**David Harding**  
Deputy Chairman  
Magnum Berhad



**Ian Harley**  
SID  
John Menzies



**Lady Barbara Judge**  
CBE  
Chairman  
Pension Protection Fund



**Alastair Lyons**  
Chairman  
Serco



**Jeremy Stone**  
Chairman of Trustees  
WH Smith Pension Fund



**Jeremy Small**  
Group Company Secretary at  
insurance company AXA UK

Contact the contributors through:  
[www.criticaleye.net](http://www.criticaleye.net)