CARTWRIGHT

COVID 19 - DB Pension Schemes

What Pension Scheme Trustees and Sponsors need to consider

The Pensions Regulator has reminded Trustees and Sponsors not to overlook the potential impact on their members during this Pandemic. This note covers the immediate issue of CETV requests and also Scheme funding in the current volatile financial markets.

Background

Transfer Values: Members more than 1 year from their normal scheme retirement date have the statutory right to request and receive a Cash Equivalent Transfer Value (CETV) quotation. Under legislation, trustees have 3 months to provide such a quotation and in certain extenuating circumstances this period can be extended to 6 months. This quotation is then guaranteed for 3 months.

Scheme Funding: The Pensions Regulator has issued the first of what are likely to be several notes to trustees. Their view was that trustees should already have in place funding monitoring procedures and contingency plans. However, clearly any trustees with a scheme funding valuation effective date in the near future may not be receiving good news and will have to work with the sponsoring employer on the long term objectives for funding the scheme.

Since the beginning of the year the FTSE 100 has fallen by approximately 30%. Similar falls have occurred on all the major exchanges around the world. Most pension schemes still invest a significant portion of their assets in equities and as a result funding levels will have dropped and deficits will have increased.

For a pension scheme that was 80% funded at the start of the year, and assuming an equity asset allocation of 70%, the current funding level is likely to have dropped to 65%. In monetary terms this would have turned a £10million deficit into a £17million deficit – an increase of 70%.

CETVs

In the short term trustees may be concerned about preserving cash within their scheme to ensure that the essential payments of pensions to existing pensioners and lump sums for any new retirements are paid as they fall due. Selling assets to meet guaranteed CETV quotations at a time when holdings in equity assets have fallen so significantly may jeopardise longer term funding.

Trustees may wish to consider suspending CETV quotations in the short term to avoid this situation. Unfortunately, the regulations (SI 1996/1847 The Occupational Pension Schemes (Transfer Values) Regulations 1996) are not overly helpful in this regard and may preclude a long delay as they confirm that CETV requests must be provided by trustees within 3 months of the request. However, such a period may be extended where trustees are unable to provide a quotation **for reasons beyond their control**. The period may be extended to up to 6 months in such circumstances.

One suggestion would be for clients to take advantage of the 3 month window to provide quotations and delay issuing quotations until 10 weeks after request, rather than the usual quick Cartwright response to dealing with such requests. In addition, it may also be worth checking with your scheme's legal advisor if such significant market turmoil could be used as a reason for further delaying such quotations.

Finally, for those trustees who offer CETVs as a matter of course as part of a retirement pack quotation or who offer non statutory CETVs – you may wish to consider revisiting that approach in light of recent events.

Scheme Funding

Employer Covenant: The effect of the current financial turmoil on the employer's covenant should be considered by the trustees in terms of the impact on the security of members' benefits – if the trustees have powers to take action (for example requesting additional contributions) they should at the very least consider using such powers.

Funding valuations that are ongoing and commenced prior to the current market turmoil can be completed and certified at their effective dates. However, the Scheme Actuary will certainly be required to add a caveat to the Funding Report about post-valuation date events and the likely impact on Scheme funding since the effective date of the valuation. Trustees may wish to consider revisiting their draft Schedules of Contributions and, after taking actuarial advice, consider extending current Recovery Plan payment schedules beyond their current end date, if they consider that financial markets are unlikely to recover anytime soon.

Funding valuations that are due to commence over the next few months are unlikely to paint a pretty picture. The Pensions Regulator has previously stated its belief that there is sufficient flexibility within the current funding regime to aid trustees and sponsoring employers to come to an appropriate outcome in their funding valuations. Clearly this will be tested! Employers may face an immediate cash squeeze and may wish to consider deferring contributions at a time that trustees require them. Trustees will need to balance the sponsoring employer's needs with their need to ensure that member benefits can be paid as they fall due.

Funding valuations that are due to commence in the future: Current funding may have deteriorated so much that an out-of-cycle valuation should be carried out and additional contributions requested; indeed the Statement of Funding Principles (SFP) may make this a requirement. Trustees need to review their SFP.

Conclusions and Cartwright views

Pension schemes have faced many stresses and strains in the past and will do so again in the future. It is important not to panic and we can ride out this storm together. However, trustees do need to address any short term stresses on their scheme finances and consider these as soon as possible.

If you would like to discuss this further, please get in touch with your usual contact at Cartwright.

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