Hammonds

Alert

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Human Capital (Pensions)

Time for trustees to take the initiative

The global financial crisis is having a significantly detrimental impact on many pension schemes and gloomy predictions by industry experts, politicians and the media indicate that this is likely to continue for some time to come. Trustees of all schemes have a basic fiduciary duty to monitor investments and should therefore consider taking a proactive role in tackling these issues head on. This could include calling an early trustee meeting to assess how the current crisis in financial markets has impacted upon their pension schemes and what they can do to best protect members' benefits.

However, trustees cannot act in isolation in such straitened economic times as these and will be even more dependent upon employer support. Trustees should ensure that sponsoring employers are actively engaged with any necessary action points. One way of doing this would be to invite company representation to any additional trustee meeting which takes place.

We discuss below some suggested agenda items for such a trustee meeting.

- **Reduction in investment values**

  Trustees of defined benefit schemes should consider the implications of the recent dramatic falls in the global equity markets on the funding level of their schemes. They may wish to use the trustee meeting to assess their investment strategy and speak to their investment advisers and managers, as well as the employer, who will no doubt have its own views on asset allocation and risk budgeting. There may be opportunities for investment de-risking which have not yet been explored. Alternatively, Trustees may consider asking employers to provide their scheme with greater financial support (subject to any covenant concerns – see below).

  On a separate but investment related note, if trustees have not already lodged claims with their investment managers to enable recovery of VAT (on the back of the *Claverhouse* judgment), they should make sure they do so before 31 March 2009 to protect refunds covering not just the three years before the date of the claim but also any relevant period between 1990 and 1996. Hammonds Tax@ction team specialises in such claims and can help with registering new claims.

- **Review of employer covenant**

  The economic slow-down and deterioration in availability of working capital may cause some employers to revisit whether they can afford to continue supporting their final salary schemes. Trustees of such schemes should take the opportunity to enter into constructive dialogue with the employer in an attempt to find a sustainable way forward. In doing so, both employers and trustees may need to revisit employer covenant issues and the appropriateness of the adopted technical provisions and recovery plans.

- **Review of contingent assets**

  Many trustees of final salary schemes have relied upon contingent assets provided by their employers in conjunction, for example, with an agreement to accept lower contributions to the scheme, and / or less conservative investment strategies or assumptions. Contingent assets include charges over property or securities, bank guarantees and group company guarantees, upon which the trustees can claim if specified events occur, such as the insolvency of a sponsoring employer. Trustees should review whether the value of their contingent assets has deteriorated as a result of the current financial slump. Trustees and employers may also wish to discuss new or additional contingent assets, particularly if increased contributions to remedy underfunding are unaffordable. It is also worth noting that the granting of certain contingent assets can reduce the amount of a scheme's Pension Protection Fund levy but such arrangements will need to be put in place quickly to benefit from a levy reduction, again before 31 March 2009 for next year's levy.

- **Concerns about security of trustee bank accounts and investments**

  Several banking and insurance institutions have recently been rescued from collapse by government-brokered packages, calling into question the security of deposits, investments and contracts with such bodies. Trustees of all pension schemes should consider their exposure to this risk, how this exposure can be minimised and the availability of compensation schemes. Further information on this issue can be obtained from our recent Insight "Pension Fund Investment; Where to Next?" (Please see http://www.hammonds.com/Default.aspx?sID=17&cID=22421&ctID=21).

- **Member communications**

  At this time of financial uncertainty, many members will understandably be concerned about the strength of their pension schemes as well as the companies supporting them. Trustees should consider updating members, reassuring them where possible and informing them of any actions taken in response to the fall in financial markets.

- **Conflicts of interest**

  Deterioration in the funding of a pension scheme can place a strain on relations between trustees and sponsoring employers, for example, when negotiating revised employer contribution rates or the need for contingent assets to be made available to the scheme. In such circumstances it is particularly important for both trustees and employers that any actual or potential conflicts of interest on the board of trustees have been identified and managed. Guidance issued by the Pensions Regulator in October 2008 on conflicts of interest emphasises that trustees should have robust systems in place to deal with conflicts, including a conflicts of interest policy and register of trustees' interests. In addition, the Companies Act 2006 established additional requirements for conflicted directors of sponsoring employer and/or corporate trustee. Confidentiality agreements and deeds of modification of duty can also be considered.

- **Timing**

  Trustee bodies typically meet every quarter or every six months. However, the next meeting may not come soon enough if trustees wish to address the pressing issues that their pension schemes face as a result of the financial downturn. This is particularly important if they have doubts about the viability of their sponsoring employer and its ability to support their scheme.

- **And don't forget about DC**

  Defined contribution schemes face the same underlying issues of course and these may be heightened where (as is commonly the case), most members are invested in equity based default funds. Since asset allocation decisions in DC schemes formally belong to the members, the importance of member communications is even greater. Both trustees and employers should be careful not to give members financial advice, but it is entirely appropriate for them to remind DC members of the need to review their investment strategy periodically.

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